

REPORT ON EXAMINATION

OF

HILLTOP SPECIALTY INSURANCE COMPANY
(FORMERLY KNOWN AS HUDSON SPECIALTY INSURANCE COMPANY)

AS OF

DECEMBER 31, 2019

DATE OF REPORT

FEBRUARY 11, 2021

EXAMINER

TEENA JOSEPH

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Department of Financial Services

ANDREW M. CUOMO
Governor

LINDA A. LACEWELL
Superintendent

February 11, 2021

Honorable Linda A. Lacewell
Superintendent
New York State Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 32029 dated January 13, 2020, attached hereto, I have made an examination into the condition and affairs of Hilltop Specialty Insurance Company (formerly known as Hudson Specialty Insurance Company) as of December 31, 2019, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Hilltop Specialty Insurance Company.

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

Due to the Governor’s Executive Order of New York State on PAUSE regarding the COVID-19 pandemic, the examination was conducted remotely.

1. SCOPE OF EXAMINATION

The Department has participated in a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2014. This examination covered the five-year period from January 1, 2015 through December 31, 2019. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination of the Company was performed as part of the multi-state coordinated examination of the Fairfax Group of regulated U.S. property and casualty insurance companies (Fairfax U.S. Group), which includes the Odyssey Re Subgroup. Delaware is the lead state for the Fairfax U.S. Group. The examination was conducted in conjunction with the state of Delaware, which was the lead state of the Hudson Subgroup. The Hudson Subgroup, which includes the Company, is part of the Odyssey Re Subgroup.

The examination was performed concurrently with the following insurers:

<u>Company</u>	<u>State of Domicile</u>
Hudson Excess Insurance Company	Delaware
Hudson Insurance Company	Delaware

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook, which requires that we plan and perform the examination to evaluate the financial condition and identify current and prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with New York laws, statutory accounting principles, and annual statement instructions.

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Reinsurance
- Holding company description
- Financial statement presentation
- Loss review and analysis
- Significant subsequent events
- Summary of recommendations

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

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

2. DESCRIPTION OF COMPANY

Hilltop Specialty Insurance Company was incorporated under the laws of the State of New York on December 13, 1984, as the Southwest International Reinsurance Company of New York (“Southwest NY”) to serve as the vehicle for the re-domestication of the Southwest International Reinsurance Company (“Southwest TX”), a Texas insurer. Effective December 31, 1985, Southwest TX merged with and into Southwest NY and the surviving company adopted the name of its predecessor. On August 30, 1993, the name of the Company was changed to General Security Indemnity Company.

Prior to July 3, 1990, the Company was 51% owned by The Dai-Tokyo Fire and Marine Insurance Company, Ltd. (“Dai-Tokyo”), Tokyo, Japan, and 49% owned by SCOR Reinsurance Company (“SCOR Re”), New York, NY. On July 3, 1990, SCOR U.S Corporation, the immediate parent of SCOR Re, purchased Dai-Tokyo’s 51% interest in the Company and subsequently contributed that interest to SCOR Re.

On October 28, 2003, Odyssey America Reinsurance Corporation (“Odyssey America”), a Connecticut domiciled reinsurance company, purchased 100% of the capital stock of the Company from SCOR Re. Odyssey America is ultimately controlled by Fairfax Financial Holdings Limited (“Fairfax”), a public Canadian financial services holding company. As part of the acquisition, all of the Company’s liabilities for business written prior to the purchase date were transferred to General Security Indemnity Company of Arizona through an “Assumption Reinsurance, Indemnification and Administration Agreement”. Effective December 29, 2003, the Company changed its name to Hudson Specialty Insurance Company.

On December 30, 2003, Odyssey America transferred ownership of the Company to its wholly-owned subsidiary, Clearwater Insurance Company (“Clearwater”), a Delaware domiciled insurer. On July 29, 2010, Clearwater transferred ownership of the Company to its wholly-owned subsidiary, Hudson Insurance Company, a Delaware domiciled insurer. On January 1, 2011, Clearwater transferred its ownership of Hudson Insurance Company to Odyssey America and as a result, the Company became an

indirect, wholly-owned subsidiary of Odyssey America. On April 1, 2011, Odyssey America changed its name to Odyssey Reinsurance Company.

Effective October 26, 2020, the Company changed its name to Hilltop Specialty Insurance Company.

