

REPORT ON EXAMINATION

OF THE

WATER QUALITY INSURANCE SYNDICATE

AS OF

NOVEMBER 30, 2005

DATE OF REPORT

MAY 18, 2007

EXAMINER

GILBERT DENTON

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

May 18, 2007

Honorable Eric R. Dinallo
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 22467, dated February 27, 2006, attached hereto, I have made an examination into the condition and affairs of the Water Quality Insurance Syndicate as of November 30, 2005 and respectfully submit the following report thereon.

Wherever the terms "Syndicate" or "WQIS" appear herein, they should be understood to indicate the Water Quality Insurance Syndicate.

Whenever the term "Department" appears in this report, it should be understood to mean the New York State Insurance Department.

The examination was conducted at the Syndicate's home office at 80 Broad Street, New York, NY 10004.

1. SCOPE OF EXAMINATION

The prior examination was conducted as of November 30, 2000. The current examination covers the five year period from December 1, 2000 through November 30, 2005, 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 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.

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, 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 the 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. As of November 30, 2005, the board of managers was as follows:

<u>Subscriber</u>	<u>Representative</u>	<u>Participation</u>
American Alternative Insurance Corporation	Robert Huffert	5.16%
American Home Assurance Company	Kenneth Kuhlmeier	9.00
Insurance Company of North America	Michael Jacobs	9.00
Liberty International Underwriters	Nigel Fitzgerald	9.00
National Casualty Company	Peter Birch	5.41
Navigators Insurance Company	Russell Johnson	9.00
New York Marine and General Insurance Company	Thomas Guarnera	9.00
North American Specialty Insurance Company	Robert Bauer	9.00
The Northern Assurance Company of America	Robert Gallagher	9.00
St. Paul Fire and Marine Insurance Company	Richard DeSimone	9.00
The Continental Insurance Company	John Murphy	8.43
Zurich American Insurance Company	Roy Salley	<u>9.00</u>
Total		<u>100.00.%</u>

As of November 30, 2005 the officers were as follows:

<u>Name</u>	<u>Title</u>
Michael I. Jacobs	Chairman of the Board
Richard DeSimone	Vice- Chairman of the Board
Richard H. Hobbie, III	President
Harry E. Yerkes, IV	Vice President
John J. Hassett	Chief Financial Officer and Secretary
Andrew J. Garger	Vice President, Legal
Harry J. Diamond	Vice President, Claims
Warren C. Dietz	Assistant Treasurer

B. Syndicate Agreement

The Syndicate conducts business for and on behalf of the subscribers, under the provisions of the Syndicate agreement. The purpose of the Syndicate is to provide, in the most convenient and efficient manner, a facility for the insurance of American marine risks whose liability is defined under the following governmental legislation:

1. Federal Water Pollution Control Act
2. Outer Continental Shelf Lands Acts Amendments
3. Comprehensive Environmental Response Compensation and Liability Act (Public Law 95-510) (“CERCLA”)
4. Oil Pollution Act of 1990 (“OPA”)

Risks of vessel owners’ civil liability to third parties for property damage are also insured.

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

The maximum insurance underwritten on any one vessel shall be:

- (1) Up to \$33,100,000 for removal costs and damages as imposed under OPA and CERLA. Included within that liability to third parties and governments of foreign countries.
- (2) Up to \$20,000,000 for removal costs and damages as imposed by the Oil Pollution Act of 1990.
- (3) Indemnification for investigation and defense costs incurred with prior approval of WQIS.

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, 2005 the Syndicate through its licensed subscribers, wrote insurance entirely in the state of New York.

D. Reinsurance

The Syndicate assumes no reinsurance. The 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, 2005, 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 (91.67% Authorized) (8.33% 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 (90.30% Authorized) (9.70% 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.
Second Excess Liability Vessel Cover (91.43% Authorized) (8.57% Unauthorized)	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. Abandoned Property Law

A review of the Syndicate's abandoned property reports revealed that, for the period of this examination, such reports were not filed pursuant to the provisions of Section 1316 of the New York Abandoned Property Law, which require that amounts payable to resident of this state from a policy of

insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

It is 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.

