ASSOCIATION REPORT ON EXAMINATION

OF THE

UNITED STATES BRANCH

OF THE

GERLING GLOBAL REINSURANCE CORPORATION

AS OF

DECEMBER 31, 1996

ZONES REPRESENTED	STATES PARTICIPATING	EXAMINERS
I	NEW YORK	JAMES DAVIS, CFE
II	MISSISSIPPI	ALAN KEATING, CFE

Honorable Robert Wilcox
Chairman, Financial Condition (EX4)
Subcommittee, NAIC
Director of Insurance
State of Utah
Salt Lake City, Utah 84114

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

Honorable Harold T. Duryee
Secretary, Midwestern Zone
Director of Insurance
State of Ohio
Columbus, Ohio 43215

Sir/Madam:

In accordance with your several instructions, an Association Examination has been made, as of December 31, 1996 into the financial condition and affairs of the United States Branch of the Gerling Global Reinsurance Corporation and the following report thereon is respectfully submitted.

Where the designation “Branch” appears herein without qualification, it should be understood to mean Gerling Global Reinsurance Corporation (U.S. Branch).

This examination has determined that the Branch’s surplus to policyholders as of December 31, 1996 was $71,880,661, which was in excess of the required to be maintained surplus of $35,000,000.

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AS OF

DECEMBER 31, 1996

DATE OF REPORT	SEPTEMBER 8, 1999
EXAMINER	JAMES DAVIS

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10003

September 8, 1999

Honorable Neil D. Levin
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 21198 dated October 31, 1997 and annexed hereto, I have made an examination into the financial condition and affairs of Gerling Global Reinsurance Corporation (U.S. Branch) located at 717 Fifth Avenue, New York, New York 10022, as of December 31, 1996 and respectfully submit the following report thereon.

Where the designation “Branch” appears herein without qualification, it should be understood to mean Gerling Global Reinsurance Corporation (U.S. Branch).

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1990. This examination covers the six year period January 1, 1991 through December 31, 1996. This examination was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: uncollected premiums, reinsurance recoverable, inter-company balances, loss and loss adjustment expense reserves, funds held by Branch under reinsurance treaties, and the provision for reinsurance. The examination included a review of income, disbursements and Branch records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Branch'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 Branch
Management and control
Corporate records
Fidelity bond and other insurance
Territory and plan of operation
Market conduct activities
Growth of Branch
Business in force by states
Reinsurance
Accounts and records
Financial statements

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

2. DESCRIPTION OF BRANCH

The Gerling Global Reinsurance Corporation, organized under the laws of the Federal Republic of Germany, was incorporated on April 23, 1954 and transacted business in the United States through its United States Branch, which was entered through New York on January 29, 1963. Effective January 1, 1997, the Branch transferred virtually its entire book of business to its affiliate, Gerling Global Reinsurance Corporation of America ("GGRCA") and went into run-off. Gerling ***Global Reinsurance Corporation*** contributed $271 million to the Branch during the period covered by the examination through Home Office remittances. Item 2.A. in this report references changes ***in the Branch's management*** subsequent to the examination date.

A. Management

The Branch operates under the management of Gerling Global Offices, Inc. ("GGO"), a New York corporation, which was appointed United States Manager on December 13, 1962. All of the issued and outstanding shares of GGO are owned by Gerling Security Corporation AG, an affiliate of the home office.

Pursuant to a management agreement dated January 1, 1988, GGO provides all staff and office accommodations required to run the business of the Branch. The Branch reimburses GGO for actual expenses incurred during the year plus a basic fee of $80,000 per annum.

Citibank, NA, located at 111 Wall Street, New York, New York, was appointed as the United States Trustee by a Deed of Trust dated December 13, 1962. This instrument, duly approved by the Superintendent of Insurance of the State of New York, contains provisions that empower the Trustee to purchase and sell securities or other personal property as the Branch may direct, subject to the laws of the State of New York.

The by-laws of GGO provide that its corporate powers shall be exercised by a board of directors consisting of not less than three members. At December 31, 1996, the board of directors was comprised of the following members:

Name and Residence	Principal Business Affiliation
Gerhard Niebuhr Bergisch Gladbach, Germany	Member of the Executive Board, Gerling-Konzern Globale Rueck-AG
Norbert Strohschen Nosrath NRW, Germany	Chairman, Gerling-Konzern Globale Rueck-AG
Juergen Zech Cologne, Germany	Chairman, Gerling-Konzern Allgemeine-AG

A review of the minutes of the board of directors' meetings held during the examination period revealed that the meetings were generally well attended and each of the directors had a satisfactory attendance record.

The principal officers of GGO at December 31, 1996 were as follows:

Name	Title
Gerhard Niebuhr	Chairman
Norbert Strohschen	Vice Chairman
Fredric G. Marziano	President
Robert W. Wooldredge	Senior Vice President, General Counsel and Corporate Secretary
John J. Myers	Senior Vice President
Robert W. Hasselgren	Treasurer
Daniel M. Sparks	Vice President and Controller
Harold L. Adelman	Vice President
Andrew J. C. Banfill	Vice President
Lourdes D. Munda	Vice President
Timothy W. Stalker	Vice President

The following changes were noted in the management of GGO at its regular board meeting held on May 7, 1997:

- The position of Vice Chairman became vacant.
- Mr. Charles Troiano was elected President and Chief Executive Officer.
- Mr. Thomas J. Tartaro was elected Executive Vice President and Chief Operating Officer.
- Mr. Robert W. Hasselgren was elected Senior Vice President, Chief Financial Officer and Treasurer.

B. Conflict of Interest

In each Annual Statement filing for the years 1991 through 1996, the Branch provided affirmative responses to the following general interrogatory:

> "Has the company an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of its officers, directors, trustees or responsible employees which is in or likely to conflict with the official duties of such person?"

However, the GGO was unable to document that any procedures were implemented which would disclose conflicts on the part of their directors and officers in the 1996 calendar year. In addition, the Branch's procedures to monitor receipt of completed conflict of interest questionnaires are deficient as the Branch was missing completed questionnaires for some of its directors and officers for calendar years 1991, 1992, 1993 and 1994.

It is recommended that GGO ensure that all directors, officers and any key employees complete conflict of interest statements on a yearly basis.

C. Territory and Plan of Operation

At December 31, 1996, the Branch was licensed to transact the kinds of insurance as defined in Section 1113(a) of the New York Insurance Law:

Paragraph	Kinds of Insurance
4	Fire
5	Miscellaneous property
6	Water damage
12	Collision
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Branch is also empowered to transact such workers' compensation insurance 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 803, 69th Congress, as amended; 33 USC Section 901 et seq. as amended). The Branch is certified by the United States Department of the Treasury as an admitted reinsurer of surety companies doing business with the United States.

Further, the Branch is authorized to reinsure risks of every kind or description, as provided for in Section 4102(c) of the New York Insurance Law.

A December 31, 1996 the Branch was authorized to transact similar lines of business in the District of Columbia and 45 states.

Based on the lines of business for which the Branch is licensed, and its current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Branch is required to maintain a minimum surplus to policyholders in the amount of $35,000,000.

As of December 31, 1996, no direct business had been written by the Branch; the Branch's business was comprised of assumed reinsurance. Effective January 1, 1997, the Branch went into run-off and transferred virtually its entire active book of assumed reinsurance business to its affiliate.

D. Reinsurance

i. Assumed Reinsurance

In 1996 the Branch assumes a small volume of property business on a quota share basis from its affiliate, Gerling America Insurance Company. This business totaled $3.6 million of the Branch's gross premium writings of $146 million in calendar year 1996, which represented 2.5% of total writings for that year. The Branch also assumed reinsurance from many other companies and underwriting associations. During the examination period, the concentration of the Branch's business shifted from property/casualty lines of business to multiple peril insurance as follows:

Line of Business	1990	1996
Property	49%	29%
Casualty	23	6
Multiple peril	28	65
Totals	100%	100%

The Branch's gross premium writings increased from $33 million in 1990 to $146 million in 1996.

ii. Ceded Reinsurance

A review of all ceded reinsurance contracts effected during the examination period indicated that they contained insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

As of the examination date, the Branch had the following ceded reinsurance program in effect:

Type of Treaty	Cover and Limits
Property	
First Layer Catastrophe Excess	
12.78% Authorized 87.22% Unauthorized	95% of $5,000,000 excess of $7,500,000 each loss occurrence.
Second Layer Catastrophe Excess	
28.70% Authorized 71.30 % Unauthorized	95% of $7,500,000 excess of $12,500,000 each loss occurrence (only 57% of this layer was subscribed.)
Third Layer Catastrophe Excess	
33.16% Authorized 66.84% Unauthorized	95% of $10,000,000 excess of $20,000,000 each loss occurrence.

The Branch also maintained second event excess catastrophe reinsurance as follows:

Type of Treaty	Cover and Limits
Second Event Excess Property Catastrophe	
100% Authorized	$3,000,000 excess of $2,000,000 each loss occurrence, subject to no recovery until the reinsured has first sustained $3,000,000 of excess losses which are otherwise recoverable hereunder. Limit $6,000,000 per contract year.

