

Examination Warrant Number 10-PC-146

Report of Examination of

Chartis Property Casualty Company
Harrisburg, Pa.

(f.k.a Birmingham Fire Insurance Company of Pennsylvania)

As of December 31, 2010

For Informational Purposes Only

Chartis Property Casualty Company

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Harrisburg, Pennsylvania
May 31, 2012

Honorable Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania 17120

Deputy Commissioner:

In accordance with instructions contained in Examination Warrant Number 10-PC-146, dated, March 5, 2010, an examination was made of

Chartis Property Casualty Company NAIC CoCode:19402

a Pennsylvania domiciled property and casualty insurance company, hereinafter may be referred to as "Company." The examination was conducted at the Company's offices, located at 180 Maiden Lane, New York, New York 10038.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2005. This examination covered the five-year period from January 1, 2006 through December 31, 2010, and consisted of a general survey of the Company's business practices and management, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department (Department) and the National Association of Insurance Commissioners (NAIC).

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a factual disclosure of other significant regulatory information.

For each year during the period under examination, the Certified Public Accounting (CPA) firm of PricewaterhouseCoopers has provided an unqualified opinion based on statutory accounting principles. Relevant work performed by the CPA firm, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

The following member companies of the Chartis U.S. Inc. Admitted Pool were examined concurrently during this examination:

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Company	NAIC Code
Chartis Casualty Company (PA)	40258
The Insurance Company of the State of Pennsylvania (PA)	19429
Granite State Insurance Company (PA)	23809
New Hampshire Insurance Company (PA)	23841
National Union Fire Insurance Company of Pittsburgh, Pa. (PA)	19445
American Home Assurance Company (NY)	19380
Commerce and Industry Insurance Company (NY)	19410
Illinois National Insurance Co. (IL)	23817

HISTORY

The Company was incorporated on May 17, 1871, licensed by the Department and commenced business on August 1, 1871.

The Company is currently authorized to transact those classes of insurance described in (40 P.S. § 382), subsection (b), paragraphs (1) fire and allied lines, (2) inland marine and auto physical damage, (3) ocean marine and subsection (c), paragraphs (1) fidelity & surety, (2) accident & health, (3) glass, (4) other liability including professional liability, medical malpractice, prepaid legal, etc., (5) boiler & machinery, (6) burglary & theft, (7) credit, (8) water damage, (9) elevator, (10) livestock, (11) auto liability, (12) mine, (13) personal property floater, and (14) workers' compensation.

MANAGEMENT AND CONTROL

CAPITALIZATION

There was no change in the capital stock during the period under examination. The total capitalization at December 31, 2010 consisted of 25,000 common shares authorized, issued and outstanding with a par value of \$200 per share resulting in capital stock of \$5,000,000, aggregate write-ins for special surplus funds of \$68,639, paid in and contributed surplus of \$799,579,453 and unassigned of \$888,961,888.

The total capitalization required of the Company to engage in the types of business for which it is licensed, is \$2,350,000 in capital and \$1,175,000 in surplus. The Company has met this surplus requirement throughout the examination period.

STOCKHOLDERS

The controlling entity of the Company is American International Group, Inc. (AIG). In September 2008, AIG experienced a severe strain on its liquidity that resulted in AIG entering into an \$85 billion revolving credit facility and a guarantee and pledge agreement with the Federal Reserve Bank of New York. Pursuant to the credit facility agreement, on March 4, 2009, AIG issued 100,000 shares of Series C Perpetual, Convertible, Participating Preferred Stock (Series C Preferred Stock) to the AIG Credit Facility Trust, a trust established for the sole benefit of the United States Treasury. In November 2008 and April 2009, AIG also issued preferred securities to the United States Department of the Treasury

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under the Troubled Asset Relief Program (TARP). At December 31, 2010, ownership of AIG was split between the AIG Credit Facility Trust, which held approximately 79% of the voting power, and public shareholders, who held approximately 21% of the voting power.

All dividends have been approved to the extent required and paid within the existing regulatory guidelines. The Company paid the following dividends to its parent during the examination period:

<u>Year</u>	<u>Amount</u>
2010	\$ 106,699,300
2009	\$ 110,000,000
2008	\$ 214,786,650
2007	\$ 130,000,000
2006	\$ -
Total	\$ 561,485,950

INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement as directed by 40 P.S. § 991.1404, Registration of Insurers. Pursuant to this requirement, an Insurance Holding Company System Registration Statement and various amendments thereto, appear to have been timely filed with the Department for the period under examination.

AIG is a holding company group that consists of three primary segments:

1. Chartis – Property & Casualty insurance operations that write substantially all lines of commercial and consumer insurance products domestically and abroad;
2. SunAmerica Financial Group – life, Accident & Health, and annuity products sold to individuals and groups;
3. Financial Services – includes aircraft leasing (International Lease Finance Corp); and Capital Markets portfolios through AIG Financial Products Corp (AIGFP).

The Company is part of the AIG holding company structure which includes insurance companies, management companies, agencies and other enterprises doing business in all states of the United States and around the world. The parent company, AIG, is a publicly traded company.

The following depicts a partial organizational structure of AIG as of December 31, 2010 (all ownership is 100% unless otherwise noted):

- ◆ American International Group, Inc.
 - AIG Life Holdings (International) LLC
 - Various Entities
 - SunAmerica Financial Group, Inc.
 - Various Entities
 - AIG Capital Corporation

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- Various Entities
- AIG Global Services, Inc.
 - Various Entities
- AIG Financial Products Corp.
 - Various Entities
- United Guaranty Corporation
 - Various Entities
- AIUH, LLC
 - Chartis Inc.
 - Chartis International, LLC
 - Various Entities
 - Chartis Global Services, Inc.
 - Chartis Global Claims Services, Inc.
 - Chartis Claims, Inc.
 - Chartis U.S. Inc.
 - National Union Fire Insurance Company of Pittsburg, Pa.
 - Chartis Specialty Insurance Company (70%)
 - Lexington Insurance Company (70%)
 - Spruce Peak Realty, LLC (1%)
 - Chartis Select Insurance Company
 - Chartis Excess Limited
 - National Union Fire Insurance Company of Vermont
 - Mt. Mansfield Company, Inc.
 - Spruce Peak Realty, LLC (99%)
 - American Home Assurance Company
 - Chartis Non-Life Holding Company (Japan), Inc.
 - The Fuji Fire & Marine Insurance Company, Limited (38.62%)
 - American Fuji Fire & Marine Insurance Company
 - Fuji Life Insurance Company Ltd.
 - Fuji International Insurance Company Limited
 - New Hampshire Insurance Company
 - Chartis Casualty Company
 - Granite State Insurance Company
 - Illinois National Insurance Co.
 - Morefar Marketing, Inc.
 - Commerce and Industry Insurance Company
 - AIG Polska Towarzystwo Ubezpieczen S.A.
 - The Insurance Company of the State of Pennsylvania
 - Chartis Specialty Insurance Company (20%)
 - Lexington Insurance Company (20%)
 - Landmark Insurance Company
 - **Chartis Property Casualty Company**
 - Chartis Specialty Insurance Company (10%)

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- Lexington Insurance Company (10%)
- Chartis Insurance Company of Canada
- Quartz Holdings LLC
 - Fieldstone Securitization I LLC
 - Graphite Management LLC
 - Lavistone Capital LLC
 - Slate Capital LLC
 - Alabaster Capital LLC
- Chartis Aerospace Insurance Services, Inc.
- Chartis WarrantyGuard, Inc.
- Chartis Warranty Services, Inc.
- Risk Specialists Companies, Inc.
 - Risk Specialists Companies, Inc.
 - Risk Specialists Companies Insurance Agency, Inc.
 - Design Professionals Association Risk Purchasing Group, Inc.
 - Medical Excess Insurance Services, Inc.
 - Medical Excess LLC (70%)

BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors (Board), which was comprised of the following members as of the examination date, December 31, 2010:

Name and Address	Principal Occupation
John Quinlan Doyle Rye, New York	President and Chief Executive Officer Chartis U.S., Inc.
David Neil Fields New York, New York	Reinsurance and Underwriting Executive Vice President, Property and Casualty Group
David Lawrence Herzog St. Albans, Missouri	Executive Vice President and Chief Financial Officer, American International Group, Inc.
Monika Maria Machon New York, New York	Senior Vice President and Chief Investment Officer, AIG Investments
Kristian Philip Moor Fairfield, Connecticut	President and Chief Executive Officer Chartis Inc.
Sid Sankaran New York, New York	Chief Risk Officer and Senior Vice President American International Group, Inc.
Robert Scott Higgins Schimek Newtown, Pennsylvania	Executive Vice President and Chief Financial Officer, Chartis Inc.

