REPORT ON EXAMINATION

OF THE

CAPITAL MORTGAGE REINSURANCE COMPANY

AS OF

DECEMBER 31, 1996

DATE OF REPORT	APRIL 20, 1998
EXAMINER	ERWIN ROCA

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

April 20, 1998

Honorable Neil D. Levin
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to instructions contained in Appointment Number 21101, dated March 28, 1997, appended hereto, I have made an examination into the condition and affairs of the Capital Mortgage Reinsurance Company as of December 31, 1996, and respectfully submit the following report thereon.

The examination was conducted at the Company's office, located at 1325 Avenue of the Americas, New York, New York 10019.

Wherever the terms "Capital" or "Company" appear herein, without qualification they should be understood to indicate the Capital Mortgage Reinsurance Company.

1. SCOPE OF EXAMINATION

This is the first full examination of the Company. The date of determination of the report on organization was January 6, 1994. The current examination covers the period from January 7, 1994, through December 31, 1996. Transactions subsequent to this period were reviewed where deemed necessary.

The examination comprised a complete verification of assets and liabilities as of December 31, 1996, a review of income and disbursements to the extent 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 bond and other insurance
Officers', employees', and agents' welfare and pension plans
Territory and plan of operation
Growth of Company
Business in force by states
Reinsurance
Loss experience
Accounts and records
Financial statements

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

Capital Mortgage Reinsurance Company was incorporated on August 20, 1993. The declaration of intention and charter were approved by the Attorney General of the State of New York and filed with the Department on the same date. The Company's office is located at 1325 Avenue of the Americas, New York, New York 10019.

In 1994, the Company issued all of its 200,000 authorized shares of $10 par value per share capital stock for a total consideration of $75,000,000. The Company was organized with capital paid in of $2,000,000 and contributed surplus of $73,000,000. An additional contribution to surplus of $45,000,000 was made that year. Another $1,000,000 was paid-in to contributed surplus in 1995. In 1996 the Company amended its certificate of incorporation and increased its authorized shares of capital stock from 200,000 to 250,000, of which 235,294 were issued. As a result of these additional shares the Company's capital increased from $2,000,000 to $2,352,940 and contributed surplus increased from $119,000,000 to $142,647,060, for a total paid in capital and contributed surplus of $145,000,000. All outstanding capital stock was owned by Capital Credit Reinsurance Company, Ltd., a Bermuda company and Capital Reinsurance Company, a Maryland company. Both are ultimately owned by Capital Re Corporation, a Delaware insurance company.

The examiner has found that the amount that was recorded for the securities received from the initial capitalization of the Company was undervalued by $1,437,761. It was determined that the securities given in exchange for the Company's stock had a market value of $921,645 more than what was recorded as the book value. The Company also failed to accrue interest on these securities which amounted to $516,116. The total of $1,437,761 was omitted from the asset "Bonds" as well as from the gross paid in and contributed surplus. None of the securities that were initially received remain in the Company's investment portfolio. The examination changes involve an increase in surplus as well as a matched decrease in investment income.

It is recommended that the Company increase its paid in and contributed surplus by $1,437,761.

A. Management

The business and affairs of the Company are exercised through a board of directors which is to consist of at least thirteen but not more than twenty-five directors.

During the three year period encompassed by this examination, the board did not hold a board meeting in 1994, 1995 or 1996. All meetings were waived. As provided for in the by-laws of the Company, the board of directors must meet four times per year. It is recommended that the Company make an effort to have meetings as outlined in the by-laws.