As of the prior examination date, the Branch maintained six layers of property catastrophe reinsurance providing coverage of $22.5 million excess of $2.5 million per occurrence. At December 31, 1996, the Branch maintained three layers providing coverage of $22.5 million excess of $7.5 million per occurrence. The increase in retention reflected the Branch's ability to retain more of the risk due to increased surplus, growth in premium, and the increasing cost of obtaining reinsurance. Cessions to unauthorized reinsurers increased relative to cessions to authorized reinsurers during the examination period.

The limit of the second event property catastrophe reinsurance changed from $1 million excess of $1 million as of the prior examination date to $3 million excess of $2 million at December 31, 1996.

A review of the documentation for the catastrophe excess of loss agreement as of December 31, 1996 found that the Branch failed to have complete signed interest and liabilities agreements with all of the participants on the contract. It is recommended that the Branch endeavor to receive signed interest and liability agreements for all participants on this contract.

It was also noted that many of the Branch's other reinsurance agreements received failed to have complete signed interest and liability agreements until one or two years after their effective dates.

E. New York Department Regulation 133 - Letters of Credit

New York Department Regulation 133 - "Letters of Credit (11NYCRR79)" provides as follows in Section 79.2:

> "For a letter of credit to be acceptable, it must…:
> (j) if obtained in conjunction with a reinsurance agreement, have the reinsurance agreement in compliance with the provisions of Section 79.5 of this Part."

Section 79.5 "Reinsurance agreements - required and permitted conditions" provides, in part, as follows:

> "(a) When a letter of credit is obtained in conjunction with a reinsurance agreement, then such reinsurance agreement must contain provisions which…:
> (iv) stipulate that the reinsurer and the ceding insurer agree that the letter of credit provided by the reinsurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the reinsurance agreement, and be utilized by the ceding insurer or any successor by operation of law of the ceding insurer including, without limitation, any liquidator, rehabilitator, receiver or conservator of such insurer for the following purposes:

(i) to reimburse the ceding insurer for the reinsurer's share of premiums returned to the owners of policies reinsured under the reinsurance agreement on account of cancellations of such policies;

(ii) to reimburse the ceding insurer for the reinsurer's share of surrenders and benefits or losses paid by the ceding insurer under the terms and provisions of the policies reinsured under the reinsurance agreement;

(iii) to fund an account with the ceding insurer in an amount at least equal to the deduction, for reinsurance ceded, from the ceding insurer's liabilities for policies ceded under the agreement. Such an amount shall include, but not be limited to, amounts for policy reserves, reserves for claims and losses incurred (including losses incurred but not reported), loss adjustment expenses, and unearned premiums; and to pay any other amounts the ceding insurer claims are due under the reinsurance agreement.

(iv) to pay any other amounts the ceding insurer claims are due under the reinsurance agreement.

A review of the Branch's ceded reinsurance contracts in effect as of December 31, 1996 found that all three layers of the catastrophe reinsurance program and all catastrophe excess of loss ceded reinsurance contracts were not in compliance with the requirements of Section 79.5(a)(2).

F. Financial Agreements

During the examination period, the Branch entered into agreements with affiliates and non-affiliates, which lacked the transfer of risk element necessary to record these arrangements as bonafide reinsurance agreements. The reporting of these agreements as reinsurance agreements have the effect of distorting the Branch's actual underwriting results and producing more favorable loss ratios. It is noted that this is the third consecutive examination report which has found the Branch to be incorrectly reporting financial agreements as reinsurance agreements. Correspondence between the Branch and its Home Office indicates that the Branch and its Home Office were fully aware that such agreements did not meet the criteria for being accounted for as bonafide reinsurance agreements. Furthermore, GGO's directors and officers were previously advised by this Department as to the proper accounting treatment for these types of agreements.

The Schedule F data, as contained in the Branch's annual statements filed for the years covered by the examination, accurately reflects the Branch's reinsurance transactions except for the reporting of various financial agreements. A description of these financial agreements is as follows:

1. Aggregate Excess of Loss Reinsurance Agreement with Centre Re - 1992

Effective January 1, 1992, the Branch entered into an Aggregate Excess of Loss Reinsurance Agreement with Centre Reinsurance Company of New York ("Centre Re"). Under the terms of this agreement, Centre Re was required to reimburse the Branch for 97.5% of the amount by which the Branch's ultimate net losses exceeded 70% of its net premiums earned during any one calendar year.

Further, Centre Re was required to make loss payments when losses were incurred by the Branch rather than when loss payments were made by the Branch. It is noted that this treatment permits the Branch to receive recoveries as soon as adverse loss development is recorded rather than after actual claim payments are made.

During the course of the examination correspondence between the Branch and Centre Re was received. It was noted that an October 14, 1991 letter from the Branch to Centre Re indicated that the concept for this agreement was as follows:

1) The Branch will cede approximately $4 million in premiums and $30 million in losses to Centre Re per annum.
2) Centre Re will retrocede 100% of the premiums and losses to two or three European reinsurers per annum.
3) The term will be from year to year, for a minimum of 5 years.
4) Accounts will be settled monthly in cash for both the reinsurance and the retrocession so that Centre Re will incur no Schedule F penalty.
5) Centre Re will have a reasonable profit margin or fee. There will be no underwriting loss for Centre Re and there will be no surplus borrowing involved.

Additional correspondence from Centre Re to the Branch and Zurich Insurance Company (Switzerland) advised that Centre Re and then Zurich would purchase retrocessional coverage from Zurich Insurance Company and then Zurich would fully retrocede the coverage to the Branch's Home Office, Gerling Global Corporation.

Based upon the above, it appears that the intent of the agreement was to transfer funds from the Home Office to the Branch while allowing the Branch to report such transfer as valid reinsurance transactions rather than Home Office remittances. The accounting treatment utilized by the Branch in reporting this transaction resulted in financial statements that favorably distorted the Branch's underwriting results. This agreement was cancelled effective December 31, 1992.

2. Prospective and Retroactive Aggregate Excess of Loss Reinsurance Agreement with Centre Re - Effective January 1, 1993 - November 1, 1996.

Effective January 1, 1993, the Branch entered into Prospective and Retroactive Aggregate Excess of Loss Reinsurance Agreements with Centre Re.

The prospective and retroactive Agreements provided the following cover and limits:

Type of Treaty	Cover and Limits
Prospective Aggregate Excess of Loss 100% Authorized	95% of the amount by which the ultimate net losses exceed 50% of the net premiums earned. Limit $19,000,000 per year.
Retroactive Aggregate Excess of Loss 100% Authorized	95% of the ultimate net loss in excess of the losses reported at December 31, 1992 plus $10 million. Limit $900,000 per year.

These agreements were submitted by the Branch to the New York State Insurance Department for approval pursuant to the requirements of Section 1505(d)(2) of the Insurance Law. The Department approved these agreements in reliance on the Branch's representation that these agreements provided joint protection to the Branch and its Home Office. Under the terms of these agreements, the Home Office would provide 85% of the premium and receive 85% of the reinsurance cover, while the Branch would pay 15% of the premium and receive 85% of the reinsurance cover. Further, these agreements allowed the Branch and its Home Office to utilize any part of the reinsurance cover not used by the other party.

An examination review of settlements under the prospective agreement revealed that although the Home Office provided 85% of the premiums, the Branch received 100% of the recoveries. By allowing the Branch to receive 100% of the recoveries, the Home Office, in effect, transferred funds to the Branch. By reporting the 100% amount as reinsurance recoveries rather than 15% as a recovery and 85% Home Office remittance, the Branch incorrectly reported this transaction. Further, the accounting treatment utilized by the Branch in reporting their transactions resulted in financial statements that favorably distorted the Branch's underwriting results.

In the Underwriting and Investment exhibit contained in this report, the premiums and losses ceded pursuant to the Prospective Agreement have been reserved and the net gain of $63,855,150 has been recorded as a Remittance from Home Office as follows:

Treaty Year	Premiums Ceded	Losses Ceded	Net Gain
1992	$3,000,000	$20,845,150	$17,845,150
1993	2,250,000	14,249,705	11,999,705
1994	2,250,000	19,510,295	17,260,295
1995	2,250,000	19,000,000	16,750,000
Totals	$9,750,000	$73,605,150	$63,855,150

The Branch correctly reported the Retroactive Aggregate Excess of Loss Agreements as a loss portfolio transfer and included the net gain as "miscellaneous income." During the examination period, the Branch has realized a net gain of $5,550,000 from this treaty as follows:

Treaty Year	Premiums Ceded	Losses Ceded *	Net Gain
1993	$750,000	$6,000,000	$5,250,000
1994	750,000	900,000	150,000
1995	750,000	900,000	150,000
Totals	$2,250,000	$7,800,000	$5,550,000

* The Branch received 100% of the Retroactive Agreement recoveries in 1993, while only paying 15% of the premiums. In 1994 and 1995, the Branch paid 15% of the premiums and received 15% of the recoveries under the Retroactive Agreement.

Under the terms of both the Prospective and Retroactive Agreements, Centre Re was required to make loss payments when losses were incurred by the Branch rather than when loss payments were made by the Branch.

Further, a review of GGO's Management Report as of December 31, 1995 noted that the President's letter contained therein indicated that Gerling Global Reinsurance Corporation contributed $16.8 million to the Branch's technical account via the aggregate excess of loss agreement with Centre Re.

