

REPORT ON EXAMINATION
OF THE
NAC REINSURANCE CORPORATION
AS OF
DECEMBER 31, 1999

DATE OF REPORT

MAY 31, 2002

EXAMINER

MARY MEANEY, CFE

TABLE OF CONTENTS

<u>ITEM NO.</u>	<u>PAGE NO.</u>
1. Scope of examination	2
2. Description of Company	3
A. Management	4
B. Territory and plan of operation	6
C. Reinsurance	8
D. Holding company system	14
E. Significant operating ratios	16
F. Abandoned Property Law	17
G. Section 310 of the New York Insurance Law	17
H. Accounts and records	18
3. Financial statements	21
A. Balance sheet	21
B. Underwriting and investment exhibit	23
4. Common stocks	24
5. Premiums in course of collection	25
6. Federal income tax recoverable	25
7. Losses and loss adjustment expenses	25
8. Provision for reinsurance	26
9. Market conduct activities	26
10. Subsequent events	26
11. Compliance with prior report on examination	27
12. Summary of comments and recommendations	29
Appendix A	



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

May 31, 2002

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

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with instructions contained in Appointment No. 21595 dated August 23, 2000, attached hereto, I have made an examination into the condition and affairs of NAC Reinsurance Corporation as of December 31, 1999 and submit the following report thereon.

The Company's home office is located at 140 Broadway, Suite 5101, New York, NY 10005. The examination was conducted at the Company's administrative office located at Seaview House, 70 Seaview Avenue, Stamford, CT 06902-6040.

Wherever the designations "the Company" or "NAC" appear herein without qualification, they should be understood to indicate NAC Reinsurance Corporation. Wherever the designation "the Department" appears herein without qualification, it should be understood to indicate the New York Insurance Department.

1. SCOPE OF EXAMINATION

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

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

- History of the Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Territory and plan of operation
- Market conduct activities
- Growth of Company
- Business in force by states
- Reinsurance
- Accounts and records
- Financial statements

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

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

2. DESCRIPTION OF COMPANY

The Company was organized under the laws of New York on May 6, 1929. It was licensed and began business in the same year. The original corporate title was Service Fire Insurance Company. This was changed to North American Company for Property and Casualty Insurance in April 1976, and effective February 10, 1989, to NAC Reinsurance Corporation. On January 1, 2001, the Company's name was changed to XL Reinsurance America, Inc. The Company's name change was approved by the Department on January 9, 2001.

The Company was controlled by NAC Re Corporation ("NAC Re"), a holding company, until NAC Re was purchased by X.L. America, Inc. ("XLA") on June 18, 1999. XLA is ultimately owned by XL Capital Ltd ("XL Capital"), a Cayman Islands holding company.

On June 18, 1999, XL Capital completed its stock merger with NAC Re. As part of the merger, XLA, a Delaware holding company, became the new U.S. holding company parent of NAC Re. Following the merger, NAC acquired 100% of the common stock of four XLA subsidiaries: XL Capital Assurance Inc. ("XL Capital Assurance"), a New York financial guarantee insurer; XL Insurance Company of New York Inc. ("XLNY"), a New York property & casualty insurer; Intercargo Corporation ("Intercargo"), a Delaware corporation and parent of XL Specialty Insurance Company ("XL Specialty"), an Illinois property & casualty insurer; and ECS Inc. ("ECS"), a Delaware corporation, which provides underwriting, claims and other services to the property & casualty insurance and reinsurance industry. NAC previously owned two other insurance companies: Greenwich Insurance Company and Indian Harbor Insurance Company.

Share Repurchase Agreement

On September 30, 1999, the Company entered into a stock purchase agreement with XLA whereby NAC agreed to purchase all of the issued and outstanding shares of capital stock of XL Insurance Company of New York (“XLNY”). In exchange for the 1,200,000 shares of XLNY, NAC transferred \$99,377,905 in cash and securities to XLA. This amount was equal to the policyholder surplus of XLNY as of August 1, 1999. The agreement was approved by the Department in September 1999.

On September 30, 1999, NAC entered into a share repurchase agreement with XLNY in which NAC agreed to sell 780,000 shares of XLNY stock for \$65,000,000. This agreement was approved by the Department on November 19, 1999.

Dividend of NAC Re International Holdings Limited to NAC Re Corporation

Effective September 30, 1999, the Company issued a dividend to NAC Re Corporation consisting of 100% of the outstanding shares of NAC Re International Holdings Limited. This transaction was approved by the Department on September 30, 1999.

As of December 31, 1999, the Company’s paid up capital was \$4,200,000. This consisted of 40,000 shares of \$105 par value per share of common stock, all issued to NAC Re Corporation.

A. Management

Pursuant to the charter and by-laws of the Company, corporate powers shall be exercised by a board of directors consisting of not less than thirteen nor more than twenty-one members.

