

REPORT ON EXAMINATION  
OF THE  
ASSET GUARANTY INSURANCE COMPANY  
AS OF  
DECEMBER 31, 1999

DATE OF REPORT

JUNE 15, 2001

EXAMINER

JIMMIE NEWSOME

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Governor

STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 10004

GREGORY V. SERIO  
Superintendent of Insurance

June 15, 2001

Honorable Gregory V. Serio  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21615 dated September 26, 2000, attached hereto, I have made an examination into the condition and affairs of the Asset Guaranty Insurance Company as of December 31, 1999 and submit the following report thereon.

The examination was conducted at the Company's administrative office located at 335 Madison Avenue, New York, New York 10017.

Wherever the designations "the Company" or "AGIC" appear herein without qualification, they should be understood to indicate the Asset Guaranty Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to indicate the New York Insurance Department.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1994. This examination covers the five-year period from January 1, 1995, through December 31, 1999. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 1999, a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

- History of the Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Officers' and employees' welfare and pension plans
- Territory and plan of operation
- Growth of the Company
- Business in force
- Loss experience
- Reinsurance
- Market conduct activities
- Accounts and records
- Financial statements

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations in the prior report on examination.

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

## 2. DESCRIPTION OF COMPANY

The Securities Guaranty Reinsurance Company was established under the laws of the State of New York on June 21, 1988. Effective July 27, 1988, the name of the Company was changed to Asset Guaranty Reinsurance Company.

Vesta American Insurance Company was incorporated under the laws of New York on December 30, 1985. On April 14, 1986, the Company absorbed by merger, the United States Branch of Gothaer Insurance Company of Cologne, Germany to effect its domestication. The latter had entered the United States through New York on October 17, 1979. On July 1, 1988, the Company changed its name to Vesta American Reinsurance Corporation.

On December 30, 1992, Asset Guaranty Reinsurance Company purchased all of the outstanding shares of Vesta American Reinsurance Corporation. On January 26, 1993, the parent, Asset Guaranty Reinsurance Company, merged into Vesta American Reinsurance Corporation, the surviving corporation. Effective the same date, Vesta American Reinsurance Corporation formally changed its name to Asset Guaranty Insurance Company.

The Company's charter was originally filed in the office of the Superintendent of Insurance of the State of New York on December 31, 1985 and was amended effective March 25, 1993 and October 20, 1994. The Company's paid-in capital was fifteen million (\$15,000,000) dollars, consisting of one hundred thousand (100,000) shares with a par value of one hundred fifty (\$150) dollars per share. The Company has 100,000 shares authorized. Paid in capital was \$54,077,000.

As of December 31, 1994, the date of the immediately preceding examination, the Company's gross paid-in and contributed surplus was \$50,777,000. The following contributions to the Company's surplus were made during the current examination period:

<u>Date</u>	<u>Contributor</u>	<u>Type</u>	<u>Amount</u>
03/95	Enhance Financial Services Group	Cash	\$3,000,000
08/97	Enhance Financial Services Group	Common Stock	<u>300,000</u>
Total			<u>\$3,300,000</u>

Subsequent to the examination date, Radian Group Inc. acquired the Company's parent, Enhance Financial Services Group Inc. on February 28, 2001. This matter is further discussed herein under Item 2D, "Holding Company System".

