

REPORT ON EXAMINATION

OF THE

ATLANTIC SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2011

DATE OF REPORT

JANUARY 17, 2013

EXAMINER

FE ROSALES, C.F.E.

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

January 17, 2013

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 30769 dated December 27, 2011, attached hereto, I have made an examination into the condition and affairs of Atlantic Specialty Insurance Company as of December 31, 2011, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Atlantic Specialty Insurance Company.

Wherever the term “Department” 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 administrative office located at 150 Royall Street, Canton, MA 02021.

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, 2006. This examination covered the five-year period from January 1, 2007 through December 31, 2011. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted in conjunction with the state of Pennsylvania, which was the coordinating state of the OneBeacon Insurance Group. The examination was performed concurrently with the examinations of the following insurers: OneBeacon Insurance Company, OneBeacon America Insurance Company, Pennsylvania General Insurance Company, The Northern Assurance Company of America, The Employers' Fire Insurance Company, Homeland Insurance Company of New York, AutoOne Select Insurance Company, AutoOne Insurance Company, Essentia Insurance Company, Traders & General Insurance Company, Camden Fire Insurance Company, OneBeacon Midwest Insurance Company, and Potomac Insurance Company. Other states participating in this examination were Massachusetts, New Jersey, Missouri and Wisconsin.

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 Company's 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
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 June 27, 1986, as the Atlantic Reinsurance Company under the laws of the State of New York. The Company was organized by Atlantic Mutual Insurance Company as a wholly-owned subsidiary. It commenced business on December 24, 1986, with capital of \$1,500,000 consisting of 150,000 shares of stock with a par value of \$10 per share and a gross paid in surplus of \$6,000,000. The Company discontinued operations in 1993. On December 16, 1994, Atlantic Mutual contributed \$5,000,000 as paid in surplus to Atlantic Reinsurance Company. Prior to 1994, the Company operated as a reinsurance company. On February 14, 1995, the Company changed its name to Atlantic Specialty Insurance Company and increased the par value of its capital stock from \$20 to \$60 per share thereby increasing its capital to \$9,000,000.

On March 31, 2004, the White Mountains Insurance Group, Ltd., a Bermuda holding company, acquired the Company. Thus, as of December 31, 2011, the Company is wholly-owned by OneBeacon Insurance Company (“OBIC”), and is ultimately owned by White Mountains Insurance Group, Ltd.

Capital paid in is \$9,000,000 consisting of 150,000 shares of \$60 par value per share common stock. Gross paid in and contributed surplus was \$80,994,161 as of December 31, 2011. Gross paid in and contributed surplus increased by \$44,210,108 during the examination period, as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
2006	Beginning gross paid in and contributed surplus		<u>\$36,784,053</u>
2010	Return of paid in surplus	\$ (789,892)	
2011	Paid in surplus contribution	<u>45,000,000</u>	
	Total surplus adjustment		<u>44,210,108</u>
2011	Ending gross paid in and contributed surplus		<u>\$80,994,161</u>

As shown above, the Company received a capital contribution of \$45,000,000 in 2011 from its direct parent OBIC. However, the Department has no record of this transaction being filed as required by Section 1505 of the New York Insurance Law and the Company could not produce a filing for this submission. The capital contribution represented 76% of the Company's admitted assets at December 31, 2010. Pursuant to Section 1505(c) of the New York Insurance Law, the superintendent's prior approval is required for transactions between a domestic controlled insurer and any person in its holding company system involving 5% or more of the insurer's admitted assets at last year-end. It is recommended that the Company comply with the requirements of Section 1505(c) of the New York Insurance Law.

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 nineteen members. The board meets four times during each calendar year. At December 31, 2011, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Alexander Constantine Archimedes Bridgewater, NJ	Senior Vice President, Atlantic Specialty Insurance Company
Jane Ellen Freedman Newton Centre, MA	Secretary, OneBeacon Insurance Group, Ltd.
Robert Charles Gallagher Brooklyn, NY	President, International Marine Underwriters

