

REPORT ON EXAMINATION

OF THE

UPPER HUDSON NATIONAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT

JANUARY 23, 2008

EXAMINER

ROBERT A. VARGAS

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

January 23, 2008

Honorable Eric R. Dinallo
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 22659 dated July 16, 2007 attached hereto, I have made an examination into the condition and affairs of Upper Hudson National Insurance Company as of December 31, 2006, and submit the following report thereon.

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

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

Wherever the term "Marine Indemnity" appears herein without qualification, it should be understood to mean Marine Indemnity Insurance Company of America.

The examination was conducted at the Company's administrative offices located at 4446 Route 42, Monticello N.Y. 12701.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2001. This examination covered the five-year period from January 1, 2002 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a verification of assets and liabilities as of December 31, 2006. 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 certified public accountants ("CPA"). 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 ("NAIC"):

- 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

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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on December 27, 1973 as the Marine Indemnity Insurance Company of America (“Marine Indemnity”), and initially commenced operations on January 1, 1974.

Effective January 1, 2002, the Company entered into two reinsurance, assignment and assumption agreements to transfer all of its liabilities and related assets, arising from its operations prior to January 1, 2002, to two affiliates; Phoenix Assurance Company of New York and Landmark American Insurance Company. The purpose of these transactions was to convert the Company to a shell company in order to sell it.

On January 17, 2006, the Company was acquired by Upper Hudson Holdings, LLC, a non-insurance business holding company. On March 1, 2006, the Company changed its name to its current title and commenced business on September 1, 2006.

At December 31, 2006, capital paid in is \$3,290,000 consisting of 9,400 shares of common stock at \$350 par value per share. Gross paid in and contributed surplus was \$4,531,560. Gross paid in and contributed surplus decreased by \$8,098,440 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2001	Beginning gross paid in and contributed surplus	\$12,300,000
2003	Repurchase of common shares	(8,098,440)
2006	Additional paid in capital	<u>330,000</u>
2006	Ending gross paid in and contributed surplus	<u>\$ 4,531,560</u>

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-one members. At December 31, 2006, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Linda Barringer Monticello, NY	Barringer & Barringer, Inc.
Robert Berman Monticello, NY	Treasurer & Chief Financial Officer, Upper Hudson National Insurance Company
Owen Clough Bradenton, FL	Independent Consultant
Christopher DuBois South Fallsburg, NY	Attorney
Carl Emstrom Binghamton, NY	Retired, DuBois and Talley
Scott Kaniewski Evanston, IL	President, Upper Hudson National Insurance Company
Lewis Klugman Ferndale, NY	Klugman Associates
Zane Morganstein Woodridge, NY	Associated Mutual Insurance Cooperative
Clifton Rosenberry Ardsley, NY	McCartney and Rosenberry Group, Inc.
Edward Schirick Rock Hill, NY	Schirick & Associates Insurance Brokers, Inc.
Richard Schmidt Ithaca, NY	Independent Consultant
David Twomey Johnson City, NY	Haylor, Freyer & Coon
Robert Wong Monticello, NY	Secretary, Upper Hudson National 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.

As of December 31, 2006, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Scott Kaniewski	President
Robert Wong	Secretary
Robert Berman	Treasurer/Chief Financial Officer

B. Territory and Plan of Operation

As of the examination date the Company was licensed in the following states:

California	Illinois	Missouri	Oregon
Florida	Louisiana	New Jersey	Pennsylvania
Georgia	Maryland	New York	Virginia
Hawaii	Massachusetts	Ohio	Washington

As of December 31, 2006 the Company was licensed 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>Kind of Insurance</u>
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

In addition, the Company is licensed to transact such workers' compensation insurance as may be incident to coverage contemplated under paragraph 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 Cong., as amended; 33 USC Section 901 et. Seq. as amended).

Based upon 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 \$1,900,000.

The Company did not begin to write business until September of 2006. The direct written premiums for the period under examination are as follows:

DIRECT PREMIUMS WRITTEN

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Percentage of U.S. Premiums Written in New York</u>
2002	\$ 0	\$ 0	0.00%
2003	\$ 0	\$ 0	0.00%
2004	\$ 0	\$ 0	0.00%
2005	\$ 0	\$ 0	0.00%
2006	\$11,756	\$11,756	100.00%

C. Reinsurance

Assumed

The Company did not assume any business during the examination period.

