

REPORT ON EXAMINATION

OF THE

COMPASS INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

DATE OF REPORT

SEPTEMBER 1, 2011

EXAMINER

ADEBOLA AWOFOSE

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawskey
Superintendent

September 1, 2011

Honorable Benjamin M. Lawskey
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 30704 dated April 11, 2011, attached hereto, I have made an examination into the condition and affairs of Compass Insurance Company as of December 31, 2010, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Compass Insurance Company.

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

The examination was conducted at the Company's administrative office located at 9277 Centre Pointe Drive, West Chester, Ohio 45069.

1. SCOPE OF EXAMINATION

The Department has performed a multi-state examination of Compass Insurance Company. The previous examination was conducted as of December 31, 2005. This examination covered the five-year period from January 1, 2006 through December 31, 2010. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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. 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
- Pensions, stock ownership and insurance plans
- 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

The Company was incorporated on March 6, 1968, under the laws of the State of New York and licensed December 22, 1969. Business was conducted under the name Medallion Insurance Company until July 19, 1971, when the current name of Compass Insurance Company was adopted. The Company discontinued writing new and renewal business in June 1984, and subject to the provisions of Section 1203 of the New York Insurance Law, must obtain prior approval of the Superintendent of Insurance before it can resume doing any insurance business.

In March 1980, the ultimate parent of the Company was Armco, Inc. After various relocations within the Armco, Inc. holding company system, Northwestern National Insurance Company (“NNIC”) eventually became the immediate parent of the Company in January 1985.

In August 1999, with the Department’s approval, the Company’s former ultimate parent, Armco, Inc., merged with AK Steel Holding Corporation and AK Steel Corporation. Pursuant to the merger agreement, the surviving corporation was AK Steel Corporation. AK Steel Holding Corporation became the Company’s ultimate parent.

In September 1999, the Company reduced its capital from \$1,696,800 consisting of 169,680 shares with a par value of \$10.00 per share to \$1,253,480 consisting of 125,348 shares with a par value of \$10 per share pursuant to a stock redemption agreement with its immediate parent, Northwestern National Insurance Company. The Company also amended its charter pursuant to the provisions of Section 1206 of the New York Insurance Law to reduce the number of its outstanding shares. The stock redemption agreement and charter amendment were approved by the Department on September 9, 1999.

As of December 31, 2010, capital paid in was \$1,253,480 consisting of 125,348 shares of common stock at \$10 par value per share. Gross paid in and contributed surplus was \$34,120,175. Gross paid in and contributed surplus did not change during the examination period.

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 seven members. At December 31, 2010, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Ernest Joseph Blache, Jr. West Chester, OH	President & Chief Executive Officer, Compass Insurance Company
Hugh Williamson Greene, Jr. Maineville, OH	Consultant (Claims)
Patricia Suzanne Henson Maineville, OH	Reinsurance Accounting Manager, Northwestern National Insurance Company
Douglas Otto Mitterholzer Springboro, OH	Assistant Treasurer, AK Steel Corporation
Richard Herman Pluschau Dix Hills, NY	President, Pluschau Consultants
Gary Mark Sussman Miamisburg, OH	Vice President and Treasurer, Compass Insurance Company
Alwin Helmut Thiemke East Amherst, NY	Vice President, Decorative Solid Surfaces

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, 2010, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Ernest J. Blache Jr.	President
Amy K. Collins	Secretary
Gray M. Sussman	Treasurer

B. Territory and Plan of Operation

The Company is licensed to write business in the following twenty-one states:

Alabama	Nevada	Pennsylvania
Arkansas	New Hampshire	South Carolina
Georgia	New York	South Dakota
Iowa	North Dakota	Texas
Louisiana	Ohio	Virginia
Minnesota	Oklahoma	West Virginia
Nebraska	Oregon	Wisconsin

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
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company is also empowered to transact such worker's compensation business as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Worker's Compensation Act (Public Law No. 803, 69th Congress as amended; 33 USC Section 901 et seq. as amended).

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 \$2,200,000.

