

REPORT ON EXAMINATION

OF

TSI INSURANCE INC.

AS OF

DECEMBER 31, 2006

DATE OF REPORT

FEBURARY 6, 2008

EXAMINER

BERNARD LOTT

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

February 6, 2008

Honorable Eric 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 22690 dated November 1, 2007, attached hereto, I have made an examination into the condition and affairs of the TSI Insurance, Inc. as of December 31, 2006, and respectfully submit the following report thereon.

This examination was conducted at the offices of Aon Insurance Managers (USA) Inc. ("Aon"), the manager of TSI Insurance, Inc., located at 199 Water Street, New York, NY 10038.

Wherever the designation "Company" or "TSI" appears herein without qualification, it should be understood to refer to TSI Insurance Inc.

Wherever the designation "Department" appears herein without qualification, it should be understood to mean the State of New York Insurance Department.

Wherever the designation "Town Sports" appears herein without qualification, it should be understood to refer to Town Sports International Inc. and all of the subsidiaries in which it maintains an interest of more than fifty percent.

1. SCOPE OF EXAMINATION

The purpose of this examination was to determine that the Company was operating within its by-laws, and was conforming with Article 70 of the New York Insurance Law and its plan of operation as submitted to the Department.

A review of the operations of TSI from its licensing as a New York State captive on December 31, 2002 to December 31, 2006 was performed. This review included an analysis of the Company's financial condition, a review of corporate records, and limited tests of various income and disbursement items as deemed necessary. This report is submitted on an "exception" basis. Comments and recommendations are limited to those items requiring financial adjustment, procedural recommendations, or instances where the Company was not conforming with the application submitted to the Department or Article 70 of the New York Insurance Law.

The report utilized work performed by the Company's independent certified public accountants ("CPA") to the extent considered appropriate.

2. DESCRIPTION OF COMPANY

TSI was incorporated on December 20, 2002 as a wholly-owned subsidiary of Town Sports International Inc. It began operating as a captive insurance company under the laws of New York State on December 31, 2002.

A. Articles of Incorporation

The purpose of the Company, as stated in its articles of incorporation, was to form a corporation for the purpose of transacting the kinds of insurance specified in Section 1113 of the New York Insurance Law, subject at all times to the limitations of the business of pure captive insurance companies set forth in Article 70 of the New York Insurance Law.

B. By-Laws

The by-laws of the Company were reviewed and except as noted in the board of directors section below, it appears that the Company was in full conformity with its by-laws in all material respects.

C. Capital Structure

TSI was incorporated as a pure captive insurance company. It was initially capitalized by issuing 100% of its authorized and issued common stock to Town Sports International, Inc. for a total paid in capital of \$250,000. The Company has maintained at least \$250,000 of paid in capital for each year covered by this examination. As of December 31, 2006, the Company's accumulated earnings totaled \$26,624,748.

D. Corporate Records

The corporate records reviewed appeared to be substantially accurate and complete in all material respects.

E. Plan of Operation

The Company's business plan states that it will provide insurance coverage for Town Sports as permitted by Article 70 of the New York Insurance Law.

F. Reinsurance

The Company does not assume or cede any reinsurance.

G. Management and Control

(i) Management Firm

The Company is managed by Aon, the captive management arm of the Aon Corporation, an insurance consultant licensed by the Department. The manager's duties, pursuant to a "captive service agreement" with TSI, includes assisting with the compliance with Article 70 of the New York Insurance Law and maintaining books and records in accordance with established accounting principles applicable to the business of insurance. The agreement also states that the manager shall assist in the maintenance of the captive's bank accounts, the preparation of its financial statements and provide administrative assistance in the implementation of any insurance/reinsurance program including:

- Drafting, preparation, review and issuance of policies, reinsurance contracts, certificates of insurance, binders or cover notes;
- Billing and collection of premiums; and

- Payment of claims and other expenses from the funds held in the Company's bank accounts.

