

REPORT ON EXAMINATION
OF THE
ACE CAPITAL MORTGAGE REINSURANCE COMPANY
AS OF
DECEMBER 31, 2002

DATE OF REPORT

JULY 11, 2003

EXAMINER

MOSES EGBON, C.F.E.

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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

July 11, 2003

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

Sir:

Pursuant to instructions contained in Appointment Number 22004, dated February 10, 2003, appended hereto, I have made an examination into the condition and affairs of the ACE Capital Mortgage Reinsurance Company as of December 31, 2002, and respectfully submit the following report thereon.

The examination was conducted at the Company's office, located at 1325 Avenue of the Americas, New York, New York 10019.

Wherever the terms "ACE Mortgage" or "Company" appear herein, without qualification they should be understood to indicate the ACE Capital Mortgage Reinsurance Company.

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

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1996. This examination covered the five year period from January 1, 1997 through December 31, 2001, and was updated to December 31, 2002. The examination was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance.

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

- History of the Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Officers', employees', and agents' welfare and pension plans
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Reinsurance
- Loss experience
- Accounts and records
- Financial statements

A review was also made to find out what action was taken by the Company with regard to comments and recommendations made 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

ACE Capital Mortgage Reinsurance Company was formerly known as Capital Mortgage Reinsurance Company and was incorporated on August 20, 1993, under the laws of the State of New York. The Company was then owned by "Capital Re Corporation" of Delaware. It began business on February 1, 1994 and exclusively provided mortgage guaranty reinsurance. The Company is now a wholly-owned subsidiary of ACE Capital Overseas Ltd. ("ACRO").

During 1999, and with the approval of this Department, Capital Re Corporation realigned its holding company structure. As part of this realignment, Capital Mortgage Reinsurance Company purchased from its parent 179,190 shares of its common stock for a consideration of \$95,815,080. Following this transaction, such shares were cancelled. The par value of the remaining issued and outstanding shares was increased to \$18. Consequently, the capital of Capital Mortgage Reinsurance Company was then reduced by \$1,343,068 to \$1,009,872.

On December 30, 1999, the Company was acquired by ACE Limited, a Cayman Island insurance holding company. Following this acquisition, the Company holding structure was reorganized. Effective March 7, 2000, the Company adopted a new name, ACE Capital Mortgage Reinsurance Company.

During 2000, the Company purchased 25,559 shares of its common stock from ACRO. In consideration for such shares, the Company paid ACRO cash in the amount of \$15,061,663. Immediately

following the purchase, such shares were cancelled, and the par value of the remaining 30,545 shares were increased from \$18.00 to \$33.00 per share. The Company also received an \$8,000,000 surplus contribution from its parent.

The net effect of the above transactions was aggregated to a net decrease of approximately \$101.5 million to the Company's capital stock and gross paid in and contributed surplus.

As of December 31, 2002, the Company's capital structure consisted of 250,000 shares authorized, and 30,545 shares issued and outstanding common stock at a par value of \$33 per share.

A. Management

Pursuant to the Company's charter and by-laws, management is vested in a board of directors consisting of not less than thirteen nor more than twenty-five members. As of the examination date, the Company had thirteen directors. During the six-year period encompassed by this examination, the board did not hold the required number of board meetings, as required by its by-laws, for four of these years. The Company has held four meetings each year since 2001 as recommended in the previous examination report, in compliance with its by-laws.

The thirteen directors as of December 31, 2002 were as follows:

<u>Name and Residence</u>	<u>Principal Affiliation</u>
Robert A. Bailenson Merrick, New York	Senior Vice President and Chief Financial Officer and Treasurer, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company

