

REPORT ON EXAMINATION  
OF THE  
COMPASS INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2000

DATE OF REPORT

FEBRUARY 15, 2002

EXAMINER

GILBERT DENTON

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

February 15, 2002

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

Sir:

Pursuant to requirements of the New York Insurance Law and in compliance with the instructions contained in Appointment Number 21796 dated October 18, 2001, annexed hereto, I have made an examination into the financial condition and affairs of the Compass Insurance Company as of December 31, 2000, and respectfully submit the following report thereon.

The examination was conducted at the administrative offices of the Company located at 709 Curtis Street, Middletown, Ohio.

Whenever the designations "the Company" or "Compass" appear herein without qualification, they should be understood to indicate the Compass Insurance Company.

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

## 1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1996. This examination covers the four year period from January 1, 1997 through December 31, 2000. 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, 2000, 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 bond and other insurance
- Employee relations and welfare
- Territory and plan of operation
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

A review was also made to ascertain what actions were 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 Company was incorporated March 6, 1968, under the laws of the State of New York and licensed December 22, 1969. Business was conducted under the name Medallion Insurance Company until July 19, 1971, when the present title of Compass Insurance Company was adopted.

In March 1980, the ultimate parent of Compass Insurance Company was Armco, Inc. After various relocations within the Armco Inc., holding company system, in January 1985, Northwestern National Insurance Company (“NNIC”) became the immediate parent of Compass.

In August 1999, with the Department’s approval, the Company’s former ultimate parent, Armco Inc., merged with AK Steel Holding Corporation and AK Steel Corporation. Pursuant to the merger agreement, the surviving corporation was AK Steel Corporation. AK Steel Holding Corporation became Compass’ ultimate parent.

In September 1999, the Company’s charter was amended. The Company redeemed 44,332 of its 169,680 issued and outstanding shares of common stock from its immediate parent, Northwestern National Insurance Company. Pursuant to the redemption agreement, the Company’s capital decreased from \$1,696,800 consisting of 169,680 shares with a par value of \$10.00 per share to \$1,253,480 consisting of 125,348 shares with a par value of \$10 per share. Total surplus as regards policyholders decreased \$3,500,026 as a result of the redemption of the 44,332 shares from NNIC, capital paid in decreased by \$443,320 and gross paid in and contributed surplus by \$3,056,706.

The amendment to the Charter was approved by the Department on September 9, 1999, pursuant to Section 1206 of the New York Insurance Law.

A. Management

The Company's amended charter and by-laws provide that corporate powers are to be exercised through a board of directors and through such officers and agents as such board shall empower.

As of the examination date, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Norman J. Bennett Boonton, NY	Consultant
Ernest J. Blaché, Jr. West Chester, OH	President and Chief Executive Officer, Northwestern National Insurance Company
Hugh W. Greene, Jr. Maineville, OH	Consultant
Barry M. Haller Hamilton, OH	Chairman of the Board, Northwestern National Insurance Company
Patricia S. Henson Maineville, OH	Manager, Northwestern National Insurance Company
Douglas O. Mitterholzer Middletown, OH	Treasurer, AFSG Holding, Inc.
Richard H. Pluschau Dix Hills, NY	Consultant
Scott W. Schaefer Middletown, OH	Claims Director, Northwestern National Insurance Company
Judy A. Schnell Blanchester, OH	Manager, Northwestern National Insurance Company
Thomas W. Seitz Hamilton, OH	Vice President and Treasurer, Northwestern National Insurance Company
Gary M. Sussman Miamisburg, OH	Vice President, Northwestern National Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Alwin H. Thiemke East Amherst, NY	Consultant
Milton Thrum Manhasset, NY	Consultant

The minutes of all meetings of the board of directors and committees thereof held during the examination period were reviewed. The meetings, held mostly via conference calls, were generally well attended.

As of December 31, 2000, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Ernest J. Blaché, Jr.	President and Chief Executive Officer
Gary M. Sussman	Vice President
Thomas W. Seitz	Vice President and Treasurer
Joseph W. Plye	Secretary

B. Territory and Plan of Operation

The Company is licensed to transact business in the following twenty-three states:

Alabama	Montana	Oregon
Alaska	Nebraska	Pennsylvania
Arkansas	Nevada	South Carolina
Georgia	New Hampshire	Texas
Iowa	New York	Virginia
Louisiana	North Dakota	West Virginia
Minnesota	Ohio	Wisconsin
Missouri	Oklahoma	

The Company's certificate of authority is under suspension in 9 states. In the other states, the certificate of authority has been non-renewed, revoked or never issued. The Company has voluntarily surrendered its certificate of authority in Puerto Rico and the Virgin Islands.

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

<u>Paragraph</u>	<u>Kind of Insurance</u>
3	Accident and 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
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

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

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 and 41 of the New York Insurance Law, Compass Insurance Company is required to maintain a minimum surplus to policyholders in the amount of \$2,200,000.