The following were the fifteen members of the board of directors as of December 31, 1999:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Martha Graeme Bannerman Greenwich, CT	Executive Vice President, General Council & Secretary, NAC Reinsurance Corporation
Brian Martin Boornazian Rocky Hill, CT	Senior Vice President & Chief Property Officer, NAC Reinsurance Corporation
Celia Reznick Brown Rye Brook, NY	Senior Vice President, Manager of Human Resources & Assistant Secretary, NAC Reinsurance Corporation
Nicholas Mark Brown, Jr. New Canaan, CT	President & Chief Executive Officer, NAC Reinsurance Corporation
Christopher Frederic Buse Wilton, CT	Senior Vice President & Manager of Casualty Treaty, NAC Reinsurance Corporation
Richard Joseph Callahan New Canaan, CT	President, Greenwich Insurance Company
Gregory Alan Douglas Ridgefield, CT	Senior Vice President & Manager of Casualty Facultative, NAC Reinsurance Corporation
John Christopher Hodge Allendale, NJ	Senior Vice President & Chief Information Officer, NAC Reinsurance Corporation
Carl Fred Madsen Fairfield, CT	Executive Vice President & Chief Underwriting Officer, NAC Reinsurance Corporation
Richard H. Miller New Fairfield, CT	Senior Vice President, Chief Financial Officer & Treasurer, NAC Reinsurance Corporation
Thomas William Muller Monroe, CT	Senior Vice President, & Manager of Property Field Operations, NAC Reinsurance Corporation
Douglas Lester Olsen New Hyde Park, NY	Senior Vice President & Manger of Claims, NAC Reinsurance Corporation
Laura Ann Shanahan Garden City, NY	Senior Vice President & Manager of Bond Profit Center, NAC Reinsurance Corporation
George Francis Stoffel Seaford, NY	Senior Vice President & Manager of Casualty Clash, NAC Reinsurance Corporation

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Thomas Albert Weidman West Hartford, CT	Senior Vice President & Chief Actuarial Officer, NAC Reinsurance Corporation

A review of the minutes of the board of directors revealed that board meetings were generally well attended.

The senior officers of the Company at December 31, 1999 were:

<u>Name</u>	<u>Title</u>
Nicholas M. Brown, Jr.	President & Chief Executive Officer
Richard H. Miller	Senior Vice President, Chief Financial Officer & Treasurer
Martha G. Bannerman	Executive Vice President, General Council & Secretary
Brian M. Boornazian	Senior Vice President
Robert M. Coop	Senior Vice President
Thomas W. Muller	Senior Vice President
Laura A. Shanahan	Senior Vice President
Celia R. Brown	Senior Vice President
Gregory A. Douglas	Senior Vice President
Douglas L. Olsen	Senior Vice President
George F. Stoffel	Senior Vice President
Christopher F. Buse	Senior Vice President
John C. Hodge	Senior Vice President
David B. Porteus	Senior Vice President
Thomas A. Weidman	Senior Vice President

B. Territory and Plan of Operation

The Company operates primarily as a reinsurer and is authorized to transact the kinds of business as specified in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident and health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft

<u>Paragraph</u>	<u>Line of Business</u>
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
20	Marine
21	Marine protection and indemnity

The Company is also authorized to write workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113, including coverages described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33 USC Section 901 et seq. as amended) and the kinds of insurance and reinsurance as specified in Section 4102(c) of the New York Insurance Law. The Company is authorized to transact within the State of New York the business of special risk insurance as defined in Article 63 of the New York Insurance Law.

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, NAC Reinsurance Corporation is required to maintain a minimum surplus to policyholders in the amount of \$35,000,000.

In addition to New York, the Company is authorized to transact business in all states of the United States, the District of Columbia, Puerto Rico and Canada.

The Company solicits business directly from insurers and through reinsurance brokers. The business is comprised of approximately 65% casualty and 35% property business.

C. Reinsurance

Inter-Company Pooling Agreement

The Company participates in an inter-company pooling agreement with four of its affiliates. The pooling agreement provides for sharing of premiums, losses and expenses based on the percentage of each company's pool participation. This agreement became effective on July 1, 1999 and was approved by the Department on September 30, 1999. The original pool percentages were not used in the 1999 pool calculations. The Company amended these percentages, as shown in the following chart:

<u>Pool Company</u>	<u>State of Domicile</u>	<u>Original Participation Percentage (Effective 7/1/99)</u>	<u>Amended Participation Percentage (Effective 12/31/99)</u>
NAC Reinsurance Corporation	NY	78.2%	76%
XL Insurance Company of New York	NY	6.4	7
XL Specialty Insurance Company	IL	5.9	7
Greenwich Insurance Company	CA	4.8	5
Indian Harbor Insurance Company	ND	<u>4.7</u>	<u>5</u>
Total Pool		<u>100%</u>	<u>100%</u>

Section 1505(d)(2) of the New York Insurance Law prohibits an insurer from entering into any agreement with any member of its holding company system:

“...unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto...and he has not disapproved it within such period...(2) reinsurance treaties or agreements...”

The amendments to the pooling agreement were not submitted to the Department pursuant to the above cited section of the New York Insurance Law. It is recommended that the Company submit all amendments to the pooling agreement to the Department prior to implementation, as set forth in the above cited statute.

Under the terms of the pooling agreement, 100% of the members' net premiums, net losses, insurance-related expenses and other related underwriting activities are assumed by the Company as pool leader. Such items are reapportioned, and then ceded to the pool members in accordance with their participation percentages. Any cessions to/from external reinsurers under reinsurance agreements placed by the individual pool members occur prior to the cession of business to the pool leader.

Subsequent to the examination, an amended pooling agreement was implemented in order to clarify certain items as follows:

1. Exclude specific lines of business from the pool.
2. Provide for "funds withheld balance."
3. Provide that cessions to the pool will be on a "net basis."

This amended agreement was submitted and non-disapproved by the Department on July 31, 2000.

In April 2001, the Company submitted a second amended pooling agreement to the Department. This agreement changes the pool percentages to reflect each participant's surplus at year-end. The pool percentages intended to be used for 2001 are as follows:

<u>Pool Company</u>	<u>State of Domicile</u>	<u>Amended Participation Percentage (Effective 1/1/01)</u>
NAC Reinsurance Corporation	NY	76%
XL Insurance Company of New York	NY	5
XL Specialty Insurance Company	IL	10
Greenwich Insurance Company	CA	5
Indian Harbor Insurance Company	ND	<u>4</u>
Total Pool		<u>100%</u>

The major change to this agreement was that cessions to the pool will now be made on a gross of reinsurance basis. Reinsurance will be placed by NAC as pool leader and reinsurance recoverables for all pool companies will be assigned to NAC. This agreement was approved by the Department on August 6, 2001, however, it did not become effective until 2002. The Company filed a third amended pooling agreement effective December 31, 2002 which added 2 additional affiliates to the pool.

