REPORT ON EXAMINATION

OF THE

SEABOARD SURETY COMPANY

AS OF

DECEMBER 31, 1998

DATE OF REPORT	JULY 31, 2000
EXAMINER	ROBERT A. VARGAS

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

July 31, 2000

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

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21538, dated May 3, 2000, attached hereto, I have made an examination into the financial condition and affairs of the Seaboard Surety Company as of December 31, 1998 and respectfully submit the following report thereon.

Whenever the term "Company" appears in this report, it should be understood to mean the Seaboard Surety Company.

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

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1993. The current examination covers the five-year period from January 1, 1994 through December 31, 1998, 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, inter-company balances, 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 Company's independent certified public accountants.

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

The examination was conducted at the Company's home office located at 385 Washington Street, St. Paul, Minnesota 55102 and at the branch office of the Company located at 5801 Smith Avenue, Baltimore, Maryland, 21209.

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 COMPANY

The Company is licensed pursuant to Article 11 of the New York Insurance Law. It was incorporated in November, 1927 under the laws of the State of New York and began business on January 1, 1928. The Company was a subsidiary of the Home Insurance Company from 1968 until January 15, 1982, when it was acquired by the St. Paul Athena Insurance Company. When the St. Paul Athena Insurance Company was liquidated in 1983, the stock of Seaboard Surety Company was transferred to its current owner, St. Paul Fire and Marine Insurance Company, a wholly-owned subsidiary of the St. Paul Companies, Inc.

As of the examination date, the paid in capital was $5,000,000 consisting of 500,000 shares of common stock with a par value of $10.00 per share.

The accounting and financial reporting systems are integrated with, and under the control of the St. Paul Fire and Marine Insurance Company. The Company remains responsible for its marketing, underwriting, administration and claims handling functions.

In 1982, the Company formed a subsidiary domiciled in Canada. The subsidiary was incorporated on June 14, 1983 and is known as the Seaboard Surety of Canada. The subsidiary’s capital consists of 40,000 issued and outstanding shares which have a par value of $100 per share. Seaboard Surety Company owns all of these shares with the exception of 27 shares which are owned equally by the nine directors of the subsidiary.

A. Management

The Company's by-laws provide that its business affairs are to be managed and controlled by a board of directors consisting of at least thirteen directors.

At December 31, 1998, the board of directors was composed of fifteen members, as follows:

Name and Residence	Principal Business Affiliation
Brian Patrick Curry Cockeysville, MD	Secretary, St. Paul Fire & Marine Insurance Company
James Francis Duffy New York, NY	Chairman, President and CEO, St. Paul Reinsurance Inc.
Kenneth Michael Farricker Chatham, NJ	Branch Manager, St. Paul Fire & Marine Insurance Company
Steven Ronald Grunsfeld Staten Island, NY	Vice President- Claims/ General Counsel, St. Paul Fire & Marine Insurance Company
Frederick John Gurba Baldwin, MD	Vice President-Surety, St. Paul Fire & Marine Insurance Company
James Frederick Harding Forest Hills, NY	Commercial Surety Manager, St. Paul Fire & Marine Insurance Company
David Long Hussey Cockeysville, MD	Vice President-Manager, St. Paul Fire & Marine Insurance Company
Michael Benjamin Keegan Westfield, NJ	Vice President-Surety Operations, St. Paul Fire & Marine Insurance Company
Robert Jule Lamendola Cockeysville, MD	Senior Vice President, St. Paul Fire & Marine Insurance Company
Paul James Liska North Oaks, MN	Executive Vice President & CFO, St. Paul Fire & Marine Insurance Company

Name and Residence	Principal Business Affiliation
Lawrence Francis McMahon Westfield, NJ	Regional Underwriting Director-Surety, St. Paul Fire & Marine Insurance Company
Rosemary Quinn Belair, MD	Senior Legal Officer, St. Paul Fire & Marine Insurance Company
Louise Anne Ryan New York, NY	Senior Vice President, St. Paul Reinsurance Inc.
John Francis Simanski Phoenix, MD	Vice President- Surety Claims, St. Paul Fire & Marine Insurance Company
Terry Scott Sutton Marlius, NY	Branch Manager, St. Paul Fire & Marine Insurance Company