A. Corporate Governance

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than seven nor more than thirteen members. The board met one time during calendar years 2015 and 2016 and had written consents in lieu of a meeting for calendar years 2017, 2018 and 2019. At December 31, 2019, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Keith Michael Brennan New York, NY	Controller, Hudson Specialty Insurance Company
Jan Christiansen Barrington, IL	Executive Vice President, Odyssey Reinsurance Company
Christopher Liam Gallagher New York, NY	President and Chief Operating Officer, Hudson Specialty Insurance Company
Margaret Mary Catherine Killeen Tinton Falls, NJ	Senior Vice President, Hudson Specialty Insurance Company
Peter Hamilton Lovell Milford, CT	Senior Vice President, Hudson Specialty Insurance Company
Elizabeth Ann Sander Bedford, NY	Executive Vice President and Chief Actuary, Hudson Specialty Insurance Company
Leslie Weihrich Shore Princeton, NJ	Senior Vice President, Hudson Specialty Insurance Company

As of December 31, 2019, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Christopher Liam Gallagher	President and Chief Executive Officer
Dina Georgia Daskalakis	Senior Vice President, General Counsel and Corporate Secretary
Keith Michael Brennan	Controller

Board Meetings

A review of the minutes of the board of director meetings held during the examination period indicated that the board conducted a majority of its meetings via written consent.

Article II, Section 13 of the Company's by-laws state:

“Unless otherwise restricted by the certificate of incorporation or these by-laws, and with the *exception of the annual meeting*, any action required or permitted to be taken by the board of directors or any committee thereof, may be taken without a meeting if the members of the board, or of such committee, consent in writing to the adoption of a resolution authorizing action.” (*emphasis added*)

The Company did not have an annual meeting for calendar years 2017 through 2019.

It is recommended that the Company comply with its by-laws by having an annual meeting of the board of directors.

Page 9 of the 2019 NAIC Annual Statement Instructions state:

“The appointed actuary must report to the board of directors each year on the items within the scope of the actuarial opinion. The actuarial opinion and the actuarial report must be made available to the board of directors. The minutes of the board of directors should indicate that the appointed actuary has presented such information to the board of directors and identify the manner of presentation.”

A review of the minutes of the board of director meetings noted that an actuarial report was not presented to the board of directors for all years under examination.

It is recommended that the Company comply with the NAIC Annual Statement Instructions by ensuring that the actuarial report is presented to the board of directors on an annual basis and by ensuring that such information is documented in minutes of the board of directors.

Shareholder Meetings and Consents

Article 1, Section 1 of the Company's by-laws state, in part:

“All annual meetings of the shareholders for the election of directors...shall be held on the second Wednesday of September of each year...”

Further, Article 1, Section 9 of the Company's by-laws state:

“Any action required or permitted to be taken at any meeting of shareholders may be taken without a meeting by the written consent thereto of the shareholders...”

The shareholder minutes from 2015 to 2019 (with the exception of 2016) indicated that the meetings and consents were not held on the second Wednesday of September of each year as required by the Company's by-laws.

It is recommended that shareholder meetings and consents be held as required by the Company's by-laws.

Non-compliance with Section 312(b) of the New York Insurance Law

Section 312(b) of the New York Insurance Law states, in part:

“A copy of the report shall be furnished . . . to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's files confirming that such member has received and read such report . . . “

The Company did not have each director sign a statement that the director has read the prior report on examination.

It is recommended that the Company comply with Section 312(b) of the New York Insurance Law by having all board members sign a statement indicating that he/she has received and read the prior report on examination, and by retaining such statements in its files.

B. Territory and Plan of Operation

As of December 31, 2019, the Company was licensed to write business solely in New York. It operates primarily as an excess and surplus lines carrier on a non-admitted basis in the remaining 49 states, the District of Columbia, Puerto Rico and the United States Virgin Islands.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property
6	Water damage

<u>Paragraph</u>	<u>Line of Business</u>
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 insurance as may be incident to coverage contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33USC Section 901 et. seq. as amended). In addition, the Company is licensed to write special risk insurance pursuant to Article 63 of the New York Insurance Law.

Based upon the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$4,400,000. However, pursuant to Section 6302(c)(1) of the New York Insurance Law, in order to be licensed to write special risks, the Company is required to maintain surplus as regards policyholders of at least 250% of its authorized control level risk-based capital; therefore, the Company was required to maintain a minimum surplus to policyholders in the amount of \$46,133,415 as of December 31, 2019.