<u>Name and Residence</u>	<u>Principal Affiliation</u>
Mahesh Bhatia Montville, New Jersey	Assistant Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Re Inc.
Lenore R. Bregman New York, New York	Executive Vice President, General Council and Secretary, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company
Carmel Caramagna Rutherford, New Jersey	Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company
Aileen Chang Great Neck, New York	Vice President and Council, ACE Capital Re Overseas Ltd.
Laurence C. D Donnelly Pelham, New York	President, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company
Jerome F. Jurschak Katonah, New York	Chairman and Chief Executive Officer, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company
Julia Hoagland New York, New York	Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Re Inc.
Martin Palmeri Bronxville, New York	Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Re Inc.
Richard W. Reese Cross River, NY	Senior Vice President ACE Capital Mortgage Reinsurance Company
David Steel New York, New York	Senior Vice President, ACE Capital Mortgage Reinsurance Company
George Wilkinson Wantagh, New York	Vice President, Counsel, and Assistant Secretary, ACE Capital Mortgage Reinsurance Company
Winston Wohrc Staten Island, New York	Vice President and Treasurer, Capital Reinsurance Company Capital Mortgage Reinsurance Company

The following were the principal officers of the Company as of December 31, 2002:

<u>Name</u>	<u>Title</u>
Laurence C. D. Donnelly	President
Robert A. Bailenson	Senior Vice President and CFO and Treasurer
Lenore R. Bregman	Executive Vice President, General Counsel and Secretary

B. Territory and Plan of Operation

As of the examination date, the Company was authorized to transact business only in the State of New York. According to its certificate of authority, the Company was empowered to transact the kind of insurance as described in paragraph 23 of Section 1113(a) of the New York Insurance Law, "Mortgage Guaranty Insurance".

Based on the kinds of insurance for which the Company is authorized to write, its current capital structure and pursuant to the requirements of Articles 13 and 65 of the New York Insurance Law, the Company is required to maintain surplus to policyholders of \$1,500,000.

C. Reinsurance

The Company writes no direct business and all of its business is assumed from other mortgage guaranty reinsurance companies.

The Schedule F data as contained in the Company's annual statements filed for the years covered by the examination was found to accurately reflect the reinsurance transactions.

The examiner reviewed the ceded reinsurance contracts effected during the examination period. These contracts contained the required standard clauses, including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 2002, the Company is protected by the following retro-cession reinsurance coverage:

<u>Type of Contract</u>	<u>Cession</u>
<u>Mortgage Business:</u>	
1995 GEMICO Pool Excess of Loss 2-layers	\$630,000,000 excess of \$65,400,000
1998 GEMICO Pool wheda Excess of Loss	Aggregate limit of loss less retention of \$5,000,000
1998 GEMICO Pool lhda Excess of Loss	Aggregate limit of loss less retention of \$1,000,000
2000 AXA/Cmac Private Mortgage Guaranty Policies Excess of Loss	Aggregate limit of loss less retention of 20% of annual limit each calendar year
1999/2000 Yorksafe Domestic Indemnity Policies Excess of Loss	Cover reinsurer's maximum liability after net retain liability of \$2,500,000
2000 Triad Mortgage Guaranty Policies Excess of Loss	\$76,000,000 excess of \$19,000,000 each and subsequent calendar year

Relative to the 1995 GEMICO business, the agreement will be terminated on September 30, 2003.

This program was ceded to both authorized and unauthorized reinsurers.

All of the Company's other retrocessions are to an unauthorized affiliate.

D. Holding Company System

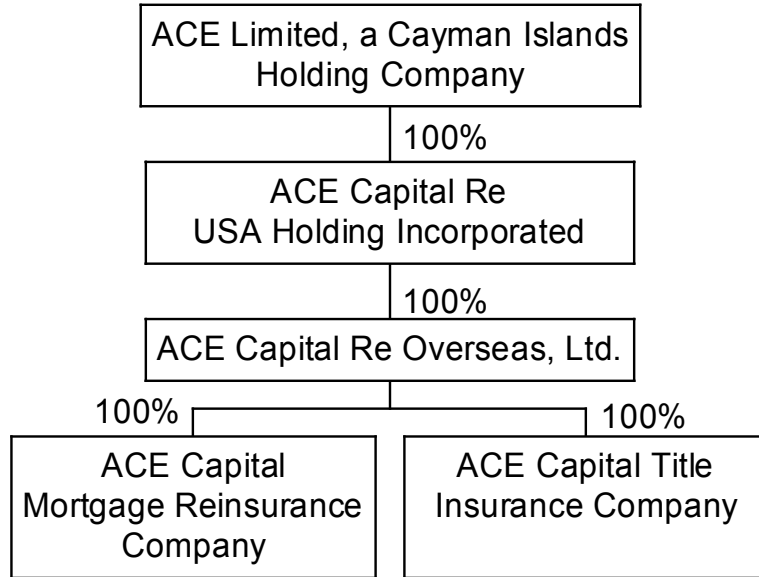
ACE Capital Mortgage Reinsurance Company (formerly called Capital Mortgage Reinsurance Company) and all of the Company's outstanding common stock was owned by Capital Credit Reinsurance Company, Ltd., a Bermuda company and Capital Reinsurance Company, a Maryland company. Both were ultimately owned by Capital Re Corporation, a Delaware insurance company.

