

REPORT ON EXAMINATION

OF THE

HERMITAGE INSURANCE COMPANY

AS OF

DECEMBER 31, 2013

DATE OF REPORT

MAY 27, 2015

EXAMINER

JOHN J. D'AMATO, CPA, CFE, MCM

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

May 27, 2015

Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
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 31063 dated December 17, 2013, attached hereto, I have made an examination into the condition and affairs of Hermitage Insurance Company as of December 31, 2013, and submit the following report thereon.

Wherever the designation “the Company” or “HIC” appears herein without qualification, it should be understood to indicate Hermitage Insurance Company.

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

The examination was conducted at the Company’s home office located at 120 Broadway, New York, NY 10271.

According to its December 31, 2013 filed annual statement, the Company was insolvent in the amount of \$7,745,755; its capital was impaired by \$10,846,795 and its minimum required to be maintained surplus of \$6,000,000 was impaired in the amount of \$13,745,755

This examination has determined that as of December 31, 2013, HIC was insolvent in the amount of \$47,019,400, and that its capital was impaired in the amount of \$50,120,440. Additionally, the Company’s minimum required to be maintained surplus of \$6,000,000 was impaired in the amount of \$53,019,400.

## 1. SCOPE OF EXAMINATION

The Department has performed a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2009. This examination covered the four year period from January 1, 2010 through December 31, 2013. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

New York was the coordinating state of the Tower Group Insurance Companies. Other states participating in this examination were California<sup>1</sup>, Florida, Illinois, Maine, Massachusetts, New Hampshire and New Jersey.

The examination was performed concurrently with the examinations of the following insurers:

### New York Domiciled Insurance Companies

- Adirondack Insurance Exchange (“ADIEX”) [NAIC #: 12583]
- CastlePoint Insurance Company (“CPIC”) [NAIC #: 17205]
- Tower Insurance Company of New York (“TICNY”) [NAIC #: 44300]

### Florida Domiciled Insurance Companies

- CastlePoint Florida Insurance Company (“CPFIC”) [NAIC #: 13599]

### Illinois Domiciled Insurance Companies

- CastlePoint National Insurance Company (“CPNIC”) [NAIC #: 40134]

### Maine Domiciled Insurance Companies

- North East Insurance Company (“NEIC”) [NAIC #: 24007]
- York Insurance Company of Maine (“YIC”) [NAIC #: 31267]

### Massachusetts Domiciled Insurance Companies

- Massachusetts Homeland Insurance Company (“MHIC”) [NAIC #: 40320]
- Tower National Insurance Company (“TNIC”) [NAIC #: 43702]

### New Hampshire Domiciled Insurance Companies

- Mountain Valley Indemnity Company (“MVIC”) [NAIC #: 10205]

### New Jersey Domiciled Insurance Companies

- New Jersey Skylands Insurance Association (“NJSIA”) [NAIC #: 11454]
- New Jersey Skylands Insurance Company (“NJSIC”) [NAIC #: 11453]
- Preserver Insurance Company (“PIC”) [NAIC #: 15586]

<sup>1</sup> - While the California Department of Insurance does not have any domestic insurers within the Tower Insurance Group (“the Group”), they participated on this examination because the Group is considered to be a "commercially domiciled insurer" in California per California Insurance Code Section 1215.13.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify 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 Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment and an evaluation based upon the ultimate parent Company, Tower Group International, Ltd. (“TGIL”), Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Loss experience
- Reinsurance
- Accounts and records
- Statutory deposits
- Financial statements
- Summary of recommendations

A review was also made to ascertain what action was taken by the Company 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 that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

Hermitage Insurance Company (“HIC”) was incorporated under the laws of the State of New York in 1984 and commenced writing business in December 1985. The Company was a wholly-owned subsidiary of Queensway Financial Holdings Ltd. from 1995 to March 18, 2005. On March 18, 2005, the Department gave regulatory approval for the acquisition of Hermitage Insurance Company by Brookfield Asset Management.

On February 27, 2009, Tower Group, Inc. (“TGI”) acquired Hermitage Insurance Company and it became part of Tower Holding Company group. TGI, the parent company, was expanding and growing its business operations regionally across the United States by acquiring several insurance companies. On August 20, 2012, TGI closed on a \$74.9 million acquisition, which provided it a 10.7% ownership of Canopus Group Limited (“Canopus Group”), a privately owned Lloyd’s insurance holding company domiciled in Guernsey Channel Islands. The Merger Agreement for the acquisition provided TGI a merger option that would allow it to merge with Canopus Bermuda to establish a presence at Lloyd’s of London through a special purpose syndicate (“SPS Transaction Right and Acquisition Right”). TGI exercised its merger right by paying to the Canopus Group a fee of \$1 million. On March 13, 2013, the Merger Agreement was finalized and formed a new ultimate parent, TGIL, with TGI becoming its indirect wholly-owned subsidiary.