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Mark Timothy Willis
Naperville, Illinois

Senior Vice President
American International Group, Inc.

All directors are elected annually at the stockholder meeting and are elected to serve a term of one year. These elections appear to have been held in compliance with the Company's By-laws.

AIG has established a Code of Conduct for use and guidance of its employees, including officers of AIG, that addresses, among other things, disclosure of any potential conflicts between their personal interests and the interests of AIG, or any of its subsidiaries. Since 2005, all officers and employees are required to recertify compliance with the Code of Conduct on an annual basis.

40 P.S. 991.1405 (c) (3) Standards of transactions between insurer and affiliate (within the holding company system) states, in part, that "not less than one-third of the directors of any domestic insurer and not less than one-third of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of such insurer or of any entity controlling, controlled by or under common control with such insurer and who are not beneficial owners of a controlling interest in the voting stock of such insurer of any such entity. At least one such person must be included in any quorum for the transaction of business at any meeting of the board of directors or any committee thereof."

Likewise, 40 P.S. 991.1405 (c) (4) Standards of transactions between affiliates (within the holding company system), further states that "the board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have the responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers."

An extension of 40 P.S. 991.1405 (c) (5) proclaims that the cited laws above shall not apply to a domestic insurer if the person controlling such insurer is an insurer or a publicly held corporation having a board of directors and committees thereof which already meet the requirements of paragraphs (3) and (4). AIG, the Company's parent, board membership has the necessary independence and has established independent committees to comply with paragraphs (3) and (4) as cited above.

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OFFICERS

As of the examination date, December 31, 2010, the following officers were appointed and serving in accordance with the Company's By-laws:

Name	Title
Kristian Philip Moor	Chairman of the Board
John Quinlan Doyle	President and CEO
Sean Thomas Leonard	CFO and Senior Vice President
Denis Martin Butkovic	Secretary
Russell Mark Johnston	COO and Executive Vice President
Frank Hienmen Douglas, Jr.	Executive Vice President
David Neil Fields	Executive Vice President
Robert Scott Higgins Schimek	Executive Vice President
Nicholas Charles Walsh	Executive Vice President
Christopher Vincent Blum	Senior Vice President
Gary Eugene Muoio	Senior Vice President
Richard Thomas Pisano	Senior Vice President
Thomas Craig Tucker	Senior Vice President
Richard Carl Woollams	Senior Vice President
Jacqueline Marie Alvino	Vice President
Susan Elizabeth Colford	Vice President
Daniel Francis Conway	Vice President
Agustin Formoso Jr.	Vice President
Gregory Joseph Giardiello	Vice President
Craig Wilson Leslie	Vice President
Josephine Bourne Lowman	Vice President
Anthony Richard Romano	Vice President
James John Rowland	Vice President
John Hugh Shalaida	Vice President
Robert Edwin Staples	Vice President

CORPORATE RECORDS

MINUTES

A review of the corporate minutes indicated the annual meetings' of the stockholder and election of directors of the Company were held in compliance with the Company's By-laws. Minutes of the stockholder annual meetings indicate that the prior year's actions of the officers and directors of the Company were ratified. Quorums were present at all stockholder and Board of Director meetings. Company officers were appointed at the Board of Director's Annual Meeting.

A review of the minutes also indicates the Company's investment transactions are approved quarterly by the Board of Directors and the meetings are all generally well attended.

ARTICLES OF INCORPORATION

There were no amendments to the Company's Articles of Incorporation during the examination year.

BY-LAWS

There were no amendments to the Company's By-laws during the examination year.

SERVICE AND OPERATING AGREEMENTS

Inter-Company Pooling Agreement

The Chartis U.S., Inc. Admitted Pool (Admitted Pool) was formed by the execution of an Inter-Company Pooling Agreement (Pooling Agreement). As amended, the Pooling Agreement establishes a "pool" in which participants share a fixed percentage of underwriting assets, liabilities, income and expenses. The current pool members ("Pooled Companies") are:

- Chartis Property Casualty Company (PA) - 5%
- American Home Assurance Company (NY) - 36%
- Commerce and Industry Insurance Company (NY) - 11%
- The Insurance Company of the State of Pennsylvania (PA) - 5%
- National Union Fire Insurance Company of Pittsburgh, Pa. (PA) - 38%
- Granite State Insurance Company (PA) - 0%
- Illinois National Insurance Co. (IL) - 0%
- New Hampshire Insurance Company (PA) - 5%
- Chartis Casualty Company (PA) - 0%

Service and Expense Sharing Agreement

The Pooled Companies and other affiliates are party to a Service and Expense Sharing Agreement with AIG. Pursuant to the terms of this agreement, AIG and/or any of its affiliates may provide the services and facilities specified in the agreement, at cost, to any named party to the agreement. Services include: Law, Investment, EDP, Internal Audit, Actuarial, Claims, Underwriting, Accounting, Tax, and Employee Benefits. Settlement for these services shall be quarterly, as per the agreement.

In the ordinary course of business, the Company utilizes the services of certain affiliated companies for data center systems, investment, salvage, subrogation and recovery services, and claims management. These companies are AIG Global Services, Inc., AIG Global Asset Management Holdings Corp., and Chartis Claims, Inc., respectively. Services from the aforementioned affiliates are provided under the Service and Expense Sharing Agreement with AIG.

This Service and Expense Sharing Agreement has been amended multiple times to add additional affiliates.

Tax Sharing Agreement

The Company files a consolidated U.S. federal income tax return with the Ultimate Parent, AIG, Inc. The Company has a written tax sharing agreement with Chartis, Inc.

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("Subgroup Parent"), which was amended, effective January 1, 2010, which provides that Subgroup Parent will not charge the Company a greater portion of the consolidated tax liability than would have been paid by the Company if it had filed a separate federal income tax return. Subgroup Parent also has a separate tax sharing agreement with AIG ("Parent"), which provides that AIG will not charge Subgroup Parent a greater portion of the consolidated tax liability than would have been paid by the Chartis Subgroup if it had filed a separate federal income tax return. Additionally, the Company's amended tax sharing agreement contains the following significant requirements:

- A tax Subgroup was formed with Chartis, Inc. as the Subgroup Parent. The Company will settle inter-company income taxes with the Subgroup Parent as if the Company were filing its own separate federal income tax return. Any net liability will be settled with the Subgroup Parent in accordance with federal estimated tax payment requirements with final payments/refunds paid within 90 days after Subgroup Parent makes or receives a final payment to or receipt of refund from Parent.
- Any tax realized by the Company from triggering a deferred inter-company gain (as determined under Treasury regulation Section 1.1502-13) in which no consideration was received will be paid by the Subgroup Parent.
- Chartis, Inc. assumes the Company's Tax Reserves in a deemed capital contribution transaction. Tax Reserves mean any liability recorded in accordance with Financial Accounting Standards Board Interpretation No. 48 – Accounting for Uncertainty in Income Taxes (FIN 48) and any tax liability recorded as the result of an agreed upon adjustment with the tax authorities, except ones arising as a result of errors or omissions.