The minutes of the board of directors' meetings held during the examination period were reviewed. The meetings were generally well attended except for Mr. James Francis Duffy who attended 53% of the meetings and Ms. Louise Anne Ryan who attended 50% of the meetings they were eligible to attend.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

The following were the principal officers of the Company as of December 31, 1998:

Name	Title
Paul James Liska	Chairman
Robert Jule Lamendola	President
Thomas Andrew Bradley	Sr. Vice President and Treasurer
Frederick John Gurba	Sr. Vice President
Gary Paul Hanson	Sr. Vice President
Michael Benjamin Keegan	Sr. Vice President
John Francis Simanski	Sr. Vice Preseident
Peter Wallace Carman	Vice President and Comptroller
Virginia Davis Briol	Insurance Reporting Officer
John Charles Treacy	Vice President
Sandra Ulsaker Wiese	Corporate Secretary
Michael Wayne Anderson	Vice President
Kathleen Ann Chagnon	Vice President
Brian Patrick Curry	Vice President
Steven Ronald Grunsfeld	Vice President
Walter Thaddeus Gryska	Vice President
David Long Hussey	Vice President
Lawrence Francis McMahon	Vice President
Edward Gaylord Pendergast	Vice President
Maureen Ann Phillips	Vice President
Eric Alden Solberg	Vice President
Paul Stanford	Vice President
Paul Edward Wulterkens	Vice President

B. Territory and Plan of Operation

At December 31, 1998, the Company was authorized to transact business in all 50 states and the District of Columbia. It is also licensed in Guam, Puerto Rico, the U.S. Virgin Islands, Canada, the Panama Canal Zone and Great Britain.

The following schedule shows the direct premiums written each year by the Company during the examination period, the direct premiums written in New York State and the percentage the New York premium bears to the countrywide premiums:

DIRECT PREMIUMS WRITTEN (in thousands)

	1994	1995	1996	1997	1998	Total
Countrywide	$108,099	$100,222	$100,405	$83,637	$75,827	$468,191
New York	$17,212	$16,028	$13,964	$13,020	$11,966	$72,192
Percentage of New York to Total	16%	16%	14%	16%	16%	15%

At December 31, 1998, the Company was authorized to transact the kinds of insurance as set forth in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Kinds of Insurance
3	Accident and health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
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 physical damage
20	Marine and inland marine
21	Marine protection and indemnity

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

Surety Bonds account for over approximately 95% of the Company's business. A majority of the remaining 5% is categorized as other liability. Based on the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13, and 41 of the New York Insurance Law, the Company must maintain at all times a surplus to policyholders of $35,000,000.

C. Reinsurance

On January 1, 1997, Seaboard Surety Company entered into an agreement with its parent, St. Paul Fire and Marine Insurance Company, which terminated various inter-company reinsurance agreements and retroactively implemented a 100% reinsurance arrangement, with the Company retaining no business. The agreement was approved by the Department.

On January 1, 1998, the Company became a party to an inter-company pooling reinsurance agreement, led by its parent, St. Paul Fire & Marine Insurance Company. Under this agreement, the Company cedes 100% of its direct and assumed business to St. Paul Fire and Marine Insurance Company and accepts a one percent share of the net premiums, net losses, net expenses and related changes in assets and liabilities on all insurance written or reinsured by St. Paul Fire & Marine Insurance Company.