Ceded Reinsurance

NAC Reinsurance Corporation has numerous reinsurance agreements in effect that limit its net exposure. A general outline of the principal agreements in effect at December 31, 1999 is as follows:

Type of Contract

Coverage

Property & Casualty

Multiple Line Aggregate Excess of Loss
100% Unauthorized

Section A:

Coverage includes casualty, property, surety & ocean marine with various limits for each, up to \$5,000,000. Written on a per occurrence basis.

Type of ContractCoverageSection B:

Net of all reinsurance, including section A for losses excess of 67.5% of the subject net earned premium earned in the respective agreement year; subject to a maximum limit of \$25,000,000 for sections A and B combined in any one agreement year.

Multiline Basket Excess of Loss
100% Authorized

Section 1 – Property Catastrophe (U.S. and Canadian territories)

\$15,000,000 of ultimate net loss with respect to each and every loss occurrence excess of \$90,000,000; subject to a limit of \$30,000,000, with respect to all loss occurrences during any one agreement year.

Section 2 – Property Catastrophe (Worldwide, excluding U.S. and Canada)

\$20,000,000 of ultimate net loss with respect to each and every loss occurrence excess of \$50,000,000. Subject to a maximum recovery of \$40,000,000, in any one agreement year.

Section 3 – Casualty (Worldwide)

\$10,000,000 of ultimate net loss with respect to each and every loss occurrence excess of \$30,000,000.

Section 4 – Surety (Worldwide)

\$5,000,000 of ultimate net loss with respect to each and every loss occurrence excess of \$15,000,000, not to exceed \$10,000,000 any one agreement year.

Property

Property Per Risk Excess of Loss
100% Authorized

\$5,000,000 ultimate net loss any one loss excess of \$5,000,000. Subject to \$25,000,000 with respect to any one loss; \$25,000,000 in the aggregate.

Property Per Risk Excess of Loss
5 Layers
Mostly Unauthorized

\$90,000,000 excess of \$10,000,000, any one loss any one risk; subject to an aggregate limit of \$300,000,000, with respect to all losses during the period of these agreements.

Property Catastrophe Excess of Loss
4 Layers
Mostly Unauthorized

\$80,000,000 excess of \$10,000,000, each and every loss occurrence and \$190,000,000 with respect to all loss occurrences during the period of these agreements. Various retentions throughout layers.

<u>Type of Contract</u>	<u>Coverage</u>
<u>Property Catastrophe – International</u> 100% Unauthorized	\$10,000,000 excess of \$40,000,000, each and every loss occurrence and \$20,000,000 all loss occurrence during the period of this agreement. Territory: Worldwide (excluding the United States, Canada and their territories).
 <u>Casualty</u>	
<u>Casualty Contingency</u> 100% Unauthorized	\$12,500,000 ultimate net loss excess of an ultimate net loss of \$7,500,000, each and every loss. Subject to a maximum limit of \$25,000,000, in any one agreement year.
	\$10,000,000 ultimate net loss excess of an ultimate net loss of \$20,000,000 each and every loss, 66.67% placed. Subject to a maximum limit of \$25,000,000, in any one agreement year.
 <u>Other</u>	
<u>Workers' Compensation Excess of Loss</u> 8 Layers Mostly Unauthorized	\$195,000,000 ultimate net loss excess of \$5,000,000 any one occurrence.
<u>Ocean Marine Excess of Loss</u> 4 Layers Mostly Unauthorized	\$29,000,000 each and every loss excess of \$1,000,000 each and every loss.
<u>Surety</u> 27% Authorized 73% Unauthorized	\$7,500,000 in respect of any one principal or buyer in excess of \$7,500,000. Subject to \$22,500,000 in respect of all principals or buyers during the term of the agreement.
<u>Aggregate Excess of Loss (Stop Loss)</u> 100% Unauthorized	100% of loss in excess of 70% of the subject net earned premium earned in the respective agreement year. Subject to an aggregate limit of \$18,000,000, in any one agreement year.

NAC has several ceded reinsurance contracts that were not signed within nine months of their effective dates. Chapter 22 of the NAIC Accounting Practices and Procedures Manual states that in order to take credit for cessions as reinsurance, the contract must be signed within in nine months or less of its effective date. In addition, some contracts did not have executed interest and liability pages, while others

had not been reduced to writing. Nonetheless, the Company took credit in Schedule F of the annual statement for these cessions. Additionally, Section 1308(a) of the New York Insurance Law requires that the contract contain an insolvency clause in order to take credit for the reinsurance. Due to the immateriality of the amounts involved, no examination changes were made to the financial statements contained herein. However, it is recommended that the Company account for all reinsurance cessions that have not been signed within nine months, in accordance with Chapter 22 of the NAIC Accounting Practices and Procedures Manual (since replaced by Statement of Statutory Accounting Principles No. 62). It is also recommended that the Company comply with Section 1308(a) of the New York Insurance Law and maintain full and complete reinsurance agreements with insolvency clauses.

It should be noted that several amounts reported by the Company in Schedule F of its filed annual statement amounts could not be supported by its internal records. The Company was either unable to provide the documentation to support Schedule F amounts or the documentation provided did not agree with the amounts reported. It is recommended that the Company exercise due care in maintaining sufficient documentation to support the amounts reported in Schedule F of future filed annual statements.

