

ASSOCIATION REPORT ON EXAMINATION

OF THE

XL CAPITAL ASSURANCE INC.

AS OF

DECEMBER 31, 2002

ZONES  
REPRESENTED

I  
II

STATES  
PARTICIPATING

NEW YORK  
MISSISSIPPI

EXAMINERS

ADEBOLA AWOFOESO  
JOSEPH PIRES, CFE, CIE

REPORT ON EXAMINATION

OF THE

XL CAPITAL ASSURANCE INC.

AS OF

DECEMBER 31, 2002

DATE OF REPORT

DECEMBER 5, 2003

EXAMINER

ADEBOLA AWOFOESO

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

December 5, 2003

Honorable Gregory V. Serio  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22080 dated July 8, 2003 attached hereto, I have made an examination into the condition and affairs of XL Capital Assurance Inc., as of December 31, 2002, and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at 1221 Avenue of the Americas, New York, NY 10020.

Wherever the designations "Company" appear herein without qualification, they should be understood to indicate XL Capital Assurance Inc.

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



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

Honorable Janie A. Miller  
Chairman, Southeastern Zone  
Commissioner of Insurance  
State of Kentucky

Honorable Gregory V. Serio  
Superintendent of Insurance  
State of New York

Honorable Donna Lee Williams  
Chairman, Northeastern Zone  
Commissioner of Insurance  
State of Delaware

Honorable George Dale  
Commissioner of Insurance  
State of Mississippi

Sirs:

Pursuant to your instructions an examination has been made into the condition and affairs of the XL Capital Assurance Inc., hereinafter referred to as "Company" at its home office located at 1221 Avenue of the Americas, New York, NY 10020.

The Examination was conducted by the New York State Insurance Department, hereinafter referred to as "Department" with participation from the State of Mississippi representing the Southeastern Zone.

The report on examination is respectfully submitted.

## 1. SCOPE OF EXAMINATION

This is the first report on examination for the Company. The Company was originally incorporated in the State of Connecticut. A report on organization was conducted as of December 18, 1998 by State of Connecticut Insurance Department. This examination covered the four-year period from January 1, 1999 through December 31, 2002. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2002. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

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

## 2. DESCRIPTION OF COMPANY

The Company was formed on September 13, 1999, and became licensed as a financial guaranty insurer in New York upon its merger with an affiliate, X.L. Risk Solutions, Inc., a Connecticut domiciled company, on September 30, 1999. On February 22, 2001, XL Reinsurance America Inc, ("XL RE AM") acquired all the outstanding shares of The London Assurance of America, Inc. ("LAA"). LAA was incorporated on July 25, 1991 under the laws of the State of New York. Prior to its acquisition by XL RE AM, LAA was a New York domiciled property and casualty insurance company that was licensed in 44 states and the District of Columbia. The business previously underwritten through LAA, together with all the liabilities of LAA, was ceded effective July 1, 2000, to an affiliate of LAA under a reinsurance assignment and assumption agreement. On February 22, 2001, XL RE AM caused the Company to merge with and into LAA on the day of acquisition (with LAA as the surviving entity) and for LAA to simultaneously adopt the name of XL Capital Assurance Inc.

Capital paid in is \$15,000,000 consisting of 2,000 shares of \$7,500 par value per share common stock. Gross paid in and contributed surplus is \$125,700,000. Gross paid in and contributed surplus and/or capital paid in increased by \$55,700,000 during the examination period, as follows:

| <u>Year</u> | <u>Description</u>                              | <u>Amount</u>        |
|-------------|---|----------------------|
| 1998        | Beginning gross paid in and contributed surplus | \$98,000,000         |
| 1999        | Transfer to capital account*                    | (\$13,000,000)       |
| 1999        | Dividend to stockholders**                      | (15,000,000)         |
| 2001        | Surplus Contribution                            | 35,700,000           |
| 2002        | Surplus Contribution                            | <u>20,000,000</u>    |
|             | Total Surplus Contributions                     | <u>55,700,000</u>    |
| 2002        | Ending gross paid in and contributed surplus    | <u>\$125,700,000</u> |

\*On November 30, 1999, the Company transferred \$13 million into capital which increased from \$2 million to \$15 million.