Ceded

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

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property/Casualty</u>	
Commercial liability Excess of loss (100% authorized)	Company's retention: \$100,000 First excess cover up to \$400,000 Second excess cover up to \$500,000 Third excess cover up to \$1,000,000
Commercial property Excess of loss (100% authorized)	Company's retention: \$100,000 First excess cover up to \$100,000 Second excess cover up to \$300,000 Third excess cover up to \$1,000,000
Commercial property catastrophe Excess of loss (100% authorized)	Company's retention: \$250,000 95% of the amount of the ultimate net loss in excess of the company's retention up to a maximum of 95% of \$2,000,000

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to Department Circular Letter No. 8 (2005). Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 42 of SSAP No. 62.

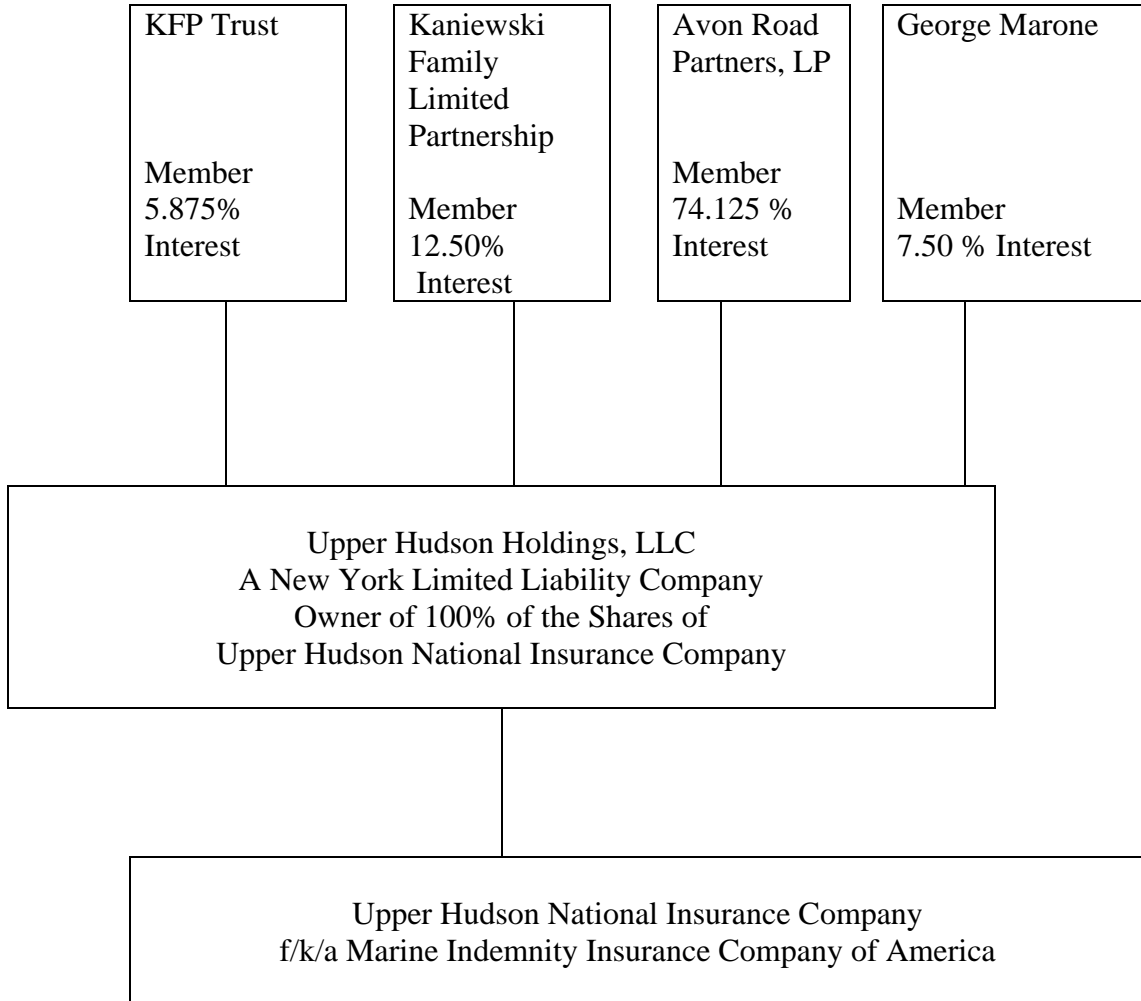
D. Holding Company System

The Company is a wholly-owned subsidiary of Upper Hudson Holdings, LLC.

A review was made of the filings submitted by the Company pursuant to the requirements and standards set forth for holding company organizations under Article 15 of the New York Insurance Law and Department Regulation 52.

The following chart shows the position of the Company in the holding company system as of December 31, 2006:

Upper Hudson National Insurance Company
Corporate Structure Chart



E. Significant Operating Ratios

As previously noted the Company did not begin to write business until September of 2006. Total premiums written during the examination period were \$11,756. Due to the Company's limited underwriting activity the significant operating ratios do not represent meaningful information therefore they were not computed.