On December 30, 1999, the Company was acquired by ACE Limited, a Cayman Islands insurance holding company. Following this acquisition, the Company holding structure was reorganized. Effective March 7, 2000, the Company adopted a new name, ACE Capital Mortgage Reinsurance Company.

The Company is now a wholly-owned subsidiary of ACE Capital Re Overseas Ltd. ("ACRO"), a Bermuda domiciled reinsurance company, which is 100% owned by ACE Capital Re USA Holdings Incorporated, and is ultimately owned by ACE Limited.

The Company has filed annual reports in accordance with the requirements of Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an organization chart of the holding company system:



As of the examination date, the Company was a party to the following agreements with affiliated entities:

1. Service and Reimbursement Agreement with ACE Guaranty Inc. (“AGRE”), ACE Capital Re Overseas Ltd., (“ACRO”) and ACE Capital Title Reinsurance

The Company is a party to a service and reimbursement agreement with its affiliates, whereby the ACE Guaranty Inc. provides certain support services to ACRO and its subsidiaries, including the Company. ACRO pays AGRE for the services, and ACRO is reimbursed by its subsidiaries. On February 20, 2001, the Department approved the agreement, pursuant to Section 1505(d)(3) of the New York Insurance Law.

3. Investment Advisory Service Agreement with ACE Asset Management Inc., and ACE Capital Title Reinsurance Company.

The Company is a party to an investment advisory service agreement with ACE Asset Management Inc. The agreement was filed and approved on July 16, 2002, in accordance with Section 1505(d)(3) of New York Insurance Law.

E. Contingent Commissions Payable

The Company discounts the profit commissions payable from assumed reinsurance contracts. Since the profit commissions are not due immediately, the Company discounts the amount to determine the present value of such liability. The Department does not permit the discounting of such liability. The accounting treatment of this liability was not in compliance with statutory accounting and was also mentioned in the previous examination report. Currently, the amount involved appears to be immaterial. However, it is again recommended that the Company report the undiscounted amount for this liability in future statements filed by this Department.

F. Significant Operating Ratios

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

Net premiums written in 2002 to Surplus as regards policyholders	.09:1
Liabilities to Liquid assets (cash and invested assets less investment in affiliate)	52.4%
Premiums in course of collection to Surplus as regards to policyholders	N/A*

*As of the examination date, the Company reported no agents' balances in course of collection, which is the numerator in this ratio calculation.

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 six year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$11,328,475	10.1%
Loss adjustment expenses incurred	(174,985)	(0.2)
Other underwriting expenses incurred	54,551,209	48.5
Net underwriting gain	<u>46,830,104</u>	<u>41.6</u>
Premiums earned	<u>\$112,534,803</u>	<u>100.0%</u>

3. FINANCIAL STATEMENTS

A. Balance Sheet

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

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-admitted Assets</u>	<u>Net-Admitted Assets</u>
Bonds	\$41,521,853	\$	\$41,521,853
Short-term Investments	2,726,176		2,726,176
Cash on deposit	122,796		122,796
Interest, dividends and real estate income due and accrued	<u>476,869</u>	<u> </u>	<u>476,869</u>
Total Assets	<u>\$ 44,847,694</u>	<u>\$ 0</u>	<u>\$44,847,694</u>