\*\*This dividend was paid to LAA prior to the acquisition by XL RE AM.

A. Management

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 thirteen members. The board met four times during each calendar year. At December 31, 2002, the board of directors was comprised of the following thirteen members:

| <u>Name and Residence</u>                    | <u>Principal Business Affiliation</u>  |
|--|--|
| Jerry M. de St. Paer<br>Paget PG 05, Bermuda | Chief Financial Officer,<br>XL Capital Ltd   |
| Michael P. Esposito, Jr.<br>Longboat Key, FL | Chairman of Board of Directors,<br>XL Capital Assurance Inc. and XL Capital Ltd  |
| Paul S. Giordano, Esq.<br>Warwick, Bermuda   | Executive Vice President, General Counsel & Secretary,<br>XL Capital Ltd   |
| Richard P. Heberton<br>Darien, CT            | Senior Managing Director,<br>XL Capital Assurance Inc.   |
| Frederick B. Hnat<br>Ridgewood, NJ           | Senior Managing Director, General Counsel & Secretary,<br>XL Capital Assurance Inc.  |
| Edward B. Hubbard<br>Upper Saddle River, NJ  | Senior Managing Director and Chief Financial Officer,<br>XL Capital Assurance Inc.   |
| Robert M. Lichten<br>Port Washington, NY     | Co-Chairman,<br>Inter-Atlantic Group   |
| Fiona E. Luck<br>Smith's Parish, Bermuda     | Executive Vice President,<br>XL Capital Ltd  |
| Robert R. Lusardi<br>New York, NY            | Chief Executive Officer,<br>XL Financial Products and Services<br>Vice Chairman of the Board,<br>XL Capital Assurance Inc. |
| Patrick L. Mathis<br>White Plains, NY        | Senior Managing Director & Chief Credit Officer,<br>XL Capital Assurance Inc.  |
| James P. McNichols<br>Paget PG 06, Bermuda   | Executive Vice President & Chief Operating Officer,<br>XL Financial Assurance Ltd.   |



| <u>Name and Residence</u>        | <u>Principal Business Affiliation</u>                             |
|----------------------------------|---|
| Alan Z. Senter<br>New York, NY   | Chairman,<br>A.Z. Senter Consulting LLC.                          |
| David C. Stevens<br>New York, NY | President & Chief Operating Officer,<br>XL Capital Assurance Inc. |

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

As of December 31, 2002, the principal officers of the Company were as follows:

| <u>Name</u>           | <u>Title</u>   |
|-----------------------|--|
| Michael Esposito, Jr. | Chief Executive Officer and Chairman                               |
| David Stevens         | Chief Operating Officer and President                              |
| Edward Hubbard        | Senior Managing Director, Chief Financial Officer<br>and Treasurer |
| Steven Czark          | Senior Managing Director   |
| Frederick Hnat        | Senior Managing Director   |
| Patrick Mathis        | Senior Managing Director   |
| David Czerniecki      | Senior Managing Director   |
| Thomas Morriss, Jr.   | Senior Managing Director   |
| Richard Herberton     | Senior Managing Director   |
| Catherine Ruth Lau    | Senior Managing Director   |

The Company's procedure for disclosing conflict of interest by its directors and officers was reviewed. During the examination period, no conflicts of interest were disclosed to the board of directors. However, it was noted that not all directors and officers had signed conflict of interest statements on file for the all years under examination. As of the date of this report, all directors and officers have signed a conflict of interest statement and these statements have been provided to the Department.

It is recommended that the Company ensure that all directors and officers complete conflict of interest statements yearly.

B. Territory and Plan of Operation

As of December 31, 2002, the Company was licensed to write business in the District of Columbia, Puerto Rico, United States Virgin Islands, Singapore and all states except West Virginia and Wyoming.

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> |
|------------------|-------------------------|
| 16 C, D, E, F    | Surety                  |
| 25               | Financial guaranty      |

The Company's operations are currently limited to the writing of financial guaranty insurance on asset backed, other corporate and municipal securities offered in domestic and foreign markets.

