

REPORT ON EXAMINATION
OF THE
UNITED STATES BRANCH
OF THE
NICHIDO FIRE & MARINE INSURANCE COMPANY, LTD.
AS OF
DECEMBER 31, 1999

DATE OF REPORT

JULY 27, 2001

EXAMINER

KENNETH I. MERRITT

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

July 27, 2001

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

Sir:

Pursuant to the provisions of the New York Insurance Law and in accordance with instructions contained in Appointment Number 21662, dated December 26, 2000 and annexed hereto, I have made an examination into the financial condition and affairs of the United States Branch of the Nichido Fire & Marine Insurance Company, Ltd. as of December 31, 1999, and respectfully submit the following report thereon.

Wherein the designations "United States Branch" and "Branch" appear in this report, without qualification, they should be understood to mean the Nichido Fire & Marine Insurance Company, Ltd. (United States Branch). Where the term "Department" appears in this report, such term shall refer to the New York State Insurance Department.

The examination was conducted at the Branch's administrative office located at 70 Pine Street, New York, New York.

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1994. This examination covered the five year period from January 1, 1995 through December 31, 1999 and 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 invested assets, loss and loss adjustment expense reserves and the provision for reinsurance. The examination included a review of income, disbursements and company 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 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 statement

This examination also encompassed a review to ascertain what action was taken by the Branch 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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF BRANCH

Nichido Fire & Marine Insurance Company, Limited (“Nichido”) was incorporated under the laws of Japan on January 25, 1914. The company commenced business in the United States on September 4, 1975, through a United States Branch established through the State of New York as its port of entry.

Under a Deed of Trust dated March 5, 1975 that was approved by this Department, Nichido appointed Bank of Tokyo-Mitsubishi Trust Company (formerly Bank of Tokyo Trust Company) as its United States trustee pursuant to Section 1315 of the New York Insurance Law. As trustee, the Bank is the custodian of the Branch’s trusteed assets that have been designated for the protection of all the Branch’s policyholders and creditors in the United States.

The Deed of Trust states that the Branch’s trusteed assets must be maintained in the United States. Section 1315 of the New York Insurance Law requires that, the trusteed assets of a licensed alien insurer entered through this state shall be continuously kept in this state.

It is recommended that Nichido file with the Department an amendment to its Deed of Trust stating the trusteed assets of the United States Branch will be maintained continuously in the State of New York in accordance with Section 1315 of the New York Insurance Law.

1. Management

Under a management agreement dated March 26, 1974, Nichido appointed North American Managers, Inc. (“NAM”), an affiliate of American International Group, Inc., to manage its United States

Branch operations. On January 1, 1985, the parties effected an amended agreement that gave NAM power of attorney for the total management of the United States Branch, consisting of record maintenance, underwriting and all other insurance related services. As such, Nichido has no active management in the United States Branch or presence on the board of directors of NAM. As compensation for services rendered, NAM receives an annual management fee plus reimbursement for any incidental charges it incurs by NAM in connection with the Branch's operations. Commencing January 1, 1997, NAM's annual management fee increased from \$50,000 to \$75,000. Other than routine record maintenance, NAM performed no underwriting or other insurance services on Nichido's behalf during the examination period.

The following four members were on NAM's board of directors as of December 31, 1999:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Maurice R. Greenberg New York, NY	Chairman of Board/Chief Executive Officer, American International Group, Inc.
Edwin A. G. Manton New York, NY	Senior Advisor, American International Group, Inc.
Joseph C. Smetana, Jr. Rockville Centre, NY	Vice President, American International Group, Inc.
Thomas R. Tizzio Middletown, NJ	Senior Vice Chairman, American International Group, Inc.

The by-laws call for the board to meet as frequently as it determines necessary, but not less than once per year. A review of the minutes of the board of directors revealed that the board met frequently during the examination period. Such board meetings were well attended by the members of the board.