After all ceded reinsurance is placed by individual pool members, the premiums and losses are then pooled and subject to a 75% quota share agreement with the Company's affiliate, XL Insurance Ltd (Bermuda). This agreement became effective on July 1, 1999 and was approved by the Insurance Department on September 30, 1999.

Subsequent to the examination, on August 2, 2000, the Department approved a revised agreement that replaced XL Insurance Ltd (Bermuda) with XL Mid Ocean Reinsurance Ltd. ("XLMO"). Financial guarantee and finite insurance are excluded under the agreement. XL Insurance Company of New York

("XLNY"), a pool member, is excluded from the 75% quota share because it has a separate 90% quota share reinsurance agreement with XLMO. The remaining 10% of XLNY's business is ceded to the pool.

In conjunction with the 75% quota share, subsequent to the examination, the Company entered into a trust agreement with XLMO. This agreement was approved by the Department on August 21, 2000 and was entered into according to Regulation 114 in order to fund the unauthorized reinsurance penalty.

D. Holding Company System

The Company is wholly-owned by NAC Re Corporation, a Delaware company. An examination review determined that the Company made the required annual filings, as registrant, pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

As of December 31, 1999, the Company owned 100% of the companies listed below, which are within its holding company system:

Company

Greenwich Insurance Company
 Indian Harbor Insurance Company
 XL Insurance Company of New York, Inc.
 XL Capital Assurance Inc.
 Intercargo Corporation (including XL Specialty Insurance Company)
 ECS, INC.
 NAC Re Investment Holdings, Inc.

An organization chart as of December 31, 1999, which details members of the system, is shown in Appendix A.

The chart in Appendix A is incomplete. Prime Advisors and Convenient Property and Casualty are two affiliates missing from the chart. It is recommended that the Company follow the Annual

Statement Instructions when completing Schedule Y of the annual statement and include all required affiliates.

During 1998, the Company organized NAC Re Investment Holdings (“NIH”), a non-insurance investment company. Section 1603(a) of the New York Insurance Law states that:

“No acquisition of a majority of any corporation’s outstanding shares shall be made...unless a notice of intention of such proposed acquisition shall have been filed with the superintendent not less than 90 days...in advance of such proposed acquisition...”.

The Company failed to notify the Department of this transaction. In the future, it is recommended that the Company comply with Section 1603(a) of the New York Insurance Law and notify the Department prior to making an acquisition of a majority of a corporation’s outstanding shares.

Service Agreements

The Company is party to several service and expense agreements with its direct parent and its affiliates. The following is a list of service agreements in effect at December 31, 1999:

1. Service agreement with XL Insurance Company of New York, Inc., dated September 30, 1999.
2. Service agreement with XL Specialty Insurance Company, dated September 30, 1999.
3. Service and property agreement with Indian Harbor Insurance Company, dated August 28, 1992.
4. Service and property agreement with Greenwich Insurance Company (formerly known as Harbor Insurance Company), dated December 13, 1990.
5. Service and property agreement with NAC Re Corporation, dated July 1, 1997.

Since the Company’s purchase by XL Capital Ltd in June 1999, the Company has not been complying with any of the above service agreements. NAC appears to have been paying most of the expenses such as rent, utilities and personnel. However, with the advent of the pooling agreement on July 1, 1999, these costs were shared by pool members according to pool percentages. Expenses were not allocated to other members of the holding company system that were not members of the pool.

It is recommended that the Company enter into written agreements that provide for all expenses to be properly allocated among members of the holding company system.

Subsequent to this examination period, in April 2001, a revised service agreement was submitted to the Department. This agreement was approved on August 2, 2001, with an effective date of April 1, 2001.

Tax Sharing Agreement

The Company participates in a tax sharing agreement with its four pool members, seven additional affiliates, and its parent, XLA. This agreement is in effect for the year 1999 and subsequent and was approved by the Department on October 29, 1999. Upon review, it was determined that the agreement is in compliance with the minimum guidelines set forth in the New York Department's Circular Letter No. 33 (1979).

E. Significant Operating Ratios

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

Net premiums written in 1999 to surplus as regards policyholders	.64 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	121% *
Premiums in course of collection to surplus as regards policyholders	94% *

*The last two ratios presented above are outside the benchmark ranges of the Insurance Regulatory Information System established by the National Association of Insurance Commissioners. The unusual values result from examination changes to the Company's investment and losses, as set forth further herein.

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 and loss adjustment expenses incurred	\$1,718,160,760	76.82%
Other underwriting expenses incurred	794,291,473	35.51
Net underwriting gain (loss)	<u>(275,737,786)</u>	<u>(12.33)</u>
Premiums earned	<u>\$2,236,714,447</u>	<u>100.00%</u>

F. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law requires certain unclaimed insurance proceeds to be reported to the State of New York by April 1st of each year. A review of the Company's records revealed that although it did not have any monies to remit, it did make the appropriate filings for all years during the examination period. However, the Company did not retain copies of the filings for the years 1995, 1996, and 1997.

It is recommended that the Company retain copies of all abandoned property filings until the examination report for those years has been filed.

G. Section 310 of the New York Insurance Law

Section 310(a)(3) of the New York Insurance Law provides that:

"the officers and agents of any insurer or person shall facilitate such examination and aid such examiners in conducting the same so far as it is in their power to do so."

It would appear that the Company did not comply with the above provisions of the law, demonstrated by the following:

- The designated contact person did not have the authority, knowledge and experience to effectively facilitate the examination;
- Requests for information were not responded to in a timely manner;
- Documentation provided was often inaccurate and incomplete.