The Company began writing financial guarantee business in 2000. 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 United States</u> | <u>Premiums Written in New York State as a percentage of United States Premium</u> |
|----------------------|-----------------------|----------------------------|--|
| 2000                 | \$26,639              | \$26,639                   | 100.00%  |
| 2001                 | \$50,329,268          | \$50,329,268               | 100.00%  |
| 2002                 | \$97,320,177          | \$154,802,493              | 62.87%   |

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 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$66,000,000.

C. Reinsurance

Assumed

The Company's assumed reinsurance premiums represented approximately 2% of its total premium writings for calendar year 2002.

During the period covered by this examination, the Company entered into an excess of loss and a facultative quota share reinsurance agreement with its subsidiary, XL Capital Assurance (U.K.) Limited, ("XLCA-UK"). Under the terms of the excess of loss agreement, the Company assumed 100% of XLCA-UK's liability for losses incurred in excess of 100% of the subsidiary's capital and surplus, subject to a maximum liability of \$50,000,000. Under the terms of the facultative quota share agreement the Company agrees to reinsure up to 97% of XLCA-UK's acceptable risks, as defined in the agreement. Both agreements were filed with this Department pursuant to as part of the Company's submission under Section 1603 of the New York Insurance Law. The Company did not assume any premiums under these agreements during the examination period.

Ceded

The Schedule F data as contained in the Company's filed annual statement was found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2002. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The Company had the following ceded reinsurance program in effect at December 31, 2002:

Effective October 6, 1999, the Company entered into a facultative quota share reinsurance treaty with an affiliate, XL Financial Assurance Ltd. (“XLFA”). Under the terms of this agreement XLFA agrees to reinsure up to 90% of the Company’s acceptable risks. This treaty was amended and restated on June 22, 2001.

The Company entered into a facultative quota share master certificate reinsurance agreement with several affiliated and non-affiliated reinsurance insurers.

The purpose of the agreements is to enable the Company to comply with single risk limitations as set forth in Article 69 of the New York Insurance Law, and/or part of the Company’s risk management procedures.

The Company filed with the Department all reinsurance agreements with affiliated companies of XLFA and XL Reinsurance America Inc.

#### Unauthorized Reinsurance

The letters of credit obtained by the Company in order to take credit for cessions made to unauthorized reinsurers were reviewed for compliance with Department Regulation 133. No exceptions were noted.

#### D. Holding Company System

The Company is 100% owned by XL Reinsurance America, Inc., a New York domiciled insurer, which is ultimately controlled by XL Capital Ltd.

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 abbreviated chart of the holding company system at December 31, 2002:



At December 31, 2002, the Company was party to the following agreements with other members of its holding company system:

General Services Agreements:

(a) Effective July 21, 2001, the Company and certain of its affiliates are beneficiaries of an agreement between their United States ultimate parent XL America, Inc. and XL Global Services Inc. Under the terms of this agreement XL Global Services Inc. performs services such as the information technology support, reinsurance services, actuarial services, finance department services, internal audit services, and human resources services. The Company indicates payment to XL Global Services Inc., for its services under this agreement shall be on cost basis. This agreement was amended January 1, 2003.

(b) Effective April 1, 2001, the Company and its United States ultimate parent X.L. America Inc., entered into a service agreement. Under the terms of this agreement X.L. America, Inc. performs specified services on behalf of the Company. The agreement indicates payment of services provided shall be on cost basis. This agreement was amended January 1, 2003.

(c) On January 28, 2002, the Company entered into a service agreement with its affiliate company, XL Financial Administrative Services Inc., (“XLFAS”). Under the terms of this agreement, XLFAS performs specified services on behalf of the Company. The agreement indicates payment of services provided shall be based on cost basis.

Tax Allocation Agreement

The Company is party to a tax allocation agreement among various affiliated members of its United States ultimate parent X.L. America Inc. The agreement has an effective date of July 1,

2001. Pursuant to the terms of the agreement, the parties will file consolidated federal income tax returns. Said agreement stipulates that the Company's tax liability on a consolidated basis would not exceed the liability had the Company filed its tax return on a stand alone basis.

#### Surplus Maintenance Agreement

Effective February 20, 2001, the Company entered into a surplus maintenance agreement with its immediate parent, XL Reinsurance America Inc. ("XL RE AM"). Under this agreement, XL RE AM agrees to financially support the Company as permitted under Sections 1408(a) and 1409(a) of the New York Insurance Law and maintain the Company's capital and surplus position of at least \$75,000,000.