Capital Maintenance Agreement

On February 23, 2010, the Company entered into a Capital Maintenance Agreement (CMA) with its Ultimate Parent, AIG. The CMA provides that in the event that the Company's Total Adjusted Capital falls below 200% of the Company's Authorized Control Level Risk Based Capital (RBC), as shown in the Company's 2009 Annual Statement, together with any adjustments or modifications required by the Company's domiciliary regulator, AIG will within thirty days of written notice thereof provide a capital contribution to the Company in an amount that equals the difference between the Company's Total Adjusted Capital and 200% of the Company's Authorized Control Level RBC. In lieu of making any such capital contribution, with the approval of the domiciliary insurance department, AIG may provide a letter of credit naming the Company as beneficiary. Please refer to the "Subsequent Events" section of this report for a discussion of similar agreements that were effective after December 31, 2010.

Investment Advisory Agreements

The Pooled Companies have agreements with AIG Asset Management (U.S.), LLC, (Manager) to provide investment advisory services to include investment advisory accounts. The agreement authorizes the Manager to supervise and direct all investments and to exercise whatever powers the Company may possess with respect to its invested assets. Investment transactions will be in accordance with investment objectives of the Company and subject to

restrictions established by the Company, as communicated to the Manager in writing from time to time. With regard to these limitations, the Manager may buy, sell, exchange, convert and otherwise trade in and engage in investment transactions of any nature whatsoever involving any stocks, bonds, commercial paper, money market instruments and other securities and assets when it deems appropriate and without prior consultation with the Company.

REINSURANCE

POOLING AGREEMENT

The Company participates in the Pooling Agreement described in the “Service and Operating Agreements” section of this report. The Pooling Agreement provides for the pooling of underwriting related assets, liabilities, income and expenses based on each member company’s pool participation percentage.

The Pooled Companies and their pooling percentages as of December 31, 2010 were as follows:

Pool Company	State of Domicile	Pool %
American Home Assurance Company	New York	36%
Chartis Casualty Company	Pennsylvania	0%
Chartis Property Casualty Company	Pennsylvania	5%
Commerce and Industry Insurance Company	New York	11%
Granite State Insurance Company	Pennsylvania	0%
Illinois National Insurance Co.	Illinois	0%
National Union Fire Insurance Co. of Pittsburgh, Pa.	Pennsylvania	38%
New Hampshire Insurance Company	Pennsylvania	5%
The Insurance Company of the State of Pennsylvania	Pennsylvania	5%
Total Pool		<u>100%</u>

CEDED

External treaty reinsurance is placed by AIG’s Global Reinsurance Division (GRD). Reinsurance officers within GRD are aligned with specific AIG Profit Centers and are responsible for determining structures, negotiating, and placing individual treaty reinsurance programs. GRD’s Catastrophe (CAT) Unit reviews, analyzes, and assists in placing AIG’s overall CAT reinsurance. GRD places reinsurance for various legal entities within AIG.

Chartis US maintains extensive reinsurance, with programs placed with U.S. domestic, international and offshore reinsurance facilities. Reinsurance strategies have been established to support management initiatives. During 2009, natural catastrophe risk appetite for 2010 was set at \$5 billion. At this time the Probable Maximum Loss (PML) was \$7.2 billion. A rebalancing of reinsurance purchases was accomplished through an increased use of domestic rather than reinsurance purchased internationally. PML as of March 2010 was \$5.4 billion. Outside of natural catastrophe management, per risk retentions are being moved, upon renewal, towards \$100 million per claim. Additionally during 2010, Chartis US for the first time obtained reinsurance supported by the capital markets. Chartis US has obtained \$425 million of

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protection against U.S. hurricanes and earthquakes through May 2013 from Lodestone Re, a special purpose vehicle incorporated under the laws of Bermuda; fully collateralized through a catastrophe bond issued by Lodestone Re.

The Pool premium net retention for December 31, 2010 is as follows:

Gross Premium Written	\$ 39,501,280,641
Ceded Premium Written	\$ 26,391,445,904
Net Written	\$ 13,109,834,737
Net Retention	33.19%

Property Catastrophe

Chartis US purchases catastrophe protection for its commercial business. The most significant are the property catastrophe covers.

Property catastrophe covers as of December 31, 2010 were as follows:

Cover			All Peril	Wind only	Cat Coverage Earthquake Only	Total Wind	Total Earthquake
500,000,000	X	1,000,000,000	-	-	50,000,000	-	50,000,000
500,000,000	X	1,500,000,000	-	-	-	-	-
500,000,000	X	2,000,000,000	102,250,000	-	-	102,250,000	102,250,000
500,000,000	X	2,500,000,000	275,000,000	-	-	275,000,000	275,000,000
500,000,000	X	3,000,000,000	225,000,000	50,000,000	120,000,000	275,000,000	345,000,000
500,000,000	X	3,500,000,000	-	400,000,000	460,000,000	400,000,000	460,000,000
500,000,000	X	4,000,000,000	304,700,000	-	145,000,000	304,700,000	449,700,000
500,000,000	X	4,500,000,000	475,000,000	-	-	475,000,000	475,000,000
500,000,000	X	5,000,000,000	-	-	-	-	-
500,000,000	X	5,500,000,000	-	-	-	-	-
500,000,000	X	6,000,000,000	471,100,000	-	-	471,100,000	471,100,000
500,000,000	X	6,500,000,000	262,100,000	-	-	262,100,000	262,100,000
729,068,000	X	5,144,603,000	475,000,000	-	-	475,000,000	475,000,000
1,000,000,000	X	5,000,000,000	250,000,000	-	-	250,000,000	250,000,000 *
1,000,000,000	X	6,500,000,000	175,000,000	-	-	175,000,000	175,000,000 *
Wind ILW	X	2,500,000,000	-	50,000,000	-	50,000,000	-
Total			3,015,150,000	500,000,000	775,000,000	3,515,150,000	3,790,150,000

*Cat Bond

ASSUMED

For the year ended December 31, 2010 the Pooled Companies' assumed premiums written were as follows:

	Assumed Premium	Percent
US Inter-company Pooling	\$ 21,036,196,000	90.71%
Affiliated US Non Pool	623,320,000	2.69%
Affiliates Other - Non US	1,029,737,000	4.44%
Other US Unaffiliated	318,784,000	1.37%
Mandatory Pools	30,981,000	0.13%
Voluntary Pools and Associations	2,229,000	0.01%
Other Non US Insurers	149,421,000	0.65%
Total	\$ 23,190,668,000	100.00%

The Admitted Pool provides an internal cat program to the surplus lines pool effective January 1, 2010 covering exposures in the US and Canada. In total \$1.65B in coverage was provided in the \$2.75B excess of \$1.0B layers for a deposit premium of \$371M. The Admitted

Pool also provided \$1.7B of second event coverage in the \$3.35B excess of \$1.0B layers. Additionally the Admitted Pool participated in a property quota share with the surplus lines pool. Together this accounts for almost \$900M of the affiliated premiums assumed. It should be noted that the Chartis U.S. Inc. surplus lines pool insurers are not part of the Pool and that their risks are assumed by the Pool through affiliated reinsurance agreements.