Capital paid in is \$3,101,040 consisting of 1,095 shares of \$2,832 par value per share common stock. Gross paid in and contributed surplus is \$23,094,050. Gross paid in and contributed surplus increased by \$2,640,091 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2009	Beginning gross paid in and contributed surplus	\$20,453,959
2013	Surplus contribution	<u>2,640,091</u>
2013	Ending gross paid in and contributed surplus	<u>\$23,094,050</u>

### A. Management

In October 2013, the Company amended its bylaws to reflect a change that the board of directors (“Board”) must have at least seven but no more than thirteen members. Prior to the amendment, the Board was to consist of not less than thirteen and not more than twenty-one members. The Company

bylaws required the Board to meet at least quarterly during each calendar year. At December 31, 2013, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Bruce W. Sanderson North Caldwell, New Jersey	President, Hermitage Insurance Company
William E. Hitselberger West Windsor, New Jersey	Executive Vice President and CFO, Tower Insurance Company of New York; To Group International, LTD
William F. Dove Princeton, New Jersey	Senior Vice President and Chief Actuary, Tower Insurance Company of New York; Tower Group International, LTD.
Brian W. Finkelstein Rye Brook, New York	Managing Vice President and Controller, Tower Insurance Company of New York
Edward Granaghan New York, NY	Tower – Director, Tower Insurance Company of New York
Scott T. Melnik Kings Park, New York	Senior Vice President Claims, Tower Insurance Company of New York
Vito A. Nigro Newtown, Pennsylvania	Treasurer, Tower Insurance Company of New York
Elliot S. Orol New York, New York	Senior Vice President, General Counsel and Secretary, Tower Insurance Company of New York
Christian K. Pechmann Mendham, New Jersey	Senior Vice President, Tower Insurance Company of New York
Laurie A. Ranegar New Hope, Pennsylvania	Senior Vice President, Operations, Tower Insurance Company of New York
Gregory A. Meyer Glen Ellyn, Illinois	President, CastlePoint Insurance Company
John J. Williams Tenafly, New Jersey	Senior Vice President Corporate Initiative; Acting Chief Information Officer, Tower Group International, LTD.
Catherine M. Wragg Jersey City, New Jersey	Senior Vice President, Human Resources and Administration

A review of the minutes of the Board's meetings held during the examination period indicated there were no regular meetings held. As noted in the prior examination report, the Board continues to conduct the Company business through "Action by Unanimous Written Consent of Directors without a Meeting". The Board of the Company's ultimate parent, TGIL, is the governing Board of all the companies within the holding company system and makes the decisions for all companies within the system. It would appear the Company is in violation of the New York Insurance Law Section 1507(a), which provides that "notwithstanding the control of an authorized insurer by any person, the insurer's officers and directors shall not thereby be relieved of any obligation or liability to which they would otherwise be subject by law, and the insurer shall be managed so as to assure its separate operating identity."

It is recommended that the Company convene regularly scheduled quarterly meetings of its board of directors as stated in its by-laws and maintain complete minutes of such proceedings. It is also recommended that the Company comply with Section 1507(a) of the New York Insurance Law and ensure that the Company is operating as a separate entity.

It is noted that the Company is in violation of Section 312(b) of the New York Insurance Law that states, in part, as follows:

"A copy of the report shall be furnished by such insurer or other person 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. . ."

It is recommended that the Company comply with Section 312(b) of the New York Insurance Law by obtaining and retaining in their files signed statements from each member of their board of directors that they have received and read the prior report on examination.

As of December 31, 2013, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Bruce W. Sanderson	President
William E. Hitselberger	Executive Vice President and CFO
William F. Dove	Senior Vice President and Chief Actuary
Vito A. Nigro	Treasurer
Elliot S. Orol	Senior Vice President, General Counsel and Secretary



B. Territory and Plan of Operation

As of December 31, 2013, the Company was licensed to write business in five states, as well as forty-three other states and the District of Columbia on an excess and surplus basis.

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
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
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
22	Residual value

Based on 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 \$6,000,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a percentage of Total Premium</u>
2010	\$42,206,006	\$72,870,366	57.92%
2011	\$39,142,227	\$73,428,580	53.31%
2012	\$41,011,705	\$101,755,892	40.30%
2013	\$46,988,100	\$122,983,987	38.21%

The Company primarily writes commercial multiple peril, homeowners multiple peril, other liability-occurrence, homeowners multiple peril, inland marine and workers compensation. In 2013, commercial multiple peril (57%), other liability- occurrence (13%), homeowners' multiple peril (8%), inland marine (7%) and workers compensation (5%) accounted for 90% of the direct premiums written.

C. Reinsurance

The Company assumed minimal premiums outside of the inter-company pooling agreement.

Inter-Company Pooling Agreement

In 2009, the Company became part of an existing inter-company pooling agreement with several of its insurance affiliates: Tower Insurance Company of New York ("TICNY"), pool manager, Tower National Insurance Company ("TNIC"), Preserver Insurance Company ("PIC"), North East Insurance Company ("NEIC"), Mountain Valley Insurance Company ("MVIC"), CastlePoint Insurance Company ("CPIC"), and CastlePoint National Insurance Company ("CPNIC").