The Company discontinued writing new and renewal business in June 1984, and subject to the provisions of Section 1203 of the New York Insurance Law, must obtain prior approval of the Superintendent of Insurance before it can resume doing any insurance business. There are no policies in force on the Company's books. However, a small amount of written and earned premiums continue to be reported in the current annual statement due to premium adjustments for retrospectively rated policies.

During the period prior to the cessation of premium writings in 1984, Compass was a direct writer of all lines of property and casualty insurance, primarily for large commercial insureds. Compass also engaged in the assumption of business from Northwestern National Insurance Company and participated with other affiliates in inter-company pools. The pooling agreement was terminated in 1990.

C. Reinsurance

The Company is in run-off and has not written any new or renewal business since 1984. All of its reinsurance activities are in run-off status, except for mandatory participation in reinsurance pools and associations as stipulated by the respective state regulatory officials as a requirement of licensing.

The Schedule F data as contained in the Company's annual statements filed for the years covered by the examination accurately reflected its remaining reinsurance transactions.

The reinsurance activity has been diminished over the years by claim settlements, the utilization of loss portfolio transfers, and commutation of various reinsurance agreements.

D. Holding Company System

The Company is a wholly-owned subsidiary of Northwestern National Insurance Company (Wisconsin), which is a wholly-owned subsidiary of Armco Insurance Group, Inc. (Delaware), which is ultimately owned by AK Steel Holding Corporation (Delaware).

The Company has registered with this Department as a controlled insurer pursuant to the requirements of Article 15 of the New York Insurance Law. All filings made by the Company pursuant to Article 15 of the New York Insurance Law and Department Regulation 52 are complete and current.

The following chart shows the holding company system as of December 31, 2000:





(i) Inter-Company Agreements

The following agreements have been entered into by the Company with members of its holding company system, all of which have been approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law:

(a) Management Services Agreement

Effective October 1, 1999, the Company entered into a management services agreement with its immediate parent, Northwestern National Insurance Company (“NNIC”). Pursuant to the agreement, NNIC is to act for the Company in matters relating to the administration of its run-off insurance and reinsurance business. Compass has no employees. The nature and extent of services to be provided by NNIC are mutually agreed to from time to time and may include every aspect of operating an insurance business. Compass Insurance Company has ultimate authority in making decisions regarding the run-off of its business. NNIC’s compensation is based on actual costs of providing the administrative services per the service agreement.

(b) Tax Sharing Agreement

Effective October 1, 1999, Compass Insurance Company entered into a tax allocation agreement with AK Steel Holding Corporation, its ultimate parent, whereby the companies file a consolidated federal income tax return. The tax agreement appears to be in compliance with the provisions of Department Circular Letter No. 33 (1979) regarding the establishment of a tax escrow account.

E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law requires the Company to file a report with the State Comptroller’s office for any amount payable to residents of New York State. The Company has made the proper filings with the Office of the Comptroller.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2000, based upon the results of this examination:

\*Net premiums written in 2000 to surplus as regards policyholders

Liabilities to liquid assets (cash and invested assets less investment in affiliates)	21.6%
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\*Premiums in course of collection to surplus as regards policyholders

\*Since the Company has been in run-off since 1984, the above ratios have not been calculated.

The applicable ratio listed above falls within the benchmark range 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	\$(227,818)	(43.2)%
Loss adjustment expenses incurred	2,504,331	474.6
Other underwriting expenses incurred	283,476	53.7
Net underwriting loss	<u>(2,032,333)</u>	<u>(385.1)</u>
Premiums earned	<u>\$ 527,656</u>	<u>100.0%</u>

### 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, 2000. This statement is the same as the balance sheet filed by the Company:

<u>Assets</u>	Ledger <u>Assets</u>	Non-Ledger <u>Assets</u>	Non-Admitted <u>Assets</u>	Admitted <u>Assets</u>
Bonds	\$7,083,306	\$	\$	\$7,083,306
Cash on deposit	100,482			100,482
Short-term investments	5,572,112			5,572,112
Receivable for securities	50,000			50,000
Agents' balances or uncollected premiums	5,127			5,127
Reinsurance recoverable on loss payments and loss adjustment expenses	84,113			84,113
Interest, dividends and real estate income due and accrued		189,053		189,053
Loss portfolio transfer 1988 – receivable	(99,542)	_____	_____	(99,542)
Total assets	<u>\$12,795,598</u>	<u>\$189,053</u>	<u>\$ 0</u>	<u>\$12,984,651</u>

Liabilities

Losses		\$2,469,650
Loss adjustment expenses		1,420,134
Other expenses		25,000
Funds held by company under reinsurance treaties		23,504
Amounts withheld or retained by company for account of others		58,556
Provision for reinsurance		151,086
Payable to parent, subsidiaries and affiliates		46,387
Remittance and items not allocated		18,526
Loss portfolio transfer – 1988		<u>(1,422,227)</u>
Total liabilities		<u>\$2,790,616</u>
Common capital stock	\$1,253,480	
Gross paid in and contributed surplus	34,120,175	
Unassigned funds (surplus)	<u>(25,179,620)</u>	
Surplus as regards policyholders		<u>10,194,035</u>
Total liabilities and surplus		<u>\$12,984,651</u>

