

REPORT ON ORGANIZATION
OF THE
ADIRONDACK INSURANCE EXCHANGE
AS OF
JULY 24, 2003

DATE OF REPORT

JULY 24, 2003

EXAMINER

JOSEPH REVERS

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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 24, 2003

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

Sir:

Pursuant to the instructions contained in Appointment Number 22083 dated July 23, 2003 attached hereto, I have made an examination on organization of Adirondack Insurance Exchange and respectfully submit the following report thereon.

Whenever the terms "Exchange" or "AIE" appear herein without qualification, they should be understood to indicate the Adirondack Insurance Exchange.

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

1. SCOPE OF EXAMINATION

The examination comprised a verification of the Exchange's initial surplus to policyholders and the determination of its assets and liabilities. The records examined included the declaration of initial subscribers and attorney-in-fact, the subscriber's agreement, the insurance management service agreement, the investment management agreement and custodial agreements entered into by the Exchange as of the examination date. Additionally, an affidavit, appended hereto, was obtained from two officers of the attorney-in-fact indicating that the transactions noted in this report were lawful and bona fide.

2. ORGANIZATION OF EXCHANGE

Adirondack Insurance Exchange was organized by twenty-six subscribers on June 30, 2003. The declaration of initial subscribers and attorney-in-fact was filed and approved by this Department on July 3, 2003. The location of the offices of the attorney-in-fact and AIE is 100 Corporate Parkway, Suite 200, Buffalo, New York 14226.

The members of the Exchange advisory committee and the principal officers of the attorney-in-fact as of July 24, 2003 were as follows:

Advisory Committee

Name and Residence

Beth Marie Gardner
Watermill, New York

James Paul Amaden III
East Hampton, NY

Louis Atti
Angola, NY

Principal Affiliation

Operations Manager,
Maran Corporate Risk Associates

President and Chief Executive Officer,
Amaden Gay Agency

Office Manager,
M & W Agency Inc.

Advisory committee (continued)

<u>Name and Residence</u>	<u>Principal Affiliation</u>
David R. Bauer Albany, NY	President, Capital Region Insurance Agency
Joseph Anthony Tedesco Rye, NY	Vice President, DeRosa, Rockefeller, Sohigian, Werdal Agency
Jonathan Grapes East Amherst, NY	VP/Treasurer, Holler Grapes Insurance Agency, Inc.
Alexander Francis Oristian Williamsville, NY	Branch Manager, OneBeacon Insurance Company
Michael Kelly Zimmerman East Amherst, NY	Vice President Claims, OneBeacon Insurance Company
John Charles Heller Williamsville, NY	VP of PL/President AAIF, OneBeacon Insurance Company

Officers

<u>Name</u>	<u>Title</u>
John P. Cavoores	Chairman
John C. Heller	President and Chief Executive Office
Alex Archimedes	Vice President
Roger M. Singer	Vice President
Dennis R. Smith	Secretary
Richard C. Hirtle	Treasurer
Alexander Oristian	Assistant Secretary
David Staples	Assistant Treasurer

3. CAPITALIZATION AND SUBSCRIPTION

White Mountains Insurance Group, Ltd. Bermuda, is the ultimate person in control of Adirondack Insurance Exchange. The Exchange has an initial surplus to policyholders of \$70,700,000.

In order to fulfill the deposit requirements of Section 4104 of the New York Insurance Law, the Exchange has placed securities with a par and market value totaling \$500,000 in an account in the name of the "Superintendent of Insurance of the State of New York in Trust for the security of all policyholders of Adirondack Insurance Exchange within the United States, its territories and possessions". The custodian is Mellon Trust of New York, LLC, located at 200 Park Avenue, New York, NY 10166, and the securities are held pursuant to a custodian agreement that conforms to the provisions of Section 1314 of the New York Insurance Law.

The Exchange's investments meet the minimum capital investment requirements of Section 1402 of the New York Insurance Law.

4. BALANCE SHEET

The following balance sheet sets forth the Exchange's financial condition as of July 23, 2003, as determined by this examination:

Assets

Bonds	\$60,740,293
Cash and short-term investments	<u>9,967,873</u>
 Total assets	 <u>\$70,708,166</u>

Liabilities

Amounts withheld for the account others	<u>\$8,166</u>
Total liabilities	<u>\$8,166</u>

Policyholders' Surplus

Subordinated Surplus Note	<u>70,700,000</u>
 Total liabilities and surplus	 <u>\$70,708,166</u>

No liability appears in the balance sheet for a loan in the amount of \$70,700,000 and accrued interest thereon. This loan was granted pursuant to Section 1307 of the New York Insurance Law. As provided in Section 1307, repayment of principal and interest shall only be made out of free and divisible surplus, subject to the prior approval of the Superintendent of Insurance of the State of New York.