This was supported by the income statement included in GGO's Management Report that categorized the recoveries under the Prospective Agreement as a Home Office contribution. It is noted that the GGO 1995 Management Report's treatment of the recoveries under the Prospective Agreement contradicts the accounting treatment reported in the income statements of the Branch's filed financial statements.

The above appears to confirm that the Prospective Agreement provided Home Office Remittances to the Branch and that the Branch incorrectly reported such remittances as reinsurance transactions. The result of this incorrect reporting was to favorably distort the Branch's underwriting results.

Chapter 22 of the Accounting Practices and Procedures Manual for Fire and Casualty Insurance Companies published by the National Association of Insurance Commissioners states, in part, as follows:

> "To the extent that a reinsurance contract does not, despite its form, transfer both components of insurance risk, all or part of the contract shall be accounted for and reported as deposits in the NAIC annual and interim financial statements in the following manner:
>
> 1. At the outset of the reinsurance contract the net consideration paid by the ceding company (premiums less commissions or other allowances) shall be recorded as a deposit on the ceding company's books and as a liability on the assuming company's books. The deposit may be reported as an admitted asset in the ceding company's annual statement (as a write-in item for "other than invested assets") if (a) the assuming company is licensed, accredited or otherwise qualified in the ceding company's state of domicile under Section 1 of the NAIC Model Law on Credit for Reinsurance or (b) there are funds held by or on behalf of the ceding company which meet the requirements of Section 2 of that law. Throughout the life of the contract, receipts and disbursements shall be recorded through the deposit/liability accounts. When the contract is completed, or when there is a loss payment in excess of the deposit, any difference between consideration and recoveries shall be recorded as other income or loss."

During the course of the examination, management was unable to furnish the examiners with the underwriting files for the aforementioned financial agreements. It is noted that these financial agreements materially affected the Branch's underwriting results for the period January 1, 1992 - September 30, 1996. Further, the Branch was advised that the examination review of the Prospective Agreement with Centre Re indicated that the agreement did not contain a transfer of risk, and was, therefore, required to be reported as retroactive reinsurance, in accordance with Chapter 22, "Reinsurance of the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies." Effective November 1, 1996, the Branch commuted the Prospective and Retroactive Agreements.

Meetings were held with management during the course of the examination to discuss the aforementioned financial agreements. At these meetings, the current management advised that officers of management responsible for execution and reporting of these agreements were no longer responsible for aforementioned financial reinsurance agreements. The Branch's management explained that the officers of the current management had taken steps to commute these agreements. It is noted documents furnished to the examiners during the examination indicated that certain officers of the Home Office were informed and involved in the process of executing the aforementioned financial agreements. At December 31, 1996 these officers still held positions in the Home Office.

3. Berkshire Hathaway Profit Treaties - 1994 and 1995

During 1994 and 1995, the Branch entered into assumed reinsurance agreements with three insurers in the Berkshire Hathaway Group - National Fire and Marine Insurance Company, National Liability & Fire Insurance Company and Columbia Insurance Company (Berkshire Hathaway Profit Treaties). These agreements were as follows:

- California Property Catastrophe Excess of Loss Earthquake Reinsurance with National Fire and Marine Insurance Company for the period April 1, 1994 through through December 31, 1995 where the original insured market loss is greater than $10 billion.

- Florida, Georgia, North Carolina and South Carolina Excess of Loss Windstorm Reinsurance with National Liability & Fire Insurance Company for the period April 1, 1994 through December 31, 1995 where the original insured market loss is greater than $7 billion.

- Texas Excess of Loss Windstorm Reinsurance with Columbia Insurance Company for the period April 1, 1994 through December 31, 1995 where the original insured market loss is greater than $5 billion.

It should be noted that the Branch was unable to provide the examiners with a list of catastrophe losses occurring in the United States in the past twenty-five years which had breached the thresholds specified in the aforementioned reinsurance arrangements.

A review of the Berkshire Hathaway Profit Treaties and accounting thereof found the following:

a. the Branch failed to maintain proper books and records relative to this business which represented 18.0% ($19.0 million/$105.4) and 17.5% ($24.0 million/$136.8 million) of its net premium writings in calendar years 1994 and 1995, respectively. The Branch could not furnish any underwriting folders for the period covered by the examination. Management's failure to maintain underwriting folders would appear to indicate a material weakness in its internal control environment.

b. the Branch was unable to demonstrate a transfer of risk for the agreements.

c. A review of GGO's Management Report as of December 31, 1995 noted that the President's letter contained therein indicated:

"…the Home Office contributed $24 million to the Branch's technical account via one of the Berkshire Hathaway Profit Treaties."

The Management Report's Income Statement also accounted for the Berkshire Hathaway Profit Treaties as a Home Office Contribution.

d. No losses were recorded under the 1995 Berkshire Hathaway Treaties.

e. The calendar year 1994 Berkshire Hathaway Profit Treaties were commuted on June 29, 1995. It was noted that GGO's files failed to contain executed copies of these agreements. Also, the 1995 Berkshire Hathaway Profit Treaties were not signed by the parties until February 14, 1996.

Effective January 1, 1995, Chapter 22 of the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies requires that reinsurance contracts not finalized, reduced to written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement are presumed to be retroactive and must be accounted for as retroactive reinsurance. The Branch failed to account for the 1995 Berkshire Hathaway Profit Treaties as retroactive reinsurance agreements in its 1995 Annual Statement.

Since the Branch was unable to provide the examiners with documentation necessary to demonstrate that the Berkshire Hathaway Profit Treaties were not in fact Home Office Remittances, these agreements are being treated as Remittances from the Home Office in this report. As a result of this treatment, the Branch's underwriting income was reduced by $43 million and its surplus account was increased by the same amount.

The following exhibit shows the effect of these financial agreements on the Branch's reported underwriting results during the examination period:

Effect of Financial Agreements on the Branch's
Combined Loss Ratio for the Period 1992 to 1996

1992 Calendar Year	Per Annual Statement	Ratios	Stop Loss		W/O Stop Loss	Restated Annual Statement Ratios
Premiums earned	$44,435,835	100%	$3,000,000	a	$47,435,835	100%
Losses and loss adjustment expenses incurred	38,668,407	**87%**	20,845,150	a	59,513,557	**125%**
Other underwriting expenses incurred	15,938,154	36%	________		15,938,154	34%
Net underwriting gain or (loss)	$(10,170,726)	-23%	$17,845,150		$(28,015,876)	-59%
1993 Calendar Year						
Premiums earned	$57,094,902	100%	$2,250,000	b	$59,344,902	100%
Losses and loss adjustment expenses incurred	51,413,562	**90%**	14,249,705	b	65,663,267	**111%**
Other underwriting expenses incurred	22,338,465	39%	_________		22,338,465	38%
Net underwriting gain or (loss)	$(16,657,125)	-29%	$11,999,705		$(28,656,830)	-49%
1994 Calendar Year						
Premiums earned	$92,771,786	100%	$(16,750,000)	c	$76,021,786	100%
Losses and loss adjustment expenses incurred	85,645,352	**92%**	19,510,295	b	105,155,647	**138%**
Other underwriting expenses incurred	21,601,633	23%	_________		21,601,633	28%
Net underwriting gain or (loss)	$(14,475,199)	-16%	$(36,260,295)		$(50,735,494)	-66%
1995 Calendar Year						
Premiums earned	$110,580,117	100%	$(21,750,000)	d	$88,830,117	100%
Losses and loss adjustment expenses incurred	92,579,620	**84%**	19,000,000	b	111,579,620	**126%**
Other underwriting expenses incurred	32,407,896	29%	_________		32,407,896	36%
Net underwriting gain or (loss)	$(14,407,399)	-13%	$(40,750,000)		$(55,157,399)	-62%
At September 30, 1996						
Premiums earned	$86,761,101	100%	$1,800,000		$88,561,101	100%
Losses and loss adjustment expenses incurred	72,982,363	**84%**	18,550,000		91,532,363	**103%**
Other underwriting expenses incurred	28,702,251	33%	_________		28,702,251	32%
Net underwriting gain or (loss)	$(14,923,513)	-17%	$(16,750,000)		$(31,673,513)	-35%

a - Amount represents results from the Aggregate Excess of Loss Reinsurance Agreement with Centre Re - 1992.

b - Amount represents results from the Prospective Aggregate Excess of Loss with Centre Re.

c - Amount represents $19 million assumed under the 1994 Berkshire Hathaway Treaties less $2.25 million ceded under the Centre Re Prospective Treaty.

d - Amount represents $24 million assumed under the 1995 Berkshire Hathaway Treaties less $2.25 million ceded under the Centre Re Prospective Treaty.

By incorrectly reporting the Aggregate Excess of Loss Reinsurance Agreement (1992), Prospective Aggregate Excess of Loss Reinsurance Agreement (1993-1996), and Berkshire Hathaway Profit Treaties (1994-1995) as reinsurance agreements, it appears that the Branch distorted its underwriting results, thereby limiting the ability of the Department to properly assess the Branch's true condition.

