REPORT ON EXAMINATION

OF THE

CONSTELLATION REINSURANCE COMPANY

AS OF

DECEMBER 31, 2009

| | |
|---|---|
| DATE OF REPORT | NOVEMBER 25, 2010 |
| EXAMINER | SHEIK H. MOHAMED |

# TABLE OF CONTENTS

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

November 25, 2010

Honorable James J. Wrynn
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 30524 dated May 18, 2010, attached hereto, I have made an examination into the condition and affairs of Constellation Reinsurance Company as of December 31, 2009, and submit the following report thereon.

Wherever the designations “the Company” or “Constellation” appear herein without qualification, they should be understood to indicate Constellation Reinsurance Company.

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

The examination was conducted at the Company’s administrative office located at 200 Metro Center Blvd., Suite 8, Warwick, RI 02886.

## 1. SCOPE OF EXAMINATION

The Department has performed a single-state examination of Constellation Reinsurance Company. The previous examination was conducted as of December 31, 2004. This examination covered the five-year period from January 1, 2005 through December 31, 2009. 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.

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

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

Constellation Reinsurance Company was incorporated under the laws of the State of New York on June 1, 1977 and commenced business on July 1, of the same year. The Company, which was a wholly-owned subsidiary of the Great American Insurance Company of Cincinnati, Ohio was sold on October 1, 1977 to Ticor 130 Inc., a subsidiary of Santa Fe Pacific Corporation.

On February 24, 1987, the Supreme Court of the State of New York issued an order placing Constellation in liquidation pursuant to Article 74 of the New York Insurance Law and appointed the superintendent of insurance of the State of New York as liquidator. The Company was in liquidation under the supervision of the Liquidation Bureau of the Department from February 24, 1987 to November 6, 1992.

On July 13, 1992, with the consent of the court, the Department approved a plan of reorganization of Constellation, terminating the liquidation and reinstating its license. On November 6, 1992, the Company, with a total capital and surplus of $250,000, was acquired by Centre Reinsurance Holdings (Delaware), Ltd., a Delaware corporation. Simultaneous with the acquisition, Centre Reinsurance Holdings (Delaware), Ltd. contributed an additional $2,250,000 to the Company’s capital and surplus. Pursuant to the terms of a stock purchase agreement dated November 6, 1992, the Company allocated $2,350,000 to capital, consisting of 100,000 shares of common stocks at par value of $23.50 per share and $150,000 to contributed surplus.

On January 30, 2009, Sun Gulf Holdings, Inc. acquired 100% of the Company. Sun Gulf Holdings, Inc. is ultimately owned by Enstar Group, Ltd.

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 nor more than twenty members. At December 31, 2009, the board of directors was comprised of the following thirteen members:

| Name and Residence | Principal Business Affiliation |
|---|---|
| Thomas J. Balkan<br>Clearwater, FL | Vice President, Secretary, and Authorized House Counsel,<br>Enstar (US) Inc. |
| Jay Banskota<br>St. Petersburg, FL | Vice President,<br>Enstar (US) Inc. |
| Robert B. Carlson<br>East Greenwich, RI | Executive Vice President,<br>Enstar (US) Inc. |
| Rudy A. Dimmling<br>Westbury, NY | Managing Director,<br>The Princeton Partnership |
| Joseph P. Follis<br>Holland, PA | Senior Vice President,<br>Enstar (US) Inc. |
| Andrea J. Giannetta<br>Providence, RI | Vice President and Reinsurance Counsel,<br>Enstar (US) Inc. |
| James Grajewski<br>Tierra Verde, FL | Executive Vice President,<br>Enstar (US) Inc. |
| Mark A. Kern<br>New York, NY | Senior Reinsurance Analyst,<br>Enstar (US) Inc. |
| Teresa M. Reali<br>Cranston, RI | Senior Accountant,<br>Enstar (US) Inc. |
| Raymond M. Rizzi<br>Warwick, RI | Vice President,<br>Enstar (US) Inc. |
| Richard C. Ryan<br>Bradenton, FL | Executive Vice President, Controller, and Treasurer,<br>Enstar (US) Inc. |
| Donna L. Stolz<br>Tampa, FL | Executive Vice President and Chief Administrative Officer,<br>Enstar (US) Inc. |
| Karl J. Wall<br>Tierra Verde, FL | President and Chief Operating Officer,<br>Enstar (US) 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.