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Joan Kathleen Geddes Hanover, MA	Assistant Secretary, Atlantic Specialty Insurance Company
Dana Perkins Hendershott Milford, CT	Senior Vice President, Atlantic Specialty Insurance Company
Josette Durling Kiel Boerne, TX	Senior Vice President and Chief Underwriting Officer, Atlantic Specialty Insurance Company
Paul Harrington McDonough Wayzata, MN	Senior Vice President and Chief Financial Officer, Atlantic Specialty Insurance Company
Timothy Michael Miller Deephaven, MN	Chairman of the Board, Atlantic Specialty Insurance Company
Michelle Eileen O'Donovan Garden City, NY	National Product Line Director, International Marine Underwriters
Brian David Poole Wayzata, MN	Senior Vice President and Chief Actuary, Atlantic Specialty Insurance Company
Anthony Albert Recanatini Staten Island, NY	Underwriting Director, International Marine Underwriters
Bradford Whitman Rich Tucson, AZ	President, Chief Executive Officer and General Counsel, Atlantic Specialty Insurance Company
Thomas Norman Schmitt Greenwood, MN	Senior Vice President and Chief Human Resources Officer, Atlantic Specialty Insurance Company

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended with the exception of Mr. Timothy Miller and Ms. Josette Kiel, each of whom attended less than 50% of the meetings for which they were eligible to attend.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. It is recommended

that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

As of December 31, 2011, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Timothy Michael Miller	Chairman
Bradford Whitman Rich	President, Chief Executive Officer and General Counsel
Virginia Ann McCarthy	Secretary
Todd Colin Mills	Vice President and Treasurer
David Brian Poole	Senior Vice President and Chief Actuary
Paul Harrington McDonough	Senior Vice President and Chief Financial Officer
Ann Marie Andrews	Controller and Chief Accounting Officer

B. Territory and Plan of Operation

As of December 31, 2011, the Company was licensed to write business in all fifty states and the District of Columbia.

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
26	Gap
27	Prize indemnification
28	Service contract reimbursement
29	Legal services

The Company is also authorized to write workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113, including coverages described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Congress as amended; 33 USC Section 901 et seq. as amended) and insurance and reinsurance of every kind or description, including those located or resident outside of the United States, its territories and possessions, except with respect to life insurance, title insurance and contracts for the payment of annuities, as specified in Section 4102(c) of the New York Insurance Law.

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 \$35,000,000.

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 Premiums</u>
2007	\$17,357,901	\$26,414,994	65.71%
2008	\$ 1,291,098	\$ 5,228,938	24.69%
2009	\$ 163,617	\$ 5,051,044	3.24%
2010	\$ 105,476	\$ 3,215,959	3.28%
2011	\$ 2,170,578	\$17,886,674	12.14%

The Company is a property and casualty insurance writer that provides a wide range of specialty products and services through a network of independent agents, regional and national brokers, wholesalers and managing general agents.

C. Reinsurance

Assumed reinsurance accounted for 26.8% of the Company's gross premium written at December 31, 2011. The business assumed was attributable to the Company's inter-company pooling agreement.

Inter-Company Reinsurance Pooling Agreement

The Company participates in the OneBeacon Pooling Agreement (“Pooling Agreement”) with various affiliated companies (collectively called “Pool Participants”), with OBIC functioning as pool leader. Under the terms of the Pooling Agreement, each of the Pool Participants cedes 100% of its direct business to OBIC and authorizes OBIC to perform various services on behalf of the Pool Participants including policy development, marketing, underwriting, policy administration, loss settlement, personnel, purchasing, accounting, data processing and facilities management. The joint expenses attributable to these services are allocated among the Pool Participants in accordance with their participation percentages. Net settlements of all amounts under the Pooling Agreement are made quarterly.

The Pool Participants also authorize OBIC to effect and be responsible for all reinsurance with third parties on contracts and insurance policies issued by the Pool Participants. As a result, all third party reinsurance of the Pool is recorded in OBIC, and only the intercompany pooling agreement reinsurance is recorded by the other Pool Participants.

The Pool Participants, their domiciliary state and their respective participation percentages in effect at December 31, 2011, are as follows:

<u>Company</u>	<u>Pooling Percentages</u>
OneBeacon Insurance Company (PA)	56.5%
OneBeacon America Insurance Company (MA)	16.4%
Homeland Insurance Company of New York (NY)	10.0%
Pennsylvania General Insurance Company (PA)	10.0%
The Northern Assurance Company of America (MA)	5.0%
The Employers’ Fire Insurance Company (MA)	1.5%
Atlantic Specialty Insurance Company (NY)	0.6%
AutoOne Select Insurance Company (NY)	0.0%
AutoOne Insurance Company (NY)	<u>0.0%</u>
Pool Total	<u>100.0%</u>

Effective October 1, 2011, in anticipation of the sale of AutoOne Insurance Company and AutoOne Select Insurance Company to Interboro Holdings, Inc. (“Interboro”), these two companies’ participation in the pool was reduced to zero percent and their former shares of 1% and 1.5%,

respectively, were retained by OBIC under the terms of the amended Pooling Agreement. On February 22, 2012, the AutoOne companies were sold to Interboro.