Effective January 1, 2012, MVIC exited the pool as a result of its sale to its affiliate, ADIEX. CPIC assumed the 3% participation percentage of MVIC.

According to the terms of the agreement, pool participants other than TICNY cede 100% of gross business (direct and assumed) to the pool manager. TICNY assumes 100% of the gross business with respect to policies issued and assumed by the pool participants. All lines of business are subject to the pooling arrangement. TICNY cedes to the pool participants their respective share of the pool including business written net of cessions on its own account.

TICNY obtains and maintains reinsurance on behalf of itself and the pool members with respect to the insurance liability under all policies written by the pool members, including the Company. All ceded balances related to internal and external reinsurance contracts are recorded in the statutory financial statements of TICNY and all reinsurers that are parties to the contracts are included in TICNY's Schedule F. It is noted that the TICNY is the only pool member that establishes a provision for reinsurance. Write-offs of uncollectible reinsurance are subject to the pooling arrangement and shared by all pool participants.

The participating percentages of each pool member as of December 31, 2013 were as follows:

<u>Company</u>	<u>State of Domicile</u>	<u>NAIC #</u>	<u>Pooling Percentage</u>
Tower Insurance Company of New York	NY	44300	22%
CastlePoint Insurance Company	NY	17205	22%
CastlePoint National Insurance Company	IL	40134	21%
Hermitage Insurance Company	NY	18376	21%
Preserver Insurance Company	NJ	15586	8%
North East Insurance Company	ME	24007	4%
Tower National Insurance Company	MA	43702	<u>2%</u>
			<u>100%</u>

The Company has structured its ceded reinsurance program to limit its maximum exposure on any one risk as follows:

#### **Quota Share**

	<u>Limit</u>	<u>Retention</u>	<u>Placed</u>
Net QS CPre (Bermuda affiliate)	Unlimited	65.0%	35.0%
Equipment Breakdown QS (Commercial)	100,000,000	0%	100.0%
Equipment Breakdown QS (Homeowners)	50,000	0%	100.0%
Identity Theft QS	15,000	0%	100.0%
Employment Practices Liability QS	250,000	0%	100.0%
Tower Homeowners QS II	2,500,000	70.0%	30.0%
Tower Homeowners QS (ACE)	2,500,000	65.0%	35.0%
Southport Re Workers Compensation QS	5,000,000	70.0%	30.0%
Hannover Re Brokerage Multiple Line QS	10,000,000	86.0%	14.0%
Arch Re Brokerage Multiple Line QS	25,000,000	82.5%	17.5%
Umbrella (Commercial & Personal) QS	5,000,000	50.0%	50.0%

**Excess Programs**

	<u>Limit</u>	<u>Retention</u>	<u>Placed</u>
Casualty Clash XOL	5,000,000	5,000,000	100.0%
1st Property XOL	5,000,000	5,000,000	100.0%
2nd Property XOL	20,000,000	10,000,000	100.0%
Property Auto Facultative	40,000,000	30,000,000	100.0%
Minnesota WCRA XL	Unlimited	1,880,000	100.0%
1st Workers Compensation XS	3,000,000	2,000,000	65.0%
2nd Workers Compensation XS	5,000,000	5,000,000	100.0%
3rd Workers Compensation XS	10,000,000	10,000,000	100.0%
4th Workers Compensation XS	40,000,000	20,000,000	100.0%
Southport Re WC ADC Aggregate XOL	Various	Various	100.0%

**Catastrophe Programs**

	<u>Limit</u>	<u>Retention</u>	<u>Placed</u>
1st Property Catastrophe XL (Nationwide)	75,000,000	75,000,000	100.0%
2nd Property Catastrophe XL (Nationwide)	150,000,000	150,000,000	100.0%
3rd Property Catastrophe XL (Nationwide)	300,000,000	300,000,000	100.0%
4th Property Catastrophe XL (Nationwide)	400,000,000	600,000,000	100.0%
Industry Loss Warranty (ILW) I	10,000,000	10,000,000	100.0%
Industry Loss Warranty (ILW) II	10,000,000	10,000,000	100.0%

**Specialty Programs**

	<u>Limit</u>	<u>Retention</u>	<u>Placed</u>
W H Greene Umbrella QS	5,000,000	20.0%	80.0%
W H Greene Umbrella XL	5,000,000	5,000,000	80.0%
NBIS Crane QS	1,000,000	70.0%	30.0%
NBIS Inland Marine XOL	9,500,000	500,000	100.0%
Cinium Surety QS	200,000	80.0%	20.0%
1st Marine Excess	2,500,000	2,500,000	100.0%
2nd Marine Excess	5,000,000	5,000,000	100.0%
3rd Marine Excess	15,000,000	10,000,000	100.0%
4th Marine Excess	25,000,000	25,000,000	100.0%
Rodney Square QS	50,000,000	90.0%	5.0%

In the third quarter of 2013, the Company entered into agreements with three reinsurers, Arch Reinsurance Ltd. (“Arch”), Hannover Re (Ireland) Plc. (“Hannover”) and Southport Re (Cayman), Ltd. (“Southport Re”); (details of the agreements listed in the above chart). These agreements provided for

surplus enhancement and improved certain financial leverage ratios, while increasing the Company's financial flexibility. The agreements with Arch and Hannover each consisted of one reinsurance agreement, while the arrangement with Southport Re consisted of several agreements with both prospective and retroactive components. The agreements with Arch and Hannover covered business written from July 1, 2013 to December 31, 2013, as well as unearned premiums at June 30, 2013.