5. CUSTODIAN AGREEMENT

The assets listed on the balance sheet are on deposit with Mellon Trust of New York, LLC located at 200 Park Avenue, New York, NY 10166. A review of the Exchange's custodian service agreement with Mellon Trust of New York, LLC indicates that the agreement lacks the following protective provision:

1. There should be a provision in the agreement that would give the insurer the opportunity to secure the most recent report on the review of the custodian's system of internal controls, pertaining to custodian record keeping, issued by internal or independent auditors.

It is recommended that the Exchange amend its custodian agreement to incorporate this provision.

6. AUTHORIZED POWERS AND MINIMUM CAPITAL REQUIRED

The Exchange is authorized by its declaration of initial subscribers and attorney-in-fact to transact the kinds of insurance described in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

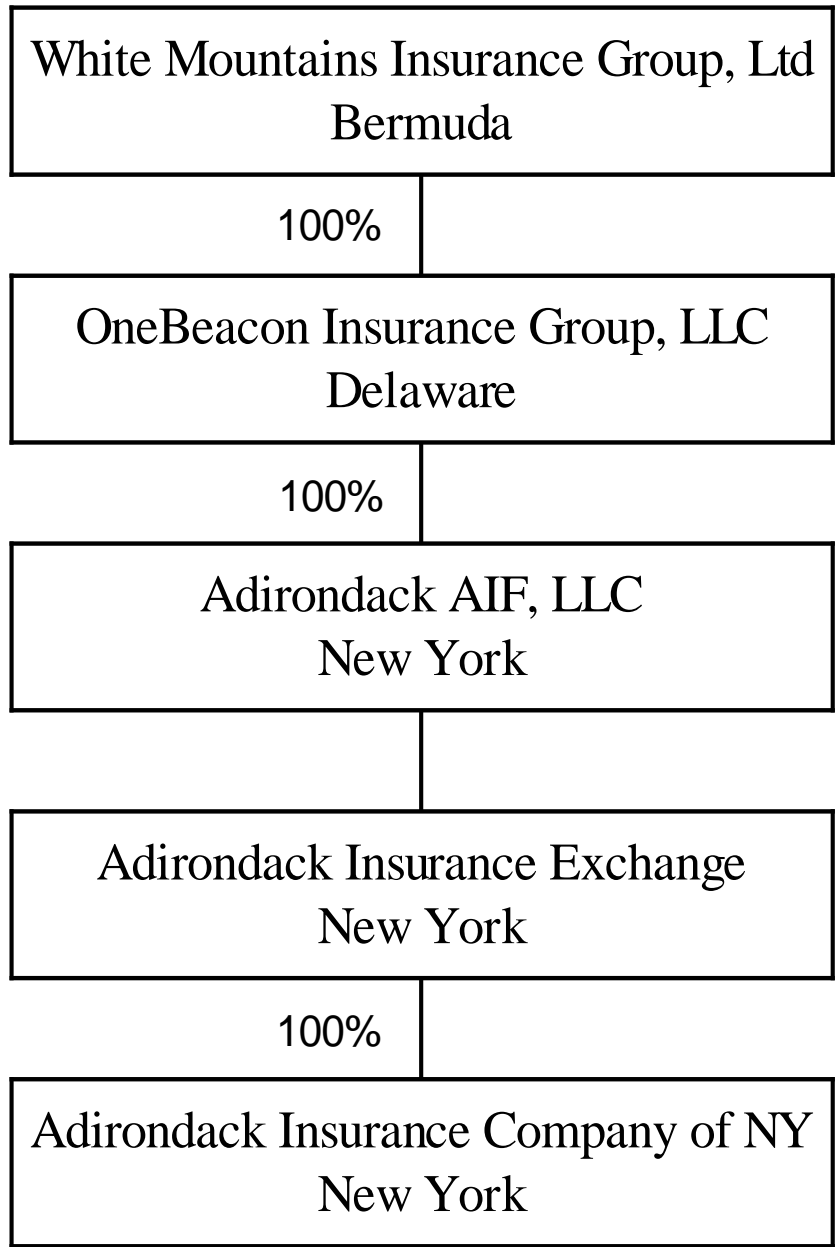
<u>Paragraph</u>	<u>Lines of Business</u>
4	Fire insurance
5	Miscellaneous property insurance
6	Water damage insurance
7	Burglary and theft insurance
8	Glass insurance
11	Animal insurance
12	Collision insurance
13	Personal injury liability insurance
14	Property damage liability insurance
17	Credit insurance
19	Motor vehicle and aircraft physical damage insurance

<u>Paragraph</u>	<u>Lines of Business</u>
20	Marine and inland marine insurance
21	Marine protection and indemnity insurance
22	Residual value insurance
26	Gap insurance

Sections 4103, 4104, 6102(e) and 6108(d)(1) of the New York Insurance Law provide that in order to be licensed to write non-assessable policies for the foregoing kinds of insurance, the Exchange shall have an initial surplus to policyholders of \$10,400,000 and shall thereafter maintain a minimum surplus to policyholders of \$9,900,000. The Exchange has met these requirements.