The following is a list of the thirteen directors of the Company as of December 31, 1996:

Name and Residence	Principal Affiliation
David A. Buzen Merrick, New York	Senior Vice President and Chief Financial Officer, Capital Reinsurance Company and Capital Mortgage Reinsurance Company
Robert M. Coors Rockville Centre, New York	Vice President, Capital Reinsurance Company
Stephen Donnarumma Brooklyn, New York	Senior Vice President, Capital Reinsurance Company; Senior Vice President and Chief Operating Officer Capital Mortgage Reinsurance Company
Laurence C.D. Donnelly Pelham, New York	Senior Vice President, Capital Reinsurance Company; President, Capital Mortgage Reinsurance Company

Name and Residence	Principal Affiliation
Marilyn A. Engel Staten Island, New York	Vice President, Capital Reinsurance Company
Susan L. Hooker Chappaqua, New York	Senior Vice President, Capital Reinsurance Company; Senior Vice President and Chief Operating Officer, Capital Credit Reinsurance Company
Jerome F. Jurschak Katonah, New York	Senior Vice President, Capital Reinsurance Company
Nicholas K. Moy Katonah, New York	Vice President, Capital Reinsurance Company
Lisa M. Mumford Port Washington, New York	Vice President and Controller, Capital Reinsurance Company and Capital Mortgage Reinsurance Company
Alan S. Roseman New York, New York	Senior Vice President, General Counsel and Assistant Secretary, Capital Mortgage Reinsurance Company
Michael E. Satz New York, New York	Chief Executive Officer and Chairman, Capital Reinsurance Company and Capital Mortgage Reinsurance Company
William Tomljanovic Scotch Plains, New Jersey	Vice President and Treasurer, Capital Reinsurance Company and Capital Mortgage Reinsurance Company
Howard S. Yaruss New York, New York	Vice President, Secretary and Assistant General Counsel, Capital Reinsurance Company and Capital Mortgage Reinsurance Company

The following is a list of the principal officers of the Company as of December 31, 1996:

Name	Title
Michael Ellis Satz	President
David A. Buzen	Senior Vice President and Chief Financial Officer
Stephen Donnarumma	Senior Vice President and Chief Operating Officer
Laurence C.D. Donnelly	Senior Vice President
Lisa M. Mumford	Vice President and Controller
Alan S. Roseman	Senior Vice President, General Counsel and Assistant Secretary
William Tomljanovic	Vice President and Treasurer
Howard S. Yaruss	Vice President, Secretary and Assistant General Counsel

B. Territory and Plan of Operation

Capital is authorized by its declaration of intention and charter to transact the kind of insurance as described in paragraph 23 of Section 1113(a) of the New York Insurance Law, “Mortgage Guaranty Insurance.”

Section 6502 of the New York Insurance Law provides that in order to be licensed to transact the foregoing kind of insurance, the Company shall have met the following minimum financial requirements:

Initial capital and surplus	$2,000,000
Surplus to be maintained	$1,500,000
Capital	$1,000,000
Minimum capital investments	$1,500,000

As of December 31, 1996, the Company was licensed only in the State of New York.

The Company is not a direct writer. All of its business is obtained by assumptions via approximately 9 treaties and 4 facultative contracts. Capital’s reinsurance business is conducted through brokers and intermediaries and involves domestic placements.

The following schedule shows the Company’s premiums written by line of business for the years 1994, 1995 and 1996:

Line of Business	1994	1995	1996	Total
Mortgage Guaranty	$19,409,680	$43,959,216	$36,738,164	$100,107,060

C. Reinsurance

As of the examination date, Capital's assumed business is retroceded under two retrocessional facilities.

Under a retrocessional facility known as the "Portfolio Excess of Loss Reinsurance Treaty," the Company cedes covered losses that are above its loss ratio of 20%. The aggregate limit for this treaty as of December 31, 1996 was $30,000,000 for the term. Aggregate limits of $10,000,000 through December 31, 1994 and $20,000,000 through December 31, 1995 were in effect as of those dates. This facility covers all mortgage guaranty business and is 100% unauthorized. Premiums of $5,000,000 were payable on January 1, 1994 and $4,000,000 were payable on January 1, 1995.

