

REPORT ON ORGANIZATION
OF THE
ADIRONDACK INSURANCE EXCHANGE
AS OF
SEPTEMBER 24, 2004

DATE OF REPORT

OCTOBER 6, 2004

EXAMINER

JOSEPH REVERS

TABLE OF CONTENTS

| <u>ITEM NO.</u> | <u>PAGE NO.</u> |
|---|-----------------|
| 1. Scope of examination | 2 |
| 2. Organization of domestic reciprocal insurers | 2 |
| 3. Capitalization and subscription | 4 |
| 4. Balance sheet | 5 |
| 5. Custodian agreement | 5 |
| 6. Authorized powers and minimum capital required | 6 |
| 7. Holding company system | 6 |
| 8. Conclusion | 9 |
| 9. Summary of comments and recommendations | 9 |
| Affidavit | |



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

October 6, 2004

Honorable Gregory 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" appears herein without qualification, they should be understood to indicate the Adirondack Insurance Exchange.

Whenever the term "Department" appears 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 the 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 DOMESTIC RECIPROCAL INSURERS

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 6400 Sheridan Drive, Suite 300, Williamsville, New York 14221.

The members of the advisory committee and the principal officers of the attorney-in-fact as of September 24, 2004 were as follows:

Advisory Committee

| <u>Name</u> | <u>Principal Affiliation</u> |
|---|---|
| James Paul Amaden III East Hampton, NY | President and Chief Executive Officer, Amaden Gay Agency |
| Louis Atti Angola, NY | Office Manager, M & W Agency Inc. |
| David R. Bauer Albany, NY | President, Capital Region Insurance Agency |
| Beth Marie Gardner Watermill, New York | Operations Manager, Maran Corporate Risk Associates |

Advisory Committee

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

Officers

| <u>Name</u> | <u>Title</u> |
|--------------------|-----------------------------------|
| John P. Cavoores | Chairman |
| John C. Heller | President, 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 parent 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 September 24, 2004, as determined by this examination:

Assets

| | |
|---------------------------------|---------------------|
| Bonds | \$70,067,482 |
| Cash and short-term investments | <u>662,481</u> |
| Total assets | <u>\$70,729,963</u> |

Liabilities

| | |
|----------------------------------|---------------------|
| Other expenses | \$29,963 |
| Total liabilities | \$29,963 |
| Subordinated surplus note | <u>\$70,700,000</u> |
| Surplus as regards policyholders | <u>70,700,000</u> |
| Total liabilities and surplus | <u>\$70,729,963</u> |

5. CUSTODIAN AGREEMENT

The Exchange's assets listed on the balance sheet above 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 indicated that the agreement lacks a provision that would allow AIE to 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:

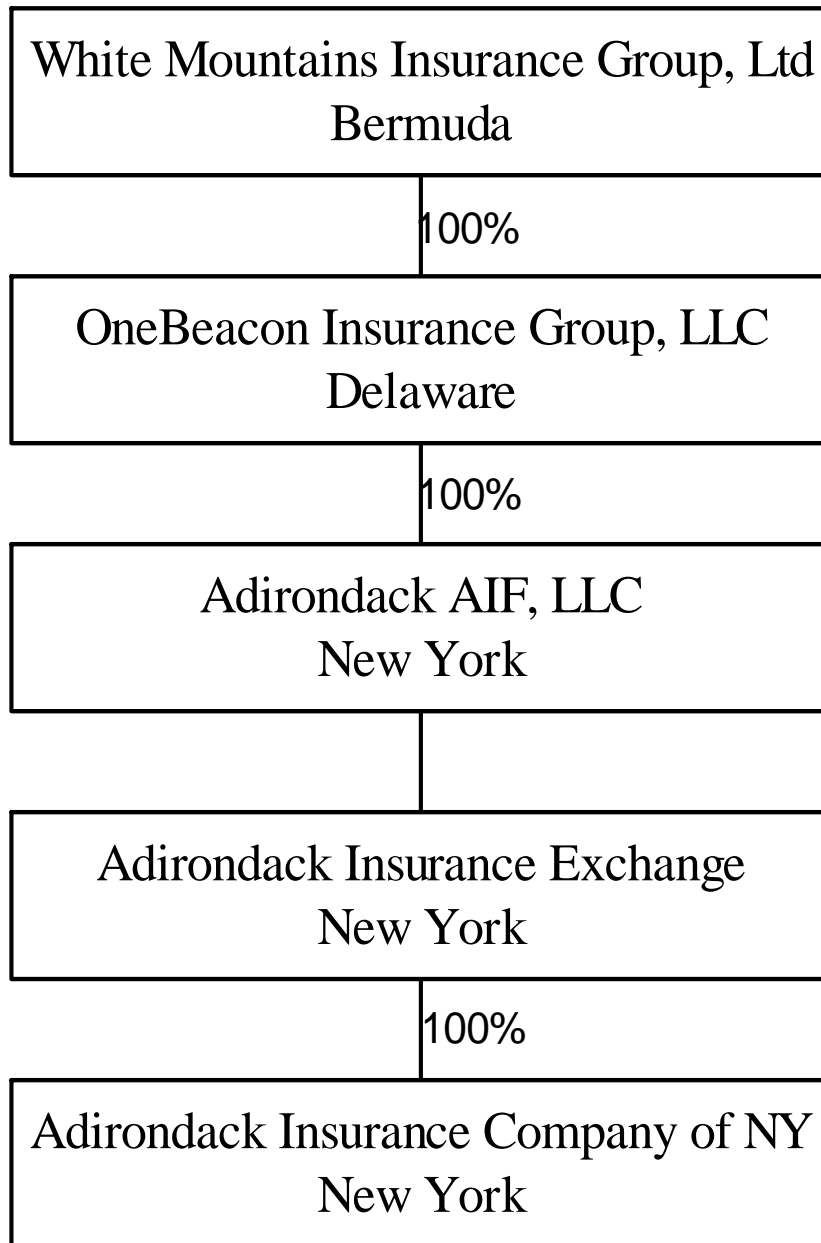
| <u>Paragraph</u> | <u>Lines of Business</u> |
|------------------|--|
| 04 | Miscellaneous Property Insurance |
| 05 | Water Damage Insurance |
| 06 | Fire Insurance |
| 07 | Burglary and Theft Insurance |
| 08 | Glass Insurance |
| 11 | Animal Insurance |
| 12 | Collision Insurance |
| 13 | Personal Injury Liability Insurance |
| 14 | Property Damage Liability Insurance |
| 17 | Credit Insurance |
| 19 | Motor Vehicle and Aircraft Physical Damage Insurance |
| 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.