In early 2014, management decided that the Southport treaties should be commuted. As a result of a negotiation between the Company and Southport, the treaties were commuted effective as of February 19, 2014, with the result of the commutation being that all premiums paid to Southport by the Company were returned to the Company, and all liabilities assumed by Southport were cancelled, and such liabilities became the obligation of the Company. It is noted that before the Company commuted the Southport treaties, management determined that such agreement should have been accounted for as deposit accounting as set forth in SSAP No.62R. It is further noted that the retroactive reinsurance treaties with Southport resulted in a surplus gain of \$3,374,705 at the examination date.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

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 Regulations 133 and 114, respectively.

All material 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.

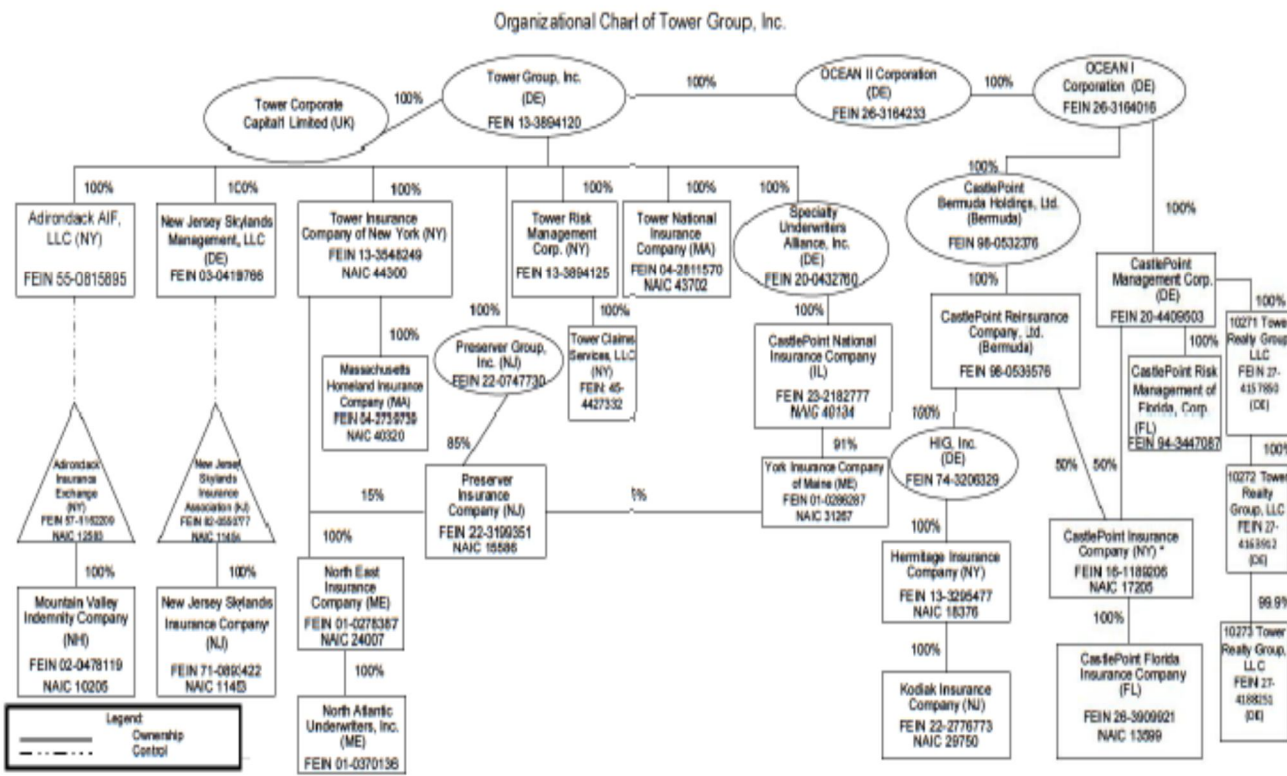
During the period covered by this examination, the Company commuted various reinsurance agreements. These commutations were neutral to the Company's surplus position.

#### D. Holding Company System

The Company is a member of the Tower Group. The Company is owned 100 % by HIG, Inc., a Delaware corporation. Both of these entities are ultimately owned by TGIL.