All of the aforementioned agreements were filed with the Department on a timely basis pursuant to Section 1505(d)(3) of the New York Insurance Law.

Effective June 30, 2002, the Company entered into a surplus maintenance agreement with its subsidiary XL Capital Assurance (U.K.) Limited ("XLCA-UK"). Under this agreement, the Company agrees to financially support XLCA-UK as permitted under Sections 1408(a) and 1409(a) of the New York Insurance Law and maintain its minimum capital and surplus position of the greater of (i) \$12,500,000 or (ii) 200% of the UK Financial Services Authority's required minimum margin of solvency.

The surplus maintenance agreement was filed for information purposes as part of the Company's Section 1603 submission.



### Financial Guarantee Policies issued on behalf of affiliated companies

The Company issued financial guarantee policies to New York trusts (“Trusts”) formed by XLCDS LLC and XLCA Admin LLC, both affiliates of the Company. Under these policies, the Company guarantees timely payment of the trusts’ obligations under structured credit default swaps issued by the related Trusts.

The Company also issues a financial guarantee policy that guarantees timely payment of investment agreements issued by an affiliate, XL Asset Funding Company LLC.

### Sublease Agreement

Effective June 1, 2002, the Company entered into a sublease agreement with an affiliate, XL RE LTD, Singapore Branch. Under this agreement, rental expense is based on the Company’s proportionate share of the total leased area.

### E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company’s abandoned property reports for the period of this examination were not filed on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned

Property Law. It is recommended that the Company file the abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002, based upon the results of this examination:

|  |      |
|--|------|
| Net premiums written to surplus as regards policyholders                               | .1:1 |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 37%  |
| Premiums in course of collection to surplus as regards policyholders                   | 2%   |

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

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

|  | <u>Amounts</u>      | <u>Ratios</u>     |
|--|---------------------|-------------------|
| Losses and loss adjustment expenses incurred | \$                  | %                 |
| Other underwriting expenses incurred         | 43,586,550          | 1,181.46          |
| Net underwriting loss                        | <u>(39,897,347)</u> | <u>(1,081.46)</u> |
| Premiums earned                              | <u>\$3,689,203</u>  | <u>100.00%</u>    |

## H. Accounts and Records

During the course of this examination, it was noted that the Company's treatment of certain items was not in accordance with generally accepted statutory accounting principles and Department guidelines. The following items were noted:

### 1. Investments

Section 1402(a) of New York Insurance Law states:

“Before investing its funds in any other investments, every domestic insurer shall invest and maintain an amount equal to the greater of the minimum capital required by law... only in investments of the types specified in this section....”

The minimum capital requirement for the Company is \$66,000,000. A review of its investment portfolio indicated only \$48,200,836 invested in investment types specified in Section 1402(a), resulting in a deficiency in its minimum capital investments of \$17,799,164.

During the examination, the Company increased its investment holdings of United States treasuries and GNMA's to \$55,184,000 and \$12,363,000 respectively.

### 2. Custodial Agreement

Management answered affirmatively to the following General Interrogatory:

“Excluding items in Schedule E, real estate, mortgage loans and investments held physically in the reporting entity's offices, vaults or safety deposit boxes, were all stocks, bonds and other securities, owned throughout the current year held pursuant to a custodial agreement with a qualified bank or trust company in accordance with Part 1-General, Section IV.H-Custodial or Safekeeping Agreements of the NAIC Financial Condition Examiners Handbook.”

However, examination review indicated that the Company's custodial agreement was lacking certain of the protective covenants set forth in Section IV.H of the NIAC Financial Condition Examiners Handbook, as follows:

- That if the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner.
- That the custodian shall secure and maintain insurance protection in an adequate amount.

Subsequent to the report date, the Company amended the agreement to include the recommended provisions.

### 3. Credit Committee

The examiner noted that Company's senior managing director in charge of surveillance is a permanent voting member of the Company's credit committee. The credit committee is ultimately responsible for the Company's acceptance or rejection of risk as part of the "Underwriting Function." Department guidelines require that the surveillance function, and those individuals performing this function, are separate and apart from the individuals involved in underwriting decisions and operations.