F. 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	\$27,551,094	40.2%
Other underwriting expenses incurred	23,902,322	34.9
Net underwriting gain	<u>17,056,622</u>	<u>24.9</u>
Premiums earned	<u>\$68,510,038</u>	<u>100.0%</u>

G. Accounts and Records

The Syndicate does not prepare an annual statement in the form of the Fire and Casualty blank, which is the form approved by the National Association of Insurance Commissioners (“NAIC”). It was recommended in the prior examination that the company prepare various exhibits and schedules using the NAIC blank. This would provide detail support for the amounts shown in the financial statement. In addition, it would serve as an internal check of amounts and balances from the general ledger to the financial statement.

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

- 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.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and the subscribers' accountability as determined by this examination and is the same as that reported by the Company in its filed annual statement as of November 30, 2005.

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Admitted Assets</u>
Cash	\$4,404,648	\$ 0	\$ 0	\$4,404,648
Premium Receivable	4,059,464		742,482	3,316,982
Reinsurance recoverable on paid losses	199,263			199,263
Other assets	<u>679,495</u>	<u>0</u>	<u>679,495</u>	<u>0</u>
Total assets	<u>\$9,342,870</u>	<u>\$ 0</u>	<u>\$ 1,421,977</u>	<u>\$7,920,893</u>
 <u>Liabilities</u>				
Losses and loss adjustment expenses				\$11,368,062
Other expenses				441,812
Unearned premiums				8,924,067
Provision for unauthorized reinsurance				46,853
Advanced premiums				13,151
Fund Held (LOC)				163,363
Provision for authorized reinsurance				<u>76,347</u>
Total liabilities				\$21,033,655
Net accountability of subscriber companies				(13,112,762)
Total liabilities and accountability				<u>\$7,920,893</u>

B. Underwriting and Investment Exhibit

The subscribers' accountability increased \$1,231,878 during the five-year examination period, December 1, 2000 through November 30, 2005, detailed as follows:

Statement of IncomeUnderwriting Income

Premiums earned		\$68,510,038
Losses incurred and loss adjustment expenses incurred	\$27,551,094	
Other underwriting expenses incurred	<u>23,902,322</u>	
Total underwriting deductions		<u>51,453,416</u>
Total underwriting gain		\$17,056,622
<u>Investment Income</u>		
Net investment income earned		<u>567,137</u>
Net income		<u>\$17,623,759</u>

Change in Subscribers' Accountability

Subscribers' accountability per report on examination as of November 30, 2000			\$(11,880,884)
	<u>Gains</u>	<u>Losses</u>	
Net income	\$17,623,759		
Change in non- admitted assets		\$ 91,799	
Provision for Reinsurance		28,964	
Change in due to/from Subscribers	1,633,066		
Net remittances to and from subscribers	<u> </u>	<u>20,367,940</u>	
Total gains and losses	<u>\$19,256,825</u>	<u>\$20,488,703</u>	
Net increase in subscribers' accountability			<u>(1,231,878)</u>
Subscribers' accountability per report on examination as of November 30, 2005			<u>\$(13,112,762)</u>

5. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses totaling \$11,368,062 is the same amount as reported by the Syndicate in its November 30, 2005 financial statements.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Syndicate's internal control records and its filed annual statements. The results indicated that the reserves as established by the Syndicate as of the examination date were adequate.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The previous report on examination as of November 30, 2000 contained one comment and recommendation. (the page number refers to the prior report).

ITEM

PAGE NO.

A. Accounts and Records

It was recommended that the Syndicate prepare and submit to the Department, on an annual basis:

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- 1) A balance sheet showing assets (including non-ledge and 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.
- 4) A reconciliation of ledger assets similar to that included in the NAIC Blank.

The Syndicate only filed reports for one year subsequent to the examination period. Thus, it has not complied with this recommendation and this recommendation is repeated herein.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Abandoned Property Law</u>	
	It is 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
B.	<u>Accounts and records</u>	
	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.	

Appointment No 22467

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Gilbert Denton

as proper person to examine into the affairs of the

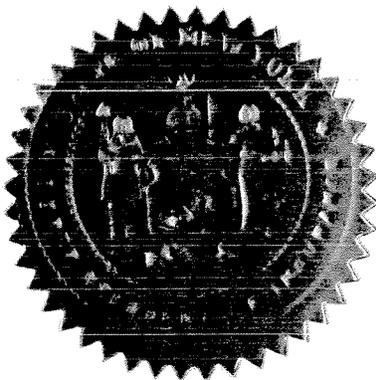
WATER QUALITY INSURANCE SYNDICATE

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 27th day of February, 2006

A handwritten signature in cursive script, appearing to read "Howard Mills".

HOWARD MILLS
Superintendent of Insurance