<u>Liabilities</u>	<u>Examination</u>
Losses and loss adjustment expenses reserves	\$626,157
Contingent commissions and other similar charges	6,001,320
Other expenses	50,441
Federal and foreign taxes and fees	1,984,028
Unearned premiums	546,124
Ceded reinsurance premiums payable	1,185,951
Provision for reinsurance	4,434,716
Net adjustments in assets and liabilities due to foreign exchange rates	(8,643)
Payable to parent, subsidiaries and affiliates	161,846
Contingency reserve	<u>8,509,273</u>
 Total liabilities	 \$ 23,491,213
 <u>Surplus and Other Funds</u>	
Common capital stock	\$ 1,007,985
Gross paid in and contributed capital	41,115,272
Unassigned funds	<u>(20,766,776)</u>
 Surplus as regards policyholders	 <u>21,356,481</u>
 Total liabilities, surplus and other funds	 <u>\$ 44,847,694</u>

NOTE: The Internal Revenue Service has examined the consolidated federal income tax returns through tax year 1998. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$123,932,763 during the six year examination period January 1, 1997 through December 31, 2002, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$112,534,803
Deductions		
Losses incurred	\$11,328,475	
Loss adjustment expenses incurred	(174,985)	
Other underwriting expenses incurred	<u>54,551,209</u>	
Total underwriting deductions		<u>65,704,699</u>
Net underwriting gain		\$46,830,104

Investment Income

Net investment income earned	\$32,148,758	
Net realized capital gain (losses)	<u>(6,548,602)</u>	
Net investment gain		25,600,156

Other Income

Other income	\$1,285,000	
Structuring fee income	<u>284,122</u>	
		<u>1,569,122</u>
Net income before federal income taxes		\$73,999,382
Federal income taxes incurred		<u>36,924,987</u>
Net income		<u>\$37,074,395</u>

Capital and Surplus Account

Surplus as regards policyholders, per report on examination as of December 31, 1996			\$145,289,243
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$37,074,395	\$	
Net unrealized capital (losses)		2,445,253	
Change in provision for reinsurance		2,959,932	
Change in foreign exchange adjustment		2,371	
Capital paid in		1,344,955	
Surplus paid in		101,531,788	
Contingency reserve fund	<u> </u>	<u>52,722,859</u>	
Total gains and losses	<u>\$37,074,395</u>	<u>\$161,007,158</u>	
Net decrease in surplus as regards policyholders			<u>\$(123,932,763)</u>
Surplus as regards policyholders, per report on examination as of December 31, 2002			<u>\$ 21,356,480</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities for loss and loss adjustment expense reserves of \$626,157 are the same as the amounts reported by the Company as of the examination date. 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. MARKET CONDUCT ACTIVITIES

The Company is a reinsurer and does not have direct contact with insureds or claimants.

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 1996, contained one comment and seventeen recommendations (page numbers refer to the prior report on examination.)