The inclusion of the head of surveillance as a voting member of the credit committee is contrary to the Department guideline.

It is recommended that the Company comply with the Department guidelines regarding the role of the senior managing director in charge of surveillance as a voting member of the credit committee.

3. **FINANCIAL STATEMENTS**A **Balance Sheet**

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2002, and as reported by the Company:

| Assets   | <u>Assets</u>        | <u>Assets Not<br/>Admitted</u> | <u>Net Admitted<br/>Assets</u> |
|--|----------------------|--------------------------------|--------------------------------|
| Bonds  | \$110,926,683        | \$ 0                           | \$110,926,683                  |
| Common stocks (stocks)                                     | 20,217,829           | 0                              | 20,217,829                     |
| Cash and short-term investments                            | 44,713,461           | 0                              | 44,713,461                     |
| Premiums and agents' balances in course of collection      | 2,712,697            | 0                              | 2,712,697                      |
| Federal and foreign income tax recoverable                 | 6,722,863            | 5,674,967                      | 1,047,896                      |
| Interest, dividends and real estate income due and accrued | 1,374,623            | 0                              | 1,374,623                      |
| Other assets nonadmitted                                   | 74,223               | 74,223                         | 0                              |
| Aggregate write-ins for other than invested assets         | <u>461,972</u>       | <u>461,972</u>                 | <u>0</u>                       |
| Total Assets   | <u>\$187,204,351</u> | <u>\$6,211,162</u>             | <u>\$180,993,189</u>           |

Liabilities

|   |    |                   |
|---|----|-------------------|
| Losses  | \$ | 0                 |
| Loss adjustment expenses  |    | 0                 |
| Other expenses (excluding taxes, licenses and fees)                   |    | 3,671,515         |
| Taxes, licenses and fees (excluding federal and foreign income taxes) |    | 1,206,297         |
| Unearned premiums   |    | 11,378,477        |
| Ceded reinsurance premiums payable (net of ceding commissions)        |    | 19,421,330        |
| Amounts withheld or retained by company for account of others         |    | 4,790             |
| Payable to parent, subsidiaries and affiliates                        |    | 10,214,781        |
| Contingency reserve for adverse losses                                |    | 1,133,736         |
| Deferred commission revenue   |    | <u>11,654,291</u> |
| <br>Total liabilities   | \$ | <br>58,685,217    |

Surplus and Other Funds

|  |    |                        |
|--|----|------------------------|
| Common capital stock                           | \$ | 15,000,000             |
| Gross paid in and contributed surplus          |    | 125,700,000            |
| Unassigned funds (surplus)                     |    | <u>(18,392,028)</u>    |
| Surplus as regards policyholders               |    | <u>122,307,972</u>     |
| <br>Total liabilities, surplus and other funds | \$ | <br><u>180,993,189</u> |

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 1999 through 2002. 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. Underwriting and Investment ExhibitUnderwriting Income

|                 |  |              |
|-----------------|--|--------------|
| Premiums earned |  | \$ 3,689,203 |
|-----------------|--|--------------|

## Deductions:

|  |                     |  |
|--|---------------------|--|
| Losses and loss adjustment expenses incurred | 0                   |  |
| Other underwriting expenses incurred         | <u>\$43,586,550</u> |  |

|                               |  |                   |
|-------------------------------|--|-------------------|
| Total underwriting deductions |  | <u>43,586,550</u> |
|-------------------------------|--|-------------------|

|                         |  |                |
|-------------------------|--|----------------|
| Net underwriting (loss) |  | \$(39,897,347) |
|-------------------------|--|----------------|

Investment Income

|                              |                    |  |
|------------------------------|--------------------|--|
| Net investment income earned | \$21,894,843       |  |
| Net realized capital gain    | <u>(3,075,542)</u> |  |

|                      |  |                   |
|----------------------|--|-------------------|
| Net investment gains |  | <u>18,819,301</u> |
|----------------------|--|-------------------|

|  |  |                |
|--|--|----------------|
| Net income before federal and foreign income taxes |  | \$(21,078,046) |
|--|--|----------------|

|   |  |                    |
|---|--|--------------------|
| Federal and foreign income taxes incurred |  | <u>(1,486,096)</u> |
|---|--|--------------------|

|            |  |                       |
|------------|--|-----------------------|
| Net Income |  | <u>\$(19,591,950)</u> |
|------------|--|-----------------------|