The other facility which includes four retrocession treaties is known as the "Aggregate Excess of Loss Mortgage Pool Retrocession Agreement." Under this facility the Company cedes approximately 52% of assumed business from a facultative excess of loss agreement with General Electric Mortgage Insurance Companies (GEMICO). This agreement covers a pool of mortgage guaranty business. There are no other retrocessional facilities for 1996. The following is a summary of the Company's quota share retrocessional facility:

Type	Limits and Retentions
1st Excess	
100.0% Unauthorized	$184,871,917 of $269,178,269, excess of $634,064,368.
2nd Excess	
100.0% Unauthorized	$225,128,083 of $358,904,359, excess of $909,000,000. Premium of $28,192,500 is payable over 6 1/2 years.

All contracts effected since this examination were examined to determine if their provisions complied with the New York Insurance Law. All of Capital's contracts were found to contain insolvency clauses which comply with the provisions of Section 1308 of the New York Insurance Law.

The examiner's review of the Company's reinsurance contract with General Electric Mortgage Insurance Company indicated that it exhibited a minimal amount of risk transfer. The Company did not prepare any cash flow analysis prior to its entering into the contract. A cash flow analysis was prepared for the examiners, which indicated that risk transfer did exist. This contract was a one-time event designed for the General Electric Mortgage Insurance Company to exit the mortgage pool business. It is recommended that in the future the Company prepare cash flow analysis in order to demonstrate that its reinsurance agreements transfer risk.

D. Holding Company Sytem

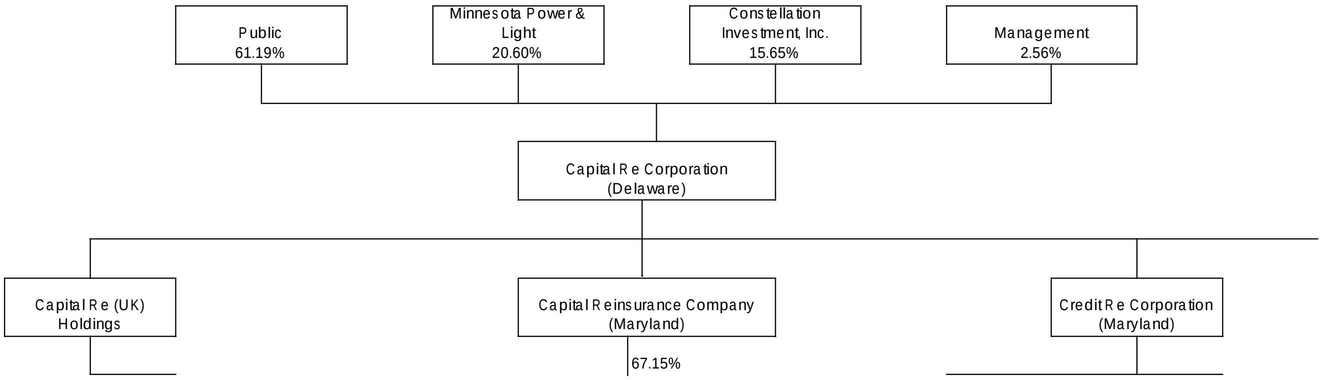
As of the year 1996, all of the Company's outstanding common shares were owned by Capital Credit Reinsurance Company, Ltd., a Bermuda company, and Capital Reinsurance Company, a Maryland company. Both are ultimately owned by Capital Re Corporation, a Delaware insurance company.

Since 1994, Capital has made filings as a controlled insurer with the Department as required by Section 1504 of the New York Insurance Law and Department Regulation 52.

It was noted that all the Company's filings made during the examination period complied fully with applicable provisions of the Law and Department Regulation 52.