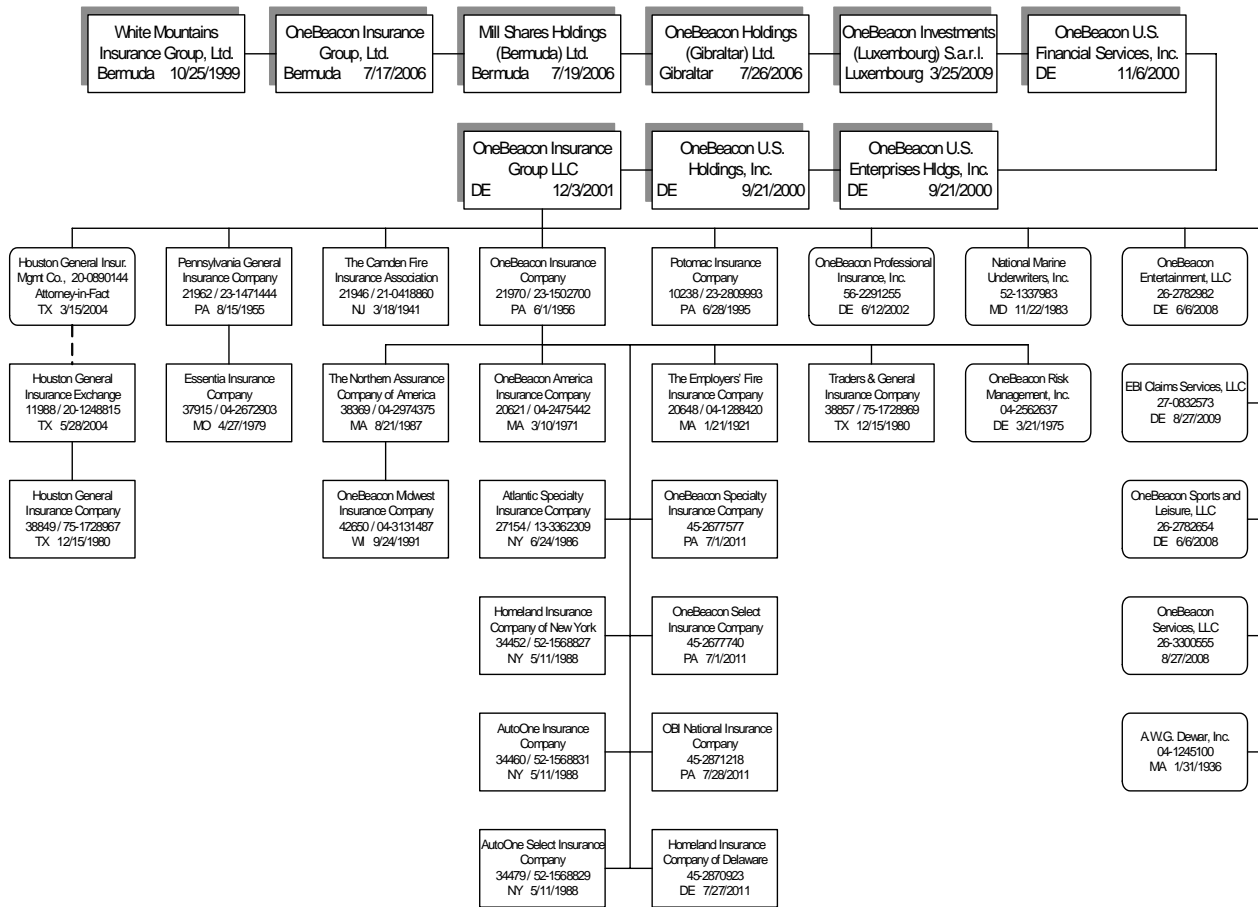
Additionally, OBIC assumes 100% of all direct underwriting activity of the following affiliates: The Camden Fire Insurance Association, OneBeacon Midwest Insurance Company, Potomac Insurance Company, and Traders & General Insurance Company. OBIC also assumes 90% of the direct underwriting activity from Essentia Insurance Company.