Risk Transfer

Treaty placement is in accordance with the AIG Risk Transfer Policy that was adopted October 1, 2005. All assumed and ceded treaties and autofac and obligatory facultative arrangements (excluding captives) must be evaluated by reinsurance services personnel. In the case of a captive, the risk transfer assessment will be conducted at the business unit level. If the treaty/certificate contains one or more characteristics or contractual features that are intended to mitigate risk transfer, they are summarized in a risk transfer worksheet safe harbor document. The Reinsurance Officer and the Business Unit CFO, or his designee must assist in the determination of whether or not an actuarial analysis is required and whether or not there is sufficient risk transfer to allow for reinsurance accounting treatment. Evidence of this analysis and approval by the Reinsurance Manager, a Reinsurance Officer, and the Business Unit CFO, or his designee, is required. In accordance with SFAS No. 113 (paragraph 11), a risk transfer analysis is not required if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer. If none of the features summarized in the risk transfer worksheet are present, risk transfer is deemed to be self-evident and the insurance transaction qualifies for insurance accounting treatment.

When a risk transfer assessment is required, it must be included in the underwriting file no later than when the treaty/certificate is bound and be available on request. The documentation of the risk transfer assessment will vary based on circumstances, but the general requirements are outlined in the risk transfer worksheet. The documentation must state the conclusion and the basis thereof, and be sufficient to support the conclusion.

The examination team reviewed controls surrounding identified risks regarding risk transfer. Controls were found to be operating and effective.

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed in all states (except Hawaii) and the District of Columbia. The Company writes nearly all forms of property and liability coverages, specializing primarily in commercial and industrial risks.

The Pooled Companies write substantially all classes of business insurance, accepting such business mainly from insurance brokers and offer many specialized forms of insurance such as aviation, accident and health, equipment breakdown, directors and officers liability, difference-in-conditions, kidnap-ransom, export credit and political risk, and various types of professional errors and omissions coverages. Additionally, the Commercial Casualty Division provides insurance and risk management programs for large corporate customers and is a leading provider of customized structured insurance products. Chartis Environmental focuses on providing specialty products to clients with environmental exposures. The Worldsource Division

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introduces and coordinates AIG's products and services to U.S.-based multinational clients and foreign corporations doing business in the U.S. The Private Client Group provides a broad range of coverages for high net worth individuals.

The following schedule presents the Company's gross, ceded and net premium writings for 2010 by line of business and the percentage that each line of business bears to the total net premiums written:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	NWP % of Total
Fire	\$62,704,327	\$56,869,642	\$5,834,685	0.9%
Allied lines	50,847,033	41,857,182	8,989,851	1.5%
Farmowners multiple peril	9,106,785	6,810,768	2,296,017	0.4%
Homeowners multiple peril	448,002,153	419,457,737	28,544,416	4.6%
Commercial multiple peril	35,393,236	12,311,697	23,081,539	3.7%
Mortgage guaranty	59,535	0	59,535	0.0%
Ocean marine	74,656,128	63,463,372	11,192,756	1.8%
Inland marine	126,970,826	118,223,348	8,747,478	1.4%
Medical malpractice - occurrence	2,393,178	1,050,000	1,343,178	0.2%
Medical malpractice - claims-made	3,626,649	1,206,533	2,420,116	0.4%
Earthquake	63,971,317	59,547,344	4,423,973	0.7%
Group accident and health	78,050,288	11,918,192	66,132,096	10.7%
Other accident and health	8,671,412	819,085	7,852,327	1.3%
Workers' compensation	193,023,047	30,272,655	162,750,392	26.3%
Other liability - occurrence	250,371,286	145,414,656	104,956,630	16.9%
Other liability - claims-made	91,152,739	28,108,933	63,043,806	10.2%
Excess workers' compensation	7,485,186	270,918	7,214,268	1.2%
Products liability - occurrence	895,522	222,285	673,237	0.1%
Products liability - claims-made	816,831	241,725	575,106	0.1%
Private passenger auto liability	50,174,585	36,409,617	13,764,968	2.2%
Commercial auto liability	36,367,673	6,593,388	29,774,285	4.8%
Auto physical damage	45,166,172	35,859,287	9,306,885	1.5%
Aircraft	20,501,529	10,738,157	9,763,372	1.6%
Fidelity	6,921,938	1,378,780	5,543,158	0.9%
Surety	818,764	1,108,132	(289,368)	0.0%
Burglary and theft	835,200	74,212	760,988	0.1%
Boiler and machinery	7,799,308	5,692,803	2,106,505	0.3%
Credit	634,240	666,788	(32,548)	0.0%
Warranty	44,277,610	6,164,755	38,112,855	6.2%
Reinsurance - Non-proportional Assumed Property	615,223	0	615,223	0.1%
Reinsurance - Non-proportional Assumed Liability	7,877	0	7,877	0.0%
Totals	\$1,722,317,597	\$1,102,751,991	\$619,565,606	100.0%

Workers' compensation is the largest line of business constituting 28% of net premiums, followed by other liability" with 27% and the remaining 45% distributed over all other lines, none of which exceed 10%. The states with the largest volume of direct written premiums are Texas (14%), Florida (13%), Connecticut (12%), Kentucky (6%), and Arizona (4%).

SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are on an earned/incurred basis, and encompass the period covered by this examination:

	Amount	Percentage
Premiums earned	\$4,466,967,716	100.0%
Losses incurred	\$3,100,572,779	69.5%
Loss expenses incurred	546,239,291	12.2%
Other underwriting expenses incl	1,067,688,937	23.9%
Aggregate write-ins for underwrit	(4,840,000)	(0.1)%
Net underwriting gain or (loss)	(242,693,291)	(5.4)%
Totals	\$4,466,967,716	100.0%

The Company reported the following net underwriting, investment and other gains or losses during the period under examination:

Chartis Property Casualty Company

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Admitted assets	\$ 4,407,693,450	\$ 4,062,461,779	\$ 4,125,709,073	\$ 4,835,789,903	\$ 4,146,017,133
Liabilities	\$ 2,714,083,471	\$ 2,506,052,213	\$ 2,669,045,691	\$ 2,951,765,452	\$ 2,812,055,608
Surplus as regards policyholders	\$ 1,693,609,979	\$ 1,556,409,566	\$ 1,456,663,382	\$ 1,884,024,451	\$ 1,333,961,525
Gross premium written	\$ 1,722,317,597	\$ 1,846,338,817	\$ 1,571,559,121	\$ 1,704,359,156	\$ 1,653,228,493
Net premium written	\$ 619,565,606	\$ 755,724,350	\$ 865,678,137	\$ 1,023,234,449	\$ 1,028,137,756
Underwriting gain/(loss)	\$ (237,850,744)	\$ (118,345,526)	\$ (8,677,703)	\$ 85,304,563	\$ 36,876,119
Investment gain/(loss)	\$ 141,723,352	\$ 30,606,666	\$ 178,025,343	\$ 162,373,330	\$ 102,247,041
Other gain/(loss)	\$ 1,804,727	\$ (3,546,360)	\$ (219,910)	\$ 1,144,125	\$ 2,240,673
Net income	\$ (94,520,544)	\$ (25,503,082)	\$ 170,894,395	\$ 180,705,910	\$ 122,170,903

ACCOUNTS AND RECORDS

The accounts and records reviewed included an evaluation of the Company's operational and organizational controls. The areas evaluated included computer systems, accounting systems, organizational structure, and the processing structure. The Company operates in a computer-dominated environment.

The Pennsylvania Insurance Department engaged the services of INS Services, Inc., as an outside consultant to perform a review of the Commercial Lines Pool companies and certain other affiliates' information systems (IS) controls. The engagement instructed INS Services, Inc., to base their review on the NAIC's Exhibit C, Information Systems Questionnaire (ISQ).

The results of the INS Services, Inc. review have been provided to the Company and have been incorporated and relied upon within the examination process where appropriate.