It is noted that in the jurat contained in the Branch's filed financial statements with the Department during the period January 1, 1992 through September 30, 1996, the officers of GGO attested that the financial statements, together with the related exhibits, schedules and explanations were a full and true statement of all the assets and liabilities and of the condition and affairs of said insurer as of (said date), and of the income and deductions therefrom for the (period ended) on that date, and were completed in accordance with the NAIC annual statement instructions and accounting practices and procedures manual, according to the best of their knowledge and belief, respectively.

It would appear that by incorrectly reporting the above financial agreements as reinsurance agreements, GGO failed to make accurate filings as required.

It is noted that this is the third consecutive examination in which the Branch incorrectly reported financial arrangements as reinsurance agreements, and therefore appears to have violated Section 307(a) of the New York Insurance Law.

G. Fronting Arrangement with North American Warranty Services

The Branch assumes 100% of business managed by North American Warranty Services (NAWS) and written through various fronting companies. This business consists of contractual liability on automobile extended service contracts and mechanical breakdown insurance (auto warranty) and non-standard automobile physical damage and liability insurance (non-standard auto). The Branch, in turn, retrocedes 100% of the auto warranty business and 50% of the non-standard auto business to a NAWS affiliate, Illinois Insurance Company (IIC).

A review of the underwriting files noted that the Branch assumed the auto warranty business on a written basis and then retroceded the business to IIC on an earned basis.

A review of the Branch's records and its filed 1995 and 1996 Annual Statements indicated that the assumed premiums from the warranty business totaled $43.5 million and $42.6 million in 1995 and 1996 respectively. These premiums represented 26% and 29% of the Branch's assumed premiums for calendar years 1995 and 1996, respectively. Effective January 1, 1997, the Branch transferred virtually its entire active book of business to its affiliate, GGRCA. It is noted that the 1997 fronting premiums from this business totaled $65.5 million, which represented 31% of GGRCA's assumed premiums for calendar year 1997.

The Branch ceded its entire net unearned premium as of January 1, 1997 of $66,893,252 to GGRCA. A review of the transfer noted that $26,925,118 (40.3%) of the Branch's unearned premiums as of December 31, 1996, related to the NAWS business.

It is noted that during the examination assumed reinsurance contracts, ceded reinsurance contracts and complete underwriting folders for the warranty business was requested. The Branch was unable to provide this documentation until three months after it was initially requested. The Branch has advised that its inability to provide the documentation in a timely manner was due to a large turnover in key personnel within its underwriting department.

The delay in providing documentation needed during the examination does not appear to meet the requirements of Section 310(a)(3) of the Insurance Law. A more detailed description of this issue is contained in Item H of this report.

Subsequent to the examination date, the IIC was placed into liquidation on July 9, 1999 by the Illinois Insurance Department.

H. Ceded Reinsurance Agreement with Berkshire Hathaway - Treaty #9203 - Combined Quota Share/Catastrophe Cover – 1995/1996

The Branch entered into a Combined Quota Share/Catastrophe Cover with National Indemnity Company (BH), an affiliated insurer in the Berkshire Hathaway Group, on December 15, 1994. The Branch paid $25 million in ceded premiums to BH on December 30, 1994 and reported this transaction as ceded reinsurance in its 1994 Annual Statement even though the contract was effective for losses occurring on or after January 1, 1995. It appears that the accounting treatment afforded this cover in the Branch's 1994 Annual Statement was incorrect and had the effect of distorting the financial statements. The Branch's reinsurance agreement with BH included a ceding commission of 30%. Hence, GGR was able to record surplus relief on this contract from the unearned premiums ceded as of December 31, 1994 of $7.5 million ($25 million X 30%), which represented 5.6% ($7.5 million/$133.2 million) of the GGR's surplus to policyholders as of the same date. The contract included a provision that allowed the Branch the option to commute this cover, if BH had a positive cash balance.

It is noted that during the course of the examination the reinsurance binder, reinsurance agreement, underwriting folder and commutation agreement for this contract were requested. The Branch was unable to provide the examiners with the aforementioned underwriting folder until three months after it was initially requested.

A review of the underwriting folder noted a June 1996 memorandum from the Branch to its Home Office, which indicated the Home Office needed to establish offsetting reserves on its books for the Branch's cession to BH. Also, the memorandum stated that the Home Office could take down its reserves after the Branch's cession to BH was commuted.

The contract with BH was commuted by the Branch effective as of June 30, 1996. It is noted that the commutation of this contract was shortly after its effective date calls into question whether or not such contract actually was for the purpose of transferring risk.

Further, the Branch was unable to provide the examiners with meaningful documentation or responses to inquiries for the following:

1. Support for transfer of risk, cash flow analyses, catastrophe modeling of pertinent risks and exposure, etc.
2. A written detailed memorandum from management explaining why it recorded the underwriting of this agreement in its 1994 Annual Statement, when, in fact, the agreement was not effective until January 1, 1995.

I. <u>Receivable from Home Office for Balances Ceded to Financially Troubled Retrocessionaires</u>

The prior report on examination noted an agreement between the Branch and its Home Office concerning the Branch's sale of reinsurance recoverables due from companies in liquidation. The prior report recommended that such transactions between the Branch and its Home Office be reported as remittances to/from Home Office and not as a bonafide sale of uncollectible reinsurance balances. During the current examination period, the Branch continued to sell its reinsurance recoverables to its Home Office as follows:

a) <u>Recoverables due from companies in liquidation</u> - During the period January 1, 1991 through December 31, 1992, the Branch received $8,731,464 from its Home Office that it recorded as received from reinsurers in liquidation. In this report, ceded losses paid was decreased with a corresponding increase to the account titled, "Remittances from Home Office." This accounting treatment decreases the

Branch's net income for the period under examination but has no effect on the Branch's surplus as of December 31, 1996.

It is noted that subsequent to December 31, 1992, the Branch correctly reported cash received from the Home Office for companies in liquidation as "Remittances from Home Office."

b) <u>Recoverables due from London companies</u> - As of December 31, 1994, the Branch had received $10,229,947 from the Home Office for recoverables due from London companies. The Branch recorded the cash received from the Home Office as received from London companies. In this report, these payments have been reclassified as Remittances from Home Office. This accounting treatment decreases the Branch's net income for the period under examination but has no effect on the Branch's surplus as of December 31, 1996.

Note: The Branch discontinued recording recoverables due from London companies after December 31, 1994.

Again, it is recommended that such transactions between the Branch and its Home Office be reported as remittances to/from Home Office.

At year end 1996, the Branch reduced its net paid losses and loss adjustment expenses by $28,389,453. This amount represented the 1996 calendar year increase in case reserves and IBNR ceded to financially troubled companies. The Branch recorded this entry as an increase of $28,389,453 to both its net loss reserves and ceded losses paid. This entry had no effect on the Branch's reported losses incurred for the period. At the same time the Branch booked the ceded losses paid, it established an asset in the same amount for reinsurance recoverable on paid losses. The Branch then not admitted this reinsurance recoverable on paid losses and reduced its surplus by the same amount. In addition, the Home Office provided a $25,000,000 guarantee to reimburse the Branch for any recoverables due from financially troubled retrocessionaires.

It is noted that by letter dated February 11, 1997, from the Branch to the Department, the Branch confirmed the Department's non-objection for the Branch to carry a $25 million receivable from its Home Office. The letter stated, in part, as follows:

> "…Gerling-Konzern Globale has issued a letter to the State of New York Insurance Department dated January 21, 1997, guaranteeing the payment of up to $25 million to its U.S. Branch…
>
> "The genesis of the U.S. Branch's request to establish the $25 million receivable stems from two factors: (1) the Department's directive to include ceded IBNR (including 1984 and prior) in the U.S. Branch's Schedule F, and (2) Gerling-Konzern Globale's historical practice of reimbursing the U.S. Branch for <u>incurred reported losses ceded to financially troubled retrocessionaires.</u> As of December 31, 1996, the U.S. Branch estimated that <u>approximately $25.33 million of 1984 and prior ceded IBNR is allocable to financially troubled retrocessionaires.</u> Since Gerling-Konzern Globale has issued a written guarantee that it will continue to reimburse the U.S. Branch for up to $25 million of reported losses ceded to financially troubled retrocessionaires, the U.S. Branch will establish a receivable from its Home Office in the amount of $25 million to essentially offset the increase surplus charge associated with these retrocessionaires.
>
> "From an accounting standpoint, the U.S. Branch will continue its past accounting practice of recording <u>all balances ceded to financially troubled retrocessionaires as paid losses recoverable,</u> and then treating such recoverables as a non-admitted asset. The U.S. Branch will also reflect the $25 million receivable from Gerling-Konzern Globale on line 17 of page 2 of the Annual Statement, "Receivable from parent, subsidiaries and affiliates," with an offsetting credit on line 26, page 4, "Net Remittances from Home Office." (Emphasis added.)

Based upon a review of the above transaction, it would appear that the Branch's accounting treatment of increasing of ceded paid losses when the ceded loss reserve balances due from financially troubled retrocessionaires are increased is improper. This accounting treatment appears to be tantamount to recording prepaid ceded paid losses. The Branch should not record ceded paid losses prior to payment of its payment of the losses it has asssumed. Further, this accounting treatment distorts the net paid amount reported in the Underwriting and Investment Exhibit - Part 3 - Losses Paid and Schedule P-Analysis of Losses and Loss Expenses of the Branch's annual statements.