The following chart depicts the interrelationships and controls within the holding company system at December 31, 1996:

CAPITAL RE CORPORATION ORGANIZATION CHART



1. Service Agreement with Capital Reinsurance Company (CRC)

Pursuant to this agreement, effective November 23, 1993, Capital Reinsurance Company pays all of the expenses which are incurred jointly by the companies in the Capital Re Corporation Group for management information systems, accounting and finance services, legal services, office space and equipment usage, and administrative support. The Company pays a flat monthly fee for these services. Expenses are to be allocated to the Company according with New York Insurance Department Regulation 30. Expenses that can be identified as belonging to the Company are directly charged to the Company.

The agreement has been submitted to the Department pursuant to Section 1505(d)(3) of the New York Insurance Law.

Department Regulation 30 prescribes uniform standards of classifications to be used by fire, marine, casualty, and surety insurers in allocating their expenses to operating expense classifications. Compliance with the uniform standards set forth in Regulation 30 ensures the accurate completion of the Insurance Expense Exhibit. The allocations set forth in the Insurance Expense Exhibit, in turn, affect the completion of Schedule P, the reserve for unallocated loss adjustment expenses, the liability for the excess of statutory reserves over statement reserves, Part 4 of the Underwriting and Investment Exhibit and premium rate filings.

A review of the Company's Insurance Expense Exhibits filed for the period under examination revealed that the Company did not allocate its joint expenses in accordance with Department Regulation 30.

Part 105.23(a) of Regulation 30, states:

> "Joint expenses. (1) Whenever personnel or facilities are used in common by two or more companies, or whenever the personnel or facilities of one company are used in the activities of two or more companies, the expenses involved shall be apportioned in accordance with Part 106 relating to Joint Expenses, and such apportioned expenses shall be allocated by each company to the same operating expense classifications as if the expenses had been borne wholly. Any difference between the actual amount paid and the amount of such apportioned expenses shall be included in the operating expense classification 'miscellaneous.'"

Furthermore, Part 106.2 of said regulation sets forth the basis of allocation of expenses to companies.

The examiner requested that the Company explain how CRC derived their flat monthly fee to determine if the amount charged was fair and equitable as described in Section 1505 of the New York Insurance Law. The Company could not provide the examiner with supporting documentation on how the fee was derived. CRC charges the Company the flat monthly fee and the Company allocates the flat monthly fee into the different classifications in its Insurance Expense Exhibit using the same classifications and the same percentages for those classifications that Capital Reinsurance Corporation has in its Insurance Expense Exhibit. No allocation was made to the expense group loss adjustment expenses from the flat monthly fee or the direct expenses incurred by the Company. Regulation 30 requires the Company to make such an allocation. This improper methodology has the effect of distorting Capital Mortgage Reinsurance Company's Insurance Expense Exhibit.

It is recommended that the Company comply with Sections 1505(a) and (b) of the New York Insurance Law and with Department Regulation 30.

2. Tax Allocation Agreements

Effective November 23, 1993, the Company entered into a tax allocation agreement with Capital Re Corporation, whereby the companies in the group file a consolidated federal income tax return. The agreement provides for the determination of Capital's tax liability on a separate return basis.

This agreement has been submitted to the Department in accordance with Section 1505(d)(3) of the New York Insurance Law.

E. Custodial Agreement

The Company's custodial agreement with Chase Manhattan Bank, New York was reviewed by the examiner and found to lack various provisions which are deemed to be representative of good business practices for the contents of such agreements. The custodial agreement should provide necessary safeguards and controls. It is recommended that the agreement between the insurer and the custodian should contain, at a minimum, the following protective covenants and provisions:

1. The bank shall secure and maintain insurance protection in an adequate amount covering the custodian's duties and activities as custodian for the insurer's assets. The custodian will give us 60 days written notice of any material change in the form or amount of such insurance, or termination of this coverage.

2. The bank will provide the insurer (at least quarterly) with a list of such securities showing a complete description of each issue, which shall include the number of shares or par value of bonds so held at the end of such quarter.

3. The bank will maintain records sufficient to verify information that the insurer is required to report in Schedule D of the Annual Statement blank of the Insurance Department of the State of New York.