The following schedule shows the direct and assumed premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums</u>	<u>Assumed Premiums</u>	<u>Total Gross Premiums</u>
2015	\$205,805,536	\$2,715,149	\$208,520,685
2016	\$195,046,340	\$2,657,673	\$197,704,013
2017	\$211,287,081	\$1,438,430	\$212,725,511
2018	\$212,430,834	\$2,566,367	\$214,997,201
2019	\$237,041,852	\$2,622,880	\$239,664,732

The Company primarily writes property and casualty insurance business on an excess and surplus lines basis in states other than New York. The two main business segments for the Company are direct business and program business. The Company generates its direct business by writing through national and regional brokers and other independent producers. The Company's program business is produced and underwritten by contracted program administrators in accordance with the underwriting guidelines established by the Company. The program administrators in turn produce this business through national and regional brokers and other independent producers. The Company's primary lines of business are other liability, commercial multiple peril, ocean marine and medical professional liability. The products that fall under other liability are commercial general liability including excess, liquor liability, medical malpractice, directors and officers including related products, professional liability (non-medical), personal umbrella including comprehensive personal liability, and sovereign nation stop loss reimbursement.

C. Reinsurance Ceded

Effective January 1, 2008, and amended effective January 1, 2009, the Company has in place a quota share agreement with its affiliate, Odyssey Reinsurance Company ("Odyssey"), under which it cedes 70% of its direct business net of applicable external reinsurance. The agreement and amendment were filed and were non-disapproved by the Department pursuant to Section 1505(d)(2) of the New York Insurance Law.

The Company reported approximately \$269,909,000 in net reinsurance recoverable from Odyssey as of the examination date. The net recoverable amount from Odyssey is not collateralized due to its authorized reinsurer status. The net reinsurance recoverables from Odyssey are the Company's most significant financial item, and, ultimately, the Company's most significant financial risk is its ability to collect on these reinsurance recoverables.

The Company has a quota share reinsurance agreement in place with its affiliate, Newline Insurance Company, Ltd., under which it cedes 100% of the policies classified by the Company as Contractual Liability Reimbursement Policy. This agreement was filed and was non-disapproved by the Department pursuant to Section 1505(d)(2) of the New York Insurance Law.

External Ceded Reinsurance Program

The Company is a participant in the ceded reinsurance program of the Fairfax Group Companies. In addition, the Company, together with Hudson Insurance Company and Hudson Excess Insurance Company, are party to the following reinsurance treaties ("Hudson Group Treaties"):

Type of CoverageCessionCommercial Umbrella Quota Share

Provides coverage for policies classified as commercial umbrella and excess business. 50% of 100% of 75% quota share participation (i.e. 37.5%) of the net liability subject to a limit of \$5,000,000 any one loss occurrence.

Commercial Auto Excess of Loss

80% of \$3,000,000 excess of \$2,000,000 ultimate net loss arising out of each occurrence with a limitation of \$33,000,000 or 350% of calculated premiums during the term of the contract.

Commercial Umbrella Excess of Loss

Provides coverage for policies classified as general liability umbrella and excess, automobile liability and professional liability business.

\$4,000,000 excess of \$2,000,000 ultimate net loss for each occurrence. The liability of the reinsurer for ultimate net loss shall not exceed \$48,000,000 in all during the term of the contract.

Contingency Excess of Loss
(Two layers)

Provides liability coverage for policies classified as business.

\$7,500,000 excess of \$2,500,000 each loss occurrence with aggregate limits of \$7,000,000 and \$8,000,000 in layers 1 and 2, respectively.

With regard to Sovereign Nation workers' compensation policies, whether written subject to Tribal Law or State or Federal Act Workers Compensation Law, the maximum loss per person, per occurrence shall be \$10,000,000. For Tribal business, the limit is \$20,000,000 per occurrence.

Corvus Cyber Liability Quota Share

75% quota share participation in respect of the net liability on policies covered. The reinsurer's total liability shall not exceed the reinsurer's quota share participation of \$16,000,000 in the aggregate, each insured.

Executive Liability Quota Share

Covers business classified as primary and excess directors and officer's liability insurance and related coverages, including but not limited to employment practices liability, fiduciary liability and crime/fidelity.

Type of CoverageCession

A) Section A – Reinsured retains 60% and reinsurer accepts 40% of net liability for private, not-for-profit policies (except Side A policies), where the limit for any one coverage does not exceed \$5,000,000.