It is recommended that, in the future, the Branch not record ceded paid losses until such time as it has actually paid the losses under its assumed contracts.

J. 100% Quota Share Reinsurance Agreement with GGRCA at January 1, 1997

Effective January 1, 1997, the Branch entered into a 100% Quota Share Reinsurance Agreement with GGRCA. Pursuant to the terms of the agreement, the Branch ceded 100% of its net liability under all reinsurance contracts in force as of January 1, 1997 to GGRCA.

The agreement was filed with and approved by the Department, in accordance with the requirement of Section 1505(d) of the New York Insurance Law.

K. Commutation Agreement with Gerling Global Reinsurance Company - Toronto (GGR – Toronto)

> Subsequent to the date of this examination the Branch entered in a Commutation Agreement with GGR – Toronto. This included the following wording:
>
> "The Reinsurer (GGR - Toronto) shall pay to the Reinsured (Branch) on or before December 31, 1997 the sum of $13,500,000 which sum shall represent a provisional commutation of the Reinsurance Agreements. This payment shall be based on ceded balances and reserves, including IBNR, as of September 30, 1997. Any change in the ceded balances and reserves, including IBNR, as of December 31, 1997, shall be adjusted in proportion to the calculations set out in Schedule B." (Emphasis added.)

It is noted that Schedule B included in the commutation agreement indicated that the reserves ceded to the reinsurer as of September 30, 1997 were discounted at different percentages.

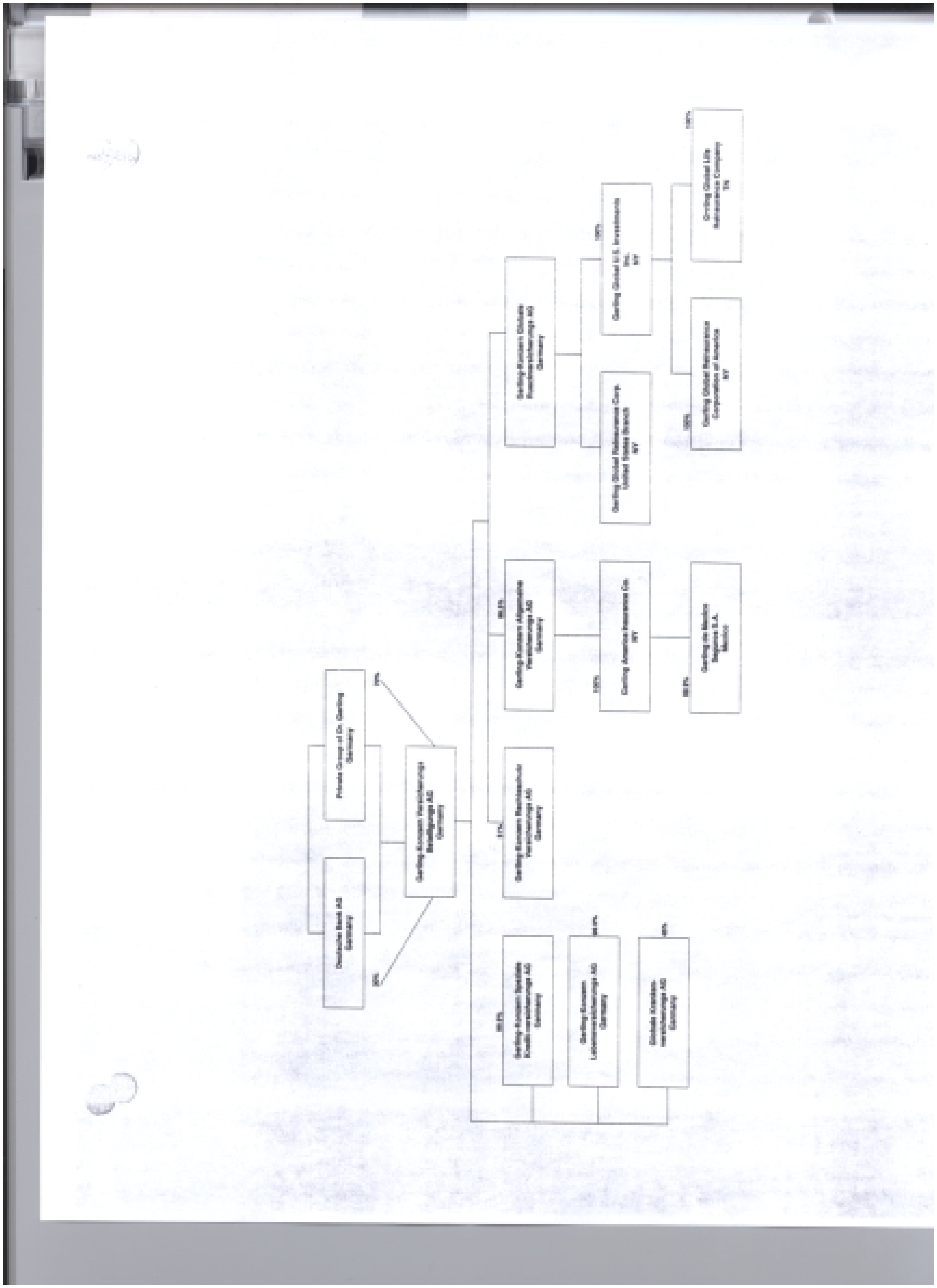
The Department's December 29, 1997 letter approving this agreement advised that any change in the September 30, 1997 reserves at December 31, 1997 should result in a proportional adjustment in the payment.

A review of Deloitte & Touche's (D&T) Net Reserve Analysis for the Branch as of December 31, 1997, found that the Branch's reserves for commuted retrocessions were between $3 million and $6 million deficient. The GGR-Toronto commutation represented 94.8% of the Branch's commuted retrocession reserves at December 31, 1997. It would appear that, as a result of the deficiency indicated by D&T, GGR-Toronto owes the Branch an additional $3.514 million. It is recommended that the Branch recoup this additional $3.514 million from GGR-Toronto.

L. Holding Company System

The Branch is a member of the Gerling Group of Insurance Companies. The parent company of the Group is Gerling-Konzern Versicherungs-Beteiligungs-Aktiengesselschaft, a holding company located in Cologne, Germany. The holding company sets the guidelines for the business policy of the group. The group is comprised of a large number of related entities in Germany, as well as throughout the world. The Branch made annual filings as required by Department Regulation 52.

The following organizational chart was derived from the Branch's 1996 filed Annual Statement:



It is noted that the NAIC Annual Statement Instructions for Property/Casualty Insurance Companies for Schedule Y - Part 1 - Organization Chart provides as follows:

> "Attach a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates, identifying insurers as such and listing the Federal Employer's Identification Number for each. The NAIC company code and two-letter state abbreviation of the state of domicile should be included for all domestic insurers. The relationships of the holding company group to the ultimate controlling person (if such person is outside the reported holding company) should be shown. No non-insurer (excluding the parent company) need be shown if it does not have any activities reported in Schedule Y - Part 2, and its total assets are less than one-half of one percent of the total assets of the largest affiliated insurer."

A review of the holding company charts included in the Branch's 1991-1996 Annual Statements indicated that they were incomplete as the charts failed to include all worldwide affiliated companies The following insurance companies were found to be missing from the 1996 chart:

<u>Direct Property Insurance Group</u>

Gerling Global General Insurance Company, Toronto
Gerling Australia Insurance Company Pty. Ltd., Sydney
"ATU" Towarzystwo Ubezpieczen S.A. Warsaw
Gerling Sul America S.A.Seguros Industriais, Rio de Janeiro

<u>Credit Insurance Group</u>

Namur - Assurances du Credit, S.A., Jambes-Namur
Namur Re S.A., Luxembourg
Gerling Nordic Kredittforsikring AS, Oslo

<u>Reinsurance Group</u>

Gerling-Konzern Welt Standard Rueckversicherungs-Gruppe AG, Cologne
Gerling Global Reinsurance Company, Toronto
Gerling Global Life Insurance Company, Toronto
Gerling Global General and Reinsurance Company Ltd., London
Gerling Global Life Reassurance Company (UK) Ltd., London
Gerling Global Reinsurance Company of Australia Pty. Ltd., Sydney
Gerling Global Life Reinsurance Company of Australia Pty. Ltd., Sydney
Gerling Global Reinsurance Company of South Africa Ltd., Johannesburg
Gerling Globale Rueckversicherungs-Gruppe AG, Zug
Aterforsakringsaktiebolaget Sverige, Stockholm

It is recommended that, in future, the holding company chart and schedule contained in annual statement filings with the Department include all of the Group's affiliates.

At December 31, 1996, the Branch was a party to the following agreements with other members of its holding company system:

1. Management Agreement

Pursuant to a management agreement, effective January 1, 1988, the day to day operations of the Branch are managed by GGO. GGO provides all staff and office accommodations required to run the business of the Branch and agrees to follow the Branch's currently existing underwriting limits and underwriting guidelines. The Branch reimburses GGO for actual expenses incurred during the year plus a fee of $80,000 per annum. A review of the agreement and supporting documentation indicated that the agreement was never submitted to the Department.