A. Management

Pursuant to the Company's charter and by-laws, as amended, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. As of the examination date, the board of directors was comprised of sixteen members. The board met four times during each calendar year. The directors as of December 31, 1999, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Samuel Bergman, Esq. Lawrence, NY	Executive Vice President, Enhance Financial Services Group Inc.
Ronald M. Davidow Brooklyn, NY	Executive Vice President, Enhance Financial Services Group Inc.
Richard J. Dunn West Harrison, NY	Executive Vice President, Enhance Financial Services Group Inc.
Elaine J. Eisenman Rye, NY	Executive Vice President, Enhance Financial Services Group Inc.
Tony M. Ettinger Chappaqua, NY	President, Enhance Financial Services Group Inc.
Daniel J. Gross Gladwyne, PA	President and CEO, Enhance Financial Services Group Inc.
Brenton W. Harries South Norwalk, CT	Retired
Martin A. Kamarck New York, NY	President, Enhance Financial Services Group Inc.
Richard P. Lutenski Chester, NJ	Executive Vice President and CFO, Enhance Financial Services Group Inc.
David R. Markin Palm Beach, FL	President and CEO, Checker Motors Corporation
Wallace O. Sellers Solebury, PA	Retired
Richard J. Shima West Hartford, CT	Private Consultant
Stephen A. Steinberg Larchmont, NY	Executive Vice President and CIO, Enhance Financial Services Group Inc.
Spencer R. Stuart Palm City, FL	Retired
Freida K. Wallison Snowmass, CO	Retired
Yorman Wind Gladwyne, PA	Professor Wharton School of Business

The minutes of all meetings of the board of directors and committees thereof held during the examination period were reviewed to determine if each director was willing and maintaining an active role in the corporate management of Asset Guaranty Insurance Company. Overall, the attendance of the board of directors was adequate during the period of examination.

Section 1411 (a) of the New York Insurance Law states,

“No domestic insurer shall make any loan or investment, unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee’s minutes should be recorded and a report submitted to the board of directors at its next meeting.”

A review of the board of directors’ minutes during this examination period did not indicate that the investments made by Asset Guaranty Insurance Company were approved by its board of directors in accordance with Section 1411 (a) of the New York Insurance Law. The Company stated that the investment committee of the board reviews and approves all investment policies and changes on a quarterly basis. However, no minutes were maintained by the investment committee. The chairman of the investment committee presents a report to the full board at each board meeting. The Company states that since all investments were within the investment guidelines, they are deemed to be approved by the board of directors.

It is recommended that the Company adhere to the provisions of Section 1411 (a) of the New York Insurance Law as regards the board of directors’ approval of investment transactions. It is also recommended that the Company’s investment committee maintain complete minutes of their meetings as per the provisions of Section 1411 (a) of the New York Insurance Law.

The principal officers of the Company as of December 31, 1999, were as follows:

<u>Name</u>	<u>Title</u>
Daniel J. Gross	Chairman and CEO
Martin A. Kamarck	President
Samuel Bergman	Executive Vice President and Secretary
Jeffrey A. Figurelli	Treasurer and Senior Vice President
Richard P. Lutenski	Executive Vice President and CFO
Stephen A. Steinberg	Executive Vice President and CIO
Ronald M. Davidow	Executive Vice President
Richard J. Dunn	Executive Vice President
Elaine J. Eisenman	Executive Vice President
Tony M. Ettinger	Executive Vice President

#### Conflict of Interest

The Company has a procedure to distribute conflict of interest questionnaires to its board of directors, executive officers and to all responsible employees on a yearly basis.

The Company has a procedure for disclosing to its board of directors any material interest or affiliation on the part of its directors, officers, or responsible employees, which is in or is likely to conflict with the official duties of such person. However, it was noted that the Company has not established procedures to permit the board of directors to properly oversee and handle any known or potential conflicts of interest.

When this matter was brought to the Company's attention they indicated that due to the nature of their business, its unlikely that a conflict of interest would arise, therefore, procedures were never implemented to handle known or potential conflicts of interest.

It is recommended that the Company establish written procedures for enforcing such a policy and permit the board of directors to properly oversee and handle any known or potential conflicts.

It is further recommended that the board of directors maintain complete minutes of its proceedings on such matters.

B. Territory and Plan of Operation

As of the examination date, the Company was licensed to transact business in all states and the District of Columbia with the exception of California, Maine, New Hampshire and North Carolina. Approximately 81% of the Company's direct writings in 1999 were concentrated in Colorado, Connecticut, Florida, Massachusetts, New York, Pennsylvania and Texas.