Section B – Reinsured retains 50% and reinsurer accepts 50% of net liability for Side A only policies (excluding the additional Side A coverage for private, not-for-profit insureds).

Section C – Reinsured retains 30% and the reinsurer accepts 70% of net liability for public ABC policies and any other stand-alone public coverage (such as stand-alone fiduciary or employment practices liability) and as respects private, not for profit policies where the limit for any one coverage exceeds \$5,000,000.

B) The net liability ceded shall be limited to the quota share percentage of \$10,000,000 any one coverage, any one insured, any one claim (or \$15,000,000 as respects to directors and officers insureds with at least \$5,000,000 of Side A directors and officers liability). The maximum combined limit for directors and officers liability including Side A and AB and ABC policies issued to the same insured shall not exceed \$15,000,000.

C) The reinsurer's liability for loss in excess of policy limits, extra contractual obligations and declaratory judgment expense, combined, shall not exceed the quota share percentage of \$15,000,000 any one coverage, any one insured, any one claim or occurrence.

Healthcare and Professional Liability
Excess of Loss

Section A: Non-Medical Professional Liability – (NMPL)

Section B: Healthcare

Schedules A-C: NMPL

Schedule D: Healthcare

Schedule A

Part I – Applies to all programs except sunrise coverage as respects environmental liability policies written through Freberg Environmental Insurance. \$3,000,000 excess of \$2,000,000 ultimate net loss in the aggregate, each policy.

Type of CoverageCession

Part II – Applies to sunrise coverage as respects environmental liability policies written through Freberg Environmental Insurance. \$3,000,000 excess of \$2,000,000 ultimate net loss in the aggregate, each policy.

Schedule B

Part I - Applies to all programs except sunrise coverage as respects environmental liability policies written through Freberg Environmental Insurance. \$10,000,000 excess of \$5,000,000 ultimate net loss in the aggregate, each policy.

Part II - Applies to sunrise coverage as respects environmental liability policies written through Freberg Environmental Insurance. \$5,000,000 excess of \$5,000,000 ultimate net loss in the aggregate, each policy.

Schedule C

\$10,000,000 excess of \$15,000,000 ultimate net loss in the aggregate, each policy.

Schedule D

\$10,000,000 excess of \$2,000,000 ultimate net loss for each event.

Offshore Marine Obligatory Quota Share

Covers business classified as offshore marine, including onshore property under the code of Clearwater Marine Pontus.

The maximum limit of liability for the Gulf of Mexico windstorm is 50% of \$200,000,000 in the aggregate; the maximum limit of liability for any one loss occurrence shall not exceed 50% of \$140,000,000.

Marine Energy Excess of Loss
(Two Layers)

Provides coverage for policies underwritten as marine energy, excluding Gulf of Mexico windstorm only policies.

\$12,500,000 excess of \$2,500,000 each and every loss and/or occurrence and/or series of losses and/or occurrences arising out of one event. (XOL treaty placed on a net basis, after quota share)

Personal Article Floater and Personal
Property Floater

Covers business classified as all risks and inland marine business in respect of personal article floaters, personal property floaters, fine arts and like policies

Type of CoverageCession

written by Monarch E&S Insurance Services. Liability is ceded on a net basis.

The reinsurer's maximum limit of liability is 80% of \$1,000,000 for any one item and 80% of \$6,000,000 of any one schedule.

Personal Umbrella Liability Excess of Loss
(Three layers)

Covers business classified as personal umbrella products or comprehensive personal liability products when written in conjunction with personal umbrella products.

\$9,000,000 excess of \$1,000,000 per occurrence limit. The reinsurer's combined term limit liability of the three layers is \$61,000,000.

Property Excess of Loss
(Four layers)

Covers business classified as commonwealth specialty program, or losses under commercial property policies.

\$57,500,000 excess of \$2,500,000 in respect of each loss, each risk. The reinsurer's combined liability limit of the four layers is \$92,500,000 in respect of each loss occurrence and \$212,500,000 in respect of all losses occurring during the contract term.

Sovereign Nation Workers Compensation and Commercial Liability Excess of Loss
(Three layers)

\$18,000,000 excess of \$2,000,000 ultimate net loss, each loss occurrence, on business classified as sovereign nation workers' compensation and employers' liability policies, sovereign nation liability policies, and sovereign nation non-occupational benefits written for Native American tribes and/or Alaska Native corporations recognized by the United States of America federal government with sovereign nation status.