The following are the companies participating in the pool:

Company	Share
St. Paul Fire and Marine Insurance Company	93.0%
Athena Assurance Company	1.0
St. Paul Surplus Lines Insurance Company	3.0
St. Paul Medical Liability Insurance Company	0.5
Northbrook Property and Casualty Insurance Company	1.0
Northbrook National Insurance Company	.5
Seaboard Surety Insurance Company	1.0
Total	100.0%

The Schedule F data contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts effected during the examination period. These contracts contained the required standard clauses including the insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The St. Paul Fire and Marine Pool has in effect the following reinsurance contracts at December 31,1998, in which the Company has a 1% participation:

Type of Contract	Cession
Property Core Excess of Loss (Four Layers)	$114,000,000 excess of $6,000,000 per risk , each loss subject to a maximum recovery of $114,000,000.
Property Catastrophe (Four layers)	$234,900,000 excess of $60,000,000 per occurrence, each and every loss occurrence.
Casualty Per Occurrence	$7,000,000 to $12,000,000 excess of $1,500,000 to $5,000,000 each and every loss occurrence.
Casualty Capacity Excess	$20,000,000 in excess of $10,000,000, per risk.
Casualty Clash and Contingency Excess	$64,000,000 in excess of $11,000,000, per risk.
Casualty Workers' Compensation Catastrophe Excess	Full unlimited coverage in excess of $10,000,000, per occurrence.
Ocean Marine Excess (Five Layers)	$47,000,000 in excess of $3,000,000, per occurrence.
Ocean Marine Cargo Surplus Quota share	$15,000,000 in excess of $2,500,000, per risk.
Surety Excess	$120,000,000 excess of $5,000,000, per occurrence.

It was noted that the Company does not report a provision for reinsurance in its filed annual statement for its share of the reinsurance the pool places with unauthorized companies. It is recommended that the Company establish a provision for unauthorized reinsurance for its respective share of the pool, in accordance with Article 4 paragraph B of the pooling agreement, which requires the pooling of all relative assets and liabilities.

The Company did not prepare an up to date cash flow analysis, which demonstrated that a significant reinsurance agreement transferred both underwriting and timing risk. It was noted that this significant reinsurance contract contained several features that would indicate that risk transfer might be in question. For this reason, the examiners requested a cash flow analysis which the Company could not provide.

The examiners relied on work performed by the Company's independent CPA Firm to conclude that the significant reinsurance transferred risk; nonetheless, it is recommended that the Company prepare and maintain cash flow analysis for certain significant reinsurance agreements that might bring risk transfer in question to support any credit taken for reinsurance.

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D. Holding Company System

The Company is 100% owned by the St. Paul Fire and Marine Insurance Company, whose ultimate parent is St. Paul Companies, Inc. Registration statements are filed pursuant to the provisions of Article 15 of the New York Insurance Law and Department Regulation 52. The filings made during the period were reviewed and the Company was found to be in compliance with statutory requirements.

The following organizational chart shows the members of the holding company system at December 31, 1998. Each member is 100% owned.

The St. Paul Companies, Inc.
MN Corp. 3-5-1853

St. Paul Fire and Marine Insurance Company
MN Corp. 4-18-1925

St. Paul Mercury Insurance Company
MN Corp. 8-27-1964

St. Paul Guardian Insurance Company
MN Corp. 4-6-1970

The St. Paul Insurance Company
TX Corp. 10-4-1957

The St. Paul Insurance Company of Illnois
IL Corp. 6-19-1972

St. Paul Fire and Causalty Insurance Company
WI Corp. 3-15-1982

St. Paul Indemnity Insurance Company
IN Corp. 4-2-1982

St. Paul Property and Casualty Insurance Company
NE Corp. 4-23-82

St. Paul Lloyds Holdings, Company
TX Corp. 6-9-92

St. Paul Management Services, Inc.
MN Corp. 10-29-1992

Seaboard Surety Company
MN Corp. 11-25-1927

Seaboard Surety Company of Canada
Fed Ottawa 6-15-1983

St. Paul Insurance Company of North Dakota
ND Corp. 6-8-1982

St. Paul Specialty Underwriting, Inc.
DE Corp. 7-16-1981

St. Paul Surplus Lines Insurance Company
DE Corp. 2-22-1974

Athena Assurance Company
MN Corp. 12-10-1982

St. Paul Medical Liability Insurance Company
MN Corp. 12-10-1982

St. Paul Risk Services
MN Corp. 10-9-1973

1. Intra-holding Agreement for Services and Other Resources and Management Agreement

Seaboard Surety Company has no employees or facilities of its own. All services necessary for the conduct of the Company's business are performed by or through the St. Paul Fire & Marine Insurance Company, subject to the ultimate direction and control of the Company's board of directors.