The Company discontinued writing new and renewal business in June 1984, and subject to the provisions of Section 1203 of the New York Insurance Law, must obtain prior approval of the Superintendent of Insurance before it can resume doing any insurance business. There are no policies in force on the Company's books.

During the period prior to cessation of premium writings in 1984, The Company was a direct writer of all lines of property and casualty insurance, primarily for large commercial insureds. The Company also engaged in the assumption of business from Northwestern National Insurance Company and participated with other affiliates in inter-company pools. The pooling agreement was terminated in 1990.

C. Reinsurance

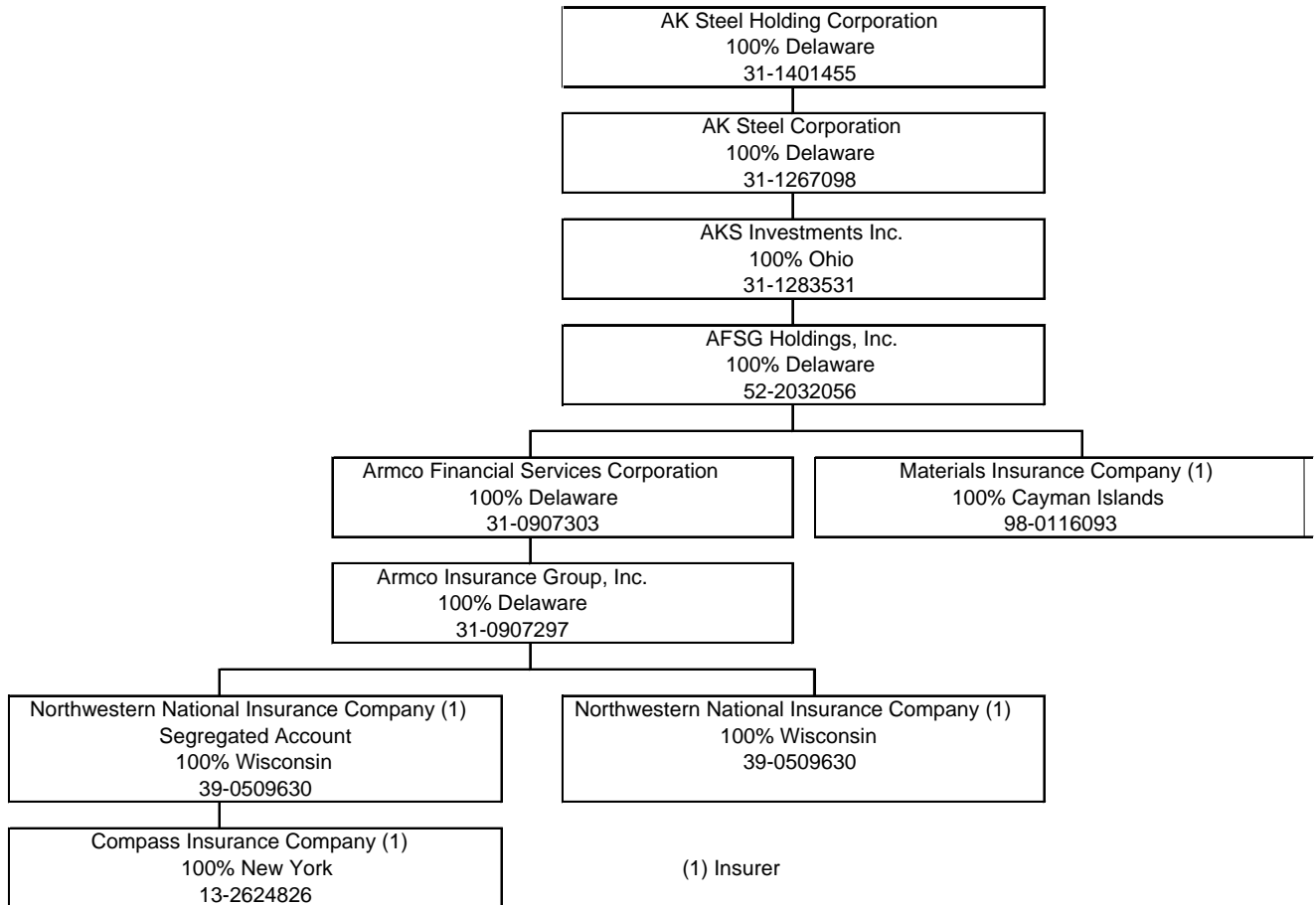
As of December 31, 2010, the Company had no reinsurance coverage in effect.