F. Accounts and Records

Custodial Agreements

The Company's custodial agreements were found to be lacking the following provisions as set forth in Part 1, Section IV – J of the NAIC Financial Condition Examiners' Handbook:

1. That the national bank, state bank, or trust company, as custodian is obligated to indemnify the insurance company for any insurance company's loss of securities in the custodian's custody.
2. That in the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.
3. That the national bank, state bank or trust company as custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.
4. That in the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability.
5. That if the custodial agreement has been terminated or if 100 percent 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.

6. That during regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company.
7. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control.
8. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information.
9. That the custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian.
10. That the custodian shall secure and maintain insurance protection in an adequate amount.
11. That the foreign bank acting as a custodian, or a U.S. custodian's foreign agent, or a foreign clearing corporation is only holding foreign securities or securities required by the foreign country in order for the insurer to do business in that country. A US custodian must hold all other securities.

It is recommended that the Company include the safeguard provisions in any custodial agreements it enters into as required by Part 1, Section IV-J of the NAIC Financial Condition Examiners Handbook.

FINANCIAL STATEMENTSA Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2006 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	\$4,510,266	\$ 0	\$4,510,266
Cash and short-term investments	2,974,016		2,974,016
Investment income due and accrued	65,586		65,586
Uncollected premiums and agents' balances in the course of collection	2,834		2,834
Deferred premiums, agents' balances and installments booked but deferred and not yet due	2,327		2,327
Electronic data processing equipment and software	<u>47,771</u>	<u> </u>	<u>47,771</u>
Total assets	<u>\$7,602,800</u>	<u>\$ 0</u>	<u>\$7,602,800</u>

Liabilities, Surplus and Other FundsLiabilities

Losses	\$ 2,500
Loss adjustment expenses	2,500
Commissions payable, contingent commissions and other similar charges	247
Other expenses (excluding taxes, licenses and fees)	81,576
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,351
Unearned premiums	7,030
Ceded reinsurance premiums payable (net of ceding commissions)	<u>1,817</u>
Total liabilities	\$ 99,021

Surplus and other Funds

Common capital stock	\$3,290,000	
Gross paid in and contributed surplus	4,531,560	
Unassigned funds (surplus)	<u>(317,781)</u>	
Surplus as regards policyholders		<u>7,503,779</u>
Total liabilities, surplus and other funds		<u>\$7,602,800</u>

NOTE: The Company was included in the consolidated tax return of Arrowpoint General Partnership ("AGP") prior to its acquisition by Upper Hudson Holdings LLC on January 17, 2006. The Internal Revenue Service has completed its audits of the AGP Consolidated Federal Income Tax returns through tax year 1998. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 1999 through 2004 are currently in appeals. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2005 through 2006.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$10,581,083 during the five-year examination period January 1, 2001 through December 31, 2006, detailed as follows:

Premiums earned		\$ 1,446
Deductions:		
Losses incurred	\$ 2,500	
Loss adjustment expenses incurred	2,500	
Other underwriting expenses incurred	<u>402,311</u>	
Total underwriting deductions		<u>407,311</u>
Net underwriting gain or (loss)		\$ (405,865)
<u>Investment Income</u>		
Net investment income earned	\$ 2,426,214	
Net realized capital gain	<u>879,922</u>	
Net investment gain or (loss)		3,306,136
<u>Other Income</u>		
Finance and service charges not included in premiums		<u>24</u>
Net income after dividends to policyholders but before federal and foreign income taxes		<u>\$2,900,295</u>
Federal and foreign income taxes incurred		<u>692,362</u>
Net income		<u>\$2,207,933</u>

Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2001			\$18,084,813
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$2,207,933	\$	
Net unrealized capital gains or (losses)	46,251		
Change in net deferred income tax		518,272	
Change in non-admitted assets	472,625		
Change in provision for reinsurance	97,676		
Capital transfer	90,000		
Cumulative change in accounting principles	171,194		
Surplus adjustments transferred to capital		7,768,440	
Dividends to stockholders		<u>5,380,000</u>	
Total gains and losses	<u>\$3,085,679</u>	<u>\$13,666,712</u>	
Net increase (decrease) in surplus			<u>(10,581,033)</u>
Surplus as regards policyholders per report on examination as of December 31, 2006			<u>\$ 7,503,779</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$5,000 is the same as reported by the Company as of December 31, 2006. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

No problem areas were encountered.