Management has attributed the lack of timely responses to examination requests to several factors, including employee turnover and the integration of the company's operations into the XL organization. Additionally, once management was made aware of the lack of cooperation issues, a new contact person was appointed and information was received in a more timely manner.

Nevertheless the above significantly increased the length of the examination, increased the cost of the examination to the Company, and put a strain on the Department's resources. It is recommended that during future examinations, the Company comply with Section 310(a)(3) of the New York Insurance Law. It is further recommended that the Company take the following corrective action to facilitate future examinations:

- The role of the Company contact person is to facilitate the examination. Individuals assigned to this function must have broad authority and appropriate knowledge;
- Responses should be qualitatively reviewed before submission to examiners;
- Sufficient human resources must be committed to facilitate the examination process.

After the contact person was changed, information was received in a more timely manner. Also, some delays may be attributed to high turnover in employee personnel.

H. Accounts and Records

i. Annual Statement Balances

During the course of this examination, it was discovered that some of the annual statement balances in cash and payable for securities were incorrectly classified. It is recommended that the Company take proper care when completing the annual statement and classify all balances correctly.

It was discovered that the Company did not have support for several of the annual statement balances as follows:

- Reinsurance payable on paid losses & loss adjustment expenses - In examination testing of this account, it was revealed the Company set up a payable based only on an e-mail from an affiliate. Also, the Company failed to provide information on a timely basis and when provided, it did not tie to the annual statement.
- Other expenses - Examination testing of this account revealed that the Company was unable to provide support for three of the five balances requested.
- Loss portfolio transfer – The Company was unable to provide any support for the balance sheet liability of \$126,000.

It is recommended that the Company maintain support for all annual statement balances.

ii. Reinsurance Payable on Paid Losses & Loss Adjustment Expenses

During the review of Reinsurance payable on paid losses & loss adjustment expenses, discrepancies were found in two of the four balances tested. These discrepancies resulted in a \$988,000 understatement of the reinsurance payable account. Due to the immateriality of this amount, no examination change was made. However, it is recommended that the Company report accurate amounts in its filed annual statements.

The open items report balance for NAC Re International, an affiliate, was \$18,786,870, however, the Company reported \$26,231,000 in Schedule F, Part 1. No support could be provided for this difference. Section 1505(b) of the New York Insurance Law states:

“The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties.”

It is recommended that the Company comply with Section 1505(b) of the New York Insurance Law and maintain support for all transactions with affiliates.

iii. Interest and Dividend Income Due and Accrued

In the examination review of interest and dividend income due and accrued, it was noted that thirteen of the fifteen sampled interest calculations were done incorrectly by the Company. Examination review indicated that this was due to an error in the Company's program for calculating accrued interest. Although the differences found were immaterial, it is recommended that the Company use a more accurate system for calculating interest and dividend income due and accrued.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as determined by this examination as of December 31, 1999 and as reported by the Company:

<u>Assets</u>	<u>EXAMINATION</u>				<u>COMPANY</u>	Surplus Increase (Decrease)
	Ledger Assets	Non-Ledger Assets	Not-Admitted Assets	Admitted Assets	Assets	
Bonds	\$1,234,728,571		\$3,748,012	\$1,230,980,559	\$1,230,980,559	
Preferred stocks	1,272,250	\$(672,250)		600,000	600,000	
Common stocks	393,162,667	(170,646,534)	80,371,000	148,324,133	222,516,133	\$(74,192,000)
Cash on hand and on deposit	97,286,034			97,286,034	97,286,034	
Other invested assets	27,736,991			27,736,991	27,736,991	
Premiums, agents' balances in course of collection	43,474,743	41,498,000	609,562	84,363,181	42,865,181	41,498,000
Premiums, agents' balances and installments booked but deferred and not yet due	71,019,431			71,019,431	71,019,431	
Accrued retrospective premiums	9,333,302			9,333,302	9,333,302	
Funds held by or deposited with reinsured companies	9,714,325			9,714,325	9,714,325	
Reinsurance recoverable on loss payments	40,290,145			40,290,145	40,290,145	
Federal income tax recoverable	39,937,763	32,372,000		72,309,763	39,937,763	32,372,000
EDP equipment	1,305,063			1,305,063	1,305,063	
Interest, dividends and real estate income due and accrued		19,561,121		19,561,121	19,561,121	
Receivable from parent subsidiaries and affiliates	63,903,441			63,903,441	63,903,441	
Accounts receivable miscellaneous	3,935,875		625,349	3,310,526	3,310,526	
Total assets	\$2,037,100,601	\$(77,887,663)	\$85,353,923	\$1,880,038,015	\$1,880,360,015	\$(322,000)

Liabilities

	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Loss and loss adjustment expenses	\$1,175,734,849	\$986,734,849	\$(189,000,000)
Reinsurance payable on paid losses and loss adjustment expenses	79,983,927	79,983,927	
Contingent commissions	5,044,265	5,044,265	
Other expenses	28,742,921	28,742,921	
Taxes, licenses and fees	1,386,801	1,386,801	
Federal income taxes	53,907	53,907	
Unearned premiums	76,373,885	76,373,885	
Funds held by Company under reinsurance treaties	3,803,977	3,803,977	
Amounts withheld or retained by company for account of others	2,443,394	2,443,394	
Provision for reinsurance	95,354,400	20,115,400	(75,239,000)
Payable to parent, subsidiaries & affiliates	234,407,539	234,407,539	
Payable for securities	116,600	116,600	
Loss portfolio transfer	126,000	126,000	
Accounts payable miscellaneous	<u>923,056</u>	<u>923,056</u>	<u> </u>
Total liabilities	<u>\$1,704,495,521</u>	<u>\$1,440,256,521</u>	<u>\$(264,239,000)</u>