According to the Company's by-laws, the board is required to meet four times during each calendar year. During the years under examination the board conducted less than the required number of meetings.

It is recommended that the board of directors hold the requisite number of regular meetings as set forth in its by-laws. A similar comment was included in the prior report on examination.

As of December 31, 2009, the principal officers of the Company were as follows:

| Name | Title |
|---|---|
| Karl J. Wall | President and Chief Executive Officer |
| Thomas J. Balkan | Secretary |
| Robert B. Carlson | Treasurer |
| Joseph P. Follis | Vice President |
| Andrea J. Giannetta | Vice President |

## B. Territory and Plan of Operation

As of December 31, 2009, the Company was licensed to write business in New York only. The Company has not written any business since its plan of reorganization and termination of liquidation transpired in 1992.

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:

| Paragraph | Line of Business |
|---|---|
| 3 | Accident & health |
| 4 | Fire |
| 5 | Miscellaneous property damage |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 9 | Boiler and machinery |

| Paragraph | Line of Business |
|---|---|
| 10 | Elevator |
| 11 | Animal |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Worker's compensation and employer's 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 was also licensed to write such workers' compensation insurance as may be incidental 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 Workers' Compensation Act, (Public Law No. 803, 69$^{th}$ Congress), 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.

C. Reinsurance

The Company was in liquidation under the jurisdiction of the New York State superintendent of insurance from 1986 to 1992 and ceased underwriting new business in 1986. In November 1992, the Company emerged from the liquidation proceedings and entered into a loss portfolio transfer agreement ("LPT Agreement") with Centre Reinsurance Company of New York ("Reinsurer"), whereby the reinsurer agreed to assume 100% of the Company's outstanding losses and allocated loss adjustment expenses on business written prior to February 24, 1987 (the date the order of liquidation was entered with the Supreme Court of the State of New York) and all unallocated loss adjustment expenses associated with the run-off of the Company's obligations. The initial consideration paid by the Company was $208 million and the maximum limit of liability was $305 million; the initial estimated gross liability was $295 million. The agreement provided that the limit of liability may be increased pursuant to an "Expansion of Limit" clause, which provided that the limit is increased by the balance, if positive, of 90% of the initial consideration plus retrocessions recovered by the reinsurer less 100% of the losses and administration expenses paid by the reinsurer plus interest.

Subsequent to the effective date of the agreement, the Reinsurer merged with Zurich Reinsurance (North America) Incorporated ("ZRNA"). In addition, the Company also assigned its rights to all other retrocessional recoveries to ZRNA. On September 6, 2001, the agreement was novated to Centre Insurance Company ("CICO").

With the Department's approval, all of the issued and outstanding shares of capital stock of the Company were sold to Sun Gulf Holdings Incorporated on January 30, 2009. As part of the transaction, CICO and the Company commuted the LPT Agreement effective January 29, 2009, pursuant to which, CICO paid the Company $4,321,454.

Department Regulation 141 Commutation Plans

In its filed annual statement as of December 31, 2002, the Company reported itself insolvent in the amount of $10,232,161. Therefore, its minimum required surplus to policyholders of $2,200,000 was impaired in the amount of $12,432,161. Pursuant to the provisions of Section 1310 of the New York Insurance Law, the Company was required to present a plan to eliminate the impairment.