The Admitted Lines Pooled companies continue to make changes to its financial systems in an effort to consolidate systems and streamline functions. The General Insurance Financial Transformation (GIFT) Project is a multi-year project designed to consolidate financial systems.

PENDING LITIGATION

Pending litigation and other commitments and contingencies as disclosed in the Company's Annual Statement footnotes were reviewed and no significant discrepancies or omissions were noted. Furthermore, the Company's management and general counsel provided representations that all material commitments and contingencies had been disclosed to the examination team.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2010, and the results of its operations for the period under review, is reflected as in the following statements:

- Statement of Assets, Liabilities, Surplus and Other Funds;
- Statement of Income;
- Statement of Capital and Surplus;
- Statement of Cash Flow.

For Informational Purposes Only

**Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,**

	2010	2009	2008	2007	2006
Bonds	\$ 1,635,747,480	\$ 1,862,038,773	\$ 1,899,226,067	\$ 2,073,446,216	\$ 2,100,926,871
Preferred stocks	0	20,000,000	40,748,437	25,084,375	66,203,750
Common stocks	1,451,085,026	1,143,530,746	885,185,642	1,556,170,357	915,592,380
Cash, cash equivalents, and short term investments	279,937,117	125,555,186	146,803,687	5,368,557	13,290,527
Other invested assets	326,821,962	306,862,497	298,235,002	323,125,749	227,710,839
Receivable for securities	306,576	249,423	0	0	1,949,323
Aggregate write-ins for invested assets	0	0	0	2,800,300	8,834,629
Subtotals, cash and invested assets	3,693,898,161	3,458,236,625	3,270,198,835	3,985,995,554	3,334,508,319
Investment income due and accrued	23,186,666	25,556,406	28,219,478	27,368,096	27,539,351
Premiums and agents' balances due	314,757,406	321,070,175	385,554,405	379,567,939	385,007,331
Amounts recoverable from reinsurers	54,764,122	65,624,727	89,418,255	63,216,944	67,657,668
Funds held by or deposited with reinsured companies	5,758,838	3,383,135	1,658,618	1,503,636	1,902,083
Current federal and foreign income tax recoverable and interest thereon	0	47,335,679	3,058,587	0	0
Net deferred tax asset	0	0	52,458,486	0	51,213,109
Guaranty funds receivable or on deposit	1,694,271	2,107,481	2,511,380	2,565,069	2,530,548
Receivable from parent, subsidiaries and affiliates	183,842,289	10,241,533	86,429,008	24,216,466	218,884
Aggregate write-ins for other than invested assets	129,791,697	128,906,018	206,202,021	331,356,199	275,439,840
Total	\$ 4,407,693,450	\$ 4,062,461,779	\$ 4,125,709,073	\$ 4,835,789,903	\$ 4,146,017,133
Losses	\$ 1,579,449,096	\$ 1,515,527,575	\$ 1,483,018,173	\$ 1,548,712,711	\$ 1,449,037,284
Reinsurance payable on paid loss and loss adjustment expenses	21,539,219	29,194,048	86,130,600	36,655,167	48,122,609
Loss adjustment expenses	290,889,917	270,039,267	274,146,099	273,951,991	248,591,492
Commissions payable, contingent commissions and other similar charges	(122,265)	(94,530)	(43,832)	(28,462)	(116,802)
Other expenses	2,637,704	30,901	9,134,864	264,027	252,288
Taxes, licenses and fees	28,877,520	29,540,788	33,015,670	31,511,410	24,721,023
Current federal and foreign income taxes	2,522,705	0	0	10,215,049	4,027,922
Net deferred tax liability	44,315,895	1,052,812	0	113,450,245	0
Borrowed money and interest thereon	0	0	0	3,046,761	8,834,629
Unearned premiums	394,277,281	464,774,598	503,654,317	593,908,274	579,456,562
Dividends declared and unpaid:					
Policyholders'	0	0	32,321	0	0
Ceded reinsurance premiums payable (net of ceding commissions)	50,431,813	39,788,229	61,724,988	68,123,740	55,067,473
Funds held by company under reinsurance treaties	18,324,183	20,750,224	23,683,042	32,438,403	31,527,884
Amounts withheld or retained by company for account of others	1,621,691	1,120,494	792,876	1,922,241	3,897,011
Remittances and items not allocated	3,948,116	5,828,861	4,186,980	5,432,733	5,172,232
Provision for reinsurance	13,355,227	12,347,155	13,269,653	16,014,979	17,771,509
Payable to parent, subsidiaries and affiliates	162,450,052	9,169,336	22,353,645	14,561,496	108,414,139
Payable for securities	8,930,288	9,882,590	590,603	29,817	0
Aggregate write-ins for liabilities	90,635,029	97,099,865	153,355,692	201,554,870	227,278,353
Total liabilities	2,714,083,471	2,506,052,213	2,669,045,691	2,951,765,452	2,812,055,608
Aggregate write-ins for special surplus funds	68,639	55,295	321,671	6,851,769	6,923,246
Common capital stock	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Gross paid in and contributed surplus	799,579,453	762,263,396	708,454,138	597,342,856	559,477,539
Unassigned funds (surplus)	888,961,887	789,090,875	742,887,573	1,274,829,826	762,560,740
Surplus as regards policyholders	1,693,609,979	1,556,409,566	1,456,663,382	1,884,024,451	1,333,961,525
Total	\$ 4,407,693,450	\$ 4,062,461,779	\$ 4,125,709,073	\$ 4,835,789,903	\$ 4,146,017,133

Comparative Statement of Income For the Year Ended December 31,

Underwriting Income	2010	2009	2008	2007	2006
Premiums earned	\$ 690,059,867	\$ 798,877,112	\$ 955,932,094	\$ 1,008,782,750	\$ 1,013,315,893
Deductions:					
Losses incurred	629,856,681	625,422,994	645,765,915	588,256,600	611,270,589
Loss expenses incurred	121,225,397	101,956,001	100,813,157	113,398,180	108,846,556
Other underwriting expenses incurred	181,668,533	189,843,643	218,030,725	221,823,407	256,322,629
Aggregate write-ins for underwriting deductions	(4,840,000)	0	0	0	0
Total underwriting deductions	927,910,611	917,222,638	964,609,797	923,478,187	976,439,774
Net underwriting gain or (loss)	(237,850,744)	(118,345,526)	(8,677,703)	85,304,563	36,876,119
Investment Income					
Net investment income earned	128,054,555	90,553,133	173,562,407	155,763,271	100,431,837
Net realized capital gains or (losses)	13,668,797	(59,946,467)	4,462,936	6,610,059	1,815,204
Net investment gain or (loss)	141,723,352	30,606,666	178,025,343	162,373,330	102,247,041
Other Income					
Net gain or (loss) from agents' or premium balances charged off	(3,641,098)	(4,879,450)	(6,737,083)	(12,115,878)	(6,911,331)
Finance and service charges not included in premiums	0	638,326	2,084,406	2,284,530	0
Aggregate write-ins for miscellaneous income	5,445,825	694,764	4,432,767	10,975,473	9,152,004
Total other income	1,804,727	(3,546,360)	(219,910)	1,144,125	2,240,673
Net income before dividends to policyholders and before federal and foreign income taxes	(94,322,665)	(91,285,220)	169,127,730	248,822,017	141,363,833
Dividends to policyholders	0	0	47,342	17,043	186,668
Federal and foreign income taxes incurred	197,879	(65,782,138)	(1,814,007)	68,099,064	19,006,262
Net income	\$ (94,520,544)	\$ (25,503,082)	\$ 170,894,395	\$ 180,705,910	\$ 122,170,903