7. HOLDING COMPANY SYSTEM

Adirondack Insurance Exchange is controlled by Adirondack AIF, LLC, the attorney-in-fact of AIE. Adirondack AIF, LLC is wholly owned by OneBeacon Insurance Group, LLC. Adirondack Insurance

Company of New York is wholly owned by AIE. The Exchange's ultimate parent is White Mountains Insurance Group, Ltd. of Bermuda. The following is the holding company system chart:



The Exchange entered into the following agreement with members of the holding company system:

Insurance Management Service Agreement

The Exchange is a party to an insurance management service agreement with Adirondack AIF, LLC. Said agreement was submitted to the Department for approval. The agreement states that Adirondack AIF, LLC will provide claims payment and adjustment, settle losses and claims, establish losses 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.

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.

Investment Management Agreement

The Exchange is also a party to an investment management agreement with White Mountains Advisors LLC (“WMA”). Said agreement was also submitted to the Department for approval. The agreement 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.

8. CONCLUSION

Based on the foregoing examination, it is concluded that the Exchange has in place the initial surplus to policyholders.

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM

PAGE NO.

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.

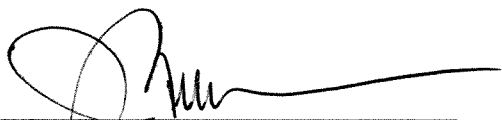
5

AFFIDAVIT

The undersigned, John C. Heller and Maurice H. Chew, are the duly appointed President and Chief Financial Officer 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 is 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 September 2004.



John C. Heller
President



Maurice H. Chew
Chief Financial Officer

ACKNOWLEDGEMENT

State of New York)
)
County of New York)

In witness whereof, the foregoing Affidavit was executed in my presence by
JOHN C. HELLER, who is personally known to me, and whom I
acknowledge to be the person who executed the foregoing instrument. I have hereunto
subscribed my name and affixed by official seal this 24th day of
September, 2004.

Linda Granda-Solis
Notary Public

My Commission Expires:

LINDA GRANDA-SOLIS
Notary Public, State of New York
No.01GR482277
Qualified in Westchester County
Commission Expires January 31, 2007

ACKNOWLEDGEMENT

State of New York)
)
County of New York)

In witness whereof, the foregoing Affidavit was executed in my presence by
MAURICE H. CHEN, who is personally known to me, and whom I
acknowledge to be the person who executed the foregoing instrument. I have hereunto
subscribed my name and affixed by official seal this 24th day of
September, 2004.

Linda Granda-Solis
Notary Public

My Commission Expires:

LINDA GRANDA-SOLIS
Notary Public, State of New York
No.01GR482277
Qualified in Westchester County
Commission Expires January 31, 2007

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 _____ 2004

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

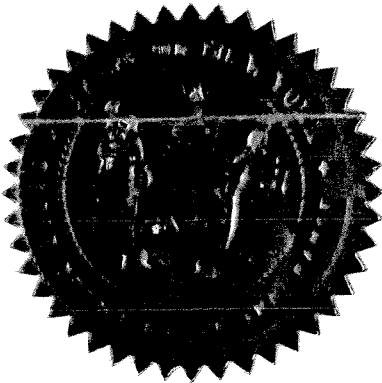
and to make a report to me in writing of the condition of the said


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