Policyholders' Surplus

Capital paid up	\$4,200,000	\$4,200,000	
Gross paid in and contributed surplus	463,608,962	463,608,962	
Unassigned funds	<u>(292,266,468)</u>	<u>(27,705,468)</u>	<u>\$(264,561,000)</u>
Surplus as regards policyholders	<u>\$175,542,494</u>	<u>\$440,103,494</u>	<u>\$(264,561,000)</u>
Total liabilities and surplus	<u>\$1,880,038,015</u>	<u>\$1,880,360,015</u>	

Notes:

The Internal Revenue Service has not commenced any audits of the consolidated income tax returns 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 & Investment Exhibit

Surplus as regards policyholders decreased \$231,481,724 during the five-year period, January 1, 1995 through December 31, 1999, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$2,236,714,447
Deductions:		
Losses and loss adjustment expenses incurred	\$1,718,160,760	
Other underwriting expenses incurred	<u>794,291,473</u>	
Total underwriting deductions		<u>2,512,452,233</u>
Net underwriting (loss)		\$(275,737,786)

Investment Income

Net investment income earned	\$481,205,056	
Net realized capital gains	<u>126,689,367</u>	
Net investment gain		607,894,423

Other Income

Miscellaneous (loss)	<u>\$(7,508,373)</u>	
Total other income		<u>(7,508,373)</u>
Net income before dividends to policyholders and federal and foreign income taxes		\$324,648,264
Federal and foreign income taxes incurred		<u>50,250,054</u>
Net income		<u>\$274,398,210</u>

“in no event shall the aggregate value of insurance company stock be allowed in excess of 50% of surplus to policyholders or 60% of the surplus of the insurer, whichever is greater.”

Due to the increase in losses and related surplus decrease, the maximum allowable investment in insurance companies decreased.

5. PREMIUMS IN COURSE OF COLLECTION

The examination asset of \$84,363,181 is \$41,498,000 more than the \$42,865,181 reported by the Company as of December 31, 1999. The examination change is due to premiums recorded after the statement date but due as of the examination date.

6. FEDERAL INCOME TAX RECOVERABLE

The examination asset of \$72,309,763 is \$32,372,000 more than the \$39,937,763 reported by the Company as of December 31, 1999. The examination change is due to the decrease in federal income tax incurred for the examination period because of the increase in losses incurred. The Company received this amount in two installments in 2002.

7. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of \$1,175,734,849 is \$189,000,000 more than the \$986,734,849 reported by the Company as of December 31, 1999. 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 in its filed annual statements. The \$189,000,000 increase is based on the Company's subsequent two year loss development at December 31, 2001.

8. PROVISION FOR REINSURANCE

The examination liability of \$95,354,400 is \$75,239,000 more than the \$20,115,400 reported by the Company in its December 31, 1999 filed annual statement. The change is detailed as follows:

From loss reserve strengthening (related to the 75% quota share reinsurance agreement with an unauthorized affiliate)	\$(78,033,000)
Unused letter of credit with above affiliate	24,085,000
Additional losses ceded (to third party unaffiliated unauthorized reinsurers)	(3,996,000)
Additional unearned premiums ceded (to third party unaffiliated unauthorized reinsurers)	<u>(17,295,000)</u>
Total	<u>\$(75,239,000)</u>

9. MARKET CONDUCT ACTIVITIES

The Company is in the reinsurance business only; consequently, it does not have direct contact with insureds or claimants.

The Company placed no advertisements during the examination period.

10. SUBSEQUENT EVENTS

Subsequent to the date of this examination, the Company received surplus contributions totaling \$506,000,000. The contributions were received as follows:

<u>Contributions</u>	<u>Year</u>
\$120,000,000	2000
\$186,000,000	2001
\$200,000,000	As of May 2002

During the 2000 and 2001 years, the Company wrote gross premiums of \$1,154,000,000 and \$1,423,000,000, respectively. On a net basis, the Company wrote \$182,000,000 and \$228,000,000 in premiums in 2000 and 2001. In addition, the Company had a reported surplus to policyholders of \$639,000,000 as of December 31, 2001.

11. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The following recommendations cited in the prior report on examination as of December 31, 1994, are summarized below (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that directors who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
The Company has complied with this recommendation.	
ii. It is recommended that all future changes to the Company's charter be completed in accordance with Sections 1206(a)(4) and (b) of the New York State Insurance Law.	6
The Company has complied with this recommendation.	
B. <u>Reinsurance</u>	
i. It is recommended that the Company amend its reinsurance contracts to comply with the provisions of Section 7427 of the New York State Insurance Law.	9
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
ii. It is against public policy in the State of New York to reinsure extra contractual obligation coverage providing for reimbursements of punitive damages. Accordingly, it is recommended that the Company exclude coverage for extra contractual obligations in its contracts. This comment no longer applies.	10
iii. It is recommended that the Company have all reinsurance agreements signed in a timely manner. The Company has not complied with this recommendation. A similar comment is contained in the current report on examination.	10
iv. An analysis of the Company's First Multiple Excess of Loss and Clash Cover Agreement raised a question regarding the level of risk transfer; however, this issue was resolved when the Company indicated that they will cancel the agreement effective December 31, 1996. This comment no longer applies.	15
v. It is recommended that the Company comply with Section 1308(e)(1)(A) of the New York State Insurance Law. The Company continues to cede more than fifty percent of its unearned premiums in force under a 75% quota share reinsurance agreement with an affiliate. This agreement was approved by the Department.	17
C. <u>Abandoned Property Law</u> It is recommended that the Company make the proper filings under the captioned law. The Company did make filings during the examination period, however no copies of these filings were retained by the Company. A comment is contained in the current report on examination.	20
D. <u>Accounts and Records</u>	
i. It is recommended that the Company amend its custodial agreement to include the additional provisions which are deemed to be representative of good business practices for the contents of such agreements. The Company has complied with this recommendation.	21
ii. It is recommended that the Company amend its letters of credit to comply with Regulation 133.	22

<u>ITEM</u>	<u>PAGE NO.</u>
The Company has complied with this recommendation.	
iii. It is recommended that the Company report the value of its electronic data processing equipment in compliance with Section 1301(a)(18) of the New York Insurance Law.	23

The Company has complied with this recommendation.

12. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance</u>	
i. It is recommended that the Company submit all amendments to the pooling agreement to the Department for approval, in accordance with Section 1505(d)(2) of the New York Insurance Law.	9
ii. It is recommended that the Company account for all reinsurance cessions that have not been signed within nine months as deposit accounting as set forth in Chapter 22 of the NAIC Accounting Practices and Procedures Manual.	13
iii. It is also recommended that the Company comply with Section 1308(a) of the New York Insurance Law and maintain full and complete reinsurance agreements with insolvency clauses.	13
iv. It is recommended that the Company exercise due care in maintaining sufficient documentation and records to support the amounts reported in Schedule F of future filed annual statements.	13
B. <u>Holding Company System</u>	
i. It is recommended that the Company follow the Annual Statement Instructions when completing Schedule Y of the annual statement and include all required affiliates.	14
ii. It is recommended that the Company comply with Section 1603(a) of the New York Insurance Law and notify the Department prior to making an acquisition of a majority of a corporation's outstanding shares.	15
iii. It is recommended that the Company enter into written agreements that provide for all expenses to be properly allocated among members of the holding company system.	16

<u>ITEM</u>	<u>PAGE NO.</u>
C. <u>Abandoned Property Law</u>	
It is recommended that the Company retain copies of all abandoned property filings until the examination report for those years has been filed.	17
D. <u>Section 310 of the New York Insurance Law</u>	
i. It is recommended that the Company comply with Section 310(a)(3) of the New York Insurance Law.	18
ii. It is further recommended that the Company take the following corrective action to facilitate future examinations:	18
<ul style="list-style-type: none"> ▪ The role of the Company contact person is to facilitate the examination. Individuals assigned to this function must have broad authority and appropriate knowledge; ▪ Responses should be qualitatively reviewed before submission to examiners; ▪ Sufficient human resources must be committed to facilitate the examination process. 	
E. <u>Accounts and Records</u>	
1. <u>Annual Statements Balances</u>	
i. It is recommended that the Company take proper care when completing the annual statement and classify all balances correctly.	18
ii. It is recommended that the Company maintain support for all annual statement balances.	19
2. <u>Reinsurance Payable on Paid Losses & Loss Adjustment Expenses</u>	
i. It is recommended that the Company report accurate amounts in its filed annual statements.	19
ii. It is recommended that the Company comply with Section 1505(b) of the New York Insurance Law and maintain support for all transactions with affiliates.	20
3. <u>Interest and Dividend Income Due and Accrued</u>	
It is recommended that the Company use a more accurate system for calculating interest and dividend income due and accrued.	20

APPENDIX A

XL Capital Holding Company Chart At December 31, 1999

NAIC #

<u>FEIN #</u>		
XL CAPITAL LTD – Cayman		
98-0191089		
EXEL HOLDINGS LIMITED - Cayman		
XL Insurance Ltd – Bermuda		
XL Financial Assurance Ltd. (85%) – Bermuda		
XL Capital Products Ltd - Bermuda		
XL Investments Ltd - Bermuda		
	X.L. Investment Private Trustee Ltd. - <i>Bermuda</i>	
	XL Investments (Barbados) Inc. - <i>Barbados</i>	
	First Cumberland Bank, Inc. - <i>Barbados</i>	
	Garrison Investments Inc. - <i>Barbados</i>	
	Kensington Investments Inc. - <i>Barbados</i>	
	XLB Partners Inc. - <i>Barbados IBC</i>	
	Cumberland Holdings, Inc. – <i>DE</i>	
98-0174616		Cumberland California, Inc. - <i>DE</i>
98-0174621		Pareto Hughes Research (30%) - <i>DE</i>
95-4590570		Pareto Partners (30%) - <i>CA</i>
13-3609837		Cumberland New York, Inc. - <i>DE</i>
98-0174619		Pareto (30%) - <i>NY</i>
95-4627346		
	InQuisLogic Ltd. – <i>Barbados</i>	
	InQuisLogic Inc. – <i>DE</i>	
06-1542517		
	RiskConnect Ltd. – <i>Barbados</i>	
	RiskConnect Inc. – <i>DE</i>	
	Financial Security Assurance International Ltd. (80%) – Bermuda	
	XL Global Services (Bermuda) Ltd. – Bermuda	
	XL Holdings Barbados Ltd. - Barbados	
	X.L. America, Inc. - <i>DE</i>	
06-1516268		
	ECS INC. (71%) – <i>PA</i>	
	23-2152934	
	ECS Alternative Market Services, Inc. - <i>PA</i>	
	23-2741979	
	ECS Holdings, Inc. – <i>DE</i>	
	23-2683777	
	ECS International, Inc. – <i>DE</i>	
	23-2683775	
	ECS Asesores en Seguros Medioambientales, S.A.R.L. - <i>Spain</i>	
	The ECS Group, Ltd – <i>UK</i>	
2711579		ECS Underwriting Ltd. – <i>UK</i>
2549841		Environmental Compliance Svcs Ltd. – <i>UK</i>
2551297		Consulting Services International Ltd. – <i>UK</i>
2551297		
	ECS Asesores en Aseguramiento de Riesgos Ambientales S.A. de C.V. - <i>Mexico</i>	
	Risk & Insurance Services, Inc. - <i>Barbados</i>	
	ECS Underwriting, Inc. - <i>PA</i>	
	23-2901851	
	ECS Claims Administrators, Inc. - <i>PA</i>	
	23-2614107	
	ECS Risk Control, Inc. - <i>PA</i>	
	23-2321718	
	ECS Child Care Center, Inc. - <i>PA</i>	
	23-2866192	
	Brockbank Insurance Services, Inc. - <i>CA</i>	
	Global Credit Analytics, Inc. - <i>DE</i>	
	XL Global Services, Inc. – <i>DE</i>	
	06-1527321	
	NAC RE CORPORATION - DE	
	13-3297840	
	NAC Re International Holdings Ltd - <i>UK</i>	
	NAC Reinsurance International Limited - <i>UK</i>	
	Denham Syndicate Management Ltd - <i>UK</i>	
	Stonebridge Underwriting Ltd - <i>UK</i>	
	NAC Re International Services Co., Ltd - <i>UK</i>	