4. The bank will furnish the insurers with the appropriate affidavits in the form as may be acceptable to the New York Insurance Department in order for the securities referred to in such affidavits to be recognized as admitted assets of the company.

5. Access shall be during regular banking hours and specifying those persons who shall be entitled to examine on your premises securities held by you on your premises and your records regarding securities held, but only upon furnishing you with written instructions to that effect from any specified authorized officer.

6. There should be a provision in the agreement that would give the insurer the opportunity to secure the most recent report on the review of the custodian's system of internal controls, pertaining to custodian record keeping, issued by internal or independent auditors.

The Company has a $3,000,000 U.S. tax loss bond which was deposited in The First National Bank of Maryland. The Company has no custody agreement with that bank. It is recommended that the Company obtain a custody agreement with the First National Bank of Maryland.

F. <u>Significant Operating Ratios</u>

The following ratios have been computed as of December 31, 1996 based upon the results of this examination:

Net premiums written in 1996 to Surplus as regards policyholders	.28:1
Liabilities to Liquid assets (cash and invested assets less investments in affiliates	56.7%
Premiums in course of collection to Surplus as regards to policyholders	3.1%

All of 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 three year period covered by this examination:

	Amounts	Ratios
Losses incurred	$8,461,352	11.5%
Loss adjustment expenses incurred	899,290	1.2
Other underwriting expenses incurred	52,257,054	70.7
Net underwriting gain	12,301,404	16.6
Premiums earned	$73,919,100	100.0%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and the surplus as regards policyholders as determined by this examination and as reported by the Company:

	EXAMINATION				COMPANY	
Assets	Ledger Assets	Non-Ledger Assets	Not-Admitted Assets	Net-Admitted Assets	Net-Admitted Assets	Surplus Increase (Decrease)
Bonds	$115,668,118	$	$	$115,668,118	$115,668,118	$
Common stocks	83,630,848	2,445,253		86,076,101	86,076,101	
Cash on deposit	9,611,713			9,611,713	9,611,713	
Other invested assets	5,791,000			5,791,000	5,791,000	
Agents' balances or uncollected premiums	4,121,101	34,000,000		38,121,101	4,121,101	34,000,000
Federal income tax recoverable	835,103		835,103		835,103	(835,103)
Interest, dividends and real estate income due and accrued		1,556,316		1,556,316	1,556,316	
Total Assets	$219,657,883	$38,001,569	$835,103	$256,824,349	$223,659,452	$33,164,897

Liabilities	Examination	Company	Surplus Increase (Decrease)
Losses	$6,999,109	$6,999,109	$
Reinsurance payable on paid losses and loss adjustment expenses	1,156,889	766,574	(390,315)
Loss adjustment expenses	899,290	899,290	
Contingent commissions and other similar charges	24,706,110	18,933,874	(5,772,236)
Other expenses	685,214	685,214	
Unearned premiums	26,187,972	(7,812,028)	(34,000,000)
Funds held by company under reinsurance treaties	390,773	390,773	
Amounts withheld or retained by company for account of others	54,772	54,772	
Provision for reinsurance	1,474,785	1,474,785	
Net adjustments in assets and liabilities due to foreign exchange rates	(2,903)	(2,903)	
Payable to parent, subsidiaries and affiliates	4,798,695	4,798,695	
Payable for securities		15,167,937	15,167,937
Mortgage dollar roll repurchase commitment	15,167,937		(15,167,937)
Contingency reserve	36,014,120	36,014,120	
Total liabilities	$118,532,763	$78,370,212	$(40,162,551)
Surplus and Other Funds			
Common capital stock	$ 2,352,940	$ 2,352,940	$
Gross paid in and contributed capital	144,084,821	142,647,060	1,437,761
Unassigned funds	(8,146,186)	289,240	(8,435,426)
Surplus as regards policyholders	$138,291,586	$145,289,240	$(6,997,654)
Total liabilities, surplus and other funds	$256,824,349	$223,659,452	