6. HOLDING COMPANY SYSTEM

ADIRONDACK AIF, LLC, the attorney-in-fact of AIE, controls Adirondack Insurance Exchange. Adirondack AIF, LLC is wholly owned by OneBeacon Insurance Group, LLC. Adirondack Insurance Company of New York is wholly owned by AIE. White Mountains Insurance Group, Ltd. of Bermuda is the ultimate person in control of the Exchange. Their holding company chart is as follows:



NOTE: Adirondack Insurance Company of New York is currently being organized as a subsidiary of the Exchange.

The Exchange was party to the following agreements with other members of its holding company system:

1) Insurance Management Service Agreement

The Exchange was a party to an insurance management service agreement with Adirondack AIF, LLC. Said agreement was effective on June 30, 2003 and states that Adirondack AIF, LLC will provide claims payment and adjustment, settle losses and claims, establish loss and loss adjustment expense reserves, provide underwriting inspection services, pay reinsurance premiums, costs and expenses, and maintain required surplus levels for the Exchange. The agreement also stipulates that Adirondack AIF, LLC is authorized in its discretion to enter into contracts with other corporations, individuals or partnerships to perform any activities set forth in the agreement. The agreement was non-disapproved pursuant to Section 1505(d)(3) by the New York Insurance Law.

In addition, the agreement provides that the Exchange authorizes payment to the Adirondack AIF, LLC of an amount equal on an annual basis to 14% of gross written premiums as compensation for insurance business and management services rendered.

2) Investment Management Agreement

The Exchange was also a party to an investment management agreement with White Mountains Advisors LLC (“WMA”). Said agreement was effective on July 1, 2003 and states that WMA will act as a discretionary adviser with respect to the assets of the Exchange, supervise and direct the investments as described in the investment guidelines. WMA agrees to provide the Exchange with a quarterly report containing a detailed listing of the invested assets and transactions in the account. The agreement was non-disapproved pursuant to Section 1505(d)(3) by the New York Insurance Department.

8. CONCLUSION

Based on the foregoing examination, it is concluded that the Exchange has received a surplus contribution in the amount of \$70,700,000.

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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A. Custodian Agreement

It is recommended that the Exchange amend its custodian agreement to incorporate a provision that would give the insurer the opportunity to secure the most recent report on the review of the custodian's system of internal controls, pertaining to custodian record keeping, issued by internal or independent auditors. 6

Respectfully submitted,

_____/S/_____
Joseph Revers
Senior Insurance Examiner

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

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

_____/S/_____
Joseph Revers

Subscribed and sworn to before me

this _____ day of _____ 2003

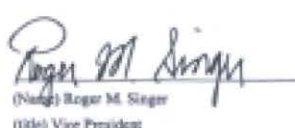
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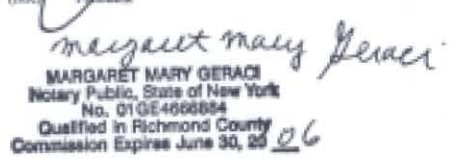
The undersigned, John C. Heller and Roger M. Singer are the duly appointed President and Vice President of Adirondack AIF, LLC, the attorney in fact for Adirondack Insurance Exchange, a New York reciprocal insurer (the "Company"). In such capacity, each of the undersigned hereby declares under penalty of perjury as follows:

1. The paid in surplus of the Company in the amount of Seventy Million Seven Hundred Thousands Dollars (\$70,700,000) has not been withdrawn, pledged or in any way impaired.
2. The paid in surplus of the Company is not to be invested or otherwise legitimately used or appropriated except for the sole and exclusive use and benefit of the Company
3. There is no agreement or understanding express or implied, made or existing between the Company and its officers, or any of them, or any person or persons, to the effect or import that the money paid in by any subscriber shall be loaned or returned to him
4. Neither the Company nor any of its officers is in any way, manner or form pledged or committed to make any investment, loan, or disposition of said paid in surplus, or any part thereof, which is not in strict conformity in all respects with the provisions of the New York Insurance Law of the State of New York.
5. That said paid in surplus is the property of Adirondack Insurance exchange and possessed by it in its corporate name and capacity for the benefit of its policyholders.

IN WITNESS THEREOF, the undersigned have executed this Affidavit as of the 24th day of July 2003.


(Name) John C. Heller
(Title) President


(Name) Roger M. Singer
(Title) Vice President


MARGARET MARY GERACI
Notary Public, State of New York
No. 01GE456684
Qualified in Richmond County
Commission Expires June 30, 2006

ACKNOWLEDGEMENT

State of Massachusetts)
)
County of Suffolk)

Kelly Ann Niemiec

On July 24, 2003, the forgoing Affidavit was executed in my presence by Roger M. Singer, who is personally known to me, and whom I acknowledge to be the persons who executed the foregoing instrument.

KELLY ANN NIEMIEC
Notary Public
Commonwealth of Massachusetts
My Commission Expires
September 23, 2009

Appointment No 22083

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:

Joseph Revers

as proper person to examine into the affairs of the

ADIRONDACK INSURANCE EXCHANGE

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

Reciprocal

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 23rd day of July, 2003




GREGORY V. SERIO
Superintendent of Insurance