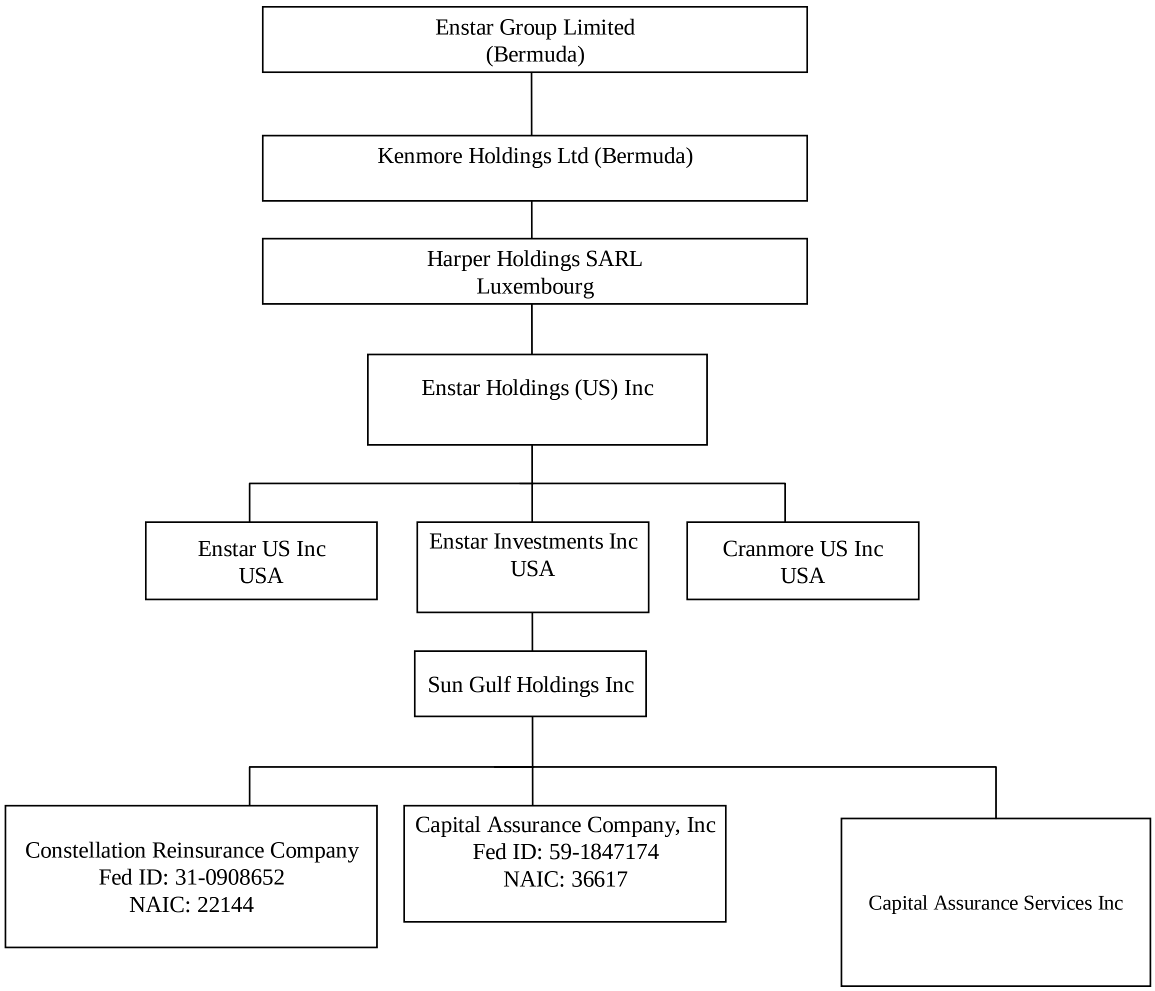
On June 5, 2003, the Company submitted a commutation plan ("the Plan") pursuant to Section 1321 of the New York Insurance Law and Department Regulation 141. Pursuant to the terms of the Plan, the Company offered to commute its assumed reinsurance obligations at 100% of paid losses and 60% of case reserves. The Plan was approved by the Department on January 27, 2004. The Company subsequently paid a total of $24 million to the various reinsureds that accepted the Plan to satisfy $37 million in payable balances, resulting in a savings of $13 million and eliminating the reported impairment.