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 organizational chart displays the chain of ownership of subsidiary and affiliated companies which were members of Tower Group, Inc. at December 31, 2013:



\*All outstanding shares of CastlePoint Insurance Company ("CPI") are owned 50% by CastlePoint Management Corp. ("CPM") and 50% by CastlePoint Reinsurance Company, Ltd. ("CPR"). With respect to the ownership of CPI, there are no voting rights preferences assigned to either CPM or CPR.

At December 31, 2013, the Company was party to the following agreements with other members of its holding company system:

Service and Expense Sharing Agreements

There are a number of Service and Expense Sharing Agreements between the affiliated parties to jointly share in underwriting and claims expenses as well as sharing any profits and losses from rendering services to third parties. While each agreement may vary, in general terms, the agreements cover the

following services which would be provided or received by any of the companies that are party to the agreement:

1. Underwriting and marketing;
2. Policy issuance, billing, and collection;
3. State filing and regulatory compliance;
4. Loss prevention, premium audit;
5. Claims services; and
6. Administrative services (i.e., Human Resources, IT, and facilities).

TICNY employs the staff that provides services to its affiliates that participate in the Intercompany Pooling Agreement. Underwriting and claim expenses are handled through the Intercompany Pooling Agreement, however, the Service and Expense Sharing Agreements are in place for other services performed by the Company employees on behalf of the referenced affiliates.

As of December 31, 2013, HIC was party to a Service and Expense Sharing Agreement with TICNY in which TICNY provides underwriting and claims services as well as administrative services.

#### Management Agreements

Affiliated parties have entered into a specific purpose management agreement. The Management Agreement between CPIC and Tower Risk Management Corp. (“TRM”) (an amendment to which adds Kodiak Insurance Company and HIC) to manage and earn management fees on Tower’s authorized brokerage business placed on CPIC paper.

#### Tax Allocation Agreement

Effective September 12, 2008, the Company entered into a tax allocation agreement with Tower Group, Inc. and several of its subsidiaries to jointly file consolidated federal income tax returns in accordance with the relevant Internal Revenue Service regulations. A tax allocation agreement between Tower Group and its subsidiaries allows the Company to compute and pay Federal income taxes on a consolidated basis. At the end of each consolidated return year, each entity must compute and pay to the Holding Company its share of the Federal income tax liability primarily based on separate return calculations. The tax allocation agreement allows the Holding Company to make certain IRS Code (“Code”) elections in the consolidated Federal tax return. In the event such Code elections are made, any benefit or liability is accrued or paid by each entity.

E. Significant Operating Ratios

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$461,804,614	88.56%
Other underwriting expenses incurred	203,442,587	39.02%
Net underwriting loss	<u>(143,800,388)</u>	<u>(27.58)%</u>
Premiums earned	<u>\$521,446,813</u>	<u>100.00%</u>

F. Accounts and Records

Material weaknesses were noted in the Company's 'internal controls' over financial reporting. The Company did not maintain effective controls over:

1. The loss reserve estimation process
2. The premium receivable account reconciliation
3. The tax valuation process
4. Information technology general controls
5. Period end financial reporting

G. Investments

It is noted that the Company has an investment in a surplus note of its affiliate, the Adirondack Insurance Exchange with an admitted value of \$6,797,426. This note can only be repaid with the permission of the Department. This investment represents a 13.861% interest in a \$70.7 million surplus note. The Company paid \$10,573,721 for its \$9,800,000 stake in the face value of the note.



During the review of the Company's investment practices, it was noted that the Company violated Section 1505 of the New York Insurance Law by transferring securities between members of its holding company system without permission from the Department.

TICNY sold 102 securities to AIDEX on December 23, 2010 without prior approval from the Department. AIDEX sold 6 securities to TICNY on February 16, 2011 without prior approval from the Department. CPIC and HIC invested in Lincoln Properties, a limited partnership formed for the purpose of developing a parcel of real estate in Edison, NJ. This partnership interest was acquired by TGI and later sold to CPIC and HIC in June of 2012 without prior approval from the Department. It is recommended that the Company comply with Section 1505 of the New York Insurance Law and obtain prior approval from the Department before transferring securities between members of the holding company group. It is recommended that Company comply with Section 1505 of the New York Insurance Law and obtain prior approval from the Department before transferring securities between members of the holding company group.

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2013 as determined by this examination and as reported by the Company:

<u>Assets</u>	Examination Net Admitted <u>Assets</u>	Company Net Admitted <u>Assets</u>	Increase (Decrease)
Bonds	\$95,756,706	\$95,756,706	
Preferred stocks (stocks)	4,559,650	4,559,650	
Common stocks (stocks)	16,264,797	20,798,349	\$(4,533,552)
Cash, cash equivalents and short-term investments	14,059,749	14,059,749	
Other invested assets	19,892,845	19,892,845	
Receivables for securities	8,315,973	8,315,973	
Investment income due and accrued	3,541,263	3,541,263	
Uncollected premiums and agents' balances in the course of collection	17,832,284	17,832,284	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	32,791,835	32,791,835	
Accrued retrospective premiums	214,435	214,435	
Amounts recoverable from reinsurers	5,616,512	5,616,512	
Funds held by or deposited with reinsured companies	6,294,154	6,294,154	
Current federal and foreign income tax recoverable and interest thereon	3,320,799	3,320,799	
Receivables from parent, subsidiaries and affiliates	81,532,132	81,532,132	
Aggregate write-ins for other than invested assets	<u>19,865,468</u>	<u>19,865,468</u>	<u>0</u>
Totals	<u>\$329,858,602</u>	<u>\$334,392,154</u>	<u>\$(4,533,552)</u>