(ii) Board of Directors

The board of directors shall exercise all of the powers of the Company, except those that are conferred upon or reserved for shareholders, pursuant to the law, the charter or the by-laws. At December 31, 2006, the board of directors was comprised of the following three members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Alexander A. Alimanestianu New York, NY	Executive Vice President, TSI Insurance Inc.
Daniel G. Gallagher Upper Saddle River, NJ	Vice President, TSI Insurance Inc.
Robert J. Giardina Edison, NJ	President, TSI Insurance Inc.

The Company's by-laws and charter both state that not less than two of the directors at any time shall be residents of the State of New York. In addition, Section 7005(g) of the New York Insurance Law states that:

“[t]he board of directors of a captive insurance company incorporated in this state shall have at least three members, with at least two of the members required to be residents of this state.”

It is recommended that the Company maintain a board of directors that fulfills the residency requirements of its charter, by-laws and Section 7005(g) of the New York Insurance Law.

The board met six times during the period covered by this examination. A review of the minutes for these meetings indicated that they were generally well attended and that each member had an acceptable record of attendance for all meetings for which they were eligible to attend.

Officers:

The by-laws of the Company state that the officers shall be a president, a treasurer and a secretary. The by-laws also provide for the board of directors to elect a chairman of the board, one or more executive vice-presidents and one or more other vice-presidents.

The following are the officers of the captive as of December 31, 2006:

<u>Name</u>	<u>Title</u>
Alexander A. Alimanestianu	President
Robert Giardina	Chief Executive Officer
Richard G. Pyle	Executive Vice President
Daniel G. Gallagher	Vice President
Robert S. Herbst	Secretary

H. Certified Public Accountant (“CPA”) and Actuarial Services

The Company was audited by PricewaterhouseCoopers LLP, 1301 Avenue of the Americas, New York, NY 10019, for the years covered by this examination. In addition, IRMG, an Aon Company, provides actuarial services for the Company.

I. Growth of Company

The following schedule sets forth the Company’s significant summary financial information for the last five years:

<u>Year</u>	<u>Net Premiums Earned</u>	<u>Net Income</u>	<u>Assets</u>	<u>Shareholders’ Equity</u>
2002	\$1,945,125	\$1,259,288	\$2,195,147	\$1,509,288
2003	3,890,250	9,855,006	17,469,574	11,427,393
2004	7,881,880	13,745,673	38,728,256	25,173,066
2005	11,670,500	13,024,992	13,513,785	13,198,058
2006	12,670,500	13,706,331	27,372,259	26,937,847

3. FINANCIAL STATEMENTS

The financial statements of the Company are presented in conformity with generally accepted accounting principles. The financial position of the Company as presented and accepted for the period examined follows:

A. Balance Sheet

BALANCE SHEET AS OF DECEMBER 31, 2006

Assets

Cash	\$ 263,402
Other invested assets	26,460,075
Investment income due and accrued	637,112
Prepaid premium taxes	11,670
Total assets	<u>\$ 27,372,259</u>

Liabilities and Shareholder's Equity

Liabilities

Losses	\$ 0
Loss adjustment expenses	0
Taxes payable	400,579
Accrued expenses	<u>33,833</u>
Total liabilities	\$434,412

Shareholder's Equity

Paid In capital (par value)	\$ 313,099
Surplus (accumulated earnings)	<u>26,624,748</u>
Total shareholder's equity	<u>26,937,849</u>
Total liabilities and shareholders' equity	<u>\$27,372,259</u>

B. Statement of Income

STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2006

Underwriting income

Net premiums earned	\$12,670,500
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Underwriting Expense

Net losses incurred	\$ 0
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Net loss adjustments expenses incurred	
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General and administrative expenses	62,091
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Other underwriting expenses	<u>50,682</u>
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Total underwriting expenses	<u>112,773</u>
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Underwriting profit (loss)	\$12,557,727
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Investment income	12,822,188
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Other income	637,112
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Other expenses	<u>(4,930,572)</u>
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Income before taxes	\$ 21,086,455
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Taxes	<u>7,380,124</u>
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Net income	<u>\$ 13,706,331</u>
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Changes in Capital and Surplus Account