## D. Holding Company System

On January 30, 2009, Sun Gulf Holdings, Inc. acquired 100% of the Company. Sun Gulf Holdings, Inc. is ultimately owned by Enstar Group, 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 a chart of the holding company system at December 31, 2009:



At December 31, 2009, the Company was party to the following agreements with other members of its holding company system:

Service Agreement

Effective January 30, 2009, the Company and Enstar (US) Inc. ("Enstar") entered into a service agreement in which Enstar would provide claims management, reinsurance recovery, accounting, processing, reporting, treasury, and third party provider services. The agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Tax Allocation Agreement

Effective January 30, 2009, the Company is a party to a tax allocation agreement with Enstar Holdings (US) Inc. ("EHUS") and various subsidiaries including the Company. The agreement provides for the calculation of the Company's tax liability on a separate basis. Settlements under the agreement shall be made within thirty days of the payment of any tax due or any tax refund actually received.

Upon review, it was noted that the tax allocation agreement was not submitted to this Department pursuant to Department Circular Letter No. 33 (1979), which states:

> "Any domestic insurer which currently does not participate in a consolidated tax return shall file a copy of its tax allocation agreement with this Department within thirty days of electing to do so. Furthermore, notification to this Department should be given within thirty days of any amendment to or termination of a tax allocation agreement."

The agreement was subsequently submitted to the Department and non-objected to. However, it is recommended that in the future, the Company adhere to the provisions of Department Circular Letter No. 33 (1979).

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2009, based upon the results of this examination:

| | |
|---|---|
| Net premiums written to policyholders' surplus | N/A* |
| Adjusted liabilities to liquid assets | 118% * |
| Gross agents balances (in collection) to policyholders' surplus | N/A * |

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners due to the fact that the Company currently does not write any business.

F. Accounts and Records

A review of the Company's accounts, records and annual statement revealed the following:

1. General Expenses Finding

The Company did not provide any evidence of method(s) used to allocate salary and any other expenses among related parties. According to Department Regulation No. 30, Part 106.2, the Company should have allocated its expenses based on special studies or overhead on salaries.

It is recommended that the Company maintain records supporting the allocation of salary and any other expenses in accordance with Department Regulation 30, Part 106.

# 3. FINANCIAL STATEMENTS

## A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2009 as determined by this examination and as reported by the Company:

| Assets | Assets | Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $2,606,058 | $ 0 | $2,606,058 |
| Cash, cash equivalents and short-term investments | 8,223,775 | 0 | 8,223,775 |
| Investment income due and accrued | 83,230 | 0 | 83,230 |
| Amounts recoverable from reinsurers | 6,039,077 | 0 | 6,039,077 |
| Current federal and foreign income tax recoverable and interest thereon | 360,121 | 0 | 360,121 |
| Net deferred tax asset | 216,841 | 216,841 | 0 |
| Total assets | $17,529,102 | $216,841 | $17,312,261 |

| Liabilities, Surplus and Other Funds<br>Liabilities | Examination | Company | Surplus Increase (Decrease) |
|---|---|---|---|
| Losses and loss adjustment expenses | $8,614,544 | $ 7,691,544 | $(923,000) |
| Reinsurance payable on paid losses and loss adjustment expenses | 1,733,495 | 1,733,495 | |
| Provision for reinsurance | 3,399,603 | 3,399,603 | 0 |
| Total liabilities | $13,747,642 | $12,824,642 | $(923,000) |
| Surplus and Other Funds | | | |
| Common capital stock | $2,350,000 | $2,350,000 | |
| Gross paid in and contributed surplus | 150,000 | 150,000 | |
| Unassigned funds (surplus) | 1,064,619 | 1,987,619 | $(923,000) |
| Surplus as regards policyholders | 3,564,619 | 4,487,619 | $(923,000) |
| Total liabilities, surplus and other funds | $17,312,261 | $17,312,261 | |

NOTE: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2005 through 2009. 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 Exhibit

Surplus as regards policyholders increased $9,760,694 during the five-year examination period January 1, 2005 through December 31, 2009, detailed as follows:

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $ 0 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | $ 66,115 | |
| Total underwriting deductions | | 66,115 |
| Net underwriting gain or (loss) | | $(66,115) |
| Investment Income | | |
| Net investment income earned | $1,546,782 | |
| Net realized capital gain | 566 | |
| Net investment gain or (loss) | | 1,547,348 |
| Other Income | | |
| Loss portfolio transfer gain (loss) | $10,677,985 | |
| Aggregate write-ins for miscellaneous income | (605,120) | |
| Total other income | | 10,072,865 |
| Net income after dividends to policyholders but before federal and foreign income taxes | | $11,554,098 |
| Federal and foreign income taxes incurred | | 1,967,847 |
| Net income | | $ 9,586,251 |

## C. Capital and Surplus Account

| | Gains in Surplus | Losses in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders per report on examination as of December 31, 2004 | | | $(6,196,075) |
| Net income | $ 9,586,251 | | |
| Change in net deferred income tax | 216,841 | | |
| Change in nonadmitted assets | | $216,841 | |
| Change in provision for reinsurance | 108,322 | | |
| Change in surplus notes | 138,000 | | |
| Aggregate write-ins for gains and losses in surplus | 0 | 71,879 | |
| Total gains and losses | $10,049,414 | $288,720 | |
| Net increase (decrease) in surplus | | | 9,760,694 |
| Surplus as regards policyholders per report on examination as of December 31, 2009 | | | $ 3,564,619 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $8,614,544 is $923,000 more than the $7,691,544 reported by the Company as of December 31, 2009. 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. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

| ITEM | | PAGE NO. |
|---|---|---|
| B. | Management | |
| | Board of Directors | |
| | It was recommended that the board of directors hold the requisite number of regular meetings as set forth in its by-laws. | 5 |
| | The Company has not complied with this recommendation. A similar comment is made in this report. | |
| | Conflict of Interest | |
| | It was recommended that the Company ensure that all directors and officers complete conflict of interest statements annually. | 6 |
| | The Company has complied with this recommendation. | |
| C. | Abandoned Property Law | |
| | It was recommended that the Company file its abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Law. | 10 |
| | The Company has complied with this recommendation. | |
| D. | Accounts and Records | |
| (i) | Prior Report Acknowledgement | |
| | It was recommended that the Company comply with Section 312(b) of the New York Insurance Law. | 11 |
| | The Company has complied with this recommendation. | |
| (ii) | It was recommended that the Company obtain an engagement letter that complies with Department Regulation 118 from its CPA firm. | 11 |
| | The Company was granted an exemption from engaging a CPA firm. Therefore, this recommendation is no longer warranted. | |

| ITEM | | PAGE NO. |
|---|---|---|
| E. | Losses and Loss Adjustment Expenses | |
| (i) | It was recommended that the Company provide complete and accurate loss and loss adjustment expense data to the Department in a timely manner.<br><br>The Company has complied with this recommendation. | 16 |
| (ii) | It was recommended that the Company's Actuarial Report underlying the Statement of Actuarial Opinion contain appropriate documentation that would be sufficient for another actuary practicing in the same field to evaluate the work.<br><br>The Company has complied with this recommendation. | 16 |

## 6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| ITEM | | PAGE NO. |
|---|---|---|
| A. | Management | |
| | Board of Directors | |
| | It is recommended that the board of directors hold the requisite number of regular meetings as set forth in its by-laws. A similar comment was made in the prior report on examination. | 5 |
| B. | Holding Company System | |
| | It is recommended that in the future, the Company adhere to the provisions of Department Circular Letter No. 33 (1979). | 9 |
| C. | Accounts and Records | |
| | It is recommended that the Company maintain records supporting the allocation of salary and any other expenses in accordance with Department Regulation 30, Part 106. | 10 |

Respectfully submitted,

/S/
Sheik Mohamed, CFE, CPCU, CPA
Senior Insurance Examiner

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

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

/S/
Sheik Mohamed

Subscribed and sworn to before me

this__________ day of ___________________, 2010.

***Appointment No.*** 30524

*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:*

**Sheik Mohamed**

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

**CONSTELLATION REINSURANCE 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* 18th *day of* *May, 2010*

*JAMES J. WRYNN*
*Superintendent of Insurance*