A comparison between direct premiums written in New York and nationwide during the examination period is detailed below:

DIRECT PREMIUMS WRITTEN

<u>Year</u>	<u>New York State</u>	<u>Nationwide</u>	<u>Premiums Written in New York State as a Percentage of United States Premiums</u>
1995	\$5,389,336	\$11,627,968	46%
1996	\$8,321,023	\$17,104,312	49%
1997	\$19,571,191	\$25,402,308	77%
1998	\$15,039,351	\$30,393,266	49%
1999	\$29,056,450	\$53,750,508	54%

As of December 31, 1999, 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>Kind of Insurance</u>
16 (C) (D) (E) (F)	Surety
17 (A)	Credit insurance
22	Residual value insurance
25	Financial guaranty insurance

Based upon 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, 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$68,400,000.

The Company principally insures financial guaranty policies and reinsures financial guaranty companies, on both a treaty and facultative basis, for new and secondary market municipal bonds as well as structured corporate and real estate backed financing. In addition, the Company services certain specialty market areas not traditionally served by the monoline financial guaranty market, such as trade credit reinsurance, financial responsibility bonds and excess-SPIC insurance. In certain of these areas, the Company operates as a primary insurer where it does not compete with the monoline financial guaranty primaries; in other areas the Company is involved by serving as a reinsurer for certain specialty primary insurers in which its ultimate parent, Enhance Financial Services Group Inc. has significant equity interests or is otherwise a participant.

The Company evaluates the risk underwriting and management of treaty customers, monitors the insured portfolio performance, and conducts a detailed underwriting review of the facultative insurance it writes. The Company believes that the reinsurance of municipal bond guaranties, which the Company expects will grow in response to the anticipated long-term growth in the municipal bond market, provides

a relatively stable source of premium income for the Company. In addition, most premiums received are credited as deferred premium revenue and are earned as the related risks amortize, thereby providing a relatively stable, predictable source of earned premiums.

C. Reinsurance

As of December 31, 1999, approximately 49% of the Company's gross premiums written consisted of assumed reinsurance premiums. The majority of the assumptions are from non-affiliates.

The Company has facultative reinsurance agreements with an authorized affiliate, Enhance Reinsurance Company, whereby both companies assume and cede business and accept their proportionate share of the liabilities under each policy as specified and agreed to by both parties in a reinsurance memorandum.

Effective April 30, 1990, as amended on January 1, 1994, the Company entered into an quota and surplus share agreement covering mining reclamation surety bonds and solid waste landfill financial assurance bonds with unauthorized affiliate, Van-American Insurance Company ("Van-Am").

Under the surplus share portion of the agreement for mining bonds, the Company assumes a surplus share over the single bond limit up to an aggregate limit of \$1,000,000 issued to any one mine operator. The Company also agrees to assume a cession of limits in excess of \$1,000,000 subject to an aggregate limit of \$2,500,000 on any single mining bond or on mining bonds in excess of an aggregate of \$5,000,000 issued to any one mine operator.

Under the quota share portion of the agreement for landfill bonds, the Company assumes a 25% quota share participation on all landfill bonds written by Van-Am subject to an aggregate limit of \$1,000,000 issued to any one landfill operator. Under the surplus share portion of the agreement; the Company assumes a 100% cession of limits in excess of the quota share limit subject to an aggregate limit of \$2,500,000 on any single landfill bond or on landfill bonds in excess of an aggregate of \$5,000,000 issued to any one landfill operator.

Effective July 1, 1998, the Company was a party to a quota share agreement, whereby the Company assumes 31.25% of the gross liabilities up to a maximum of \$2,500,000 per insured/per risk for all business classified as export credit and political risk insurance from an unauthorized affiliate, Exporters Insurance Company, Ltd. Also, effective July 1, 1998, the Company was party to an excess cession and surplus share treaty agreement, whereby the Company assumes 10% of the gross liabilities in excess of the abovementioned quota share agreement up to a maximum of \$5,400,000 per insured/per risk. For single risks, the Company participates on an excess liability basis and for pooled risks on a surplus share basis.