(a) Agreement for Services and Other Resources

This agreement between Seaboard Surety Company and Seaboard Surety Company of Canada as the "consuming companies" and The St. Paul Companies, Inc and St. Paul Fire and Marine Insurance Company as the "providing companies" allows the providing companies to furnish and the consuming companies to purchase such of the services, facilities, supplies, and other resources upon which they mutually agree.

(b) Management Agreement

This agreement between Seaboard Surety Company and Seaboard Surety Company of Canada, collectively known as the "Companies" and St. Paul Fire and Marine Insurance Company, St. Paul Mercury Insurance Company and St. Paul Guardian Insurance Company, collectively known as the "Manager" grants the Manager full authority to act as the Companies' underwriting manager for all surety and property casualty insurance business conducted by the Companies.

(c) Consolidated Tax Allocation Agreement

Seaboard Surety Company has implemented a consolidated tax allocation agreement with its direct and indirect parent corporations. The agreement complies with the requirements of the Department Circular Letter #33 (1979). These agreements have been filed with this Department pursuant to Section 1505 of the New York Insurance Law.

E. Abandoned Property Law

The Company is not in compliance with Section 1316 of the New York State Abandoned Property Law which requires that certain unclaimed insurance proceeds be reported to the State of New York by April 1st of each year. The Company indicated that these reports were not filed because it has not held unclaimed insurance proceeds. Reports must be filed whether or not the Company has held unclaimed insurance proceeds.

It is recommended that the Company comply with Section 1316 of the New York State Abandoned Property Law, and file reports with the State of New York by April 1st of each year.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 1998, based upon the results of this examination:

	Ratio
Net premiums written in 1998 to Surplus as regards policyholders	.32 to 1
Liabilities to Liquid assets (cash and invested assets less investments in affiliates)	45.7%
Premiums in course of collection to Surplus as regards policyholders	4.0%

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The underwriting ratios presented below are on an earned-incurred basis and encompass the five-year period covered by this examination:

	Amounts	Ratios
Losses incurred	$64,648,406	28.9%
Loss adjustment expenses incurred	29,188,462	13.1
Other underwriting expenses incurred	126,348,772	56.6
Net underwriting gain (loss)	3,128,785	1.4
Premiums earned	$223,314,425	100.0%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 1998. This statement is the same as the balance sheet filed by the Company.

Assets	Ledger Assets	Non-ledger Assets	Not Admitted Assets	Net-Admitted Assets
Bonds	$213,310,837			$213,310,837
Common stocks	4,016,500	$7,649,023	$	11,665,523
Cash	19,533,200			19,533,200
Agents' balances	9,988,331	5,000	615,142	9,378,188
Funds held by or deposited with reinsurance companies	238,402			238,402
Reinsurance recoverables on loss and loss adjustment expense payments	503,974			503,974
Electronic data processing equipment	402,737			402,737
Interest, dividends and real estate income due and accrued		3,625,983		3,625,983
Equities and deposits in pools and associations	528,597		3,123	525,474
Net adjustment due to foreign exchange rates		614,742		614,742
Other assets	97,636		5,135	92,501
Total assets	$248,620,214	$11,894,748	$623,400	$259,891,561

Liabilities, Surplus and Other Funds

Losses		$69,816,810
Reinsurance payable on paid loss and loss adjustment expenses		229,237
Loss adjustment expenses		15,108,051
Contingent commissions		489,475
Other expenses		946,684
Taxes, licenses and fees		280,881
Federal and foreign income taxes		33,745
Unearned premiums		16,262,353
Funds held by company under reinsurance treaties		212,898
Drafts outstanding		992,815
Payable to parent, subsidiaries and affiliates		984,276
Payable for securities		1,005,938
Total liabilities		$106,363,163
Surplus		
Common capital stock	$5,000,000	
Gross paid in and contributed surplus	17,484,317	
Unassigned funds	131,044,081	
Surplus as regards policyholders		153,528,398
Total liabilities and surplus		$259,891,561