For Informational Purposes Only

**Comparative Statement of Capital and Surplus
For the Year Ended December 31,**

	2010	2009	2008	2007	2006
Surplus as regards policyholders, December 31, previous year	\$ 1,556,409,566	\$ 1,456,663,382	\$ 1,884,024,451	\$ 1,333,961,525	\$ 955,426,097
Net income	(94,520,544)	(25,503,082)	170,894,395	180,705,910	122,170,903
Net unrealized capital gains or (losses)	224,740,777	230,006,174	(476,469,187)	450,933,860	213,746,245
Change in net deferred income tax	59,214,634	(6,038,500)	(10,435,040)	6,026,706	(2,787,161)
Change in nonadmitted assets	11,339,500	(9,270,030)	1,816,879	10,975,031	40,535,242
Change in provision for reinsurance	(1,008,072)	922,498	2,745,326	1,756,530	8,775,993
Cumulative effect of changes in accounting principles	0	(8,461,886)	0	0	0
Surplus adjustments:					
Paid in	37,316,057	28,779,279	111,111,282	37,865,317	0
Dividends to stockholders	(106,699,300)	(110,000,000)	(214,786,650)	(130,000,000)	0
Aggregate write-ins for gains and losses in surplus	6,817,362	(688,269)	(12,238,074)	(8,200,428)	(3,905,794)
Change in surplus as regards policyholder for the year	137,200,414	99,746,184	(427,361,069)	550,062,926	378,535,428
Surplus as regards policyholders, December 31, current year	\$ 1,693,609,980	\$ 1,556,409,566	\$ 1,456,663,382	\$ 1,884,024,451	\$ 1,333,961,525

For Informational Purposes Only

**Comparative Statement of Cash Flow
For the Year Ended December 31,**

	2010	2009	2008	2007	2006
Cash from Operations					
Premiums collected net of reinsurance	\$ 645,302,264	\$ 801,150,722	\$ 861,540,836	\$ 1,043,642,781	\$ 902,360,742
Net investment income	136,154,308	98,690,148	181,293,288	165,527,876	109,133,657
Miscellaneous income	(570,976)	(5,270,877)	(374,892)	1,542,572	9,090,081
Total income	780,885,596	894,569,993	1,042,459,232	1,210,713,229	1,020,584,480
Benefit and loss related payments	562,729,384	626,056,616	668,186,331	515,607,891	469,694,845
Commissions, expenses paid and aggregate write-ins for deductions	274,874,270	308,132,120	308,236,358	303,005,143	333,751,374
Dividends to policyholders	0	32,321	15,021	17,043	186,668
Federal and foreign income taxes paid (recovered)	(36,898,395)	52,235,524	(7,223,945)	65,471,200	(37,514,124)
Total deductions	800,705,259	986,456,581	969,213,765	884,101,277	766,118,763
Net cash from operations	(19,819,663)	(91,886,588)	73,245,467	326,611,952	254,465,717
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	310,156,112	238,417,006	317,364,409	652,504,906	356,847,369
Stocks	215,404,263	169,736,622	393,981,530	273,843,970	271,629,035
Other invested assets	42,726,579	11,958,114	7,308,905	13,392,707	76,113,689
Miscellaneous proceeds	0	9,291,987	3,570,767	7,803,788	953,198
Total investment proceeds	568,286,954	429,403,729	722,225,611	947,545,371	705,543,291
Cost of investments acquired (long-term only):					
Bonds	101,098,879	239,850,681	165,306,592	641,774,388	1,086,851,534
Stocks	156,850,506	97,852,842	336,453,934	274,512,723	300,873,720
Other invested assets	47,512,067	42,113,719	35,066,699	66,627,854	26,233,631
Miscellaneous applications	1,009,455	249,423	0	0	27,636,749
Total investments acquired	306,470,907	380,066,665	536,827,225	982,914,965	1,441,595,634
Net cash from investments	261,816,047	49,337,064	185,398,386	(35,369,594)	(736,052,343)
Cash from Financing and Miscellaneous Services					
Other cash provided (applied):					
Capital and paid in surplus, less treasury stock	37,316,057	53,809,258	111,111,282	37,865,317	0
Borrowed funds received or (repaid)	0	0	(3,046,761)	(5,787,868)	8,834,629
Net deposits on deposit-type contracts and other insurance liabilities	1,848,841	10,335,341	5,069,561	9,900,269	0
Dividends to stockholders (paid)	(106,699,300)	(110,000,000)	(214,786,650)	(130,000,000)	0
Other cash provided or (applied)	(20,080,051)	67,156,424	(15,556,155)	(211,142,046)	475,824,210
Net cash from financing and miscellaneous sources	(87,614,453)	21,301,023	(117,208,723)	(299,164,328)	484,658,839
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	154,381,931	(21,248,501)	141,435,130	(7,921,970)	3,072,213
Cash and short-term investments:					
Beginning of the year	125,555,186	146,803,687	5,368,557	13,290,527	10,218,314
End of the year	\$ 279,937,117	\$ 125,555,186	\$ 146,803,687	\$ 5,368,557	\$ 13,290,527

NOTES TO FINANCIAL STATEMENTS

INVESTMENTS

As of December 31, 2010, the Company's invested assets were distributed as follows:

	Total Invested Assets	% of Total Invested Assets
Bonds	\$ 1,635,747,480	44.28%
Common Stock	1,451,085,026	39.28%
Short-term investments	279,937,117	7.58%
Other invested assets	326,821,962	8.85%
Receivables for securities	306,576	0.01%
Subtotals; cash and invested assets	<u>\$ 3,693,898,161</u>	<u>100%</u>

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

	1 yr or less	1 yr through 5 yr	6 yr through 10 yr	11 yr through 20 yr	Over 20 yr	Total Current Year
Class 1	311,127,676	983,514,676	240,823,275	112,695,884	237,868,573	1,886,030,084
Class 2	7,850,000	21,691,521				29,541,521
Class 3						-
Class 4						-
Class 5	53,863	59,129				112,992
Class 6						-
Total	319,031,539	1,005,265,326	240,823,275	112,695,884	237,868,573	1,915,684,597
% of Total	16.7%	52.5%	12.6%	5.9%	12.3%	100.0%

The Company's investment portfolio consists of mix of securities with the highest concentration in municipals (38%), unaffiliated equities (22%) and affiliated equities (17%). The rest of the investments are almost equally divided between short term and other invested assets. All securities are of high quality and the short term securities being highly liquid. The Company's custodial agreement is in compliance with 31 Pa. Code § 148a.3.

The Company's ownership in affiliated companies (including subsidiaries) is reported in compliance with valuation procedures as described in Statement of Statutory Accounting Principles SSAP No. 97 "Investment in Subsidiary, Controlled and Affiliated Entities." Investments in affiliates are accounted for using the equity method of accounting.

Undistributed equity in earnings of affiliates is included as a component of unrealized investment gains or losses. Dividends received from such affiliates are recorded as investment income when received.

The Company has a written investment policy as required by 40 P.S. § 653 b (b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company, at December 31, 2010, was following its investment policy.

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported reserves in the amount of \$1,579,449,096 for losses and \$290,889,917 for loss adjustment expenses (LAE) on the December 31, 2010 annual statement.

Frank H. Douglas, ACAS, MAAA, Executive Vice President and Actuary of the Company was the Company's appointed actuary for all years in the examination period. For each year of the examination period, Mr. Douglas issued a Statement of Actuarial Opinion (Opinion) concluding that the Company's reserves made a reasonable provision for all unpaid loss and LAE obligations of the Company.

The reserve analysis is performed on a pooled basis, as the Company is a member of an inter-company pooling agreement with affiliates, as defined earlier in this report as the Chartis Admitted Pool. Pooled reserves are then allocated to the individual insurers based on the pooling agreement in effect.