D. Holding Company System

As of December 31, 2011, the Company was a member of the OneBeacon Insurance Group. The Company was a wholly-owned subsidiary of OneBeacon Insurance Company, a property and casualty insurance company domiciled in Pennsylvania, which is ultimately controlled by White Mountains Insurance 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, 2011:



In addition to the intercompany pooling arrangement discussed previously in the Reinsurance section of this report, the Company was party to the following agreements with other members of its holding company system at December 31, 2011:

Investment Management Agreement

Effective July 1, 2002, the Company entered into an investment management agreement with White Mountain Advisors, LLC (“WMA”), formerly known as OneBeacon Asset Management, Inc., an affiliated investment advisor. The agreement stipulated for WMA to provide investment research and advice, including the execution of orders for the purchase and sale of securities.

On November 14, 2006 the Company replaced the above agreement with a similar agreement with WMA, whereby WMA agreed to provide treasury management services in addition to the services provided in the previous agreement. This agreement was filed with the Department on November 6, 2006 pursuant to Section 1505 of the New York Insurance Law.

Effective October 1, 2010, the Company entered into a new investment management agreement with WMA pursuant to which WMA provides investment research and advice, including the execution of orders for the purchase and sale of securities. The fee for these services is paid quarterly and is equal to a percentage of the value of the investment portfolio on the last day of the preceding calendar quarter. This agreement was filed with the Department on August 26, 2010 pursuant to Section 1505 of the New York Insurance Law.

Tax Allocation Agreement

Effective December 31, 2001, the Company became a party to a federal income tax sharing agreement with Fund American Enterprise Holdings, Inc. and its subsidiaries, which form a consolidated group. This tax allocation agreement provides that in any year, or part thereof, that the parties file consolidated federal income tax returns, a computation shall be made on or before the date provided by law for the payment of any federal income tax or estimate of the amount of income taxes or estimated tax refund to which each party would have to make or to which such party would be entitled if it filed at that time a return declaration or refund claim as a separate corporation and had not at the time been a member of the consolidated group.. This agreement was filed with this Department on August 14, 2001 pursuant to Section 1505 of the New York Insurance Law.

Effective December 31, 2004, the Company amended the above original tax allocation agreement with Fund American Enterprises Holdings, Inc. to reflect an assignment and assumption agreement to its wholly owned subsidiary, Fund America Financial Services, Inc. (“Holdco”), now known as OneBeacon U.S. Financial Services, Inc.

During the examination period, subsidiaries were added and entities deleted as members of the original agreement due to changes in the OneBeacon organization.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2011, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	7%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	11%
Premiums in course of collection to surplus as regards policyholders	1%

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 five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$26,396,363	59.04%
Other underwriting expenses incurred	16,040,622	35.88
Net underwriting loss	<u>2,274,156</u>	<u>5.09</u>
Premiums earned	<u>\$44,711,141</u>	<u>100.00%</u>

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2011 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u>	<u>Net Admitted</u>
		<u>Assets Not Admitted</u>	<u>Assets</u>
Bonds	\$ 88,187,848	\$ 0	\$ 88,187,848
Cash, cash equivalents and short-term investments	14,574,958		14,574,958
Receivables for securities	(165)		(165)
Investment income due and accrued	558,536		558,536
Uncollected premiums and agents' balances in the course of collection	473,814		473,814
Deferred premiums, agents' balances and installments booked but deferred and not yet due	677,314		677,314
Current federal and foreign income tax recoverable and interest thereon	269,215		269,215
Net deferred tax asset	383,476	28,377	355,099
Electronic data processing equipment and software	26,878	7,434	19,444
Furniture and equipment, including health care delivery assets	2,024	2,024	0
Sundry balances	<u>66,421</u>	<u>28,002</u>	<u>38,419</u>
Total assets	<u>\$105,220,319</u>	<u>\$65,837</u>	<u>\$105,154,482</u>