NOTE: The Company files a consolidated federal income tax return. The Internal Revenue Service has examined the tax years through 1994. No adjustments were made which affected this Company. Audits covering tax years 1995 through 1997 are in progress. 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 and Investment Exhibit

Surplus as regards policyholders increased $34,868,552 during the five-year examination period, January 1, 1994 through December 31, 1998, detailed as follows:

Statement of Income

Underwriting income		
Premiums earned		$223,314,425
Deductions:		
Losses incurred	$64,648,406	
Loss expenses incurred	29,188,462	
Other underwriting expenses incurred	126,348,772	
Total underwriting deductions		220,185,640
Net underwriting gain		$3,128,785
Investment income		
Net investment income earned	$78,591,336	
Net realized capital losses	(336,526)	
Net investment gain		78,254,810
Other income or (loss):		
Net gain agents' balances charged off	$6,633	
Foreign exchange loss	(1,138,658)	
Miscellaneous loss	(969,781)	
Total other income(loss)		(2,101,806)
Net income before dividends to policyholders and before federal and foreign income taxes		$79,281,789
Dividends to policyholders		3,087,756
Net income, after dividends to policyholders but before federal and foreign income taxes		$76,194,033
Federal and foreign income taxes incurred		17,170,157
Net income		$59,023,876

Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders, per report on examination, as of December 31, 1993			$118,659,846
Net income	$59,023,876		
Net unrealized capital gains	987,127		
Change in non-admitted assets	10,596,733		
Change in provision in reinsurance	3,098,852		
Change in foreign exchange adjustment	1,516,715		
Change in excess of statutory reserves over statement reserves	1,372,301		
Change in accounting policy to report loss reserves net of tabular discount (workers' compensation)	608,343		
Dividends to stockholders		$42,335,395	
Total gains and losses in surplus	$77,203,947	$42,335,395	
Net increase in surplus as regards policyholders			34,868,552
Surplus as regards policyholders, per report on examination as of December 31, 1998			$153,528,398

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses, totaling $69,816,810 and $15,108,051 respectively, are the same amounts as reported by the Company in its 1998 filed annual statement.

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 control records and in its filed annual statements. The results indicated that the reserves as established by the Company as of the examination date were adequate.

An examination of the St. Paul group of companies was performed by the Minnesota Department of Insurance as of December 31, 1997. Its review of the loss reserves encompassed loss reserves through December 31, 1998, and concluded that the loss reserves were adequate.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed as to encompass the more precise scope of a market conduct investigation, which is performed by the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following major areas:

1. Sales and advertising
2. Underwriting
3. Rating
4. Claims

To accomplish this review, the Company's advertising material, applications, policy forms, correspondence files, rates, and claims were examined.

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

ITEM		PAGE NO.
	Reinsurance	
A.	It was recommended that the Company obtain signed contracts from its reinsurers pursuant to the New York Insurance Department Regulation 17. The Company has complied with this recommendation.	8
B.	It was recommended that the agreement between the two affiliates, Seaboard Surety Insurance Company and St. Paul International Insurance Company be submitted to the New York Insurance Department, pursuant to Section 1505(d)(2) of the New York Insurance Law. The Company has complied with this recommendation.	8

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Management	
	It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
B.	Reinsurance	
i.	It is recommended that the Company set up a provision for unauthorized reinsurance for its respective share of the pool.	10
ii.	It is recommended that the Company prepare and maintain cash flow analysis for certain significant reinsurance agreements that might bring risk transfer in question to support any credit taken for reinsurance.	11
C.	Abandoned Property Law	
	It is recommended that the Company comply with Section 1316 of the New York State Abandoned Property Law, and file reports with the State of New York by April 1st of each year.	14

Respectfully submitted,

/S/
____
Robert A. Vargas
Senior Insurance Examiner

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

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

/S/
____
Robert A. Vargas

Subscribed and sworn to before me

this _____ day of _________ 2001.

Appointment No 21538

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:*

Robert Vargas

as proper person to examine into the affairs of the

Seaboard Surety Company

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 3rd *day of* May, 2000

NEIL D. LEVIN
Superintendent of Insurance