In addition to the business assumed above, effective September 1, 1999, the Company also participates in a credit and political risk multi-buyer limits quota share treaty agreement with the Foreign Credit Insurance Association ("FCIA"), all of whose members including the Company are authorized companies. The treaty covers policy limits up to \$40,000,000 for any one buyer or any one country, of which the Company's proportionate share is 25%. Maximum cession to the reinsurers, including the Company's share is 71.5% of \$40,000,000 for any one buyer or any one country.

FCIA business is shared by its members, Great American Insurance Company and Asset Guaranty Insurance Company; their proportionate shares are 80% and 20% respectively. In some instances, FCIA places reinsurance with non-member reinsurers, which are not authorized in the State of New York.

The Schedule F data as contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions except for reporting the reinsurance payable on paid loss and loss adjustment expenses in 1999. This matter is further discussed herein under Item 2H, "Accounts and Records".

The examiner reviewed all ceded reinsurance contracts effected during the examination period. The contracts contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 1999, the Company was a party to the following ceded reinsurance treaty agreements:

<u>Type of Treaty</u>	<u>Cession</u>
I. <u>Surety</u>	
Quota Share Excess SPIC Bonds 100% Unauthorized	\$2,000,000 per Customer, with total liability not to exceed \$50,000,000, per Principal in the aggregate.
Quota Share Mining Bonds 100% Unauthorized	100% quota share not to exceed the reinsurer's single bond limit of 10% of its capital and surplus.
Quota Share Landfill Bonds 100% Unauthorized	75% quota share not to exceed the reinsurer's single bond limit of 10% of its capital and surplus.

Type of TreatyCessionII. Financial Guaranty

Quota Share	100% quota share on financial guaranty
100% Unauthorized	losses.

III. Credit

## Credit and Political Risk Excess of Loss:

First Layer	95% of \$4,000,000 excess of \$1,000,000
100% Authorized	any one country or any one-buyer group subject to an aggregate limit of 95% of \$12,000,000.

Second Layer	95% of \$5,000,000 excess of \$5,000,000
100% Authorized	any one country or any one-buyer group subject to an aggregate limit of 95% of \$15,000,000.

Third Layer	95% of \$10,000,000 excess of \$10,000,000
100% Authorized	any one country or any one-buyer group subject to an aggregate limit of 95% of \$25,000,000.

Subsequent to the examination date, the Company entered into a commutation agreement with MBIA Insurance Corporation effective December 31, 2000 wherein the parties have agreed to commute the reinsurance of all the policies ever ceded to the Company in their entirety on a cut-off basis effective December 31, 2000. Also, MBIA Insurance Corporation will simultaneously cede the reinsurance of the policies to the Company's affiliate, Enhance Reinsurance Company, pursuant to its financial guaranty facultative reinsurance agreement.

D. Holding Company System

In June 1990, Asset Guaranty Inc. merged into Enhance Financial Services Inc. and as a result the surviving company's name was changed to Enhance Financial Services Group Inc.

Enhance Financial Services Group Inc. is the ultimate parent in the holding company system. Members of the holding company system are detailed in the holding company organizational chart, appended to this report. No person beneficially owns more than 10% of the presently issued and outstanding shares of Enhance Financial Services Group Inc.

Enhance Financial Services Group Inc. owns 100% of the stock of the Enhance Investment Corporation (“EIC”), which owns 100% of the stock of the Company. Subsequent to the examination date, EIC was dissolved and its assets were transferred to Enhance Financial Services Group Inc. in March 2000.

Asset Guaranty Insurance Company became a controlled insurer of Enhance Financial Services Group Inc. on January 26, 1993.

Subsequent to the examination date, pursuant to the provisions set forth in Section 1506 of the New York Insurance Law and Department Regulation 52, Radian Group Inc. and Gold Acquisition Corporation filed an “Application for Approval of the Acquisition of Control of a Domestic Insurer” for the acquisition and control of Asset Guaranty Insurance Company on December 1, 2000.