The following individuals were the principal officers of the United States manager as of December 31, 1999:

<u>Name</u>	<u>Title</u>
Vincent A. De Conti	Vice President
Merrit W. Fabel	Assistant Vice President
Maurice R. Greenberg	Chairman of the Board and CEO
Kenneth V. Harkins	Vice President and General Counsel
Edwin A. G. Manton	Vice Chairman of the Board
Christian M. Milton	Vice President
Alan Pawson	Treasurer and Comptroller
Joseph C. Smetana, Jr.	President
Michael V. Tripp	Vice President
Elizabeth M. Tuck	Secretary

Conflict of Interest

All officers and directors of NAM are required to file annually conflict of interest statements with the parent company, American International Group, Inc. (“AIG”). It was noted that the conflict of interest statements had not been filed for several persons during the examination period. It could not be ascertained whether the missing documents were due to such individuals failing to complete such statements or whether they had been misplaced in storage. Based upon the documents that were available, it was noted that several officers and directors responded affirmatively regarding their involvement in certain outside activities or issues of conduct. There was no evidence that these circumstances were presented to the board of directors of AIG for review.

It is recommended that the Branch:

1. Exercise due care obtaining and maintaining completed and signed conflict of interest statements from all of its officers and directors.

2. Review and enforce its conflict of interest policy. The board of directors should properly oversee and handle any potential conflicts disclosed.
3. Maintain complete minutes of its board of directors' proceedings involving such matters.

B. Territory and Plan of Operation

As of December 31, 1999, the Branch was licensed to transact the kinds of insurance as set forth in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Kinds of insurance</u>
3	Accident and health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine
21	Marine protection and indemnity

The Branch is also empowered to transact such workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113(a), including insurance described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law 803, 69th Congress, as amended; USC Section 901 et seq. as amended).

As of December 31, 1999, the Branch was licensed to transact the kinds of insurance in the District of Columbia and all states except Maine, North Carolina and Wyoming. In Wyoming, the Branch was an accredited reinsurer.

The majority of the Branch's direct business during the examination period was written in the state of California, which accounted for 59% of the Company's premiums written.

All direct business of the Branch was ceded 100% to Birmingham Fire Insurance Company of PA, an AIG affiliate. In turn, all reported net written premiums of the Branch were derived from assumed reinsurance from AIG insurers.

Based on the kinds of insurance for which the Branch is licensed, 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 totaling \$2,150,000.

C. Reinsurance

The Branch's reinsurance coverage in effect as of December 31, 1999, was limited to the following agreements with affiliates of AIG:

(1) Ceded Reinsurance Agreement

Under the ceded reinsurance agreement, effective January 1, 1985, the Branch cedes 100% of its direct premiums and loss and loss adjustment expense reserves to Birmingham Fire Insurance Company of Pennsylvania ("Birmingham Fire").

The ceded reinsurance agreement in effect during the examination period contained all the required standard provisions including the insolvency clause as required pursuant to Section 1308 of the New York Insurance Law.