Note: The Internal Revenue Service has completed its audits of the Company’s federal income tax returns through tax year 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. Audit covering tax year 1996 has yet to commence. Except for any impact which might result from the examination changes contained in this report, 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 $63,291,586 during the three year examination period January 7, 1994 through December 31, 1996, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$73,919,100
Deductions		
Losses incurred	$8,461,352	
Loss adjustment expenses incurred	899,290	
Other underwriting expenses incurred	52,257,054	
Total underwriting deductions		$61,617,696
Net underwriting gain		$12,301,404
Investment Income		
Net investment income earned	$18,302,273	
Net realized capital (loss)	(2,482,961)	
Net investment gain		15,819,312
Other Income		
Other income	$54,618	
Structuring fee income	494,000	
		548,618
Net income before Federal income taxes		$28,669,334
Federal income taxes incurred		1,774,760
Net income		$26,894,574

Capital and Surplus Account

Surplus as regards policyholders, per report on organization as of January 4, 1994			$75,000,000
	Gains in Surplus	Losses in Surplus	
Net income	$26,894,574		
Net unrealized capital gains	2,445,253		
Change in provision for reinsurance		$1,474,785	
Change in foreign exchange adjustment	2,903		
Capital paid in	352,940		
Surplus paid in	71,084,821		
Contingency reserve fund		36,014,120	
Total gains and losses	$100,780,491	$37,488,905	
Net increase in surplus as regards policyholders			$63,291,586
Surplus as regards policyholders, per report on examination as of December 31, 1996			$138,291,586

4. BONDS

As previously described in Item 2, the examiner found that the amount recorded for the securities received from the initial capitalization of the Company was undervalued by $1,437,761. It was determined that the securities given in exchange for the Company's stock had a market value of $921,645 more than the amount recorded as the book value. The Company also failed to accrue interest on these securities which amounted to $516,116. The total of $1,437,761 was omitted from the asset Bonds as well as the gross paid in and contributed surplus. None of the securities that were initially received remain in the Company's investment portfolio. The examination changes involve an increase in surplus as well as a matched decrease in realized capital gain. It is recommended that the Company record securities transferred from the parent to the Company at market value, at the date of transfer, with any accrued interest included in the total.

5. AGENTS' BALANCES OR UNCOLLECTED PREMIUMS

The examination admitted asset of $38,121,101 is $34,000,000 more than the $4,121,101 reported by the Company in its 1996 annual statement.

Capital has entered into a multi-year reinsurance treaty with GEMICO pursuant to which it will receive insurance premiums from GEMICO on an installment basis of approximately $8,000,000 annually throughout the six and one-half year term of the policy. Capital has recorded the insurance premiums from GEMICO on an installment basis. Thus as cash is received the Company records the amount of cash as written premium and establishes an unearned premium reserve ("UPR") of an equal amount. As required under the contract between GEMICO and Capital, Capital ceded a portion of the risk incurred for the entire seven year period to a third party reinsurer and paid the full premium prior to 12/31/96. Capital deducted as ceded premiums the amount of premiums paid to the third party reinsurer. As a result of the premiums paid for reinsurance exceeding the premiums received from the insured, Capital's unearned premium reserve relating to this one contract was reduced to a negative ($13,262,692) balance at 12/31/96.

As noted above, the Company has been recording premiums due on an installment basis as opposed to a gross method. This has caused the Company to understate their uncollected premiums by $40,000,000. Ceded balances payable would also be effected by $6,000,000, for a net change of $34,000,000 for this asset. The Company is not recognizing the whole sale at one time, rather they are recording the premiums as they receive them.

It is recommended that the Company recognize the full impact of this contract by reporting premiums on a gross basis rather than on an installment basis.

