

REPORT ON EXAMINATION

OF THE

WATER QUALITY INSURANCE SYNDICATE

AS OF

NOVEMBER 30, 2010

DATE OF REPORT

FEBRUARY 29, 2012

EXAMINER

IAN MARTIN

Appointment No. 30646

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Ian Martin

as proper person to examine into the affairs of the

WATER QUALITY INSURANCE SYNDICATE

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

Syndicate

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 25th day of January, 2011



James J. Wrynn

JAMES J. WRYNW

Superintendent of Insurance

TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1.	Scope of examination	2
2.	Description of Syndicate	2
	A. Management	3
	B. Syndicate agreement	4
	C. Territory and plan of operation	5
	D. Reinsurance	5
	E. Significant operating ratios	6
	F. Accounts and records	6
3.	Financial statements	7
	A. Balance sheet	7
	B. Underwriting and investment exhibit	8
4.	Losses and loss adjustment expenses	9
5.	Compliance with prior report on examination	9
6.	Summary of comments and recommendations	10



NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawskey
Superintendent

February 29, 2012

Honorable Benjamin M. Lawskey
Superintendent of Financial Services
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 30646 dated January 25, 2011 attached hereto, I have made an examination into the condition and affairs of Water Quality Insurance Syndicate as of November 30, 2010, and submit the following report thereon.

Wherever the designation “the Syndicate” appears herein without qualification, it should be understood to indicate Water Quality Insurance Syndicate.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Syndicate’s home office located at 60 Broad Street, New York, 10004.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of November 30, 2005. This examination covered the five-year period from December 1, 2005 through November 30, 2010, 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 Syndicate records deemed necessary to accomplish such analysis or verification and utilized to the extent deemed appropriate, work performed by the Syndicate's independent public accountants.

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

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

The Syndicate does not retain assets corresponding to the amount of its liabilities. As a result, the financial statements contained in this report demonstrate an excess of liabilities over assets. The subscribers are held accountable for the resulting deficiency.

2. DESCRIPTION OF SYNDICATE

The Water Quality Insurance Syndicate is an unincorporated association of insurance companies, called subscribers, that are authorized to transact the business of marine insurance in the United States.

The Syndicate was organized in June 1971, for the specific purpose of providing the insurance protection required by owners and operators of vessels of one hundred or more tons against liability imposed under the Water Quality Improvement Act of 1970. Under the provisions of this Act, owners and operators of vessels incurred liability, with some exceptions, for the cost of removal of oil discharged into or upon the navigable waters of the United States. With the passage of the Federal Water Pollution Control Act Amendments of 1972, the Syndicate expanded its coverage to include the cost of removal of a great variety of substances designated as hazardous. Further amendments

were enacted by the Clean Water Act of 1977. In 1978, the Public Law 95-576 combined the aforementioned Acts of 1972 and 1977. The combined legislation prohibits, and imposes liability for discharges of oil or hazardous substances into or upon navigable waters of the United States. Protection is afforded against said liability or in connection with activities under the Outer Continental Shelf Lands Act or Deepwater Port Act of 1974, or which may affect natural resources owned or managed by the United States Government, including resources under the Fishery Conservation and Management Act of 1976.

A. Management

The business and affairs of the Syndicate are the responsibility of the board of managers. Each of the subscribing companies is entitled to have a representative on the board, each casting one vote. A review of the minutes of the board meetings indicated that such meetings were well attended. The board meets four times during each calendar year. As of November 30, 2010, the board of managers was as follows:

<u>Subscriber</u>	<u>Representative</u>	<u>Participation</u>
American Alternative Insurance Corporation	Robert Huffert	4.97940%
Insurance Company of North America	Karen Grizwold	8.685
Liberty International Underwriters	Faith Ozdemir	8.685
National Casualty Company	James Stevens	5.22065
National Union Fire Insurance Company	Brian Wood	8.685
Navigators Insurance Company	Russell Johnson	8.685
New York Marine and General Insurance Company	Tim McAndrew	8.685
North American Specialty Insurance Company	Anthony Cowie	8.685
RLI Insurance Company	Robert Schauer	3.500
St. Paul Fire and Marine Insurance Company	Richard DeSimone	8.685
The Continental Insurance Company	Steve Clark	8.13495
The Northern Assurance Company of America	Robert Gallagher	8.685
Zurich American Insurance Company	James Nawojchik	<u>8.685</u>
Total		<u>100.00%</u>

As of November 30, 2010, the principal officers were as follows:

<u>Name</u>	<u>Title</u>
Robert Gallagher	Chairman of the Board
James Nawojchik	Vice- Chairman of the Board
Richard H. Hobbie, III	President & Chief Executive Officer
Russell Brown	Executive Vice President
John J. Hassett	Chief Financial Officer and Secretary
Andrew J. Garger	Vice President, Legal and General Counsel

<u>Name</u>	<u>Title</u>
Harry J. Diamond	Vice President, Claims
Anthony Gerone	Assistant Vice President
Warren C. Dietz	Assistant Treasurer

B. Water Quality Insurance Syndicate Agreement

The Syndicate conducts business for and on behalf of its subscribers pursuant to the provisions of the Water Quality Insurance Syndicate Agreement, which states that the purpose of the Syndicate is to provide, in the most convenient and efficient manner, a facility for the insurance of the following risks:

1. The costs incurred by the United States Government in the removal of oil and hazardous substances (including any costs incurred in the restoration or replacement of natural resources damaged or destroyed as a result of such discharge of oil or hazardous substance), and for civil penalties imposed in the case of non-removable of hazardous substances as defined in the Federal Water Pollution Control Act.
2. The costs and damages associated with the removal of oil and hazardous substances as defined in the Outer Continental Shelf Lands Act Amendments of 1978.
3. The liability for response costs and damages as defined in the Comprehensive Environmental Response Compensation and Liability Act of 1980.
4. Liabilities as defined in the Oil Pollution Act of 1990.
5. The risks of vessel owners' civil liability to third parties, including the Governments of foreign countries, for physical damage to or loss of real or personal property arising out of a discharge of oil or a hazardous substance.

The subscribers severally, but not jointly, agree to insure, and reinsure all risks pertinent to the subject of the agreement.

Effective June, 2006, the underwriting guidelines of the Syndicate provide that the largest vessel which the Syndicate may insure is 50,000 gross tons, subject to a maximum limit of liability of \$50,000,000. The Syndicate may insure larger risks, provided that such risks in excess of its maximum limit of liability are reinsured, subject to the approval of the Board of any such additional reinsurance arrangements.

C. Territory and Plan of Operation

The Syndicate's subscribers are authorized to write the kinds of marine risks as specified in Section 1113(a) of the New York Insurance Law, paragraphs 20 and 21 of the New York Insurance Law.

As of November 30, 2010, the Syndicate through its licensed subscribers, wrote insurance entirely in the state of New York.

D. Reinsurance

The Syndicate assumes no reinsurance. Information produced by the Syndicate, equivalent to an insurance company's Schedule F, accurately reflected its reinsurance transactions for the five-year examination period.

The examiners reviewed all ceded reinsurance contracts in effect during the examination period, all of which contained the required standard clauses, including insolvency clauses as required by Section 1308 of the New York Insurance Law.

As of November 30, 2010, the Syndicate had the following non-obligatory, excess of loss reinsurance program in effect:

<u>Type of Contract</u>	<u>Cession</u>
Primary Excess Liability (89% Authorized) (11% Unauthorized)	\$4,000,000 excess of \$1,000,000, any one loss or series of losses arising from one event (excess of \$4,000,000 in the aggregate otherwise recoverable), subject to a maximum recoverable of \$8,000,000. Such losses to be taken in chronological order of settlement.
First Excess Liability Sub-Retention Cover (89.50% Authorized) (10.50% Unauthorized)	Section 1: \$4,000,000 excess of \$1,000,000, any one loss or series of losses arising from one event (after exhaustion of the underlying excess liability cover), subject to a maximum recoverable of \$12,000,000. Section 2: \$15,000,000 excess of \$5,000,000, any one loss or series of losses arising from one event, subject to a maximum recoverable of \$60,000,000.

Type of ContractCession

Second Excess Liability
Vessel Cover
(100.00% Authorized)

Pays the difference between \$120,000,000 any one loss or series of losses arising from one event in respect of any one vessel, and recoveries under the underlying policies. In no event shall reassured's retention be less than \$1,000,000, any one loss or series of losses arising from one event.

E. Significant Operating Ratios

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$32,085,320	37.6%
Other underwriting expenses incurred	31,122,864	36.5
Net underwriting gain	<u>22,105,415</u>	<u>25.9</u>
Premiums earned	<u>\$85,309,599</u>	<u>100.0%</u>

F. Accounts and Records

In March 2011, the Syndicate provided the Department with an unaudited financial statement as of November 30, 2010, which indicated a Net subscribers' accountability of \$12,798,414. Subsequently, the Syndicate's financial statements were audited and the audited financial statement indicated a Net subscribers' accountability of \$13,062,979, or \$264,565 more than the unaudited financial statement. The net difference was not material; however, the unaudited financial statement included several errors, including one incorrect journal entry which caused premiums receivable to be overstated by \$1,071,687 and cash to be understated by the same amount.