In 2011, Mr. Douglas retired and the Company hired Mark Scully, FCAS, MAAA. Mr. Scully was appointed by the Board of Directors on June 9, 2011 to be the appointed actuary for the Company beginning December 31, 2011.

The Department engaged the actuarial services of both INS Consultants, Inc. and Towers Watson (Towers) to assist the Department in the actuarial aspects of the risk focused examination. INS's scope focused on risk identification and control work for the reserve segments presenting the greatest volatility to the Company. INS concluded that the actuarial processes at the Company had strong controls, were well documented, and showed evidence of a strong peer review process. Due to high inherent risk in the Company's reserves, which are concentrated in long tailed lines, most risks, despite the noted strength of controls, were assessed by the exam team to have a residual risk rating of moderate to high. This assessment supported the Department's decision to use Towers to complete an independent reserve analysis in support of our substantive testing procedures. The scope of Towers' review and analysis included identified segments that represent about 85% of the Pool reserves as of December 31, 2010.

As a result of the Towers' independent analysis and after considering various subsequent events as described below, the Department accepts the Company's appointed actuary's conclusion, as of December 31, 2010, that the Company's reserves "make a reasonable provision in the aggregate for all unpaid loss and loss expense obligations and unearned premium obligations of the Company related to long duration contracts under the terms of its contracts and agreements."

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES SUBSEQUENT EVENTS

In 2011, the Pooled Companies and certain affiliates ("Chartis Reinsureds") entered into two loss portfolio transfer (LPT) agreements with its affiliate, Eaglestone Reinsurance Company ("Eaglestone"). Under the terms of the LPTs, Eaglestone assumed the Chartis Reinsureds asbestos and excess workers compensation unpaid loss and allocated LAE liabilities. The impact of these transactions resulted in a reduction to the Admitted Pool's reserves of \$2.2 billion for asbestos and \$2.7 billion excess workers' compensation. As a result of these LPTs, the carried

net asbestos reserves and excess workers' compensation reserves for the Pooled Companies as of December 31, 2011 have been reduced to zero. Additional information about these LPTs can be found in the "Subsequent Events" section of this report.

The Company strengthened the Pooled Companies' loss and LAE reserves by \$630 million for accident years 2010 and prior across all lines of business during calendar year 2011. The strengthening amounted to \$242 million for segments independently reviewed by Towers.

A project (the "Project") was initiated to conduct an up to date evaluation of the various structural drivers that may impact reserves by quantifying and testing their sensitivity on losses. Based on the results of the Project, management has made recommendations to underwriting, claims, actuarial and strategy and planning personnel that are intended to enhance the Company's ability to assess the impact of the structural drivers on future losses. Such recommendations are intended to lead to risk selection and loss ratio improvement.

The Project included an analysis of the majority of Chartis U.S. loss reserves relating to guaranteed cost Workers Compensation, General Liability including Excess Casualty, Commercial Auto Liability, Healthcare, and Financial Lines.

The Project has also provided management with additional insights of the loss reserves. For example,

1. The evaluation of loss sensitivity to medical inflation, lost time frequency, longevity, demographics, state mix and employer size as it relates to workers compensation led to a recommendation that certain claims utilize medical case management to more proactively manage claim costs.

2. It was recommended that legal case reserve methodology that relies more on case-management and less on actuarial-focused assessments to calculate legal case reserve adequacy be implemented. Structural drivers were identified for each of the claim stages of evaluation, dispositive motion, discovery, mediation, trial and appeal. A proof of concept predictive model has been developed to estimate the ultimate legal expenses on certain closed claims. It is expected that this analysis will be more responsive to the changes in the mix of explanatory variables.

The Project was shared with the Department and Towers in the late stages of the examination. While not all initiatives are fully implemented, nor results fully recognized, the Department and Towers both agree that the results of these multi-faceted initiatives could potentially have a favorable impact on future loss obligations of the Company and the volatility of losses.

SUBSEQUENT EVENTS

The following events were noted to have occurred subsequent to the December 31, 2010 examination date through May 31, 2012 and have been deemed significant for disclosure by the Pennsylvania Insurance Department:

On January 14, 2011, AIG completed a series of integrated transactions (the Recapitalization) with the Federal Reserve Bank of New York (FRBNY), the Department of the Treasury, and the AIG Credit Facility Trust (Trust) to recapitalize AIG. As part of the Recapitalization, AIG repaid to the FRBNY approximately \$21 billion in cash, representing complete repayment of all amounts owing under the FRBNY credit facility, and the FRBNY credit facility was terminated. In addition, (i) the shares of the Series C Preferred Stock held by the Trust were exchanged for 562,868,096 shares of AIG common stock and were subsequently transferred by the Trust to the Department of the Treasury; (ii) the shares of the AIG's Series E Fixed Rate Non-Cumulative Perpetual Preferred Stock, par value \$5.00 per share, held by the Department of the Treasury were exchanged for 924,546,133 shares of AIG common stock; and (iii) the shares of AIG's Series F Fixed Rate Non-Cumulative Perpetual Preferred Stock, par value \$5.00 per share, held by the Department of the Treasury were exchanged for (a) preferred interests in two special purpose vehicles, (b) 20,000 shares of AIG's Series G Cumulative Mandatory Convertible Preferred Stock, par value \$5.00 per share, a new series of TARP preferred stock, and (c) 167,623,733 shares of AIG common stock. As a result of the Recapitalization, the Department of the Treasury held 1,655,037,962 shares of newly issued AIG common stock, representing ownership of approximately 92 percent of the outstanding AIG common stock. After the share exchange and distribution were completed, the Trust terminated pursuant to the terms and conditions of the agreement that established the Trust. It is expected that over time the Department of the Treasury will sell its shares of AIG common stock on the open market. After various stock sales in 2011 and 2012 and other related transactions, the ownership of AIG by the Department of Treasury has been reduced to approximately 61%.

On March 31, 2011, the Company and certain other Chartis affiliated insurers (collectively, the Chartis Reinsureds) entered into a loss portfolio transfer reinsurance agreement (Asbestos Reinsurance LPT), with an inception date of January 1, 2011, with Eaglestone. Under the Asbestos Reinsurance LPT, the Chartis Reinsureds transferred all of their net U.S. asbestos liabilities to Eaglestone. The Chartis Reinsureds paid \$2,790,351,000 to Eaglestone (representing the net carrying value of their asbestos reserves as of January 1, 2011) and Eaglestone agreed to provide coverage up to an aggregate limit of \$5,000,000,000 on the assumed asbestos portfolio. Eaglestone and the Chartis Reinsureds received the required regulatory approvals to enter into the Asbestos Reinsurance LPT. The transaction closed and settled on May 13, 2011. The transaction was recorded as prospective reinsurance in accordance with Statement of Statutory Accounting Principles No. 62R.

On March 31, 2011, the Admitted Pool member companies, including the Company, entered into an Excess Workers' Compensation Reinsurance loss portfolio transfer agreement with Eaglestone to transfer \$2,720,102,000 of net excess workers' compensation liabilities to Eaglestone on a funds withheld basis. The agreement was effective January 1, 2011. The Admitted Pool member companies established an initial funds withheld liability

in the aggregate of \$2,720,102,000, with each Admitted Pool member company's establishing a funds withheld liability equal to its pooling participation percentage. Eaglestone agreed to provide coverage up to an aggregate limit of \$5,500,000,000 on the assumed exposures. The Admitted Pool member companies will pay interest of 4.25 percent per annum on the funds withheld balance. The agreement was recorded as prospective reinsurance in accordance with Statement of Statutory Accounting Principles No. 62R.

National Union, American Home Assurance Company, and New Hampshire Insurance Company, with the approval of their domiciliary regulators, returned capital of \$510 million, \$1.02 billion, and \$170 million, respectively, to their immediate parent (Chartis U.S., Inc.) that was ultimately used to capitalize Eaglestone. Additionally, Chartis, Inc. contributed \$375 million to capitalize Eaglestone.