D. Holding Company System

The Company is a wholly owned subsidiary of Northwestern National Insurance Company (Wisconsin), which is a wholly owned subsidiary of Armco Insurance Group, Inc. (Delaware), which is ultimately owned by AK Steel Holding Corporation (Delaware).

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 a chart of the holding company system at December 31, 2010:



At December 31, 2010, the Company was party to the following agreements with other members of its holding company system:

(a) Management Services Agreement

Effective October 1, 1999, the Company entered into a management services agreement with its immediate parent, Northwestern National Insurance Company. Pursuant to the agreement, NNIC is to act for the Company in matters relating to the administration of its run-off insurance and reinsurance business. The Company has no employees. The nature and extent of services to be provided by NNIC are mutually agreed to from time to time and may include every aspect of operating an insurance business. Compass Insurance Company has ultimate authority in making decisions regarding the run-off of its business. NNIC's compensation is based on actual costs of providing the administrative services per the service agreement.

(b) Tax Sharing Agreement

Effective October 1, 1999, Compass Insurance Company entered into a tax allocation agreement with AK Steel Holding Corporation, its ultimate parent, whereby the companies file a consolidated federal income tax return. The tax agreement appears to be in compliance with the provisions of Department Circular letter No. 33 (1979) regarding the establishment of a tax escrow account.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2010, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	N/A
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	10%
Premiums in course of collection to surplus as regards policyholders	N/A

The second ratio falls within the benchmark range set forth in the Insurance Regulatory Information System (“IRIS”) of the National Association of Insurance Commissioners.

The premium based IRIS ratios and the underwriting ratios are not presented since the Company has been in run-off since 1984.

F. Accounts and RecordsCustodian Agreement

Effective November 6, 2009, National City Bank, the Company’s prior custodian, merged with the PNC Bank, with the latter being the surviving bank. The custodial agreement provided for examination review references National City Bank, which no longer exists, as the custodian.

It is recommended that the Company amend the custodial agreement to reflect PNC Bank, N.A. as its current custodian.

Investment Management Agreement

The investment management agreement provided for examination review references National City Bank, which no longer exists, as the manager. The investment management agreement should be updated to reflect the current investment management company.

It is recommended that the Company amend the investment management agreement to reflect PNC Bank, N.A. as its current investment management company.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2010 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$12,475,988	\$ 0	\$12,475,988
Cash, cash equivalents and short-term investments	1,243,924	0	1,243,924
Investment income due and accrued	189,717	0	189,717
Amounts recoverable from reinsurers	60,772	60,772	0
Loss Portfolio Transfer	<u>100,249</u>	<u>0</u>	<u>100,249</u>
Total assets	<u>\$14,070,649</u>	<u>\$60,772</u>	<u>\$14,009,877</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$ 2,585,442
Other expenses (excluding taxes, licenses and fees)	48,000
Funds held by company under reinsurance treaties	8,496
Amounts withheld or retained by company for account of others	50,000
Payable to parent, subsidiaries and affiliates	31,081
Loss portfolio transfer account	<u>(1,317,453)</u>
Total liabilities	\$ 1,405,566

Surplus and Other Funds

Common capital stock	\$ 1,253,480	
Gross paid in and contributed surplus	34,120,175	
Unassigned funds (surplus)	<u>(22,769,345)</u>	
Surplus as regards policyholders		<u>12,604,311</u>
Total liabilities, surplus and other funds		<u>\$14,009,877</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2006. There were no changes by the Internal Revenue Service to the Company's reported filed tax. Audits covering tax years 2007 through 2010 have not yet begun. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders increased \$2,425,821 during the five-year examination period January 1, 2006 through December 31, 2010, detailed as follows:

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses and loss adjustment expenses incurred	\$2,464,643	
Other underwriting expenses incurred	<u>886,902</u>	
Total underwriting deductions		<u>3,351,545</u>
Net underwriting loss		\$(3,351,545)

Investment Income

Net investment income earned	\$2,802,442	
Net realized capital gain	<u>352,175</u>	
Net investment gain		3,154,617

Other Income

Loss portfolio transfer	\$2,212,640	
Reinsurance balances charged off	(127,514)	
Miscellaneous expense	4,620	
Recovery of escheated funds	<u>2,021</u>	
Total other income		<u>2,091,767</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ 1,894,839
Federal and foreign income taxes incurred		<u>0</u>
Net income		<u>\$ 1,894,839</u>

Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2005		\$10,178,489
	<u>Gains in Surplus</u>	
Net income	\$1,894,839	
Net unrealized capital gains	51,757	
Change in non admitted assets	<u>479,225</u>	
Net increase in surplus	<u>\$2,425,821</u>	<u>2,425,821</u>
Surplus as regards policyholders per report on examination as of December 31, 2010		<u>\$12,604,311</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$2,585,442 is the same as reported by the Company as of December 31, 2010. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

5. LOSS PORTFOLIO TRANSFER

Effective April 1, 1988, the Company entered into a loss portfolio transfer agreement with its immediate parent, Northwestern National Insurance Company (the "reinsurer"), whereby the reinsurer assumed 100% of the net retained liability of the Company on business previously written by the Company and classified as public entity liability.

As used in the agreement, the term "Net Retained Liability" means the remaining portion of the Company's gross liability on each policy after deduction of recoveries from all reinsurance other than the reinsurance provided under the agreement.

Pursuant to the agreement, the Company transferred initial reserves in the amount of \$20,642,725, for which it paid an initial consideration of \$16,971,017, resulting in an initial gain of \$3,671,708 at inception. As of the examination date, losses and allocated loss adjustment expenses transferred under this agreement have been paid in the amount of \$14,272,834 with reserves outstanding of \$1,317,453 for a total of \$15,590,287 of losses incurred. The agreement was accounted for by the Company as retroactive reinsurance pursuant to the provisions of Department Regulation 108.

It is noted that NNIC entered rehabilitation in the State of Wisconsin in March 2007.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Holding Company System</u></p> <p>It is recommended that the Company submit the commutation agreement with its parent, Northwestern National Insurance Company to the Department in accordance with Section 1505(d) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	<p>8</p>
<p>B. <u>Accounts and Records</u></p> <p>i. It is recommended that the Company maintain the minimum required capital investments pursuant to Section 1402 of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p> <p>ii. It is recommended that the Company revise its custodial agreement to comply with the NAIC Financial Examiners Handbook Part 1 Section IV - J.</p> <p>The Company has complied with this recommendation.</p>	<p>9</p> <p>11</p>

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It is recommended that the Company ensure that the contract with its CPA firm complies with the requirements of Department Regulation 118. The Company has complied with this recommendation.	12
C. <u>Amounts Recoverable from Reinsurers</u>	
It is recommended that the Company non-admit amounts recoverable from reinsurers that are not likely to be collected, pursuant to the provisions of Section 1302(b) of the New York Insurance Law and SSAP 62, paragraph 56. The Company has complied with this recommendation.	15

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Account and Records</u>	
i. It is recommended that the Company amend its custodial agreement to reflect PNC Bank, N.A. as its current custodian.	8
ii. It is recommended that the Company amend its investment management agreement to reflect PNC Bank, N.A. as its current investment management company.	9

Respectfully submitted,

_____/s/_____
Adebola Awofeso,
Senior Insurance Examiner

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

ADEBOLA AWOFESE, 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 _____, 2011.

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn 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

COMPASS INSURANCE COMPANY

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 11th day of April, 2011



James J. Wrynn

JAMES J. WRYNN

Superintendent of Insurance