\$23,000,000 excess of \$2,000,000 for tribal liability (including ALA & EL)

\$15,000,000 excess of \$10,000,000 for excess policies (cession layers)

Sovereign Nation Workers Compensation and Commercial Liability Quota Share

The reinsured cedes 10% of its gross liabilities of its sovereign nation liability program and its tribal first workers' compensation program written by Alliant Insurance Services, Inc. and Alliant Specialty Insurance Services, Inc.

Section 1505(d) of the New York Insurance Law states, in part:

“The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or with regard to reinsurance treaties or agreements at least forty-five days prior thereto, or such shorter period as the superintendent may permit, and the superintendent has not disapproved it within such period:. . . (2) reinsurance treaties or agreements...”

The Company’s affiliate, Odyssey, is a subscribing reinsurer in many of the Hudson Group Treaties. None of these treaties were filed with the Department. It is recommended that the Company implement procedures to ensure that all affiliated reinsurance agreements are filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

A majority of the Company’s ceded business was to authorized reinsurers. It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulation No. 133 and No. 114, respectively. The Company’s trust agreement with CRC Reinsurance Limited, an unauthorized affiliated reinsurer, did not include the following provision, as required per Department Regulation No. 114, Part 126.3(d)(3):

“The trust agreement must indicate that it is not subject to any conditions or qualifications outside of the trust agreement.”

It is recommended that the Company amend the trust agreement to include the provision required by Department Regulation No. 114.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles (“SSAP”) No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC annual

