

REPORT ON EXAMINATION

OF THE

NOVA CASUALTY COMPANY

AS OF

DECEMBER 31, 2014

DATE OF REPORT

JUNE 2, 2016

EXAMINER

SHEIK H. MOHAMED

TABLE OF CONTENTS

| <u>ITEM NO.</u> | | <u>PAGE NO.</u> |
|-----------------|---|-----------------|
| 1 | Scope of Examination | 2 |
| 2. | Description of Company | 3 |
| | A. Management | 4 |
| | B. Territory and plan of operation | 6 |
| | C. Reinsurance | 7 |
| | D. Holding company system | 8 |
| | E. Significant operating ratios | 11 |
| 3. | Financial Statements | 12 |
| | A. Balance sheet | 12 |
| | B. Statement of income | 13 |
| | C. Capital and Surplus Statement | 13 |
| 4. | Losses and loss adjustment expenses | 14 |
| 5. | Compliance with prior report on examination | 14 |
| 6. | Summary of comments and recommendations | 14 |



NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

June 2, 2016

Honorable Maria T. Vullo
Superintendent
New York State
Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31256 dated November 14, 2014, attached hereto, I have made an examination into the condition and affairs of Nova Casualty Company as of December 31, 2014, and submit the following report thereon.

Wherever the designation “the Company” or “Nova Casualty” appears herein without qualification, it should be understood to indicate Nova Casualty Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s administrative office located at 440 Lincoln Street, Worcester, MA 01653.

1. SCOPE OF EXAMINATION

The Department has performed a coordinated examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2012. This examination covered the two year period from January 1, 2013 through December 31, 2014. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination of the Company was performed concurrently with the examinations of the following sixteen insurers within The Hanover Insurance Group:

- AIX Specialty Insurance Company
- Allmerica Financial Alliance Insurance Company
- Allmerica Financial Benefit Insurance Company
- Campmed Casualty & Indemnity Company, Inc.
- Citizens Insurance Company of America
- Citizens Insurance Company of Illinois
- Citizens Insurance Company of Ohio
- Citizens Insurance Company of the Midwest
- The Hanover Insurance Company
- Hanover Lloyd's Insurance Company
- Massachusetts Bay Insurance Company
- Professionals Direct Insurance Company
- The Hanover American Insurance Company
- The Hanover New Jersey Insurance Company
- The Hanover National Insurance Company
- Verlan Fire Insurance Company

Other states participating in this examination were: Delaware, Illinois, Indiana, Michigan, New Hampshire, Ohio, and Texas.

The examination was conducted in conjunction with the state of New Hampshire, which was the coordinating state of The Hanover Insurance Group.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook ("Handbook"), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant

estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Loss experience
- Reinsurance
- Financial statements
- Summary of recommendations

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Nova Casualty Company was incorporated under the laws of the State of New York on September 13, 1979 as the First Security Corporation. It became licensed and commenced business effective July 18, 1980. On December 30, 1988, the present name, Nova Casualty Company, was adopted.

On August 13, 2008, The Hanover Insurance Group, Inc. ("THIG"), a Delaware publicly traded insurance holding company, filed with the Department an application for the acquisition of control of the Company pursuant to Section 1506 of the New York Insurance Law and Department Regulation 52. The application provided that THIG would acquire all of the outstanding stock of AIX Holdings, Inc., which

was the ultimate parent of the Company prior to the acquisition. The aggregate purchase price in connection with this transaction was \$104.5 million. The application was approved by the Department on November 24, 2008.

Capital paid in is \$4,200,000 consisting of 14,000 shares of \$300 par value per share common stock. Gross paid in and contributed surplus is \$82,871,445. Gross paid in and contributed surplus did not change during the examination period.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than fourteen members. During the examination period, the board met at least twice during each calendar year, and also took action by unanimous written consents. As of December 31, 2014, the board of directors was comprised of the following fourteen members:

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|--|--|
| Steven Frank Cibelli Liverpool, NY | Assistant Regional Vice President – NY Sales, The Hanover Insurance Company |
| Christine Bilotti-Peterson Simsbury, CT | Senior Vice President and Chief Human Resource Officer Nova Casualty Company |
| Frederick Henry Eppinger Grafton, MA | President, The Hanover Insurance Group, Inc. |
| Joseph David Freitas Sturbridge, MA | Vice President – Finance, The Hanover Insurance Company |
| Andrew Christopher Furman North Grafton, MA | Vice President and Treasurer, Nova Casualty Company |
| Jeffrey Louis Gordon Rockaway Park, NY | Vice President – Fidelity & Crime, The Hanover Insurance Company |
| David Bruce Greenfield Weston, CT | Executive Vice President and Chief Financial Officer, Nova Casualty Company |
| J. Kendall Huber Sudbury, MA | Executive Vice President and General Counsel, Nova Casualty Company |

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|---|--|
| Craig Michael Rappaport Simsbury, CT | Vice President, AIX Operations and Nova Casualty Company |
| John Joseph Risavi Jamesville, NY | Regional Vice President, NY Executive, The Hanover Insurance Company |
| Andrew Scott Robinson East Greenwich, RI | Executive Vice President - Specialty, The Hanover Insurance Company |
| John Conner Roche Hopkinton, MA | Senior Vice President – Commercial Lines, The Hanover Insurance Company |
| Robert Dean Schultz West Simsbury, CT | Vice President, AIX Leadership, Nova Casualty Company |
| Ann Kirkpatrick Tripp Rutland, MA | Vice President and Chief Investment Officer, Nova Casualty Company |

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended with the exception of Robert Dean Schultz who attended less than 50% of the meetings for which he was eligible to attend. There were six eligible meetings during the examination period. Mr. Schultz only attended two by teleconference.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

As of December 31, 2014, the principal officers of the Company were as follows:

| <u>Name</u> | <u>Title</u> |
|---------------------------|--|
| Frederick Henry Eppinger | President |
| Charles Frederick Cronin | Secretary |
| Andrew Christopher Furman | Vice President & Treasurer |
| Mark Leo Berthiaume | Senior Vice President |
| David Bruce Greenfield | Executive Vice President & Chief Financial Officer |
| J. Kendall Huber | Executive Vice President & General Counsel |

B. Territory and Plan of Operation

As of December 31, 2014, the Company was licensed to write business in all fifty states licensed and the District of Columbia.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| <u>Paragraph</u> | <u>Line of Business</u> |
|------------------|--|
| 3 | Accident & health |
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 9 | Boiler and machinery |
| 10 | Elevator |
| 11 | Animal |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Workers' compensation and employers' liability |
| 16 | Fidelity and surety |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine |
| 21 | Marine protection and indemnity |
| 26 | Gap |

The Company was also licensed to write Special Risks insurance pursuant to Article 63 of the New York Insurance Law.

The Company was also empowered to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Congress as amended; 33 USC Section 901 et seq. as amended).

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$4,000,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

| <u>Calendar Year</u> | <u>New York State</u> | <u>Total Premiums</u> | <u>Premiums Written in New York State as a percentage of Total Premium</u> |
|----------------------|-----------------------|-----------------------|--|
| 2013 | \$30,378,189 | \$246,164,724 | 12.34% |
| 2014 | \$25,759,197 | \$237,889,280 | 10.83% |

The Company's principal lines of business are workers' compensation, commercial multi-peril, other liability, commercial auto, commercial auto physical damage and inland marine comprise approximately 99% of direct written premiums. This business is written through its licensed and appointed agents. The Company does not appoint brokers.

AIX Specialty Insurance Company ('AIX'), the Company's 100 percent owned insurance subsidiary, is domiciled in the State of Delaware. AIX is licensed in the State of Delaware and is eligible to do business in the other 49 states and the District of Columbia as an excess surplus lines carrier. AIX primarily serves as a writer of niche specialty programs, specifically property and liability coverage risks generally not insured in the admitted market. AIX's largest premium writings, in 2014, were in Florida, New York, California, Illinois, and Texas representing 49.2% of total direct written premiums in 2014.

It is noted that the Company cedes out 100% of its premiums and reserves through a 100% quota share agreement described in Section 2C, entitled Reinsurance. As a result the Company, on a net basis, does not report underwriting activity or loss reserves. The only activities reported on the Company's income statement relate to investment income and federal income taxes.

C. Reinsurance

Assumed reinsurance accounted for less than 1% of the Company's gross premium written as of December 31, 2014 and consisted solely of business assumed from various mandatory pools.