On November 13, 2000, the Company’s parent, Enhance Financial Services Group Inc. (“Enhance Financial”) and Radian Group Inc. entered into an agreement providing for the merger of Enhance Financial with Gold Acquisition Corporation, a wholly-owned subsidiary of Radian Group Inc., with Enhance Financial the surviving company. This acquisition was approved by the Department on February 21, 2001 and the merger was completed on February 28, 2001.

As of February 28, 2001, Radian Group Inc. is the ultimate parent in the holding company system. Radian Group Inc. owns 100% of the stock of Enhance Financial Services Group Inc., which owns 100% of the stock of the Company.

A review was made of the filings made by the Company, as registrant, pursuant to the requirements of Article 15 of the New York Insurance Law and Department Regulation No. 52. No exceptions were noted.

(1) Tax Allocation Agreement

On February 5, 1991, as amended effective September 16, 1996, the Company entered into a tax allocation agreement with its parent, Enhance Financial Services Group Inc. The amended agreement was executed and submitted to the Department on September 16, 1996, pursuant to Department Circular Letter No. 33 (1979). The effective date for this agreement relates to all taxable years beginning on, or after, January 1, 1995.

As determined by this examination, the Tax Allocation Agreement entered into by, and between, the Company and its parent Enhance Financial Services Group Inc. met the minimum guidelines set forth in the Department's Circular Letter 33 (1979).

The Department on October 3, 1996 accepted the amended agreement without objection to the terms thereof, pursuant to Section 1505 (d) of the New York Insurance Law.

(2) Expense Allocation Agreement

On February 5, 1991, as amended effective March 14, 1991, the Company entered into an expense allocation agreement with its parent, Enhance Financial Services Group Inc. Expenses are allocated among the companies on a monthly basis, pursuant to a method which equitably reflects the actual cost to each company. On March 27, 1991, the Department accepted the amended agreement without objection to the terms thereof pursuant to Section 1505(d) of the New York Insurance Law. As determined by this examination, the allocation of expenses was consistent with the provisions of Department Regulation No. 30.

E. Custodian Agreements

As of December 31, 1999, the Company maintained various custodian agreements with the Bank of New York, Fleet National Bank and U.S. Trust Company. The custodian agreements lacked certain necessary safeguards, controls and protective covenants deemed appropriate by the Insurance Department, for the custody or safekeeping of securities.

In some instances, the Company was unable to provide the examiners with copies of the custodian agreements.

It is recommended that the Company amend their custodian agreements to meet the necessary safeguards and controls permitted by the Insurance Department, for the custody or safekeeping of securities.

It is recommended that the Company exercise due care in obtaining and maintaining custodian agreements.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 1999 based upon the results of this examination:

Net premiums written in 1999 to surplus as regards policyholders	.79:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	72.95%
Premiums in course of collection to surplus as regards policyholders	12.11%

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$37,588,698	23.66%
Loss adjustment expenses incurred	873,704	0.55
Other underwriting expenses incurred	111,790,077	70.38
Net underwriting gain	<u>8,586,492</u>	<u>5.41</u>
Premiums earned	<u>\$158,838,971</u>	<u>100.00%</u>

G. Abandoned Property Law

As determined by this examination and based on the information, as contained in the Company's abandoned property reports filed with the New York State Comptroller's Office for the years covered by this examination period, the Company appears to be complying with Section 1316 of the New York Abandoned Property Law, with regard to filing such reports.

H. Accounts and Records

For several balance sheets items, either the Company was unable to provide certain supporting records or supporting records did not always agree with amounts reported. The examiners noted this condition relative to such items as funds held by or deposited with reinsured companies, losses, loss adjustment expenses, contingency reserves, reinsurance recoverable on paid loss and loss adjustment expenses and reinsurance payable on paid loss and loss adjustment expenses.