Section 1505(d)(3) of the New York Insurance Law requires that the Branch notify the Superintendent in writing of its intention to enter into any transaction with any person in its holding company system at least 30 days prior thereto involving, "rendering of services on a regular or systematic basis." It is recommended that the Management Agreement, and any amendments thereto, be submitted to this Department pursuant to the requirements of Section 1505(d)(3).

2. Expense Reimbursement Agreement

Pursuant to an expense reimbursement agreement, effective January 1, 1992, the Home Office agreed to reimburse 100% of the actual expenses incurred by GGO in the administration of the run-off of the pre-1985 business of the Branch up to a maximum of $4 million per annum. During the five year period January 1, 1992 through December 31, 1996, GGO received reimbursement of $19,475,839 for run-off expenses as follows:

	1992	1993	1994	1995	1996	Totals
Total overhead expenses	$6,556,412	$7,094,727	$7,204,877	$8,540,241	$10,716,533	$40,112,790
Run-off expenses paid by the Home Office	3,475,839	4,000,000	4,000,000	4,000,000	4,000,000	19,475,839
Net overhead expenses	$3,080,573	$3,094,727	$3,204,877	$4,540,241	$6,716,533	$20,636,951

The effect of this agreement is that $11,242,920 of the Branch's unallocated loss adjustment expenses and $8,232,919 of underwriting expenses were paid by the Home Office. Such agreements between a Home Office and, in effect, its Branch, are not valid because these represent an agreement between a Home Office and itself. The Branch is only a business unit through which the Home Office transacts business within the United States.

These expenses were reimbursed directly by the Home Office to GGO and not charged to the Branch. The Branch's accounting for these reimbursements was incorrect and distorted the expenses as reflected in the Underwriting & Investment Exhibit and Schedule P included with its filed annual statements. The Branch should have reflected the expenses in its Annual Statements gross of these reimbursements and included the reimbursement as Home Office Remittances.

In the financial statements contained in this report, loss expenses incurred and other underwriting expenses have each been increased by the aforementioned amounts with a corresponding increase of $19,475,839 to the account titled, "Remittances from Home Office." This accounting treatment decreases the Branch's net income for the period under examination, but has no effect on the Branch's surplus as regards policyholders as of December 31, 1996.

It is recommended that future transactions between the Branch and its Home Office be reported as Remittances to/from Home Office.

M. Directors' Fiduciary Responsibility

As a result of findings in the prior report on examination of the Branch, the directors of GGO were aware of the Branch's financial reporting responsibilities under the Department's Regulation 108. GGO's directors signed an affidavit, dated May 5, 1993, acknowledging having received a copy of the Report on Examination as of December 31, 1990.

Documentation reviewed during the course of the current examination, indicated that the Home Office was apprised of the past and current financial agreements entered into by the Branch. In fact, it appears that the Home Office financed these agreements using third parties. It is noted that GGO has advised that management in the Home Office was not familiar with the rules of statutory reporting in the United States. However, directors of GGO are responsible for overseeing the operation of the Branch, including the duty of ensuring that accurate financial statements are filed by the Branch.

It is recommended that any directors of GGO who are unable to fulfill a director's obligations be replaced.

N. Lack of Co-operation

Section 310(a) of the New York Insurance Law provides, in part, as follows:

> "(2) Any examiner authorized by the superintendent shall be given convenient access at all reasonable hours to the books, records, files, securities and other documents of such insurer or other person …which are relevant to the examination, and shall have power to administer oaths and to examine under oath any officer or agent of such insurer or other person, and any other person having custody or control of such documents, regarding any matter relevant to the examination.

> (3) The officers or agents of such insurer or other person shall facilitate such examination and aid such examination in conducting the same so far as it is in their power to do so." (Emphasis added.)

During the course of the examination the examiners were made to wait for several months for requested documentation relative to financial agreements, fronting agreements, other ceded reinsurance contracts. Further, when such documentation was furnished, it was either incomplete, or provided on a piecemeal basis. This delay in furnishing information appears to indicate GGO did not intend to comply with the requirements of Section 310(a)(2) and (3).

It is recommended that the Branch's management facilitate future statutory financial examinations in a complete and timely manner, in accordance with the requirements of Section 310(a).

O. Compliance with Regulation 118

A review was made of the contracts between the Branch and its independent certified public accounting firm to ascertain compliance with Part 89 of Department Regulation 118 and Section 307 of the New York Insurance Law. The following deficiencies were noted in the contracts for the audits of calendar years 1994, 1995 and 1996:

1. The contracts did not require that the audited financial statements and opinion be provided on or before June 1, as stipulated in Section 307(b)(1) of the New York Insurance Law.

2. The contracts did not require that if the statements contain any material misstatements or if the Branch does not meet the minimum trusteed surplus requirements, the superintendent will be notified within 15 days of such determination, as stipulated by Part 89.2(b) of New York Regulation 118.

3. The contracts did not state that the workpapers and communications will be retained for not less than 5 years, as stipulated by Part 89.2(c) of New York Regulation 118.

It is recommended that the Branch's contract with its independent certified public accountant be amended to comply with the provisions of Part 89.2 of Regulation 118 and Section 307.

P. Fidelity Bond

At December 31, 1994, GGO and its affiliates maintained fidelity bond coverage for its employees with a limit of $500,000. Based on the total admitted assets and gross income of GGO and its affiliates, the N.A.I.C.'s Financial Condition Examiners Handbook recommends a minimum fidelity bond amount of $1,250,000.

After being apprised upon examination of the deficiency in the level of its fidelity bond coverage, GGO and its affiliates increased the fidelity bond to $4,000,000 at January 1, 1996.

Q. Significant Operating Ratios

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	1.81 to 1
Liabilities to Liquid assets (cash and invested assets less investments in affiliates)	104%
Premiums in course of collection to Surplus as regards policyholders	17%

The above ratios are within the bench mark 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 six-year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$590,756,917	135.47%
Other underwriting expenses incurred	154,247,353	35.37
Net underwriting gain (loss)	(308,927,471)	(70.84)
Premiums earned	$436,076,799	100.00%

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, 1996, and as reported by the Branch in its filed annual statement:

	Examination				Branch	
Assets	Ledger Assets	Non-ledger Assets	Not-admitted Assets	Admitted Assets	Admitted Assets	Surplus Increase (Decrease)
Bonds	$380,207,527	$	$	$380,207,527	$380,207,527	$
Stocks:						
Preferred	1,980,000		18,750	1,961,250	1,961,250	
Common	11,258,318	1,556,627		12,814,945	12,814,945	
Cash and short-term investments	109,789,911			109,789,911	109,789,911	
Surplus drafts		1,941,770	1,941,770			
Premium and agents' balances in course of collection	5,718,809	7,019,000	168,977	12,568,832	5,549,832	7,019,000
Premiums and agents' balances booked but deferred and not yet due	20,498,834			20,498,834	20,498,834	
Accrued retrospective premiums	(593,985)			(593,985)	(593,985)	
Funds held by or deposited with reinsured companies	24,253,064			24,253,064	24,253,064	
Reinsurance recoverable on losses and loss adjustment expense payments	65,392,014		36,775,556	28,616,458	28,616,458	
Federal income taxes recoverable	477,121			477,121	477,121	
Interest, dividends, and real estate income due and accrued		4,996,247		4,996,247	4,996,247	
Receivable from parent, subsidiaries and affiliates	27,079,185			27,079,185	27,079,185	
Total assets	$646,060,798	$15,513,644	$38,905,053	$622,669,389	$615,650,389	$7,019,000

Liabilities, Surplus and Other Funds	Examination	Branch	Surplus Increase (Decrease)
Losses and loss adjustment expenses	$403,242,387	$372,060,819	$(31,181,568)
Reinsurance payable on paid losses and loss adjustment expenses	28,131,652	28,131,652	
Contingent commissions	1,234,891	1,234,891	
Other expenses	714,151	714,151	
Unearned premiums (after deducting ceded reinsurance unearned premiums of $8,454,735)	66,893,252	66,893,252	
Funds held by Company under reinsurance treaties	2,044,958	2,044,958	
Amounts withheld or retained by Company for account of others	70,036	70,036	
Provision for reinsurance	34,846,138	19,474,407	(15,371,731)
Provision for uncollectible reinsurance	13,500,000	0	(13,500,000)
Payable to parent, subsidiaries and affiliates	111,263	111,263	
Total liabilities	$550,788,728	$490,735,429	$(60,053,299)
Aggregate write-ins for special surplus funds			
Statutory deposit	$4,200,000	$4,200,000	$
Unassigned funds (surplus)	67,680,661	120,714,960	(53,034,299)
Surplus as regards policyholders	$71,880,661	$ 124,914,960	$(53,034,299)
Total liabilities and surplus	$622,669,389	$615,650,389	$7,019,000

Notes:

1. The Internal Revenue Service has not performed any audits of the Branch’s federal income tax returns. The examiner is unaware of any potential exposure of the Branch to any further tax assessment and no liability has been established herein relative to such contingency.