On January 1, 2009, the Company entered in a 100% quota share agreement whereby it ceded 100% of its business, both on a retrospective and prospective basis, to The Hanover Insurance Company, an affiliated New Hampshire domestic insurer. This treaty is still in effect; therefore the Company does not have any net reserves.

The agreement was submitted to the Department and was not disapproved in conjunction with the sale of the Company to The Hanover Insurance Group. The agreement was reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law. Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions.

AIX, the Company's subsidiary, also entered into a 100% quota share agreement with The Hanover Insurance Company, whereby it ceded 100% of its business on both a prospective and retrospective basis. The treaty is still in effect and AIX does not have any net reserves.

On December 31, 2014, the Company reported approximately \$409 million in reinsurance recoverables from The Hanover Insurance Company. These reinsurance recoverables are the Company's most significant financial items, representing approximately 444% of the Company's surplus. The Company's most significant financial risk is its ultimate ability to collect on these reinsurance recoverables. It is noted that The Hanover Insurance Company was examined concurrently with the Company and there were no examination changes made to its balance sheet and income statement.

It is additionally noted that, as of December 31, 2014, AIX reported approximately \$112 million in reinsurance recoverables from The Hanover Insurance Company. These reinsurance recoverables are AIX's most significant financial item representing approximately 226% of AIX's surplus. AIX's surplus position at December 31, 2014 was \$49,775,949, which is reported on Nova Casualty's balance sheet as an equity investment representing over 50% of Nova Casualty's surplus.

D. Holding Company System

The Company is a member of The Hanover Insurance Group, which is ultimately controlled by The Hanover Insurance Group, Inc. ("THIG"), a publicly traded Delaware insurance holding corporation.

A review of the Holding Company Registration Statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2014:



As of December 31, 2014, the Company was party to the following agreements with other members of its holding company system:

Tax Allocation Agreement

Upon its acquisition in 2008, the Company became part of a consolidated income tax agreement between The Hanover Insurance Group, Inc. (the “Parent”) and its subsidiaries (the “Affiliated Group”). The agreement, which originally became effective for the tax year ending December 31, 2001, and as amended on September 4, 2007, provides that the Parent will file a consolidated tax return for the Affiliated Group. The consolidated liability shall be allocated among the members of the Affiliated Group in the same proportion that each member’s separate return tax liability bears to the sum of the separate tax liabilities for all members.

The tax allocation agreement was submitted to the Department in conjunction with the application for acquisition of control of the Company by its ultimate parent.

Management Service Agreement

Effective January 1, 2010, the Company entered into a consolidated service agreement with its ultimate parent, The Hanover Insurance Group, Inc. Pursuant to the terms of the agreement, the Parent provides such services as it may require for the Company’s operations. The management service agreement was submitted to the Department in conjunction with the application of control of the Company by its ultimate parent.

Advisory Agreement

Effective February 1, 2009, the Company entered into an advisory agreement with Opus Investment Management, Inc. (“OPUS”). Pursuant to the agreement, OPUS will provide investment related services. This agreement was submitted to the Department in conjunction with the application of control of the Company by its ultimate parent.

General Agency Agreements

Effective February 16, 2005, the Company entered into a general agency agreement with Professional Underwriters Agency, Inc. (“PUAI”). Pursuant to the agreement, PUAI will be the

Company's managing general agent in the State of Florida. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law and was not disapproved.

Effective December 21, 1982, the Company entered into a general agency agreement with Nova American Group, Inc. d/b/a Brokers' Marketplace, Inc. ("NAGI"). Pursuant to the agreement NAGI will be the Company's managing general agent in the State of New York. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law and was not disapproved.

Subsequent to the examination date, on July 17, 2015, the two general agency agreements were terminated.