(2) Assumed Quota Share Reinsurance Agreement

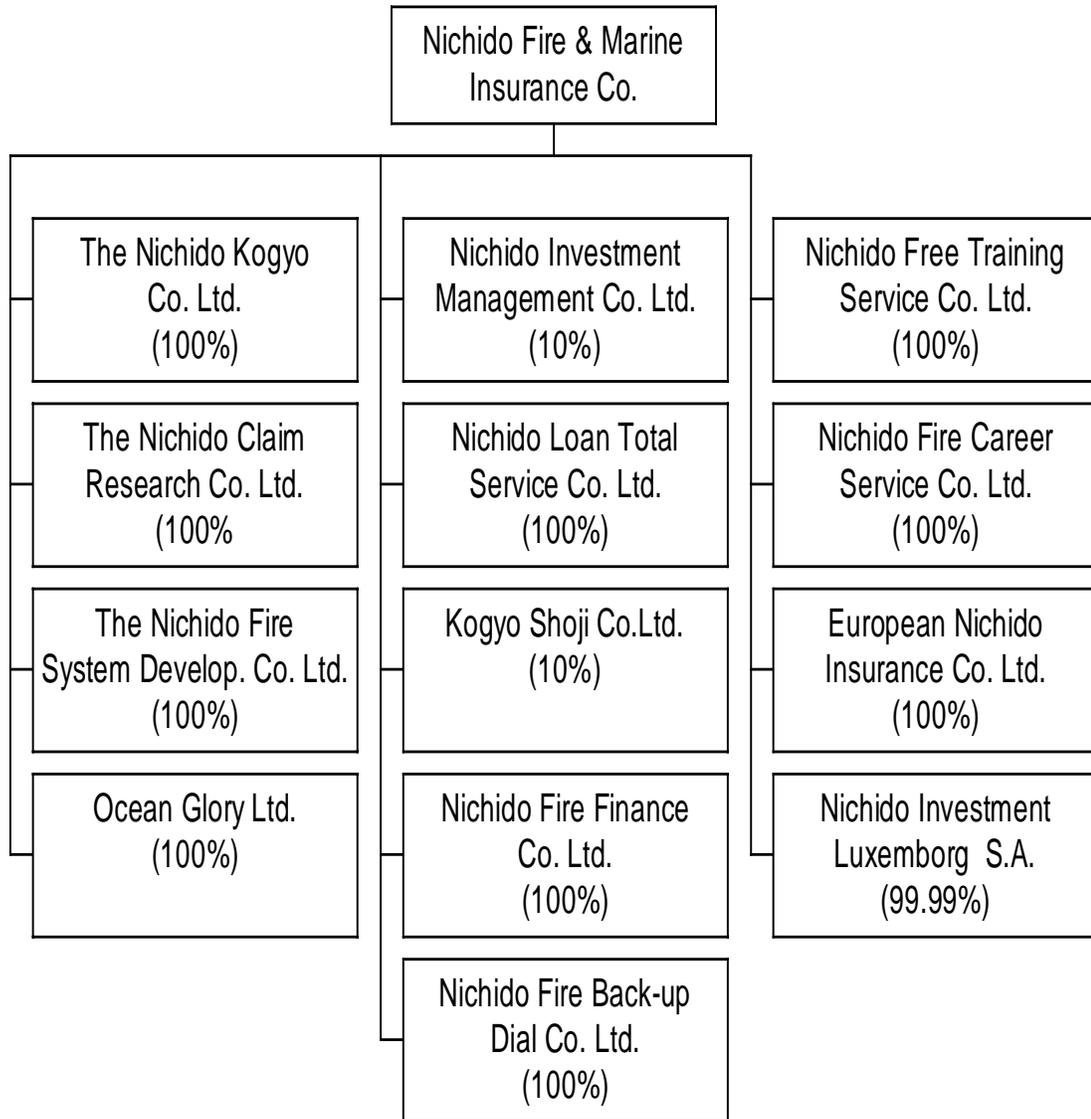
Effective January 1, 1987, the Branch assumes 0.2% of the aggregate premiums, expenses and loss and loss adjustment expense reserves of AIG inter-company pool, excluding Foreign Association and other Japanese branch office business. National Union Fire Insurance Company of Pittsburgh, PA and American Home Assurance Company are the lead companies in the pool, with pool participation percentages of 38% and 36% respectively for each insurer. Such pool business represented 99% of the Branch's book of business. The remaining 1% consisted of non-pool assumed business associated with a facultative treaty with China America Insurance Company Ltd, also an AIG affiliate.

During the course of this examination, a review was made of the methods for reporting reinsurance data in Schedule F of its filed annual statements. It was noted that the Branch's management continues the practice of netting assumed premiums and assumed paid losses against uncollected premiums and unpaid loss balances while failing to report separate accounts for assumed paid losses in Schedule F, Part 1 and assumed reinsurance losses payable. However, due to immateriality, the incorrect reporting did not result in any financial change per this examination.

It is again recommended that the Branch comply with the NAIC annual statement instructions by reporting assumed premiums and assumed paid losses separately in Schedule F, Part 1 of the Branch's annual statements filed with the Department.

D. Holding Company System

Attached is an organizational chart of the United States Branch, Nichido Fire and Marine Insurance Company Limited (Japan), as of December 31, 1999:



During the examination period, no individual held a controlling interest in Nichido. As of the examination date, Fuji Bank, Ltd., a Japanese commercial bank, was Nichido's majority shareholder having owned 4.9% of Nichido's issued common voting shares. Fuji Bank currently owns 7.5% of the issued common voting shares.

E. Significant Operating Ratios

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

Net premiums written in 1999 to surplus as regards policyholders	.26 to 1
Liabilities to liquid assets (cash and invested assets)	.46%
Premiums in course of collection to surplus as regards policyholders	.40%

The above ratios fall within the benchmark ranges as set forth by the Insurance Regulatory Information System of the National Association of Insurance Commissioners ("NAIC").