Liabilities, surplus and other funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase (Decrease)
Losses and loss adjustment expenses	\$261,085,000	\$226,344,907	\$(34,740,093)
Reinsurance payable on paid losses and loss adjustment expenses	449,581	449,581	
Commissions payable, contingent commissions and other similar charges	874,475	874,475	
Other expenses (excluding taxes, licenses and fees)	9,894,010	9,894,010	
Taxes, licenses and fees (excluding federal and foreign income taxes)	157,981	157,981	
Unearned premiums	60,443,477	60,443,477	
Advance premium	2,464,779	2,464,779	
Ceded reinsurance premiums payable (net of ceding commissions)	37,240,927	37,240,927	
Funds held by company under reinsurance treaties	21,718,603	21,718,603	
Amounts withheld or retained by company for account of others	217,193	217,193	
Payable for securities	3,372,398	3,372,398	
Deferred commission income	1,408,783	1,408,783	
Reserve for unsecured reinsurance recoverable	14,096,040	14,096,040	
Premium collateral and loss fund deposit	4,768,577	4,768,577	
Retroactive reinsurance reserves - ceded	(41,548,520)	(41,548,520)	
Miscellaneous liabilities	143,698	143,698	
Workers' compensation fund assessment payable	<u>91,000</u>	<u>91,000</u>	<u>0</u>
Total liabilities	<u>\$376,878,002</u>	<u>\$342,137,909</u>	<u>(\$34,740,093)</u>
<u>Surplus and other funds</u>			
Aggregate write-ins for special surplus funds	\$ 3,374,705	\$ 3,374,705	
Common capital stock	3,101,040	3,101,040	
Gross paid in and contributed surplus	23,094,050	23,094,050	
Unassigned funds (surplus)	<u>(76,589,195)</u>	<u>(37,315,550)</u>	<u>\$39,273,645</u>
Surplus as regards policyholders	<u>\$(47,019,400)</u>	<u>\$(7,745,755)</u>	<u>\$39,273,645</u>
Total liabilities, surplus, and other funds	<u>\$329,858,602</u>	<u>\$334,392,154</u>	

Note: The Internal Revenue Service is currently conducting audits of the Company's consolidated Federal Income Tax returns for tax years 2010 through 2012. The results of this audit were not known at the date of this report and there has been no liability established herein.

B. Statement of IncomeUnderwriting Income

Premiums earned		\$521,446,813
Deductions:		
Losses and loss adjustment expenses incurred	\$461,804,614	
Other underwriting expenses incurred	<u>203,442,587</u>	
Total underwriting deductions		<u>665,247,201</u>
Net underwriting gain or (loss)		\$(143,800,388)

Investment Income

Net investment income earned	\$55,165,634	
Net realized capital gain	<u>1,147,936</u>	
Net investment gain or (loss)		56,313,570

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (2,968,710)	
Finance and service charges not included in premiums	5,028,568	
Reserve for unsecured reinsurance recoverable	(14,096,040)	
Retroactive reinsurance gain	3,373,635	
Interest on funds held	(1,949,767)	
Allowance for doubtful accounts	<u>(735,000)</u>	
Total other income		<u>(11,347,314)</u>
Net income before federal and foreign income taxes		\$(98,834,132)
Federal and foreign income taxes incurred		<u>3,385,367</u>
Net Income		<u>\$(102,219,499)</u>

C. Capital and Surplus

Surplus as regards policyholders decreased \$143,095,494 during the four-year examination period January 1, 2010 through December 31, 2013, detailed as follows:

Surplus as regards policyholders per report on examination as of December 31, 2009			\$96,076,094
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net loss		\$102,219,499	
Net unrealized capital gains or (losses)	\$2,173,225		
Change in net deferred income tax		18,989,762	
Change in nonadmitted assets		16,933,193	
Surplus adjustments paid in	2,640,091		
Dividends to stockholders		4,800,000	
Aggregate write-ins for gains and losses in surplus	<u>                    </u>	<u>4,966,356</u>	
	<u>\$4,813,316</u>	<u>\$147,908,810</u>	
Net increase (decrease) in surplus			<u>(143,095,494)</u>
Surplus as regards policyholders per report on examination as of December 31, 2013			<u>\$(47,019,400)</u>

Note: This examination has determined that as of December 31, 2013, HIC was insolvent in the amount of \$47,019,400, and that its capital was impaired in the amount of \$50,120,440. Additionally, the Company's minimum required to be maintained surplus of \$6,000,000 was impaired in the amount of \$53,019,400.