statement instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

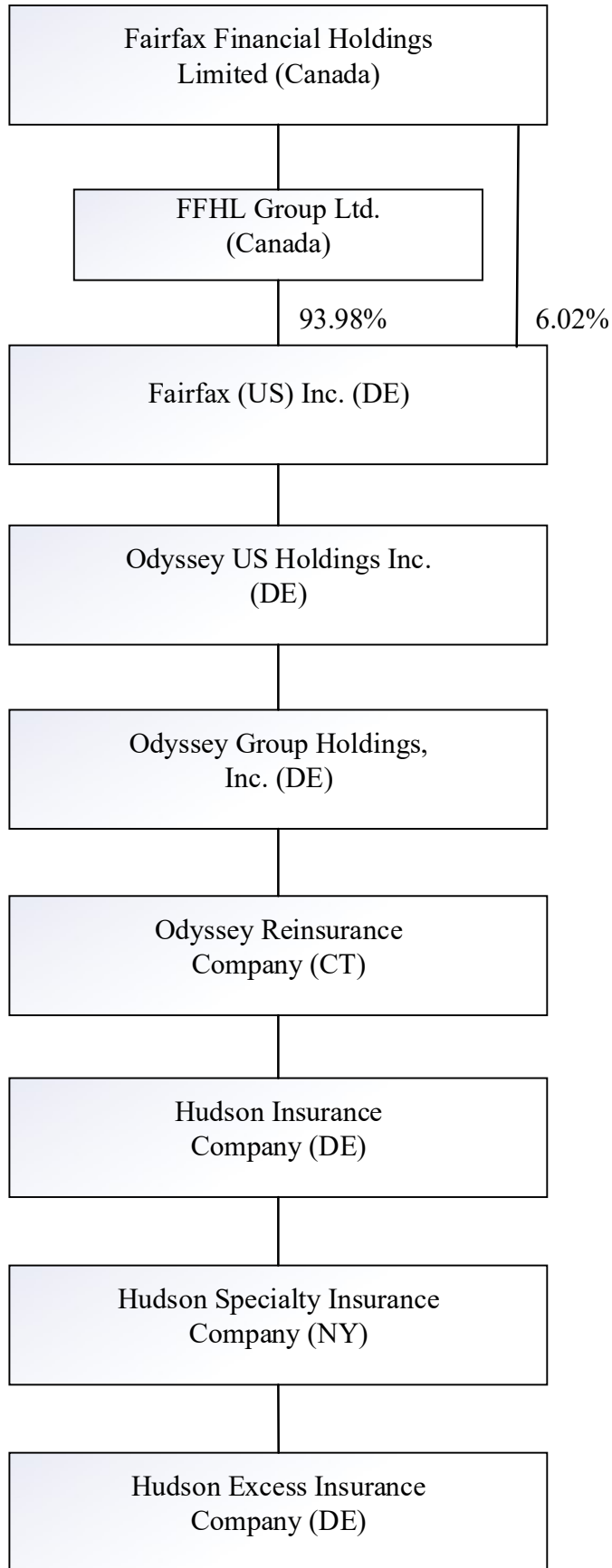
D. Holding Company System

The Company is a member of the Odyssey Re Subgroup, which is part of the Fairfax U.S. Group. The Company is an indirect subsidiary of Fairfax Financial Holdings Ltd, a publicly traded Canadian financial services holding company based in Toronto, Ontario. The Company is wholly owned by Hudson Insurance Company (“Hudson”), a Delaware domiciled company, which is wholly owned by Odyssey Reinsurance Company, a Connecticut domiciled reinsurance Company.

The Company is the direct parent of Hudson Excess Insurance Company (“Hudson Excess”), a Delaware licensed insurer. Hudson Excess was approved by the Excess Line Association of New York as an excess and surplus line insurer in the State of New York.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2019:



Holding Company Agreements

As of December 31, 2019, the Company was party to the following agreements with other members of its holding company system:

Investment Agreement

Effective October 28, 2003, the Company entered into an investment agreement with Hamblin Watsa Investment Counsel Ltd. ("HWIC") and Fairfax. The agreement authorizes HWIC and Fairfax to jointly manage and administer the Company's investment accounts for a variable fee. The investment agreement was approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

Inter-company Tax Allocation Agreement

Effective October 28, 2003, the Company entered into a tax allocation agreement with its indirect parent, Odyssey Re Holdings Corp. In 2018, Odyssey Re Holdings Corp. was renamed Odyssey Group Holdings, Inc. ("OGHI"). Pursuant to the agreement, the Company is included in the consolidated federal income tax return of OGHI and its affiliates. The tax liability or refund under the agreement represents the amount the Company would pay or receive if it had filed a separate return with the Internal Revenue Service. The tax allocation agreement was approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

Tax Services Agreement

Effective October 28, 2003, the Company entered into a tax services agreement with Fairfax (US) Inc. ("FFUS"). The agreement authorizes FFUS to provide tax consulting and tax return preparation services to the Company. Per the terms of the agreement, the Company reimburses FFUS on a cost basis; allocated expenses shall be on a fair and equitable basis in accordance with Department Regulation 30. The tax service agreement was approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

Expense Sharing Agreement

Effective November 1, 2008, the Company entered into an expense sharing agreement with Odyssey. Pursuant to the agreement, Odyssey provides the Company office space and management services, including, but not limited to, underwriting, actuarial, claims, accounting, financial, legal, personnel, data processing services and treasury on a cost basis. It requires that expenses be allocated in a

fair, reasonable and consistent manner in accordance with Department Regulation 30. The expense sharing agreement was approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

Master Administrative Services Agreement

Effective November 1, 2014, and subsequently amended on August 1, 2018, the Company entered into a master administrative services agreement (the “MASA”) with certain of its U.S. affiliates, all of which are part of the Fairfax Group. Pursuant to the agreement, the Company has agreed to provide and to accept, from other parties, certain administrative and general services and facilities subject to such guidelines, procedures and limitations as may be duly established and approved by the board of directors of the receiving party. The services include, but are not limited to, accounting, underwriting, claims, reinsurance, actuarial, legal and human resources. Pursuant to the agreement, the parties agree that compensation for providing the services shall be based on actual cost without a profit factor being built into that cost. The MASA and amendment were approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

Program Administrator Agreement

Effective January 1, 2007, the Company entered into a program administrator agreement with Napa River Insurance Services, Inc. (“NRIS”). Pursuant to the agreement, the Company has appointed NRIS as its general agent in the state of California to underwrite, issue and deliver insurance policies or contracts of business known by both parties as the “California Healthcare Liability program”.

Exhibit 2 of the NRIS agreement states, in part:

“The Company shall pay the program administrator (“PA”) an estimated fee of \$460,000 per year, payable in bi-annual installments of \$230,000 for all services under this agreement. At the end of each calendar year, the Company and the PA shall calculate and agree upon the actual cost in providing the services rendered during such calendar year . . . ”

The Company did not make any payments for these services for the examination period. As per the Company, this was due to an oversight caused by a change in staff. On February 16, 2021, a payment in the amount of \$60,744 was rendered for the period 2015 through 2019.