Capital and surplus at December 31, 2005	\$13,231,516
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Net income	<u>13,706,331</u>
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Capital and Surplus at December 31, 2006	<u>\$26,937,849</u>
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4. LOSS AND LOSS ADJUSTMENT EXPENSES

TSI provides coverage to Town Sports in excess of its varying underlying primary insurance. As of December 31, 2006, TSI did not report liabilities for loss and loss adjustment expenses. The Company's Statement of Actuarial Opinion ("Opinion"), prepared by Serge Lobonov of IRMG, notes that as of the December 31, 2006, no open claims were expected to breach the primary policy limits for Town Sports. Since the primary limits were not expected to be reached, the Opinion concluded TSI did not meet one of the necessary conditions for establishing a reserve for loss contingencies in FASB No. 5, paragraph 8. FASB No. 5, paragraph 8 states:

"An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated."

The Opinion states that:

"...[i]n my opinion, at this time there is no basis for 'reasonable possibility' for the Company to have a loss due to this claim, and therefore the condition a. above is not met."

It goes on to say that the reserves carried by the Company met the requirements of the New York State Insurance Law; were computed in accordance with accepted loss reserving standards and principals and made a reasonable provision for all unpaid loss and loss adjustment expense obligations under the terms of its contracts and agreements.

Based on the Opinion, no examination change will be made to the Company's reported reserve for loss and loss adjustment expenses.

5. ARTICLE 70 COMPLIANCE

Article 70 of the New York State Insurance Law is the governing law for the formation and continued operation of captive insurance companies in New York State. A review was performed to test the Company's compliance with Article 70. No material area of non-compliance with Article 70 was found during the course of this examination.

6. ORGANIZATIONAL STRUCTURE

The Company is 100% owned and controlled by Town Sports International, Inc. Town Sports International, a New York based corporation is one of the two leading owners and operators of fitness clubs in the Northeast and Mid-Atlantic regions of the United States and the third largest fitness club operator in the United States.

7. INSURANCE PROGRAM

TSI provides Town Sports with insurance, on an occurrence basis, in excess of its varying existing underlying coverages. The Company's insurance policy provides for coverages up to \$200 million per occurrence and in the aggregate for employment practices liability insurance, excess/umbrella liability insurance, property insurance, directors and officers liability insurance, fiduciary liability insurance, blanket crime insurance, international liability insurance and sabotage and terrorism risk insurance.

The policy states that:

“[e]xcept as respects Reputation Risk this policy is excess of underlying limits of liability as scheduled in this policy or in the event that the underlying policies are no longer in force, or if the coverage granted under this policy responds on a primary basis, the per occurrence deductible will be \$25,000.”

With regards to Reputation Risk, the policy provides up to \$20 million, each event and in the aggregate, only for events in excess of the “Each Reputation Risk Deductible” of \$10 million.

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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It is recommended that the Company maintain a board of directors that fulfills the residency requirements of its charter, by-laws and Section 7005(g) of the New York Insurance Law.

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Respectfully submitted,

_____/S/_____
Bernard Lott
Senior Insurance Examiner

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

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

_____/S/_____
Bernard Lott

Subscribed and sworn to before me
this _____ day of _____ 2008.

Appointment No. 22690

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Bernard Lott

as proper person to examine into the affairs of the

TSI INSURANCE, INC.

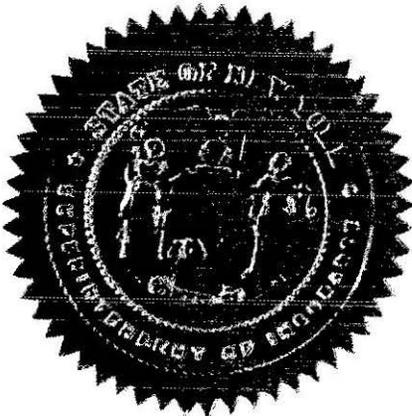
and to make a report to me in writing of the condition of the said

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 1st day of November, 2007



A handwritten signature in cursive script, appearing to read "Eric Dinallo".

ERIC R. DINALLO

Superintendent of Insurance