2. The Branch, with Department’s permission, reported an admitted asset for receivables from the Home Office of $25,000,000 representing losses ceded to retrocessionaires in liquidation or rehabilitation. The Home Office has committed to reimburse the Branch in order to offset the surplus impact on these cessions.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $6,671,715 during the six-year examination period January 1, 1991 through December 31, 1996, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$436,076,799
Deductions:		
Losses and loss adjustment expenses incurred	$590,756,917	
Other underwriting expenses incurred	154,247,353	
Total underwriting deductions		745,004,270
Net underwriting gain (loss)		$(308,927,471)
Investment Income		
Net investment income earned	$118,034,994	
Net realized capital gains	17,431,925	
Net investment gain		135,466,919
Other Income		
Net gains (losses) from agents' or premium balances charged off	$(13)	
Aggregate write-ins for miscellaneous income:		
Ceded uncollectible balances charged off	(19,012,748)	
Proceeds received from loss portfolio transfer	5,550,000	
Realized foreign exchange gain/(loss)	(527,951)	
Interest on funds held by Company	(9,884,447)	
Recoverables from companies in liquidation	(8,731,464)	
Recoverables due from London companies	(10,229,947)	
Total other income		(42,836,570)
Net income before federal income taxes		$(216,297,122)
Federal income taxes incurred		(988,710)
Net income (loss)		$(215,308,412)

Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders, December 31, 1990, per report on examination			$65,208,946
Net income	$	$215,308,412	
Net unrealized capital gains	5,340,872		
Change in not admitted assets		35,186,505	
Change in provisions for reinsurance		30,598,335	
Net remittance from home office	271,873,219		
Extraordinary amount of taxes from prior years		169,485	
Reinsurance payable on paid losses and loss adjustment expenses	10,720,361		
Total gains and losses in surplus	$287,934,452	$281,262,737	
Net increase in surplus			6,671,715
Surplus as regards policyholders, December 31, 1996, per report on examination			$71,880,661

C. Trusteed Surplus Statement

The following statement shows the trusteed surplus of the Branch calculated in accordance with Section 1312 of the New York Insurance Law as determined by this examination:

Assets

Securities deposited with state insurance departments for the protection of all policyholders and creditors within the United States:		
New York	$6,062,187	
Ohio	149,522	
Total general deposits		$6,211,709
Vested in and held by United States Trustee:		
Bonds	$365,654,285	
Preferred stocks	1,961,250	
Common stocks	12,814,945	
Short-term investments	103,741,218	
Accrued interest	4,802,398	
Cash	2,634,307	
Total vested in and held by United States Trustee		491,608,403
Total assets		$497,820,112

Liabilities

Total liabilities and reserves as determined by this examination		$550,788,728
Additions to Liabilities		
Ceded balances payable	$8,917,570	
Agents' credit balances	593,985	
Total additions		9,511,555
Total		$560,300,283
Deductions from Liabilities and Reserves:		
Reinsurance recoverable on paid losses (authorized companies)	$18,247,826	
Reinsurance recoverable on paid losses (unauthorized companies)	2,625,509	
Special State Deposits, not exceeding net liabilities carried thereon	3,360,851	
Accrued interest on Special State Deposits	90,858	
Agents' balances or uncollected premiums not more than ninety days past due, not exceeding unearned premium reserves carried thereon	41,985,236	
Funds held or deposited with reinsured companies	24,253,064	
Accounts receivable - Affiliates	27,079,185	
Total deductions		117,642,529
Total adjusted liabilities		$442,657,754
Trusteed surplus		55,162,358
Total liabilities and trusteed surplus		$497,820,112

4. PREMIUMS AND AGENTS' BALANCES IN COURSE OF COLLECTION

The examination admitted asset of $12,568,832 is $7,019,000 more than the $5,549,832 reported by the Branch as of December 31, 1996. The examination increase represents 1996 premiums recorded by the Branch in calendar year 1997.

5. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for losses and loss adjustment expenses of $403,242,387 is $31,181,568 more than the $372,060,819 reported by the Branch in its filed Annual Statement at December 31, 1996.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based upon statistical information contained in the Branch's internal records reconciled to the data contained in its filed and sworn to Annual Statements.

The examination increase in losses and loss adjustment expenses consists of the following two items:

a. A deficiency of $11,915,000, as reflected in the Branch's one-year development of losses and allocated loss adjustment expense reserves as of December 31, 1996, as reported in the Branch's 1997 filed Annual Statement.

b. $14,766,568 deficiency in the Branch's unallocated loss adjustment expense reserve as of December 31, 1996.

A review of the Company's Schedule P as contained in its December 31, 1996 filed Annual Statement revealed that no provision was made for unpaid unallocated loss adjustment expenses.

Section 1303 - Loss or claim reserves of the New York Insurance Law provides as follows:

> "Every insurer shall…maintain reserves in an amount estimated in the aggregate to provide payment of all losses or claims incurred prior to the date of the statement, whether reported or unreported, which are unpaid as of such date and for which such insurer may be liable, and also <u>reserves in an amount estimated to provide the expenses of adjustment or settlement of such losses or claims."</u> (Emphasis added.)

It is recommended that the Branch establish an appropriate reserve for unallocated loss adjustment expenses, in accordance with Section 1303.

Additionally, the liability was increased by $4,500,000 for a commuted ceded reinsurance contract with Gerling Global Reinsurance Company-Toronto and Provinzial Feuerversicherung at December 31, 1997. A review of the actuarial analysis performed by the Branch's outside consultant indicated that the Branch's gross loss reserves were understated as of December 31, 1997. Since the Branch had no 1997 accident year losses, its gross loss reserves as of December 31, 1996 were understated as well. Also, since the Branch had commuted its reinsurance agreements with two of its reinsurers, the Branch was responsible for all of the indicated gross loss reserve deficiency associated with said business. The deficiency for the commuted arrangements totaled $4,500,000.

6. PROVISION FOR REINSURANCE

The examination liability of $34,846,138 is $15,371,731 more than the $19,474,407 reported by the Branch in its filed annual statement as of December 31, 1996 as follows:

Description	($000's omitted) Branch	Examination	Change
Paid losses and loss adjustment expenses	$9,057	$9,057	$
Unpaid losses and loss adjustment expenses on known cases	42,342	42,342	
Unpaid losses and loss adjustment expenses on IBNR	40,010	58,793	18,783
Sub-total	$91,409	$110,192	$18,783
Less: Funding			
Funds held by company under reinsurance treaties	$ 1,852	$ 1,852	
Letters of Credit	31,892	31,892	
Regulation 20 credit	47,659	50,352	*
Sub-total funding	$80,684*	$84,096	$3,412
Sub-total unauthorized reinsurance	$10,725	$26,096	$15,371
Reinsurance recoverable on paid losses from unauthorized companies over 90 days past due	1,161	1,161	
Provision for unauthorized reinsurance	$11,886	$27,257	$15,371
Provision for overdue authorized reinsurance (Schedule F-Part 6)	316	316	
Provision for overdue reinsurance (Schedule F-Part 7)	7,272	7,272	
Total provision for reinsurance	$19,474	$34,845	$15,371

* Amount does not total correctly because offsets for reinsurers are only allowed up to the amount of recoverables.

The aforementioned examination increase in the Branch's provision for reinsurance resulted from the cumulative effect of the following:

i. Disallowance of Regulation 20 Credit for GGR - Toronto

The Branch reported reinsurance recoverable from its unauthorized affiliate, GGR-Toronto, of $16,644,000 at December 31, 1996. The Branch's 1996 Annual Statement Schedule F, Provision for Unauthorized Reinsurance, showed that the Schedule F penalty for cessions to GGR-Toronto were reduced by $6,433,000 pursuant to Regulation 20. Regulation 20, Part 125.4(e) states, in part, as follows:

> "… (e) In the case of cessions to non-affiliated assuming insurers who have not complied with the requirements of subdivision (a), (c) or (d) of this section, but are authorized in their domiciliary jurisdiction to assume the kind or kinds of insurance ceded thereto:
>
> (1) The ceding insurer shall establish an unauthorized reinsurance reserve which shall be a percentage of all reinsurance recoverable, including unearned premiums, from such assuming insurers described in this subdivision, after reducing such recoverable for any acceptable funds withheld under a reinsurance agreement with such an insurer as security for payment of obligations thereunder, pursuant to the provisions of Section 1301(a)(14) of the Insurance Law, which percentage shall equal the greater of:
>
> (i) the largest percentage of all uncollectible unauthorized reinsurance recoverable during any one of the last five full calendar years;
> (ii) the largest percentage of unearned premiums on cessions to all unauthorized insurers; or
> (iii) fifteen percent."

Since GGR-Toronto is an unauthorized affiliate, no credit for reinsurance is permitted under Regulation 20-Part 125.4(e). Therefore it appears that the Branch's Schedule F penalty for reinsurance recoverable cessions to GGR-Toronto was incorrectly reduced by $6,433,000 as of December 31, 1996. It is noted that in 1997 the Branch commuted its reinsurance agreements with GGR-Toronto for $13,500,000. (See Item 2K in this report for more details).

ii. Non-compliance with Regulation 114

A review indicated that one of the Branch's Trust Fund agreements permitted foreign investments, and that at December 31, 1996 the trust fund included $7,200,000 of such fund. It is noted that foreign investments do not qualify under Section 126.5(a)(2) of Regulation 114. This examination change to the provision for reinsurance reflects the disallowance of these foreign investments. However, the Branch was permitted Regulation 20 credit for 85% of the disallowed amount of $7,200,000. This resulted in a net disallowance of $1,080,000 ($7,200,000 X 15%).