Liabilities, surplus and other funds

<u>Liabilities</u>	<u>Examination</u>
Losses and loss adjustment expenses	\$ 7,605,168
Other expenses (excluding taxes, licenses and fees)	16,833
Taxes, licenses and fees (excluding federal and foreign income taxes)	97,324
Unearned premiums	3,182,201
Advance premium	862
Payable to parent, subsidiaries and affiliates	816,584
Payable for securities	100
Unearned L.A.D. service fees	72,242
Unearned NY take-out credits	5,274
NYAIP liability and sundry balances	<u>2,760</u>
Total liabilities	<u>\$11,799,348</u>
<u>Surplus and other funds</u>	
Common capital stock	\$ 9,000,000
Effect of implementation of SSAP No. 10R	59,724
Gross paid in and contributed surplus	80,994,161
Unassigned funds (surplus)	<u>3,301,249</u>
Surplus as regards policyholders	\$ <u>93,355,134</u>
Total liabilities, surplus and other funds	<u>\$105,154,482</u>

Note: The Internal Revenue Service has not completed any Federal Income Tax audits during the examination period. However, audits covering tax years 2007 through 2009 are currently under examination. 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 by \$45,198,577 during the five-year examination period January 1, 2007 through December 31, 2011, detailed as follows:

Underwriting Income

Premiums earned		\$44,711,141
Deductions:		
Losses and loss adjustment expenses incurred	\$26,396,363	
Other underwriting expenses incurred	16,666,490	
Aggregate write-ins for underwriting deductions	<u>(625,868)</u>	
Total underwriting deductions		<u>42,436,985</u>
Net underwriting gain or (loss)		\$ 2,274,156

Investment Income

Net investment income earned	\$11,074,344	
Net realized capital gain	<u>567,725</u>	
Net investment gain or (loss)		\$11,642,069

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(59,540)	
Finance and service charges not included in premiums	170,362	
Aggregate write-ins for miscellaneous income	<u>224,747</u>	
Total other income		<u>335,569</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$14,251,794
Dividends to policyholders		<u>6,523</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$14,245,271
Federal and foreign income taxes incurred		<u>4,075,807</u>
Net Income		<u>\$10,169,464</u>

Surplus as regards policyholders per report on examination as of December 31, 2006			\$48,156,557
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$10,169,464	\$ 0	
Net unrealized capital gains or (losses)	72,141		
Change in net deferred income tax		955,595	
Change in nonadmitted assets	852,843		
Surplus adjustments paid in	44,210,108		
Dividends to stockholders		9,210,108	
Aggregate write-ins for gains and losses in surplus	<u>59,724</u>	<u>0</u>	
Net increase (decrease) in surplus	<u>\$55,364,280</u>	<u>\$10,165,703</u>	<u>45,198,577</u>
Surplus as regards policyholders per report on examination as of December 31, 2011			<u>\$93,355,134</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$7,605,168 is the same as reported by the Company as of December 31, 2011. 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 two recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A <u>Accounts and Records</u>	
i. <u>CPA Contract</u> It was recommended that the Company ensure that the contract with the CPA for all future audits, contain the provisions required by Department Regulation 118. The Company has complied with this recommendation	13
ii. <u>Agents' Balances and Premiums Receivable Over 90 Days Past Due</u> It was recommended that the Company institute procedures to assure GAAP to STAT allowance reconciliation processes are instituted to provide assurance that the calculation is properly presented and recorded. The Company has complied with this recommendation.	13

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Capital Contribution</u> It is recommended that the Company comply with the requirements of Section 1505(c) of the New York Insurance Law.	4
B.	<u>Management</u> It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5

Respectfully submitted,

_____/s/
Fe Rosales, C.F.E.
Associate Insurance Examiner

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

FE ROSALES, being duly sworn, deposes and says that the foregoing report, subscribed by her,
is true to the best of her knowledge and belief.

_____/s/
Fe Rosales

Subscribed and sworn to before me

this _____ day of _____, 2012.

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:

Fe Rosales

as a proper person to examine the affairs of the

ATLANTIC SPECIALTY INSURANCE COMPANY

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

COMPANY

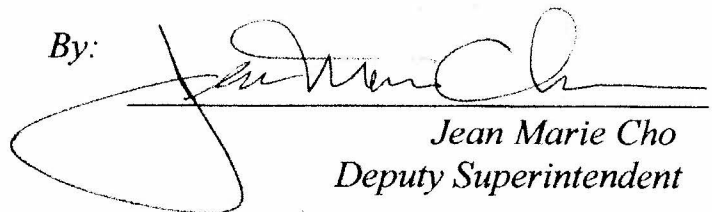
with such other information as she shall deem requisite.

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

this 27th day of December, 2011

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:


Jean Marie Cho
Deputy Superintendent