It is recommended that the Company make payments in accordance with the NRIS agreement. It is further recommended that the Company establish procedures to ensure that settlements are made in accordance with contract provisions. This program administrator agreement was approved by the Department pursuant to Section 1505(d) of the New York Insurance Law.

E. Significant Ratios

Two of the Company's operating ratios, computed as of December 31, 2019, fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC.

<u>Operating Ratios</u>	<u>Result</u>
Net premiums written to policyholders' surplus	29%
Adjusted liabilities to liquid assets	73%
Two-year overall operating	106% *

*The Company's two-year overall operating ratio of 106% falls outside the benchmark range. The variance is primarily driven by the underwriting expense ratio.

Underwriting Ratios

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

	<u>Amount</u>	<u>Ratio</u>
Losses and loss adjustment expenses incurred	\$168,766,565	61.54%
Other underwriting expenses incurred	111,697,071	40.73
Net underwriting gain (loss)	<u>(6,216,101)</u>	<u>(2.27)</u>
Premiums earned	<u>\$274,247,535</u>	<u>100.00%</u>

The Company's reported risk-based capital ("RBC") score was 947.6% at December 31, 2019. The RBC score is a measure of the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. An RBC score of 200% or below can result in regulatory action.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2019, as reported by the Company:

Assets

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$ 93,255,105	\$ 0	\$ 93,255,105
Common stocks (stocks)	74,911,397		74,911,397
Cash, cash equivalents and short-term investments	129,083,219		129,083,219
Other invested assets	8,571,938		8,571,938
Investment income due and accrued	944,291		944,291
Uncollected premiums and agents' balances in the course of collection	15,372,514	7,359,578	8,012,936
Deferred premiums, agents' balances and installments booked but deferred and not yet due	8,298,646	707,725	7,590,921
Amounts recoverable from reinsurers	30,863,667		30,863,667
Current federal and foreign income tax recoverable and interest thereon	600,853		600,853
Net deferred tax asset	3,266,564		3,266,564
Electronic data processing equipment and software	3,624,206	3,548,982	75,224
Furniture and equipment, including health care delivery assets	120,601	120,601	0
Receivables from parent, subsidiaries and affiliates	9,438		9,438
Loss clearing	23,876,737		23,876,737
Miscellaneous receivable	124,584	124,584	0
Leasehold improvement	<u>42,507</u>	<u>42,507</u>	<u>0</u>
Total assets	<u>\$392,966,267</u>	<u>\$11,903,977</u>	<u>\$381,062,290</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$ 95,253,360
Commissions payable, contingent commissions and other similar charges	1,819,523
Other expenses (excluding taxes, licenses and fees)	494,839
Taxes, licenses and fees (excluding federal and foreign income taxes)	118,194
Unearned premiums	23,489,369
Advance premium	1,656,840
Ceded reinsurance premiums payable (net of ceding commissions)	26,732,739
Funds held by company under reinsurance treaties	9,261,143
Amounts withheld or retained by company for account of others	4,933,778
Provision for reinsurance	2,914,000
Payable to parent, subsidiaries and affiliates	1,955,941
Excess ceded commission	<u>5,581,790</u>
 Total liabilities	 \$174,211,516

Surplus and Other Funds

Common capital stock	\$ 7,500,000
Gross paid in and contributed surplus	33,500,000
Unassigned funds (surplus)	<u>165,850,774</u>
 Surplus as regards policyholders	 <u>206,850,774</u>
 Total liabilities, surplus and other funds	 <u>\$381,062,290</u>

Note: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2018. Audit covering the tax year 2019 is currently under examination. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

The net income for the examination period as reported by the Company was \$54,498,177 as detailed below:

Underwriting Income

Premiums earned		\$274,247,535
Deductions:		
Losses and loss adjustment expenses incurred	\$168,766,565	
Other underwriting expenses incurred	<u>111,697,071</u>	
Total underwriting deductions		<u>280,463,636</u>
Net underwriting gain or (loss)		\$ (6,216,101)

Investment Income

Net investment income earned	\$ 39,609,294	
Net realized capital gain	<u>26,094,744</u>	
Net investment gain or (loss)		65,704,038

Other Income

Interest expense	\$ (198,075)	
Amortization of intangible assets	<u>(1,534,108)</u>	
Total other income		<u>(1,732,183)</u>
Net income before federal and foreign income taxes		\$ 57,755,754
Federal and foreign income taxes incurred		<u>3,257,577</u>
Net income		\$ <u>54,498,177</u>