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

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$42,701,178	70.4%
Loss adjustment expenses incurred	10,909,609	18.0
Other underwriting expenses incurred	12,079,464	19.9
Net underwriting loss	<u>(5,031,429)</u>	<u>(8.3)</u>
Premiums earned	<u>\$60,658,822</u>	<u>100%</u>

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as determined by this examination as of December 31, 1999. This statement is the same as the Branch's filed annual statement:

<u>Assets</u>	Ledger <u>Assets</u>	Non-ledger <u>Assets</u>	Non-admitted <u>Assets</u>	Admitted <u>Assets</u>
Bonds	\$75,608,341	\$	\$	\$75,608,341
Cash on hand and on deposit	1,295,993			1,295,993
Short-term investments	4,775,000			4,775,000
Uncollected premiums	181,997			181,997
Federal income tax recoverable		76,315		76,315
Interest due and accrued		1,151,580		1,151,580
Miscellaneous accounts receivable	<u>29,335</u>	<u> </u>	<u> </u>	<u>29,335</u>
Total assets	<u>\$81,890,666</u>	<u>\$1,227,895</u>	<u>\$ 0</u>	<u>\$83,118,561</u>
<u>Liabilities, Surplus and Other Funds</u>				
Losses				\$24,189,632
Loss adjustment expenses				3,892,624
Other expenses				60,000
Taxes, licenses and fees				1,253
Unearned premiums				9,590,601
Accounts payable				1,945
Brokers' balances				<u>15,370</u>
Total liabilities				\$37,751,425
Statutory deposits		\$4,100,000		
Gross paid in and contributed surplus		4,500,000		
Unassigned surplus		<u>36,767,136</u>		
Surplus as regards policyholders				<u>45,367,136</u>
Total liabilities and surplus				<u>\$83,118,561</u>

B. Underwriting and Investment Exhibit

The Surplus as regards policyholders increased \$17,880,796 during the five year examination period, January 1, 1995 through December 31, 1999 detailed as follows:

Underwriting Income

Premiums earned		\$60,658,822
Deductions:		
Losses incurred	\$ 42,701,178	
Loss adjustment expenses incurred	10,909,609	
Other underwriting expenses incurred	<u>12,079,464</u>	
Total underwriting deductions		<u>\$65,690,251</u>
Net underwriting loss		\$(5,031,429)

Investment Income

Net investment income earned	\$23,158,411	
Net realized capital losses	<u>(2,757)</u>	
Net investment gain		23,155,654

Other income (losses)

Miscellaneous losses		<u>(180,231)</u>
Net income before income taxes		\$17,943,994
Federal and foreign income taxes incurred		<u>199,303</u>
Net income		<u>\$17,744,691</u>

C. Capital and Surplus Account

Surplus as regards policyholders, per report on examination, as of December 31, 1994			\$27,486,340
	<u>Gains in</u> <u>Surplus</u>	<u>Losses in</u> <u>Surplus</u>	
Net income	\$17,744,691	\$ 0	
Prior period tax adjustment	<u>136,105</u>	<u> </u>	
Total gains and losses	<u>\$17,880,796</u>	<u>\$ 0</u>	
Net increase in surplus			<u>17,880,796</u>
Surplus as regards policyholders, per report on examination, as of December 31, 1999			<u>\$45,367,136</u>

D. Trusted Surplus Statement

The following statement shows the trusted surplus of the Branch, calculated in accordance with Section 1312 of the Insurance Law and as determined by this examination:

Assets

Securities deposited with state insurance departments
for the protection of all policyholders and creditors
within the United States

Bonds	\$ 2,565,705	
Accrued investment accrued	<u>44,939</u>	
Total general deposits		\$ 2,610,644

Vested in and held by United States Trustee:

Bonds	\$40,950,277	
Accrued interest	<u>577,668</u>	
Total vested in and held by United States Trustee		<u>41,527,945</u>
Total assets		<u>\$44,138,589</u>
Net liabilities		37,751,425
Trusted surplus		<u>6,387,164</u>
Total liabilities and surplus		<u>\$44,138,589</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses of \$24,189,632 and \$3,892,624, respectively, are the same as the amounts reported by the Branch in its December 31, 1999 filed annual statement.