#### 4. **COMMON STOCK**

The examination asset for the captioned item of \$16,264,797 is \$4,533,552 less than the \$20,798,349 reported by the Company in its December 31, 2013, filed annual statement.

This change represents the disallowed portion of HIC's investment in subsidiary Kodiak Insurance Company per Section 1408(b) of the New York Insurance Law. Section 1408(b), limits the admitted value of insurance company shares to the greater of fifty per centum of the surplus to policyholders or sixty per centum of surplus.

#### 5. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$261,085,000 is \$34,740,093 more than the \$226,344,907 reported by the Company in its December 31, 2013, filed annual statement. 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 the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 55 ("SSAP No. 55").

It is noted, by virtue of its nine month runoff for accident years 2013 and prior as reported by the Company in its filed quarterly statement as of September 30, 2014, the Company has recognized approximately \$9.6 million of the Department's \$35 million projected Loss and loss adjustment expense reserve deficiency.

#### 6. **CONCLUSION**

This examination has determined that as of December 31, 2013, HIC was insolvent in the amount of \$47,019,400, and that its capital was impaired in the amount of \$50,120,440. Additionally, the Company's minimum required to be maintained surplus of \$6,000,000 was impaired in the amount of \$53,019,400.

## 7. SUBSEQUENT EVENTS

On January 3, 2014, TGIL, the ultimate parent of the Company entered into an Agreement and Plan of Merger (“the Merger Agreement”) with ACP Re, Ltd. (“ACP Re”) and London Acquisition Company, LTD (“LACL”), a wholly owned subsidiary of ACP Re. ACP Re is a Bermuda-based reinsurance company which historically reinsured a portion of the property and casualty business of National General Holdings Corporation (“NGHC”). The controlling shareholder of ACP Re is a trust established by the founder of AmTrust Financial Services, Inc. (“AmTrust”), NGHC and Maiden Holdings, Ltd.

The terms of the Merger Agreement indicate that TGIL would be merged with LACL and TGIL would be the surviving corporation and become a wholly-owned subsidiary of ACP Re. Additionally, AmTrust would acquire the renewal rights and assets of TGIL’s commercial lines insurance operations, and specialty personal-lines insurer NGHC would acquire the renewal rights and assets of TGIL’s personal lines insurance operations.

On January 3, 2014, the Company and its insurance affiliates entered into a Commercial Lines Cut-Through Quota Share Reinsurance Agreement with Technology Insurance Company, Inc. (“Technology”) in connection with the Merger. Technology is a New Hampshire domiciled affiliate of ACP Re and a subsidiary of AmTrust. The agreement requires the ceding companies to use the reinsurers underwriting standards on all new and renewed policies. The reinsurer will assume 100% of all losses on non-excluded policies. The ceding companies will transfer the unearned premium of reinsured policies less a ceding commission and 100% of all premiums on new and renewed policies less a ceding commission.

On January 3, 2014, the Company and its insurance affiliates entered into a Personal Lines Cut-Through Quota Share Reinsurance Agreement with Integon National Insurance Company (‘Integon’) in connection with the Merger Agreement previously mentioned. Integon is a North Carolina domiciled authorized insurance company that is a subsidiary of NGHC and an affiliate of ACP Re. The terms of the Personal Lines Cut-Through Reinsurance Agreement are the same as the Commercial Lines described above.

By letter dated September 12, 2014 (the “Approval Letter”), the NYDFS approved ACP Re’s acquisition of TGIL New York insurers (subsidiaries), Tower Insurance Company of NY, Hermitage Insurance Company and Castle Point Insurance Company (“Tower Companies”).

On September 15, 2014, the Merger Agreement of TGIL was completed. It is noted that as part of the merger, the Company entered into the following agreements effective September 15, 2014:

1. A loss portfolio transfer agreement with CastlePoint Reinsurance Company, Ltd of Bermuda (‘CP Re’), pursuant to which CP Re assumed all of the insurance liabilities of the Company as well as cash and invested assets equal to the assumed liabilities. Once the LPT agreement becomes effective, the NY insurers, TICNY, HIC and CPIC will have no net claim liabilities. CP Re is an unauthorized Bermuda reinsurer that was part of the pre-merger Tower Group holding company system.
2. A quota share reinsurance agreement with Technology, under which the Company prospectively cedes 100% of its commercial lines of business issued pursuant to a managing general agent agreement between the Company and AmTrust North America, Inc.
3. A quota share reinsurance agreement with Integon under which the Company prospectively cedes 100% of its personal lines business issued pursuant to a managing general agent agreement between the Company and National General Insurance Marketing, Inc.

The two quota share reinsurance agreements and cut through endorsements related to the commercial and personal lines dated January 3, 2014, were terminated on a run-off basis effective the September 15, 2014 merger agreement.