NOTE: The Company was acquired by AK Steel Holding Corporation via the merger of Armco Inc., and AK Steel Holding Corporation and AK Steel Corporation in 1999. The Internal Revenue Service has not completed any audit of the consolidated income tax return filed on behalf of the Company. 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 decreased \$472,131 during the four-year examination period, January 1, 1997 through December 31, 2000, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$527,656
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Deductions

Losses incurred	\$(227,818)	
Loss adjustment expenses incurred	2,504,331	
Other underwriting expenses incurred	<u>283,476</u>	

Total underwriting deductions		<u>2,559,989</u>
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Net underwriting income (loss)		\$(2,032,333)
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Investment Income

Net investment income earned	\$2,538,332	
Net realized capital gains	<u>699,370</u>	

Net investment gain		3,237,702
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Other Income

Agents' balances charged off	\$24,286	
Litigation settlement	89,722	
Reinsurance charge off	(47,304)	
Loss portfolio transfer	1,512,486	
Miscellaneous income	<u>164,770</u>	

Total other income (loss)		<u>1,743,960</u>
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Net income (loss)		<u>\$2,949,329</u>
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Capital and Surplus Account

Surplus as regards policyholders, as of December 31, 1996, per report on examination			\$10,666,166
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net Income	\$2,949,329	\$	
Change in provision for reinsurance	78,566		
Change in Capital paid in		443,320	
Change in Surplus paid in	_____	<u>3,056,706</u>	
Total gains and (losses)	<u>\$3,027,895</u>	<u>\$3,500,026</u>	
Net decrease in surplus			<u>(472,131)</u>
Surplus as regards policyholders, as of December 31, 2000, per report on examination			<u>\$10,194,035</u>

**4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liabilities of \$2,469,650 and \$1,420,134 are the same as the amounts reported by the Company as of the examination date. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and filed annual statements and verified by the examiner.

**5. LOSS PORTFOLIO TRANSFER**

Effective April 1, 1988, the Company entered into a loss portfolio transfer agreement with Northwestern National Insurance Company, its parent, that was approved by the Department. Loss and allocated loss adjustment expense reserves totaling \$20,642,725 were transferred to NNIC as a cost to the

Company of \$16,971,017. This portfolio agreement initially reflected a gain of \$3,671,708. As of the examination date, the losses and allocated loss adjustment expenses transferred under this agreement have been paid in the amount of \$12,384,759 with reserves outstanding of \$1,422,227 for a total of \$13,806,986 in losses incurred.

The loss and loss adjustment expense reserves reported by the Company in its December 31, 2000 annual statement are gross of the 1988 loss portfolio transfer outstanding balance. The required contra-liability reflects the reserves transferred that remain outstanding as of the examination date, as required by Department Regulation 108. However, it was noted that the Company incorrectly completed Note 19 of the annual statement. The amount reported for current reserves transferred does not reconcile to line 22, page 3 of the annual statement.

It is recommended that the Company complete the Note No. 19 to the financial statement in accordance with the annual statement instructions.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained four comments and recommendations as follows (page numbers refers to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
1. <u>Management</u>	
i. It was recommended that the Company comply with the provisions of Section 1201 (a)(5)(B)(v) of the New York Insurance Law and have at least thirteen members on its board of directors.	6

The Company has complied with this recommendation.

<u>ITEM</u>	<u>PAGE NO.</u>
ii. It was recommended that the Company comply with the provisions of Section 1201 (a)(5)(B)(vi) of the New York Insurance Law and have at least three of its board of directors reside in the State of New York.  The Company has complied with this recommendation.	6
iii. It was recommended that the Company maintain conflict of interest questionnaires for all members of the board of directors, including outside directors.  The Company has complied with this recommendation.	6-7  15
2. <u>Territory and Plan of Operation</u>  The Company discontinued writing new and renewal business in 1984 and subject to the provisions of Section 1203 of the New York Insurance Law must obtain prior approval of the Superintendent of Insurance before it can resume doing any insurance business.	8
3. <u>Accounts and Records</u>  It was recommended that the Company review its method of allocation pertaining to unallocated loss adjustment expenses in accordance with the requirements of Department Regulation 30.  The Company has complied with this recommendation.	12-13
4. <u>Loss Adjustment Expenses</u>  It was recommended that the Company report the total unallocated loss adjustment expense reserves needed to cover the ultimate cost of running off its business in all future filed annual statements.  The Company has complied with this recommendation.	19

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Territory and Plan of Operation</u>  The Company discontinued writing new and renewal business in 1984 and subject to the provisions of Section 1203 of the New York Insurance Law must obtain prior approval of the Superintendent of Insurance before in can resume doing any insurance business.	7

ITEMPAGE NOB. Loss Portfolio Transfer

It is recommended that the Company complete the Note No. 19 to the financial statement in accordance with the annual statement instructions.

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Appointment No. 21796

STATE OF NEW YORK  
INSURANCE DEPARTMENT

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

**Gilbert Denton**

as proper person to examine into the affairs of the

**COMPASS 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 18th day of October 2001



  
GREGORY V. SERIO  
Superintendent of Insurance