6. SUBSEQUENT EVENT

Subsequent to the examination date, the Company reported the following contingency in Note 14 of its 2007 filed annual statement:

“On January 29, 2008, Endurance Reinsurance Corporation of America (“Endurance”), the Company’s reinsurer, notified the Company that on October 16, 2007, a fraudulent payment and performance bond had been issued by the Company’s former Chief Underwriting Officer purportedly obligating Endurance to a \$38,513,464 surety bond. The bond also provided that it was purportedly ‘Administered Through: Upper Hudson National Insurance Company.’ Both the Company and Endurance have disavowed any responsibility on this bond obligation and provided no authorization for any person to commit either party in any way to be named on this bond. Neither the Company nor Endurance received any premiums in regards to this bond. The Company and Endurance are continuing their investigations and have notified the appropriate regulatory and law enforcement agencies. The Company’s former Chief Underwriting Officer agreed to resign on November 29, 2007. The Company is not aware of any risk exposure at this time.”

When the Company became aware of this issue, it immediately terminated the Chief Underwriting Officer and began its process of due diligence to determine if any bonds were issued without authority in the Company’s name. The Company was able to account for all power of attorney forms authorized, and all were signed by the Company’s president. The Company has stated that it has fully investigated its risk exposure and has determined that it does not have any exposure on any bonds that were not authorized. The Department examiners reviewed a copy of the complaint against the former Chief Underwriting Officer filed by the United States Attorney. It is noted that the defendant pleaded guilty to all charges in December 2008 and that these charges were unrelated to any activities or transactions of Upper Hudson National Insurance Company.

7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It was recommended that board members who are unable or unwilling to attend meetings consistently resign or be replaced.	5
The Company is in compliance with this recommendation.	
ii. It was recommended that the Company comply with section 1201(a)(5)(B)(vi) of the New York Insurance Law, Article VI of the Company's charter and Article VI of the Company's charter and Article III Section 2 of the Company's bylaws by ensuring that not less than three of its board of directors be residents of the State of New York.	5
The Company is in compliance with this recommendation.	
B. <u>Holding Company System</u>	
It was recommended that the Company comply with the prior notification requirements of Section 1505 of the New York Insurance Law.	17
The Company is in compliance with this recommendation.	
C. <u>Accounts and Records</u>	
i. <u>Contract with Certified Public Accountants</u>	
It was recommended that the Company ensure that all future agreements with its independent certified accountants contain the provisions required by Department Regulation 118.	19
The Company is in compliance with this recommendation.	
ii. <u>Custodial Agreements</u>	
It was recommended that the custody agreement include the provisions set forth in the NAIC Financial Condition Examiners' Handbook, Part1, Section IV-H.	20
The Company is not in compliance with this recommendation and a similar recommendation is made in this report.	

<u>ITEM</u>	<u>PAGE NO.</u>
D. <u>Losses and Loss Adjustment Expenses</u>	
i. It was recommended that the Company recover the \$710,886 identified overpayment related to the unpaid loss and loss adjustment expenses transferred as of January 1, 2002 from the appropriate affiliates.	25
ii. It was further recommended that the Company recover the \$26,252 losses and loss adjustment expenses paid during 2001 relative to the six claims as being erroneously coded to the Company from the appropriate affiliates.	25
These recommendations are no longer applicable due to the sale of the Company.	

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Custodial Agreement</u>	
It is recommended that the Company include the safeguard provisions in any custodial agreements it enters into as required by Part 1, Section IV-J of the NAIC Financial Condition Examiners Handbook.	10

Respectfully submitted,

_____/S/
Robert A.Vargas
Senior Insurance Examiner

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

I, ROBERT A. VARGAS, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____/S/
Robert A.Vargas

Subscribed and sworn to before me
this _____ day of _____, 2008.

Appointment No. 22659

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

*I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:*

Robert Vargas

as proper person to examine into the affairs of the

UPPER HUDSON NATIONAL INSURANCE COMPANY

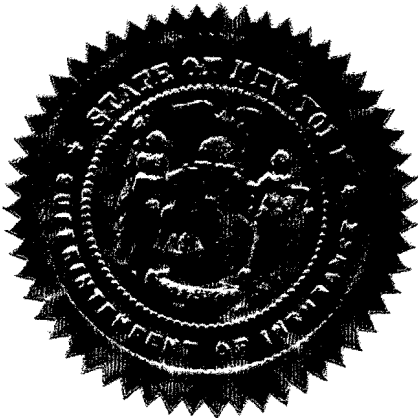
and to make a report to me in writing of the condition of the said

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 16th day of July, 2007



A handwritten signature in black ink, appearing to read "Eric Dinallo", written over a horizontal line.

ERIC R. DINALLO
Superintendent of Insurance