It is recommended that, in future, the Branch's trust agreements comply with the requirements of Regulation 114.

iii. Exam Increase in Ceded Outstanding Reserves Allocated to Unauthorized Reinsurers

The remainder of the examination change results from the change in ceded outstanding loss reserves allocated to unauthorized reinsurers, offset by an increase in Regulation 20 credit. The increase in Regulation 20 credit was calculated utilizing the same percentage of the Branch's Regulation 20 credit to reported reinsurance recoverables from unauthorized reinsurers as of December 31, 1996, and applying said percentage to the examination increase in outstanding loss reserves attributable to unauthorized reinsurers.

7. PROVISION FOR UNCOLLECTIBLE REINSURANCE

The establishment of this examination liability of $13,500,000 as of December 31, 1996 results from an increase in the Branch's gross loss and loss adjustment expense reserves as of December 31, 1996. This increase is documented by an actuarial review of the Branch's reserves through December 31, 1997 performed by the Branch's outside consultant.

8. TREATMENT OF POLICYHOLDERS AND CLAIMANTS

The Branch is a professional reinsurer, and as such, has no direct contact with insureds. In the course of this examination a review was made of the manner in which the Branch conducts its business practices and fulfills its contractual obligations. No problem areas were encountered.

9. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained ten comments and recommendations that are summarized below with the Branch's subsequent actions thereon. (The page numbers shown below refer to the prior report):

ITEM		PAGE NO.
A.	Reinsurance	
	It was recommended that the Branch's ceded reinsurance contracts include insolvency clauses meeting all of the requirements of Section 1308 of the New York Insurance Law.	6-7
	All reinsurance contracts reviewed during this examination contained insolvency clauses complying with the requirements of Section 1308 of the New York Insurance Law.	
B.	Holding Company System	
i.	It was recommended that the Branch notify the Insurance Department of its affiliates' participation in the Branch's working excess covers in its annual holding company statement (Form HC-1) filed with this Department.	11
	The Branch has complied with this recommendation.	
ii.	It was recommended that, when the Branch enters into any service agreements, reinsurance agreements, or extensions of credit with its affiliates, the Branch make appropriate and timely filings with this Department as stipulated in Section 1505 of the New York Insurance Law.	12

ITEM		PAGE NO.
	Agreements between the Branch and its affiliates that were effective subsequent to the filing date of December 31, 1990 report were filed with this Department pursuant to the requirements of Section 1505 of the New York Insurance Law.	
C.	Loss Portfolio Transfer	
	The prior report commented that the Department has ruled that stop loss reinsurance agreements such as the Aggregate Stop Loss Reinsurance Agreement - 2nd Stop Loss and the Stop Loss Reinsurance Agreement on Active Business are loss portfolio transfers as contemplated under Department Regulation 108. By reporting both the 2nd Stop Loss and Stop Loss Reinsurance Agreement on Active Business as reinsurance rather than as a loss portfolio transfer, it appears that the Branch's financial statements were distorted, thereby limiting the ability of regulators to assess the Branch's true financial condition. The Branch appears to have violated Section 307(a)(1) of the New York Insurance Law.	15-19
	Effective January 1, 1992, the Branch canceled the above referenced stop loss agreements.	
D.	Accounts and Records	
i.	It is recommended that the Branch comply with all reporting requirements of Regulation 108.	19
	The Branch has complied with this recommendation.	
ii.	It was recommended that future agreements between the Branch and its Home Office be recorded as Remittances to/from Home Office and not as valid agreements.	19-20
	The Branch has not complied with this recommendation. A similar recommendation is contained in the current report.	
E.	Trusteed Surplus Statement	
i.	It is recommended that the Branch include in the Trusteed Surplus Statement only those assets held in trusteed accounts, in accordance with Section 1312(a)(1)(C) of the Insurance Law.	20
	The Branch has complied with this recommendation.	

ITEM		PAGE NO.
ii.	It is recommended that the Branch use the proper accounting treatment in deducting reinsurance recoverable on paid losses from liabilities in the trusteed surplus statement, in accordance with Section 1312(a)(2) of the New York Insurance Law and as spelled out in Volume 4 of Examination of Insurance Companies.	20-21
	The Branch has complied with this recommendation.	
F.	Premiums and Agents' Balances in Course of Collection	
	It is recommended that the Branch adhere to the form of the annual statement blank in future filings when reporting reinsurance payable on paid losses.	30
	The Branch has complied with this recommendation.	
G.	Provision for Reinsurance	
	It was recommended that if the Branch chooses to avail itself of the credit against cessions to unauthorized reinsurance companies provided for in Department Regulation 20, that the Branch be in compliance with all of the provisions of Section 125.4(e) of Regulation 20.	32-35
	The Branch has complied with this recommendation.	

10. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Conflict of Interest	
	It is recommended that GGO endeavor to ensure that all directors, officers and key employees complete conflict of interest statements on a yearly basis.	5
B.	Ceded Reinsurance	
	It is recommended that the Branch endeavor to receive signed completed interest and liability agreements from all participants in its catastrophe excess of loss agreement.	9
C.	New York Department Regulation 133 - Letters of Credit	10
	It is noted that the Branch's ceded reinsurance contracts in	

ITEM		PAGE NO.
	1996 respectively. These premiums represented 26% and 29% of the Branch's gross assumed premiums for calendar years 1995 and 1996, respectively. It is noted that the 1997 fronting premiums from this warranty business totaled $65.5 million, which represented 31% of GGRCA's assumed premiums for calendar year 1997.	
F.	Ceded Reinsurance Agreement with Berkshire Hathaway - Treaty #9203 - Combined Quota Share/Catastrophe Cover 1995-1996	
	It appears that the accounting treatment afforded this cover in the Branch's 1994 Annual Statement was incorrect and had the effect of distorting financial statements.	23-24
G.	Receivable from Home Office for Balances Ceded to Financially Troubled Retrocessionaires	
1.	It is recommended that such transactions between the Branch and its Home Office be reported as remittances to/from Home Office.	25
2.	The Branch reported an admitted asset for receivables from the Home Office of $25,000,000 representing losses ceded to retrocessionaires in liquidation or rehabilitation. The Home Office has committed to reimburse the Branch in order to offset the surplus impact of these cessions.	25-26
3.	It is recommended, that in the future, the Branch not record ceded paid losses until such time as it has actually paid the losses under its assumed contracts.	26
H.	Commutation Agreement with Gerling Global Reinsurance Company - Toronto	
	It is recommended that the Branch recoup an additional $3.514 million from GGR-Toronto.	28
I.	Holding Company System	
	It is recommended that in the future the holding company chart and schedules contained in annual statement filings with the Department include all of the Group's affiliates.	31
J.	Management Agreement	
	It is recommended that the Management Agreement, and any amendments thereto, be submitted to the Department pursuant to the requirements of Section 1505(d)(3).	31

ITEM		PAGE NO.
K.	Expense Reimbursement Agreement	
	It is recommended that future transactions between the Branch and its Home Office be reported as Remittances to/from Home Office.	33
L.	Directors' Fiduciary Responsibility	
	It is recommended that any directors of GGO who are unable fulfill a director's obligations be replaced.	33
M.	Lack of Co-operation	
	It is recommended that the Branch's management facilitate future statutory financial examinations in a complete and timely manner, in accordance with the requirements of Section 310(a).	34
N.	Compliance with Regulation 118	
	It is recommended that the Branch's contracts with its independent certified public accountant be amended to comply with the provisions of Part 89.2 of Regulation 118 and Section 307.	35
O.	Unallocated Loss Adjustment Expenses	
	It is recommended that the Branch establish an appropriate reserve for unallocated loss adjustment expenses, in accordance with Section 1303.	44
P.	Non-compliance with Regulation 114	
	It is recommended that in future filings the Branch's trust agreements comply with the requirements of Regulation 114.	47

Respectfully submitted,

__________/S/________________
James Davis,
Associate Insurance Examiner

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

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

_______/S/____________________
James Davis

Subscribed and sworn to before me

this __________day of _________________________2000.

Respectfully submitted,

/S/

Alan Keating, CFE
Mississippi Insurance Examiner

STATE OF NEW JERSEY)
) SS.
)
COUNTY OF MORRIS)

ALAN KEATING, being duly sworn, deposes and says that the foregoing report is true to the best of his knowledge and belief.

/S/

Alan Keating, CFE

Subscribed and sworn to before me

this 28th day of June 2001.

/S/

SONIA KONOPI
NOTARY PUBLIC OF NEW JERSEY
Commission Expires 3/25/2004

Appointment No. 21198

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, NEIL D. LEVIN *, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

James Davis

as proper person to examine into the affairs of the

GERLING GLOBAL REINSURANCE CORPORATION

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

CORPORATION

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 31st *day of* October *1997*

NEIL D. LEVIN
Superintendent of Insurance

(by) *Deputy Superintendent*