It is recommended that the Syndicate exercise greater care in maintaining its financial records. It is also recommended that the Syndicate file a copy of its audited financial statements with the Department on an annual basis.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and the subscribers' accountability as determined by this examination and as reported in the Syndicate's audited financial statement as of November 30, 2010.

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Admitted Assets</u>
Cash	\$ 5,166,554	\$ 0	\$ 5,166,554
Premiums receivable	7,445,098	1,718,383	5,726,715
Reinsurance recoverable on paid losses	980,977		980,977
Other assets	<u>865,145</u>	<u>865,145</u>	<u>0</u>
Total assets	<u>\$14,457,774</u>	<u>\$2,583,528</u>	<u>\$11,874,246</u>
 <u>Liabilities</u>			
Losses and loss adjustment expenses			\$10,873,867
Other expenses			958,768
Unearned premiums			11,913,726
Provision for unauthorized reinsurance			234,152
Provision for overdue reinsurance			<u>956,712</u>
Total liabilities			\$24,937,225
Net subscribers' accountability			<u>(13,062,979)</u>
Total liabilities and accountability			<u>\$11,874,246</u>

B. Underwriting and Investment Exhibit

The subscribers' accountability decreased \$49,783 during the five-year examination period, December 1, 2005 through November 30, 2010, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$85,309,599
Losses incurred and loss adjustment expenses incurred	\$32,085,320	
Other underwriting expenses incurred	<u>31,122,864</u>	
Total underwriting deductions		<u>63,208,184</u>
Total underwriting gain		\$22,101,415

Investment Income

Net investment income earned		<u>581,959</u>
Net income		<u>\$22,683,374</u>

Change in Subscribers' Accountability

Subscribers' accountability per report on examination as of November 30, 2005			\$ (13,112,762)
	<u>Gains</u>	<u>Losses</u>	
Net income	\$22,683,374		
Change in non- admitted assets		\$ 165,225	
Change in Provision for reinsurance		1,067,664	
Net remittances to and from subscribers	<u>0</u>	<u>21,400,702</u>	
Total gains and losses	<u>\$22,683,374</u>	<u>\$22,633,591</u>	
Net decrease in subscribers' accountability			<u>49,783</u>
Subscribers' accountability per report on examination as of November 30, 2010			<u>\$ (13,062,979)</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses totaling \$10,873,867 is the same amount as reported by the Syndicate in its November 30, 2010 financial statements.

The examination analysis was based on statistical information contained in the Syndicate's internal control records and its financial statements. The results indicated that the reserves as established by the Syndicate as of the examination date were adequate.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The previous report on examination as of November 30, 2005 contained two recommendations. (The page number refers to the prior report).

ITEM

PAGE NO.

A. Abandoned Property Law

It was recommended that the Syndicate file its abandoned property reports in a timely manner pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

6

The Company has complied with this recommendation.

B. Accounts and Records

It was recommended that the following schedules and exhibits be submitted to the Department on an annual basis:

6

- 1) A balance sheet showing assets (including not admitted), liabilities and subscribers' accountability.
- 2) A statement of income similar to that included in the Underwriting and Investment Exhibit of the NAIC Blank.
- 3) An exhibit showing all expenses paid and incurred, allocated among loss adjustment expenses, other underwriting expenses, and investment expenses.

The Company has been sending unaudited financial statements to the Department each year; however, it was noted that the financial statements included several errors, which were not material on a net basis, but which caused individual balance sheet items to be materially misstated. This report includes a recommendation that the Syndicate exercise greater care in maintaining its financial records.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Accounts and Records</u>	
i.	It is recommended that the Syndicate exercise greater care in maintaining its financial records.	6
ii.	It is also recommended that the Syndicate file a copy of its audited financial statements with the Department on an annual basis.	6

Respectfully submitted,

_____/s/
Ian Martin,
Senior Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

IAN MARTIN, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____/s/
Ian Martin

Subscribed and sworn to before me
this _____ day of _____, 2012.

Appointment No. 30646

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,
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Ian Martin

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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 25th day of January, 2011



James J. Wrynn

JAMES J. WRYNW

Superintendent of Insurance