This transaction has no effect on surplus, as a corresponding examination increase in the liability for unearned premiums of $34,000,000 has been made. Please see Item 11 of this report for further details.

6. <u>FEDERAL INCOME TAX RECOVERABLE</u>

The Company reported an admitted asset in the amount of $835,103 as of the examination date. Pursuant to this examination, the admitted asset has been eliminated.

The Company has created this asset to show the amount of over payment of taxes for tax year 1996. The Company has not paid this amount to the Internal Revenue Service but to its parent. The Company has a tax allocation agreement with Capital Re Corporation (Delaware), whereby they file a consolidated federal income tax return for the group as a whole, which includes their parent, subsidiaries and affiliates. Pursuant to the provisions outlined in Circular Letter 15 (1975), "A balance due as a result of participation in a consolidated tax return should be paid over promptly by the parent."

It is recommended that the Company not classify this asset as a federal income tax recoverable but as a Receivable from parent, subsidiaries and affiliates in the future. The funds were never received from the parent. It is recommended that in the future such amounts be paid over promptly by the parent.

7. LOSSES

The examination liability of $6,999,109 is the same as the amount reported by the Company in its 1996 annual statement.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based upon statistical information contained in the Company's internal records and its filed annual statements.

In reviewing the underlying workpapers supporting annual and quarterly statements filed by the Company, it was noted that the loss data supplied by PMI Mortgage Insurance Company was not readily available on an accident year basis as required for Schedule P.

It is recommended that the Company request accident year data covering the business assumed from PMI on a quarterly basis, so that the Company can fill out their quarterly and annual statement correctly. It is incumbent upon the assuming insurer to obtain this information.

8. REINSURANCE PAYABLE ON PAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of $1,156,889 is $390,315 more than the $766,574 reported by the Company in its 1996 annual statement.

The examiner found that the liability established by the Company did not include activity for the month of December 1996. However, the corresponding asset for uncollected premiums was inclusive of all such transactions through year-end.

It is recommended that the Company apply consistent accounting methodology when accruing for assets and establishing liabilities.

9. LOSS ADJUSTMENT EXPENSES

The examination for loss adjustment expenses of $899,290 is the same as that reported by the Company in its 1996 filed annual statement.

The information Capital receives from its cedents does not separate losses from loss adjustment expenses. The Company calculates its unpaid loss adjustment expense by taking a percentage of unpaid losses reported. It is recommended that the Company request its ceding insureds to furnish separate loss adjustment expense statistics so that proper loss adjustment expense analysis can be undertaken.

As noted in Item 2.D.1 herein, the Company has not allocated any of its overhead expenses to loss adjustment expenses. Regulation 30 requires the Company to make such an allocation. It is recommended that the Company allocate its overhead expenses to loss adjustment expenses as required in Regulation 30.

10. CONTINGENT COMMISSIONS

The examination liability of $24,706,110 is $5,772,236 more than the $18,933,874 reported by the Company as of December 31, 1996.

The Company discounts the profit commissions that are due to the companies from whom they assume business. Since the profit commissions are not due immediately the Company has used a five percent discount factor to arrive at the present value of this liability. The Department does not permit the discounting of this liability.

It is recommended that the Company cease discounting this liability and record the liability at full value.

11. UNEARNED PREMIUMS

The examination liability of $26,187,972 is $34,000,000 more than the ($7,812,028) reported by the Company as of December 31, 1996.

As discussed in Item 5, Capital has entered into a multi-year reinsurance treaty with GEMICO pursuant to which it will receive insurance premiums from GEMICO on an installment basis of approximately $8,000,000 annually throughout the six and one-half year term of the policy. Capital has recorded the insurance premiums from GEMICO on an installment basis. Thus, as cash is received, the Company records it as written premium and establishes an unearned premium reserve (“UPR”) of an equal amount. As required under the contract between GEMICO and Capital, Capital ceded a portion of the risk incurred for the entire seven year period to a third party reinsurer and paid the full premium prior to 12/31/96. Capital deducted as ceded premiums the amount of premiums paid to the third party reinsurer. As a result of the premiums paid for reinsurance exceeding the premiums received from the insured, Capital’s unearned premium reserve relating to this one contract was reduced to a negative ($13,262,692) balance at 12/31/96.

