REPORT ON EXAMINATION

OF THE

WATER QUALITY INSURANCE SYNDICATE

AS OF

NOVEMBER 30, 2000

DATE OF REPORT	NOVEMBER 30, 2001
EXAMINER	ROBERT A. VARGAS

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

November 30, 2001

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 the instructions contained in Appointment Number 21719, dated April 9, 2001, attached hereto, I have made an examination into the condition and affairs of the Water Quality Insurance Syndicate as of November 30, 2000 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.

1. SCOPE OF EXAMINATION

The prior examination was conducted as of November 30, 1995. The current examination covers the five year period from December 1, 1995 through November 30, 2000, 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.

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

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 (subscribers) 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 designed 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, 2000, the board of managers were as follows:

Subscriber	Representative	Participation
American Alternative Insurance Corporation	Robert Huffert	2.32%
American Home Assurance Company	Kenneth Kuhlmey	7.07
American Motorists Insurance Company	Steven Connor	2.87
Atlantic Mutual Insurance Company	Scott Beebe	7.17
Commercial Union Insurance Company	Raymond Marine	6.57
The Continental Insurance Company	Frederick Robertie	8.00
Fireman's Fund Insurance Company	Dennis Marvin	8.00
Hartford Fire Insurance Company	John Miklus	7.47
Insurance Company of North America	Michael Jacobs	7.17
Liberty Insurance Underwriters	Joseph Morency	6.97
New York Marine and General Insurance Company	Thomas Guarnera	7.57
North American Specialty Insurance Company	Robert Bauer	4.57
Royal Insurance Company of America	Christine Tye	7.15
St. Paul Fire and Marine Insurance Company	Richard DeSimone	7.07
Underwriters Insurance Company	Elizabeth Nittolo	2.57
XL Specialty Insurance Company	Chris Brown	2.09
Zurich Insurance Company	J. Nawojchik	5.37
Total		100%

As of November 30, 2000 the officers were as follows:

Name	Title
Raymond Marine	Chairman of the Board
Thomas Guarnera	Vice- Chairman of the Board
Richard H. Hobbie, III	President
Harry E. Yerkes, IV	Vice President
John J. Hassett	Treasurer 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) (“CERLA”)
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 $33,000,000 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. <u>Territory and Plan of Operation</u>

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

As of November 30, 2000 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 examiner reviewed all ceded reinsurance contracts effected 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, 2000, the Syndicate had the following non-obligatory, excess of loss reinsurance program in effect:

Type of Contract	Cession
Primary Excess Liability (70.5% Authorized) (29.5% Unauthorized	$4,000,000 any one loss or series of losses from one event (subject to a maximum recoverable of $8,000,000), all in excess of $1,000,000 anyone loss or series of losses arising from one event, which in turn is excess of the first $2,000,000 of losses in the aggregate. Such losses to be taken in chronological order of settlement.
First Excess Liability Sub Retention Cover (80.7% Authorized) (19.3% Unauthorized)	$4,000,000 anyone loss or series of losses arising from one event nor more than $12,000,000, all excess of $1,000,000 anyone loss or series of losses arising from one event.

Type of Contract	Cession
Vessel Cover	$10,000,000 anyone loss or series of losses arising from one event in respect of any one vessel nor more than $40,000,000 in all excess of $5,000,000, anyone loss or series of losses arising from one event in respect of any one vessel.
Event Cover	$10,000,000 anyone loss or series of losses arising from one event in respect of anyone vessel nor more than $40,000,000 in all excess of $5,000,000, anyone loss or series of losses arising from one event in respect of anyone vessel.
Second Excess Liability Vessel Cover (Authorized 85.9% (Unauthorized 14.1%)	Pays the difference between $45,000,000 anyone loss or series of losses arising from one event in respect of anyone vessel and recoveries under the underlying policies, with a retention of $1,000,000, any one loss or series of losses arising from one event.
Event Cover	Pays the difference between $80,000,000 anyone loss or series of losses arising from one event in respect of anyone vessel and recoveries under the underlying policies, with a retention of $1,000,000, any one loss or series of losses arising from one event.
Third Excess Liability Cover (Authorized 83.2%) (Unauthorized 16.8%)	$40,000,000 anyone loss or series of losses arising from one event in excess of $80,000,000, anyone 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:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$47,479,272	43.85%
Other underwriting expenses incurred	23,932,863	22.10
Net underwriting gain	36,872,182	34.05
Premiums earned	$108,284,317	100.00%

F. Accounts and Records

The Syndicate does not prepare an annual statement which is in the form of the Fire and Casualty blank which is 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 non-ledger 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.