20583

		NAC Reinsurance Corporation (A - 76%) - <i>NY</i>	
		NAC Re Investment Holdings, Inc. - <i>DE</i>	
	06-1529606		
		Greenwich Insurance Company (A - 5%) - <i>CA</i>	22322
	95-1479095		
		Indian Harbor Insurance Company (A - 5%) - <i>ND</i>	36940
	06-1346380		
		XL Insurance Company of New York, Inc. (A - 7%) - <i>NY</i>	40193
13-3787296		XL Capital Assurance Inc. - <i>NY</i>	
	11007	13-4709733	
		Intercargo Corporation - <i>DE</i>	
36-3414667			
		International Advisory Services Inc. - <i>IL</i>	
36-3081634			
		XL Specialty Insurance Company(A - 7%) - <i>IL</i>	37885
85-0277191			
		Intercargo Insurance Company HK Ltd. - <i>HK</i>	
		Intercargo International Limited - <i>BVT</i>	
AA-004102			
		ECS INC. (29%) - <i>PA</i>	
		23-2152934	
		Prime Advisors	
		Convenient Property & Casualty	
		Sovereign Risk Insurance Ltd. (50%) - Bermuda	
		X.L. One Ltd. - Bermuda	
		XL Europe (50%) - <i>Republic of Ireland</i>	
		X.L. Two Ltd. - Bermuda	
		XL Europe (50%) - <i>Republic of Ireland</i>	
		XL Australia Pty Ltd - <i>Australia</i>	
		XL Prevent Ltd - <i>UK</i>	
		Le Mans Re (A - 49%) - <i>France</i>	
		IPT Compliance Limited - UK	
		EXEL Cumberland Limited - UK	
		Pareto Partners (30%) - <i>UK</i>	
		Pareto Australia - <i>Australia</i>	
		Vision Loyal Ltd. (30%) - <i>UK</i>	
		InQuisCapital Holdings (Bermuda) Limited - Bermuda	
		InQuisLogic (Bermuda) Limited - <i>Bermuda</i>	
		RiskConnect Limited - <i>Bermuda</i>	

FEIN #

NAIC #

		Annuity Life & Re (Holdings) Ltd (12%) - Bermuda	
		EXEL Acquisition Ltd. - Cayman	
		GCR Holdings Limited - Cayman (In Liquidation)	
		Reeve Court Insurance Company (.04%) - Bermuda	
		Reeve Court Holdings Ltd. (50%) - Bermuda	
		X.L. Property Holdings Ltd. - Bermuda	
		Mid Ocean Limited (100%) - Cayman	
		Mid Ocean Holdings Limited - Bermuda	
		XL Mid Ocean Reinsurance Ltd - <i>Bermuda</i>	
		ECS Reinsurance Company Inc. - <i>Barbados</i>	
98-0086637			
		Sunshine State Holdings Corporation (24%) - <i>FL</i>	
		The Shipowners Insurance and Guaranty Company Ltd. (4.6%) - <i>Bermuda</i>	
		Global Capital Underwriting Ltd. - <i>UK</i>	
		LARC Holdings Ltd. - <i>Bermuda</i>	
		Latin America Reinsurance Company Ltd. - <i>Bermuda</i>	
		Ridgewood Holdings Company - <i>Bermuda</i>	
		Admiral Group Limited (10%)	
		The Brockbank Group Plc - <i>UK</i>	
		Brockbank Holdings Limited - <i>UK</i>	
		Baltusrol Holdings Ltd - <i>Bermuda</i>	
		County Down Limited - <i>Corporate member Syndicate 2253</i>	
		Dornoch Limited - <i>Corporate member Syndicate 1209</i>	
		Brockbank Underwriting Limited - <i>UK</i>	
		Brockbank Personal Lines Limited - <i>Syndicates 253/2253</i>	
		Cassidy Brockbank Limited (<i>Dormant</i>)	
		Brockbank Syndicate Management Limited - <i>Syndicates 588/861/1209</i>	
		Brockbank Syndicate Services Limited	
		Sextant International Limited (20%)	

A. Company is a member on NAC Reinsurance, Intercargo Pooling Agreement with individual company pooling %'s noted.

Appointment No 21595

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:

Mary Meaney

as proper person to examine into the affairs of the

NAC Reinsurance Corporation

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

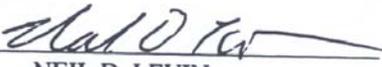
Corporation

with such other information as ~~she~~ 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 23 rd day of August, 2000




NEIL D. LEVIN
Superintendent of Insurance