On June 17, 2011, the Chartis Reinsureds and Eaglestone completed a transaction, effective as of January 1, 2011, with National Indemnity Company (NICO), a subsidiary of Berkshire Hathaway Inc., under which the bulk of the Chartis Reinsureds' U.S. asbestos liabilities that were assumed by Eaglestone under the Asbestos Reinsurance LPT were transferred through a reinsurance agreement by Eaglestone to NICO as part of Chartis' ongoing strategy to reduce its overall loss reserve development risk. The NICO transaction did not cover asbestos accounts that the Chartis Reinsureds believe have already been reserved to their limit of liability or certain other ancillary asbestos exposures of Chartis Reinsureds.

NICO's aggregate limit of liability under this agreement is \$3.5 billion. The aggregate limit includes NICO's assumption of collection risk for existing third-party reinsurance recoverables associated with the transferred liabilities of the Chartis Reinsureds.

Effective January 1, 2012, Landmark Insurance Company (CA) was merged with and into the Company. Loss reserves assumed by the Company as a result of the merger were reinsured via a loss portfolio transfer to Lexington Insurance Company.

On January 17, 2012, Chartis Inc. announced that it had aligned its geographic structure to enhance execution of its commercial and consumer strategies and to add greater focus on its growth economies initiatives. Under this framework, Chartis was organized into three geographical areas: The Americas, Asia and EMEA (Europe, Middle East and Africa). Previously, Chartis was organized into four geographical areas: the United States and Canada, Europe, the Far East, and Growth Economies (primarily consisting of Asia Pacific, the Middle East, and Latin America). In conjunction with the geographical realignment significant changes were also made to the organizational structure and operational oversight of the organization.

Effective February 17, 2012, the Pooled Companies and certain other affiliates (collectively, the Fleet) entered into a Capital Maintenance Agreement with AIG and Chartis, Inc. (AIG CMA). The AIG CMA provides that in the event that the Fleet's Total Adjusted Capital (TAC) falls below its Specified Minimum Percentage (SMP) of 350 percent of the Fleet's Authorized Control Level (ACL) Risk Based Capital (RBC), as estimated by Chartis, Inc. on a semi-annual basis subject to any adjustments or modifications required by the Company's domiciliary regulator or its independent auditors, AIG will,

within a specified time period prior to the close of the following fiscal quarter, contribute cash, cash equivalents, securities or other acceptable instruments that qualify as admitted assets to the Fleet so that the Fleet's TAC is projected to be equal to or greater than the SMP as of the upcoming year-end. Additionally, each applicable member agreed, subject to approval by its board of directors and, if necessary, its domestic regulator, as applicable, to pay dividends that will be paid to AIG up to an amount equal to the lesser of (i) the amount necessary to reduce the Fleet's ACL RBC to an amount not materially greater than the SMP or (ii) the maximum ordinary dividends permitted by any applicable domiciliary regulator.

Effective February 17, 2012, the Fleet entered into a CMA (Chartis CMA) with Chartis, Inc., Chartis U.S. Inc. and Chartis International, LLC (the Chartis entities). The Chartis CMA provides that in the event that the Fleet's TAC exceeds the SMP (as determined pursuant to the terms of the AIG CMA) while at the same time any Fleet member, as an individual legal entity, has a TAC below 300 percent of such Company's ACL RBC (the Individual Entity Minimum Percentage) as determined by Chartis pursuant to the methodology set forth in the AIG CMA that is used to determine the SMP, the Chartis Entities and each Fleet member agree to make contributions, pay dividends or cause other transactions to occur that would result in each Fleet member's TAC being above the Individual Entity Minimum Percentage. No Fleet member is required to pay any dividend which would trigger the extraordinary dividend provisions of its domiciliary state or that is otherwise prohibited by such state.

At December 31, 2011, Chartis Specialty Insurance Company ("Chartis Specialty") and Lexington Insurance Company ("Lexington") were owned by The Insurance Company of the State of Pennsylvania (20%); Chartis Property Casualty Company (10%) and the Company (70%). Effective March 31, 2012, ownership of Chartis Specialty and Lexington was consolidated into the Company through a series of dividend return of capital and contribution transactions. The consolidation was accomplished by ISOP and CPC distributing their shares to Chartis U.S., Inc and Chartis U.S., Inc. contributing those shares to the Company.

The following adjustments related to the prior period are being treated as a subsequent event for purposes of this examination:

Policyholder Surplus 12/31/2010	\$1,693,609,979
<u>Adjustments:</u>	
Asset Realization	(24,332,047)
Liability correction	(11,412,270)
Income Taxes	5,457,593
Total Adjustments to beginning Capital & Surplus	<u>(30,286,724)</u>
Balance at 01/01/2011	\$1,663,323,255
Percentage increase in beginning surplus	-1.79%

These adjustments were reflected in the Company's 2011 results as prior period corrections in accordance with SSAP#3.

RECOMMENDATIONS

PRIOR EXAMINATION

1. It is recommended the Company, during the remediation of the identified control weaknesses and deficiencies implement the necessary accounting systems that will service all the statutory requirements of insurance accounting. (See Accounts and Records page 21).

The Company has materially complied with this recommendation.

2. It is recommended the Company continue their remediation efforts and keep the Pennsylvania Insurance Department abreast of the remediation milestones as they are achieved. (See Premium Key Functional Activity Machine only Page 33, Non Machine Key Functional Activity page 35, Domestic Brokerage Group – Fusion page 38, Loss Reserve Credits Related to High Deductibles, page 42, Outstanding Loss Drafts, page 42, and Reinsurance page 43).

The Company has complied with this recommendation.

3. It is recommended that the Company perform, liquidity analyses testing the sensitivity of the Company's financial position to the combined stresses of ratings downgrade, reserve development and financial market deterioration. (See Loss and Loss Adjustment Expenses, page 41.)

The Company has complied with this recommendation.

CURRENT EXAMINATION

There are no report recommendations as a result of this examination.

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CONCLUSION

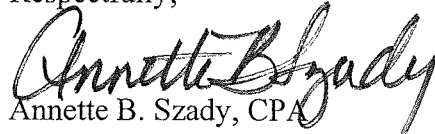
As a result of this examination, the financial condition the Company as of December 31, 2010, was determined to be as follows.

	Amount	Percentage
Admitted assets	<u>\$ 4,407,693,450</u>	<u>100.0%</u>
Liabilities	<u>\$ 2,714,083,471</u>	<u>61.6%</u>
Surplus as regards policyholders	<u>1,693,609,979</u>	<u>38.4%</u>
Total liabilities and surplus	<u>\$ 4,407,693,450</u>	<u>100.0%</u>

This examination was conducted by Barry Armstrong, CFE, Gregory Bealuk, CFE, Kate Bolbas, CFE, Anthony Cardone, CFE, David Carter, CFE, John Clark, CPCU, Matt Council, Frederick Doran, CFE, David Hughes, John Normile, CFE, Richard Randour, CFE, April Tom, CFE, William Umbaugh, CFE, CISA, AES, Julianne S. Wolfe and Gerald J. Hickey, CFE, with the latter in charge.

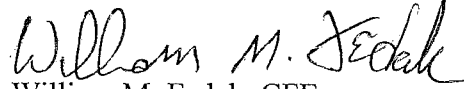
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Respectfully,



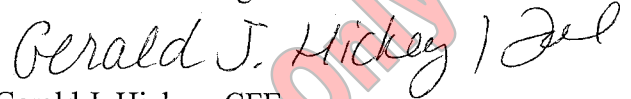
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Examiner-in-Charge

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