E. Significant Operating Ratios

| | |
|---------------------------------------|-----|
| Adjusted liabilities to liquid assets | 16% |
|---------------------------------------|-----|

There are no applicable underwriting ratios as the Company cedes 100% of its business to The Hanover Insurance Company; therefore, its underwriting income and expenses are \$0.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2014 as reported by the Company:

| <u>Assets</u> | <u>Assets</u> | <u>Examination</u> Assets Not <u>Admitted</u> | Net Admitted <u>Assets</u> |
|--|----------------------|---|-------------------------------|
| Bonds | \$33,687,352 | | \$33,687,352 |
| Common stocks (Investment in subsidiary) | 49,775,949 | | 49,775,949 |
| Cash, cash equivalents and short-term investments | 10,953,309 | | 10,953,309 |
| Receivables for securities | 10,750 | | 10,750 |
| Investment income due and accrued | 230,051 | | 230,051 |
| Current federal and foreign income tax recoverable and interest thereon | 339,013 | | 339,013 |
| Net deferred tax asset | 4,058,096 | | 4,058,096 |
| Electronic data processing equipment and software | 1,648,936 | \$ 1,595,687 | 53,249 |
| Furniture and equipment, including health care delivery assets | 221,943 | 221,943 | 0 |
| Miscellaneous assets - TPA cash | <u>11,326,767</u> | <u>11,326,767</u> | <u>0</u> |
| Total assets | <u>\$112,252,166</u> | <u>\$13,144,397</u> | <u>\$99,107,769</u> |
| <u>Liabilities, surplus and other funds</u> | | | <u>Examination</u> |
| <u>Liabilities</u> | | | |
| Ceded reinsurance premiums payable (net of ceding commissions) | | | \$7,278,231 |
| Payable to parent, subsidiaries and affiliates | | | <u>84,814</u> |
| Total liabilities | | | \$7,363,045 |
| <u>Surplus and other funds</u> | | | |
| Common capital stock | | \$ 4,200,000 | |
| Gross paid in and contributed surplus | | 82,871,445 | |
| Unassigned funds (surplus) | | <u>4,673,279</u> | |
| Surplus as regards policyholders | | | <u>91,744,724</u> |
| Total liabilities, surplus and other funds | | | <u>\$99,107,769</u> |

Note: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2010. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Tax years 2011 and 2012 will be audited. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2013 and 2014. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

The net income for the two-year examination period January 1, 2013 through December 31, 2014, was \$4,361,336 as detailed below:

Investment Income

| | | |
|-------------------------------|---------------|-------------|
| Net investment income earned | \$4,440,734 | |
| Net realized capital gain | <u>23,535</u> | |
| Net investment gain or (loss) | | \$4,464,269 |

Other Income

| | | |
|--|-------------------|--------------------|
| Interest expense on funds held | <u>\$(44,710)</u> | |
| Total other income | | <u>(44,710)</u> |
| Net income before federal and foreign income taxes | | \$4,419,559 |
| Federal and foreign income taxes incurred | | <u>58,223</u> |
| Net Income | | <u>\$4,361,336</u> |

C. Capital and Surplus Statement

Surplus as regards policyholders decreased \$3,216,183 during the two-year examination period January 1, 2013 through December 31, 2014, as detailed below:

| | | | |
|--|-------------------------|--------------------------|---------------------|
| Surplus as regards policyholders per report on examination as of December 31, 2012 | | | \$94,960,907 |
| | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income | \$4,361,336 | | |
| Net unrealized capital gains or (losses) | | \$ 837,091 | |
| Change in net deferred income tax | 3,007,080 | | |
| Change in nonadmitted assets | <u>0</u> | <u>9,747,508</u> | |
| Net increase (decrease) in surplus | <u>\$7,368,416</u> | <u>\$10,584,599</u> | <u>(3,216,183)</u> |
| Surplus as regards policyholders per report on examination as of December 31, 2014 | | | <u>\$91,744,724</u> |

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$0 is the same as reported by the Company as of December 31, 2014. The Company ceded 100% of its insurance liabilities to Hanover Insurance Company.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained no comment or recommendation.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| <u>ITEM</u> | | <u>PAGE NO.</u> |
|-------------|--|-----------------|
| A | <u>Management</u> | |
| i. | It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced. | 5 |

APPOINTMENT NO. 31256

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

*I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:*

Sheik Mohamed

as a proper person to examine the affairs of the

Nova Casualty Company

and to make a report to me in writing of the condition of said

COMPANY

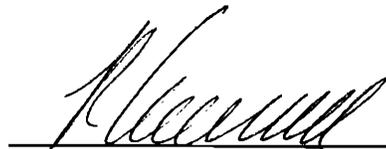
with such other information as he shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York*

this 14th day of November, 2014

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:



Rolf Kaumann
Deputy Chief Examiner