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Description of Company</u>	
It was noted that the securities received from the parent for the initial capitalization of the Company were undervalued by \$1,437,761.	3-4
The Company has corrected this finding.	
It is recommended that the Company increase its gross paid in and contributed capital by \$1,437,761.	4
The Company has complied with this recommendation.	
B. <u>Management</u>	
It is recommended that the board of directors have the required board meetings as stipulated in their by-laws.	4
The Company has complied with this recommendation.	
C. <u>Reinsurance</u>	
It is recommended that in the future the Company prepare cash flow analysis in order to demonstrate that its reinsurance agreements transfer risk	8
These agreements were obtained to satisfy the rating agencies and were not considered a means of financial arrangement beyond that usually provided by traditional reinsurance.	
D. <u>Holding Company System</u>	
It is recommended that the Company comply with Section 1505(a) and (b) of the New York Insurance Law and Regulation 30.	12
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
E. <u>Custodian Agreement</u>	
It is recommended that the Company include the provisions listed in this report in its custodian agreement.	13
The Company has complied with this recommendation.	
It is recommended that the Company obtain a custody agreement with the First National Bank of Maryland.	14
The Company has complied with this recommendation.	
F. <u>Bonds</u>	
It is recommended that the Company record securities transferred from the parent to the Company at market value, at the date of transfer, with any accrued interest included in the total.	20
The Company has complied with this recommendation.	
G. <u>Agents' Balances or Uncollected Premiums</u>	
It is recommended that the Company recognize the full impact of this contract by reporting premiums on a gross basis rather than on an installment basis.	21
The Company has complied with this recommendation.	
H. <u>Federal Income Tax Recoverable</u>	
It is recommended that the Company not classify amounts over paid to the parent for taxes due under the named caption, but classify these amounts as due from their parent, subsidiaries and affiliates.	22
The Company has complied with this recommendation.	
It is recommended that in the future such amounts be paid over promptly by the parent.	22
The Company has complied with this recommendation.	
I. <u>Losses</u>	
It is recommended that the Company request accident year data from their ceding insured PMI on a quarterly basis, so that the Company can fill out their annual and quarterly statements correctly. It is incumbent upon the assuming insurer to obtain this information.	23

<u>ITEM</u>	<u>PAGE NO.</u>
The Company has complied with this recommendation	
J. <u>Reinsurance Payable On Paid Losses and Loss Adjustment Expenses</u>	
It is recommended that the Company accrue for the last month of the year for this item in the future to correctly record the expenses incurred at year-end.	23
The Company has complied with this recommendation.	
K. <u>Loss Adjustment Expenses</u>	
It is recommended that the Company request its ceding insureds to furnish separate loss adjustment expense statistics so that proper loss adjustment expense analysis can be undertaken.	24
The Company has complied with this recommendation.	
It is recommended that the Company allocate its overhead expenses to loss adjustment expenses as required by Regulation 30.	24
The Company has complied with this recommendation.	
L. <u>Contingent Commissions</u>	
It is recommended that the Company cease discounting this liability and record it at full value.	24
The Company has not complied with this recommendation, and it is repeated in this report.	
M. <u>Unearned Premiums</u>	
It is recommended that the Company calculate their unearned premiums on a gross basis as opposed to an installment basis.	25
The Company has complied with this recommendation.	
N. <u>Payable for Securities</u>	
It is recommended that the Company reclassify this liability as a write-in line called Mortgage Dollar Roll Repurchase Commitment.	26
The Company has complied with this recommendation.	

7. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

ITEM

PAGE NO.

A. Contingent Commissions Payable

It is again recommended that the Company report the undiscounted amount for this liability in future statements filed by this Department.

10

Respectfully submitted,

_____/S/_____
Moses Egbon, C.F.E.
Senior Insurance Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF NEW YORK)

Moses Egbon, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

_____/S/_____
Moses Egbon

Subscribed and sworn to before me

this _____ day of _____ 2003.

Appointment No. 22004

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

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

Moses Egbon

as proper person to examine into the affairs of the

ACE CAPITAL MORTGAGE REINSURANCE COMPANY

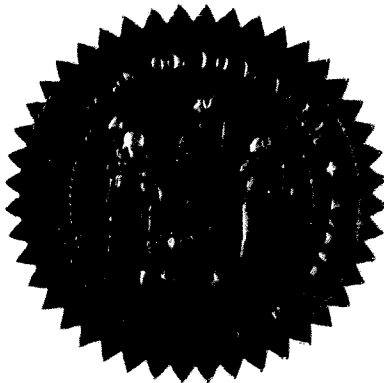
and to make a report to me in writing of the condition of the said

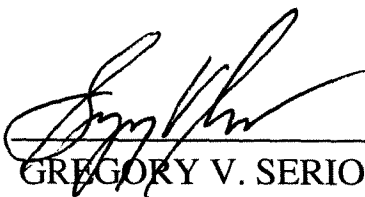
Company

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 10th day of February, 2003




GREGORY V. SERIO
Superintendent of Insurance