As indicated in Item 5, it is recommended that the Company recognize the full impact of this contract by reporting premiums on a gross basis rather than an installment basis. It is also recommended that the Company record its unearned premium on a gross basis as opposed to an installment basis.

This transaction has no effect on surplus, as a corresponding examination increase in the asset for Agents’ balances or uncollected premiums of $34,000,000 has been made. Please see Item 5 of this report for further details.

12. PAYABLE FOR SECURITIES

The Company reported a liability in the amount of $15,167,937 as of the examination date. Pursuant to this examination, the liability has been eliminated.

The examination review revealed that the Company had classified this account incorrectly. The liability was set up to repurchase mortgage-backed securities under a dollar roll repurchase agreement. Please see Item 13 of this report for further details.

It is recommended that the Company reclassify this amount to the write-in liability, "Mortgage dollar roll repurchase commitment."

13. MORTGAGE DOLLAR ROLL REPURCHASE COMMITMENT

The Company reported no liability under this caption as of the examination date. The examination has established the captioned liability in the amount of $15,167,937.

The examination revealed that the Company had classified this account incorrectly, as Payable for securities. The liability was set up to repurchase mortgage-backed securities under a dollar repurchase agreement.

14. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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	It is recommended that the Company record securities transferred from the parent to the Company at market value, at the date of transfer, with any accrued interest included in the total.	20
G.	Agents' Balances or Uncollected Premiums	
	The Company is financing a reinsurance contract and is recording the premium on an installment basis as opposed to a gross basis. It is recommended that the Company recognize the full impact of this contract by reporting premiums on a gross basis rather than on an installment basis.	21
H.	Federal Income Tax Recoverable	
	It is recommended that the Company not classify amounts over paid to the parent for taxes due under the named caption, but classify these amounts as due from their parent, subsidiaries and affiliates.	22
	It is recommended that in the future such amounts be paid over promptly by the parent.	22

I. Losses

It is recommended that the Company request accident year data from PMI on a quarterly basis, so that the Company can fill out their annual and quarterly statements correctly. It is incumbent upon the assuming insurer to obtain this information. 22

J. Reinsurance Payable On Paid Losses and Loss Adjustment Expenses

It is recommended that the Company apply consistent accounting methodology when accruing for assets and establishing liabilities. 23

K. Loss Adjustment Expenses

It is recommended that the Company request its ceding insureds to furnish separate loss adjustment expense statistics so that proper loss adjustment expense analysis can be undertaken. 23

It is recommended that the Company allocate its overhead expenses to loss adjustment expenses as required in Regulation 30. 24

L. Contingent Commissions

It is recommended that the Company cease discounting this liability and record them at full value. 24

M. Unearned Premiums

It is recommended that the Company record its unearned premium on a gross basis as opposed to an installment basis. 25

N. Payable for Securities

It is recommended that the Company reclassify this liability as a write-in line called “Mortgage dollar roll repurchase commitment.” 26

Respectfully submitted,

___________/S/______________
Erwin Roca
Senior Insurance Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF NEW YORK)

ERWIN ROCA, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

_____________/S/_________
Erwin Roca

Subscribed and sworn to before me

this ______day of _____________________2001.

Appointment No. 21101

STATE OF NEW YORK
INSURANCE DEPARTMENT

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

Erwin Roca

as proper person to examine into the affairs of the

CAPITAL MORTGAGE REINSURANCE 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 28th *day of* March *1997*

GREGORY V. SERIO
Acting Superintendent of Insurance

(by) Deputy Superintendent