While the differences noted were not considered material, it is recommended that the Company maintain accurate and complete workpapers supporting amounts reported in its filed annual statements.

### **3. FINANCIAL STATEMENTS**

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 1999. This statement is the same as reported by the Company:

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$239,259,910	\$	\$	\$239,259,910
Preferred stocks	7,300,000		6,676,495	623,505
Common stocks	1,274,560		435,733	838,827
Cash and short-term investments	10,543,866			10,543,866
Premiums and agents' balances in course of collection	9,209,761			9,209,761
Funds held by or deposited with reinsured companies	31,234,346			31,234,346
Reinsurance recoverable on loss and loss adjustment expense payments	434,222			434,222
Electronic data processing equipment	138,650			138,650
Interest, dividends, real estate income due and accrued		3,264,529		3,264,529
Equities and deposits in pools and associations	1,265,750			1,265,750
Other assets non-admitted	19,626		19,626	
Receivables – Other	688,255		688,255	
Intangibles	788,525		788,525	
Prepaid expenses	<u>275,253</u>		<u>275,253</u>	
<b>Total Assets</b>	<b><u>\$302,432,724</u></b>	<b><u>\$3,264,529</u></b>	<b><u>\$8,883,887</u></b>	<b><u>\$296,813,366</u></b>

<u>Liabilities</u>	<u>Amount</u>
Losses and loss adjustment expenses	\$19,219,771
Reinsurance payable on paid loss and loss adjustment expenses	8,092,645
Contingent commissions	(32,591)
Other expenses	4,065,935
Taxes, licenses and fees	598,519
Federal and foreign income taxes	2,947,321
Unearned premiums	132,216,677
Funds held by company under reinsurance treaties	45,000
Provision for reinsurance	3,932,020
Payable to parent, subsidiaries and affiliates	3,947,925
Contingency reserve	<u>31,211,754</u>
Total Liabilities	<u>\$206,244,976</u>
 <u>Surplus and Other Funds</u>	
Common capital stock	\$15,000,000
Gross paid-in and contributed surplus	54,077,000
Unassigned funds (surplus)	<u>21,491,390</u>
Surplus as regards policyholders	<u>\$ 90,568,390</u>
Total Liabilities, Surplus and Other Funds	<u>\$296,813,366</u>

NOTE: The Internal Revenue Service is currently conducting its audits of the consolidated income tax returns filed on behalf of the Company for tax years 1994 and 1995. 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. Audits covering tax years 1996 to 2000 have yet to commence; however, the Internal Revenue Service has requested an extension of the statute of limitations for the 1996 and 1997 tax years. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$18,683,399 during the five-year examination period, (January 1, 1995 through December 31, 1999) detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$158,838,971
Deductions:		
Losses incurred	\$37,588,698	
Loss adjustment expenses incurred	873,704	
Other underwriting expenses incurred	<u>111,790,077</u>	
Total underwriting deductions		<u>150,252,479</u>
Net underwriting gain or (loss)		\$8,586,492

Investment Income

Net investment income earned	\$59,432,487	
Net realized capital gains or (losses)	<u>5,246,950</u>	
Net investment gain or (loss)		64,679,437

Other Income

Miscellaneous income or (loss)	\$(2,604,458)	
Late filing fees	(2,542)	
Earnings in affiliates	(2,527,253)	
Foreign exchange loss	<u>(30,380)</u>	
Total other income		<u>(5,164,633)</u>
Net income before dividends to policyholders and federal income taxes		68,101,296
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal income taxes		\$68,101,296
Federal income taxes incurred		<u>17,847,640</u>
Net income		<u>\$50,253,656</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1994, per report on examination			\$71,884,991
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income or (loss)	\$50,253,656	\$	
Net unrealized capital gains or (losses)		1,063,538	
Change in non-admitted assets		638,864	
Change in provision for reinsurance		3,932,020	
Paid in surplus	3,300,000		
Dividends to stockholders		9,000,000	
Contingency reserve		21,553,876	
Benefit from tax and loss bonds	<u>1,318,041</u>	_____	
Total gains and losses	<u>\$54,871,697</u>	<u>\$36,188,298</u>	
Net increase to surplus as regards policyholders			<u>18,683,399</u>
Surplus as regards policyholders, December 31, 1999, per report on examination			<u>\$90,568,390</u>

#### **4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability of \$19,219,771 is the same amount reported by the Company as of the examination date.