The examination liabilities were calculated in accordance with generally accepted actuarial principles and practices and were based upon the Branch's historical data statistical information contained in the Branch's filed annual statements as verified during the examination.

A review of the Branch's Schedule P revealed that the total salvage and subrogation was omitted in Schedule P, Part 1, Summary. It is recommended that the Branch report in Schedule P salvage or subrogation received or anticipated in its filed annual statements pursuant to the NAIC annual statement instructions. It was further noted that the Branch failed to include claim count information for the number of claims reported (direct and assumed) and the number of claims outstanding (direct and assumed). It is recommended that the Branch's management disclose such information in its filed annual statements in accordance with NAIC annual statement instructions.

Section 4117(d)(1) of New York Insurance Law provides as follows:

“For all such compensation policies where losses were incurred more than three years prior to the date of determination, such reserves shall be the sum of the present values, at five percent interest per annum, of the determined and estimated unpaid losses computed on an individual case basis plus the estimated unpaid loss expenses computed in accordance with subsection (b) thereof”

It was noted that the Branch applied non-tabular discounting on its workers' compensation reserves using the Pennsylvania Insurance Department discount factors. Such accounting treatment had an immaterial effect on the Branch's loss reserves. Therefore, no financial change was made per this examination.

It is recommended that any discount applied by the Branch to its worker's compensation loss reserves be done in accordance with Section 4117(d)(1) of the New York Insurance Law.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 1994, contained two comments and recommendations. The current status of these matters is as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Accounting and records</u></p> <p>It is again recommended that the Branch comply with the instructions to the annual statement which provide for the segregation of premiums and assumed paid losses into the uncollected premium and assumed loss payable accounts.</p> <p>Branch's management has not complied with this recommendation.</p>	<p>10</p>
<p>B. <u>Lack of Cooperation</u></p> <p>It is recommended that the board of directors adopt a resolution requiring compliance with Section 310(a)(3) of the New York Insurance Law which requires the Branch to facilitate and aid the examiners in the conduct of the examination.</p> <p>The Branch has complied with this recommendation.</p>	<p>10</p>

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Description of Branch</u></p> <p> <u>Deed of Trust</u></p> <p> It is recommended that Nichido file with the Department an amendment to its Deed of Trust stating the trusteed assets of the United States Branch will be maintained continuously in the State of New York in accordance with Section 1315 of the New York Insurance Law.</p>	<p>3</p>
<p>B. <u>Management</u></p> <p> <u>Conflict of interest statements</u></p> <p> It is recommended that the Branch:</p> <p> 1. Exercise due care obtaining and maintaining completed and signed conflict of interest statements from all of its officers and directors.</p> <p> 2. Review and enforce its conflict of interest policy. The board of directors should properly oversee and handle any potential conflicts disclosed.</p> <p> 3. Maintain complete minutes of its board of directors' Proceedings involving such matters.</p>	<p>5</p> <p>6</p> <p>6</p>
<p>C. <u>Reinsurance</u></p> <p> It is again recommended that the Branch comply with the NAIC annual statement instructions by reporting assumed premiums and assumed paid losses separately in Schedule F, Part 1 of the Branch's annual statements filed with the Insurance Department.</p>	<p>8</p>

<u>ITEM</u>		<u>PAGE NO.</u>
D.	<u>Loss and Loss Adjustment Expense Reserves</u>	
1.	It is recommended that the Branch report in Schedule P salvage or subrogation received or anticipated in its filed annual statements pursuant to the NAIC annual statement instructions.	16
2.	It is recommended the Branch report claim count information in Schedule P in accordance with the NAIC annual statement instructions.	16
3.	It is recommended that any discount applied by the Branch to its worker's compensation loss reserves be done in accordance with Section 4117(d)(1) of the New York Insurance Law.	17

Appointment No. 21662

STATE OF NEW YORK
INSURANCE DEPARTMENT

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

Kenneth Merritt

as proper person to examine into the affairs of the

NICHIDO FIRE & MARINE INSURANCE COMPANY, LTD.

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

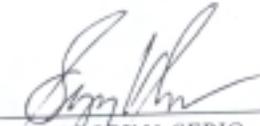
Company

with such other information as he shall deem requisite.

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

this 26th day of December, 2000





GREGORY V. SERIO
First Deputy Superintendent of Insurance