C. Capital and Surplus

Surplus as regards policyholders increased \$20,072,237 during the five-year examination period January 1, 2015 through December 31, 2019, as reported by the Company, detailed as follows:

Surplus as regards policyholders as reported by the Company as of December 31, 2014			\$186,778,537
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$54,498,177		
Net unrealized capital gains or (losses)	12,370,097		
Change in net unrealized foreign exchange capital gain or loss		\$ 173,673	
Change in net deferred income tax		3,555,298	
Change in nonadmitted assets		2,953,066	
Change in provision for reinsurance	186,000		
Dividends to stockholders	<u>0</u>	<u>40,300,000</u>	
Total gains and losses	<u>\$67,054,274</u>	<u>\$46,982,037</u>	
Net increase (decrease) in surplus			<u>20,072,237</u>
Surplus as regards policyholders as reported by the Company as of December 31, 2019			<u>\$206,850,774</u>

Capital paid in is \$7,500,000 consisting of 25,000 shares of \$300 par value per share common stock. Gross paid in and contributed surplus is \$33,500,000. There have been no changes to paid in capital or gross paid in and contributed surplus since the prior examination. No adjustments were made to surplus as a result of this examination.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$95,253,360 is the same as reported by the Company as of December 31, 2019. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including SSAP No. 55. The lines of business that holds significant reserves are bind and bill liability, centrex liquor and personal umbrella.

5. SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared an outbreak of a novel coronavirus (“COVID-19”) pandemic. The COVID-19 pandemic has continued to develop throughout 2020, with significant uncertainty remaining regarding the full effect of COVID-19 on the U.S. and global insurance and reinsurance industry. At the time of releasing this report, the examination’s review noted that there has not been a significant impact to the Company. The Department has been in communication with the Company regarding the impact of COVID-19 on its business operations and financial position. The Department continues to closely monitor the impact of the pandemic on the Company and will take necessary action if a solvency concern arises.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained 2 recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Description of Company</u></p> <p>It was recommended that the Company comply with Sections 1608(d) and 1505(c) and submit to the Department for approval all transactions meeting the thresholds of Section 1608(d) and Section 1505(c) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	<p>4</p>
<p>B. <u>Loss and Loss Adjustment Expenses</u></p> <p>It was recommended that the Company’s future actuarial reports include details of the actual versus expected analysis and the ULAE analysis.</p> <p>The Company has complied with this recommendation.</p>	<p>23</p>

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Corporate Governance</u>	
i. It is recommended that the Company comply with its by-laws by having an annual meeting of the board of directors.	5
ii. It is recommended that the Company comply with the NAIC Annual Statement Instructions by ensuring that the actuarial report is presented to the board of directors on an annual basis and by ensuring that such information is documented in minutes of the board of directors.	5
iii. It is recommended that shareholder meetings and consents be held as required by the Company's by-laws.	6
iv. It is recommended that the Company comply with Section 312(b) of the New York Insurance Law by having all board members sign a statement indicating that he/she has received and read the prior report on examination, and by retaining such statements in its files.	6
B. <u>Reinsurance Ceded</u>	
i. It is recommended that the Company implement procedures to ensure that all affiliated reinsurance agreements are filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.	13
ii. It is recommended that the Company amend the trust agreement to include the provision required by Department Regulation No. 114.	13
C. <u>Holding Company System</u>	
It is recommended that the Company make payments in accordance with the NRIS agreement.	17
It is recommended that the Company establish procedures to ensure that settlements are made in accordance with contract provisions.	17

Respectfully submitted,

_____/S/_____
Teena Joseph
Senior Insurance Examiner

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

Teena Joseph, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

_____/S/_____
Teena Joseph

Subscribed and sworn to before me

this _____ day of _____, 2021.

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Linda A. Lacewell, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Teena Joseph

as a proper person to examine the affairs of the

Hudson Specialty Insurance Company

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

COMPANY

with such other information as she shall deem requisite.

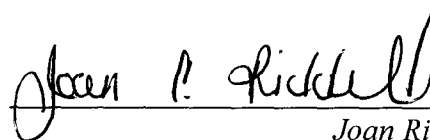
In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York

this 13th day of January, 2020

LINDA A. LACEWELL
Superintendent of Financial Services



By:



Joan Riddell
Deputy Bureau Chief