The Company establishes a case base reserve for the present value as an estimate when reported by primary insurers or when, in the Company's opinion, the insured risk is in default or the likelihood of default is probable and determinable on the balance sheet date. Pursuant to Section 6903 (b) of the New York Insurance Law, financial guaranty companies are allowed to discount their loss reserves by a rate equal to the average rate of return on the admitted assets of the insurer as of the day of the computation of any such reserves. As of the examination date, the Company discounted certain financial guaranty liabilities at an annual rate of 5.95%. The amount of discount reflected as a reduction in the Company's loss reserves was \$2,900,000.

Reserves for losses and loss adjustment expenses for the Company's other lines of business are based on reports and individual loss estimates received from ceding companies, net of salvage and subrogation. In addition, a liability is included for losses and loss adjustment expenses incurred but not reported.

In addition to case reserves, the Company is required to establish and maintain contingency reserves for the protection of insureds and claimants against the effect of excessive losses occurring during adverse economic cycles. The amount required for these reserves depend on the type of bonds being insured and are established pursuant to the provisions of Section 6903 (a) of the New York

Insurance Law. Reinsurers are required to establish a contingency reserve equal to their proportionate share of the reserve established by the primary insurer. As of December 31, 1999, the Company reported contingency reserves in the amount of \$31,211,754.

## 5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Department's Property Bureau.

The general review was directed at practices of the Company in the following major areas:

- 1) Sales and advertising
- 2) Underwriting
- 3) Rating
- 4) Treatment of policyholders and claimants

No problem areas were encountered.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

A review was made into the actions taken by the Company with regards to the comments and recommendations contained in the prior report on examination. The item letters and page numbers shown below refer to that of the prior report:

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Conflict of Interest Statements</u>	
It is recommended that the Company's board of directors' members and officers fill out conflict of interest statements.	10
The Company has complied with this recommendation. In 1997, the Board of Directors approved a Code of Ethics policy regarding conflicts of interest disclosure for their directors and officers. Pursuant to the Code of Ethics, on an annual basis, directors and officers were required to sign conflicts of interest statements.	
B. <u>Unauthorized Reinsurance</u>	
It is recommended that the Company settle outstanding balances with Van American Insurance Company affiliates in a timely manner. Balances deemed uncollectible should be written off.	16
The Company has complied with this recommendation. The Company's current policy is to settle all inter-company balances within 90 days. As per this examination, the Company has settled balances in a timely manner and any such balances over 90 days were non-admitted.	
C. <u>Abandoned Property Law</u>	
It is recommended that the Company file an abandoned property report to the state. Insurance companies, which neither holds nor owns abandoned property, is nevertheless required to file accordingly.	17
The Company has complied with this recommendation. In 1997, the Company implemented a procedure to submit abandoned property reports to the State of New York Office of the State Comptroller. The first filing was made in 1998.	

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company adhere to the provisions of Section 1411 (a) of the New York Insurance Law as regards the board of directors' approval of investment transactions.	6
ii. It is also recommended that the Company's investment committee maintain complete minutes of their meetings as per the provisions of Section 1411 (a) of the New York Insurance Law.	6
B. <u>Conflict of Interest</u>	
i. It is recommended that the Company establish written procedures for enforcing such a policy and permit the board of directors to properly oversee and handle any known or potential conflicts.	8
ii. It is further recommended that the board of directors maintain complete minutes of its proceedings on such matters.	8
C. <u>Custodian Agreements</u>	
i. It is recommended that the Company amend their custodian agreements to meet the necessary safeguards and controls permitted by the Department, for the custody or safekeeping of securities.	16
ii. It is recommended that the Company exercise due care in obtaining and maintaining custodian agreements.	17
D. <u>Accounts and Records</u>	
It is recommended that the Company maintain accurate and complete workpapers supporting amounts reported in its filed annual statements.	18