C. Capital and Surplus Account

Surplus as regards policyholders increased \$21,774,422 during the four-year examination period January 1, 1999 through December 31, 2002, detailed as follows:

|   |                         |                          |                      |
|---|-------------------------|--------------------------|----------------------|
| Surplus as regards policyholders per report on organization as of December 31, 1998 |                         |                          | \$100,533,550        |
|   | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> |                      |
| Net income  |                         | \$19,591,950             |                      |
| Net unrealized capital gains  | \$ 168,385              |                          |                      |
| Change in net deferred income tax   | 6,621,523               |                          |                      |
| Change in nonadmitted assets  |                         | 6,211,162                |                      |
| Cumulative effect of changes in accounting principles                               | 101,340                 |                          |                      |
| Capital changes transferred to surplus  | 13,000,000              |                          |                      |
| Surplus adjustments paid in   | 55,700,000              |                          |                      |
| Surplus adjustments transferred from capital  |                         | 13,000,000               |                      |
| Dividends to stockholders   |                         | 30,200,000               |                      |
| Mandatory contingency reserves for adverse losses                                   |                         | 1,133,737                |                      |
| Merger with London Assurance of America Inc.  | <u>16,320,023</u>       | <u>0</u>                 |                      |
| Net increase in surplus   | <u>\$91,911,271</u>     | <u>\$70,136,849</u>      | \$ <u>21,774,422</u> |
| Surplus as regards policyholders per report on examination as of December 31, 2002  |                         |                          | <u>\$122,307,972</u> |



4. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

| <u>ITEM</u> |   | <u>PAGE NO</u> |
|-------------|---|----------------|
| A           | <u>Management</u>   |                |
|             | It is recommended that the Company ensure that all directors and officers complete conflict of interest statements yearly.  | 5              |
| B           | <u>Abandoned Property Law</u>   |                |
|             | It is recommended that the Company file its abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.                       | 14             |
| C           | <u>Accounts and Records</u>   |                |
|             | <u>Credit Committee</u>   |                |
|             | It is recommended that the Company comply with the Department guidelines regarding the role of the senior managing director in charge of surveillance as a voting member of the credit committee. | 17             |

Respectfully submitted,

\_\_\_\_\_/S/  
Adebola Awofeso,  
Senior Insurance Examiner

STATE OF NEW YORK     )  
                                  )SS:  
                                  )  
COUNTY OF NEW YORK )

ADEBOLA AWOFOESO, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

\_\_\_\_\_/S/  
Adebola Awofeso,

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2004.



State of New York  
County of New York

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES  
- USED IN AN EXAMINATION

JOSEPH PIRES, BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of Mississippi in the examination of XL Capital Assurance Inc.
2. Mississippi is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report and the examination of XL Capital Assurance Inc. was performed in a manner consistent with the standards and procedures required by the State of Mississippi.

The affiant says nothing further.

  
Examiner's Signature

Subscribed and sworn before me by Joseph M. Pires on this 4th day of August 2004.

(SEAL)

  
Notary Public

My commission expires 05/31/07 [date].

FLORIE GOODING  
NOTARY PUBLIC, State of New York  
No. 01-GO4832398  
Qualified in Kings County  
Commission Expires May 31, 2007

Appointment No 22080

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Adebola Awofeso**

*as proper person to examine into the affairs of the*

**XL CAPITAL ASSURANCE INC.**

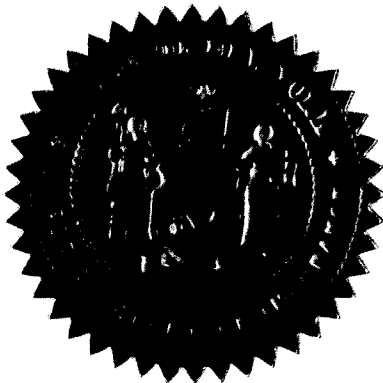
*and to make a report to me in writing of the condition of the said*


**Corporation**

*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 8th day of July, 2003*



  
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GREGORY V. SERIO  
Superintendent of Insurance