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, 2000.

Assets	Ledger Assets	Non-Ledger Assets	Assets not Admitted	Admitted Assets
Cash	$3,859,836	$	$	$3,859,836
Uncollected premiums	3,793,680		1,238,935	2,554,745
Reinsurance recoverable on paid losses	4,820,888			4,820,888
Claims paid but not processed	93,421			93,421
Other assets	957,032			957,032
Total assets	$13,524,857	$ -0-	$ 1,238,935	$12,285,922

Liabilities	
Losses and loss adjustment expenses	$14,822,509
Other expenses	538,818
Unearned premiums	7,622,858
Provision for unauthorized reinsurance	1,031,701
Advanced premiums	133,580
Accounts payable	17,340
Total liabilities	$24,166,806
Net accountability of subscriber companies	(11,880,884)
Total liabilities and accountability	$12,285,922

B. Underwriting and Investment Exhibit

The subscribers' accountability decreased $4,301,164 during the five-year examination period, December 1, 1995 through November 30, 2000, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		$108,284,317
Losses incurred and loss adjustment expenses incurred	$47,479,272	
Other underwriting expenses incurred	23,932,863	
Total underwriting deductions		71,412,135
Total underwriting gain		$36,872,182

Investment Income

Net investment income earned		1,834,681
Net income		$38,706,863

Change in Subscribers' Accountability

	Gains	Losses	
Subscribers' accountability per report on examination as of November 30, 1995			$(7,579,720)
Net income	$38,706,863		
Change in non- admitted assets		$775,011	
Decrease in authorized and overdue reinsurance		1,023,826	
Gains and losses in surplus		524,094	
Net remittances to and from subscribers		40,685,096	
Total gains and losses	$38,706,863	$43,008,027	
Net increase in subscribers' accountability			$(4,301,164)
Subscribers' accountability per report on examination as of November 30, 2000			$(11,880,884)

5. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses totaling $14,822,509 is the same amount as reported by the Syndicate in its November 30, 2000 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.

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

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The previous report on examination as of November 30, 1995 contained four comments and recommendations. (the page numbers refer to the prior report).

ITEM		PAGE NO.
A.	Reinsurance	6
	It was recommended that the Syndicate obtain all interest and liability statements from assuming reinsurers in a timely manner.	
	The Syndicate complied with this recommendation	

ITEM		PAGE NO.
B.	Accounts and Records	8
i.	It was recommended that the syndicate prepare and submit to the Department, on an annual basis: 1) A balance sheet showing assets (including non-ledger 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 did not comply with this recommendation and a similar recommendation is made in this report.	
ii.	It was recommended that the Syndicate prepare adjusting journal entries to reconcile the trial balance to the financial statement. The Syndicate complied with this recommendation.	8
iii.	It was recommended that the Company record premiums in a timely manner. The Company complied with this recommendation.	9

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	It is again recommended that the Syndicate prepare and submit to the Department, on an annual basis: 1) A balance sheet showing assets (including non-ledger and not admitted), liabilities, and subscribers' accountability. 1) A statement of income similar to that included in the Underwriting and Investment Exhibit of the NAIC Blank. 2) An exhibit showing all expenses paid and incurred, allocated among loss adjustment expenses, other underwriting expenses, and investment expenses. 3) A reconciliation of ledger assets similar to that included in the NAIC Blank.	8

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 _________ 2002.

Appointment No. 21719

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:*

Robert Vargas

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 9th *day of* April, 2001

GREGORY V. SERIO
First Deputy Superintendent of Insurance