## APPENDIX "A"

ENHANCE FINANCIAL SERVICES GROUP INC.  
HOLDING COMPANY ORGANIZATIONAL CHART

The following table sets forth subsidiaries of Enhance Financial Services Group Inc., together with the jurisdiction of domicile of each and the percentage of voting securities owned as of December 31, 1999. Unless otherwise indicated, all of the persons included in the table are corporations, the voting securities of which are directly or indirectly owned by Enhance Financial Services Group Inc.

<u>Name of Subsidiary</u>	<u>Jurisdiction of Incorporation</u>	<u>Percentage of Voting Securities Owned</u>
Enhance Investment Corporation	Delaware	100
Asset Guaranty Insurance Company	New York	100
Van-American Companies, Inc.	Delaware	95.8
Van-American Insurance Agency, Inc.	Kentucky	100
Van-American Insurance Company, Inc.	Kentucky	100
Vantage Coal Sales, Inc.	Kentucky	100
Van-American Business Services, Inc.	Kentucky	100
Enhance Reinsurance Company	New York	100
Enhance Reinsurance (Bermuda) Limited	Bermuda	100
Asset Guaranty UK Representatives Limited	United Kingdom	100
Litton GP LLC	Delaware	47.94
Litton Loan Servicing LP	Delaware	47.46
Wynwood Servicing and Technology LLC	Delaware	100
Wynwood Inc.	Washington	100
South Plains Mortgage LLC	Delaware	100
South Plains Mortgage Company	Texas	100
Enhance Consumer Services LLC	Delaware	100
Enhance Life Benefits LLC	Delaware	100
Enhance Consumer Services (Canada) Company	Canada	100
ABC Accelerated Benefits Corporation	Canada	100
Singer Asset Finance Company, LLC	Delaware	100
EIC Corporation Ltd.	Bermuda	36.5
Exporters Insurance Company Ltd.	Bermuda	100
Exporters Insurance Services Inc.	Connecticut	100
Exporters Insurance Company (Overseas) Ltd.	Bermuda	100
Enhance C-BASS Residual Finance Corporation	Delaware	100
Enhance Residuals, LP	Delaware	99
Credit Based Asset Servicing and Securitization LLC	Delaware	47.94

<u>Name of Subsidiary</u>	<u>Jurisdiction of Incorporation</u>	<u>Percentage of Voting Securities Owned</u>
Alegis Group Inc.	Texas	100
Alegis Corporation	Texas	100
Sherman Financial Group LLC	Delaware	45.5
AGS Financial LLC	Delaware	80
AGS Brazil S.A.	Brazil	99
FINPAC Securitizadora S.A.	Brazil	95
AGS Securities Inc.	New York	100
FCIA Management Company, Inc.	New York	21
Orleans Acquisition Corp.	Illinois	100
LLS Inc.	Texas	100
Credit Based Asset Servicing Securitization, Inc.	New York	100
SBF Participacoes Ltda.	Brazil	49.5
UBF Garantias & Seguros S.A.	Brazil	100
Seguradora Brasileira de Fiancas S.A.	Brazil	50
UBF Surety Limited	Bermuda	100
AG Intermediaries Inc.	New York	100
Guaranty Risk Services, Inc.	New York	100



Appointment No. 21615

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, First Deputy Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

**Jimmie Newsome**

as proper person to examine into the affairs of the

**Asset Guaranty Insurance Company**

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

**Company**

with such other information as he shall deem requisite.

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

this 26th day of September, 2000



  
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GREGORY V. SERIO  
First Deputy Superintendent of Insurance