CP Re in turn entered into an aggregate stop loss reinsurance contract under which it is indemnified with respect to the liability that may accrue to it as a result of losses reinsured by CP Re under the loss portfolio agreement that it entered into with the Company identified above. The coverage attaches at the first dollar of adverse development, based on the TGIL U.S. insurers’ liabilities as of the closing of the Tower transactions.

There are two participating reinsurers in the aggregate stop loss reinsurance contract, each with a 50% interest which is several only. The two participating reinsurers are AmTrust International Insurance, Ltd. and National General Re, Ltd., which are subsidiaries of AmTrust and NGHC, respectively. The aggregate limit of liability of the reinsurers under this contract is \$250 million with each reinsurer having a liability limited to \$125 million. CP Re will pay \$56 million dollars for this coverage on the fifth anniversary of the effective date of the contract.



## 8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A.     <u>Management</u></p> <p>It was recommended that the Company convene regularly scheduled quarterly meetings of its Board as stated in its bylaws and maintain complete minutes of such proceedings.</p> <p>The Company has not complied with this recommendation. A similar comment is made in this report.</p>	<p>5</p>
<p>B.     <u>Reinsurance</u></p> <p>It is recommended that the Company comply with Article IX, Section B of its pooling agreement that was filed with the Department in accordance with Section 1505(d)(2) of the New York Insurance Law</p> <p>The Company has not complied with this recommendation. Due to the merger, this recommendation is no longer applicable.</p>	<p>8</p>

## 9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A	<u>Insolvency</u>	
	This examination has determined that as of December 31, 2013, HIC was insolvent in the amount of \$47,019,400, and that its capital was impaired in the amount of \$50,120,440. Additionally, the Company's minimum required to be maintained surplus of \$6,000,000 was impaired in the amount of \$53,019,400.	1,19,20
B	<u>Management</u>	
i.	It is recommended that the Company convene regularly scheduled quarterly meetings of its board of directors as stated in its by-laws and maintain complete minutes of such proceedings.	6
ii.	It is recommended that the Company comply with Section 1507(a) of the New York Insurance Law and ensure that the Company is operating as a separate entity.	6
iii.	It is recommended that the Company comply with Section 312(b) of the New York Insurance Law by obtaining and retaining in their files signed statements from each member of their board of directors that they have received and read the prior report on examination.	6
C	<u>Reinsurance</u>	
	It is noted that the retroactive reinsurance treaties entered into with Southport Re resulted in a surplus gain of \$3,374,705 at the examination date. These treaties were commuted on February 19, 2014.	11
D	<u>Accounts and Records</u>	
	Material weaknesses were noted in the Company's 'internal controls' over financial reporting.	14

E	<u>Investments</u>	
	i. It is recommended that Company comply with Section 1505 of the New York Insurance Law and obtain prior approval from the Department before transferring securities between members of the holding company group.	15
	ii. It is noted that the Company has an investment in a surplus note of its affiliate, the Adirondack Insurance Exchange with an admitted value of \$6,797,426. This note can only be repaid with the permission of the Department.	14
F	<u>Common Stock</u>	
	The examination non-admitted \$4,533,552 in the common stock of insurance company subsidiaries per Section 1408(b) of the New York Insurance Law.	20
G	<u>Loss and Loss Adjustment Expense</u>	
	The examination concluded that the Company's loss and loss adjustment expense reserves were understated by \$34,740,093. This conclusion is reflected in the financial statements included in this report.	20

Respectfully submitted,

\_\_\_\_\_  
<Examiner's Name>, <designation>  
<Examiner's Title>

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

<Examiner's Name>, being duly sworn, deposes and says that the foregoing report, subscribed by <him/her>, is true to the best of <his/her> knowledge and belief.

\_\_\_\_\_  
<Examiner's Name>

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 20xx.

APPOINTMENT NO. 31063

**NEW YORK STATE**

**DEPARTMENT OF FINANCIAL SERVICES**

I, **BENJAMIN M. LAWSKY**, 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:

**John Damato**

as a proper person to examine the affairs of the

**Hermitage Insurance Company**

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

**COMPANY**

with such other information as he shall deem requisite.

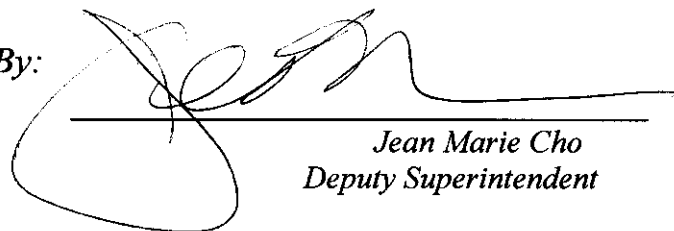
In Witness Whereof, I have hereunto subscribed by name  
and affixed the official Seal of the Department  
at the City of New York

this 17th day of December, 2013

**BENJAMIN M. LAWSKY**  
Superintendent of Financial Services



By:

  
\_\_\_\_\_  
Jean Marie Cho  
Deputy Superintendent