

Examination Warrant Number 10-PC-160

Report of Examination of  
Granite State Insurance Company  
Harrisburg, PA

As of December 31, 2010

For Informational Purposes Only

# Granite State Insurance 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-160, dated, March 5, 2010, an examination was made of

**Granite State Insurance Company CoCode: 23809**

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:

## Granite State Insurance Company

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Company	NAIC Code
Chartis Property Casualty Company (PA)	19402
The Insurance Company of the State of Pennsylvania (PA)	19429
National Union Fire Insurance Company of Pittsburgh, Pa. (PA)	19445
New Hampshire Insurance Company (PA)	23841
Chartis Casualty Company (PA)	40258
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 June 26, 1874, licensed by the Department and commenced business on November 12, 1885.

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, paid in and contributed surplus of \$1,175,129 and unassigned funds of \$31,219,379.

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 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 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.

A deemed dividend of \$1,543 related to the Tax Sharing Agreement was paid to the Company's parent in 2009 which was approved to the extent required and paid within the existing regulatory guidelines.

## **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
    - Various Entities
  - AIG Global Services, Inc.
    - Various Entities
  - AIG Financial Products Corp.
    - Various Entities
  - United Guaranty Corporation

## Granite State Insurance Company

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- 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%)
        - 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:

<b>Name and Address</b>	<b>Principal Occupation</b>
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.
Robert Scott Higgins Schimek Newtown, Pennsylvania	Executive Vice President and Chief Financial Officer, Chartis Inc.
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.

## **OFFICERS**

As of the examination date, December 31, 2005, the following officers were appointed and serving in accordance with the Company’s By-laws:

<b>Name</b>	<b>Title</b>
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



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 period.

### **BY-LAWS**

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

## **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:

## Granite State Insurance Company

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- 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. ("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 assumed pooling percentages as of December 31, 2010

## Granite State Insurance Company

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were as follows:

<b>Pool Company</b>	<b>State of Domicile</b>	<b>Pool %</b>
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%
<b>Total Pool</b>		<b>100%</b>

## 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 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 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

## Granite State Insurance Company

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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	-
<b>Total</b>			<b>3,015,150,000</b>	<b>500,000,000</b>	<b>775,000,000</b>	<b>3,515,150,000</b>	<b>3,790,150,000</b>

\*Cat Bond

## ASSUMED

For the year ended December 31, 2010 the Company has no assumed business. All direct written business is ceded to the Pool.

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 and the District of Columbia. The Company writes nearly all forms of property and liability coverages, specializing primarily in commercial and industrial risks. The Company cedes all of its direct and assumed writings into the pool and does not assume any business from the pool.

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 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 and ceded premium writings for 2010 by line of business:

# Granite State Insurance Company

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Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written
Fire	\$22,904,570	\$22,904,570	\$0
Allied lines	7,710,285	7,710,285	0
Commercial multiple peril	87,075,837	87,075,837	0
Ocean marine	127,806	127,806	0
Inland marine	9,144,548	9,144,548	0
Medical malpractice - occurrence	6,567,127	6,567,127	0
Medical malpractice - claims-made	99,815	99,815	0
Earthquake	1,533,489	1,533,489	0
Group accident and health	441,291	441,291	0
Workers' compensation	143,675,201	143,675,201	0
Other liability - occurrence	36,817,817	36,817,817	0
Other liability - claims-made	3,204,677	3,204,677	0
Excess workers' compensation	(53,506)	(53,506)	0
Products liability - occurrence	2,903,666	2,903,666	0
Products liability - claims-made	454,674	454,674	0
Private passenger auto liability	150,121	150,121	0
Commercial auto liability	58,750,862	58,750,862	0
Auto physical damage	9,184,167	9,184,167	0
Surety	42,217	42,217	0
Burglary and theft	(3,647)	(3,647)	0
Boiler and machinery	2,453,857	2,453,857	0
<b>Totals</b>	<b>\$393,184,874</b>	<b>\$393,184,874</b>	<b>\$0</b>

Workers' compensation is the largest line of business constituting 37% followed by commercial multi peril 22% and the remaining 41% distributed over all other lines, none of which exceed 15%. The states with the largest volume of direct written premiums are California (33%), Massachusetts (7%), Florida (5%), and Texas (4%).

## SIGNIFICANT OPERATING RATIOS AND TRENDS

There are no underwriting ratios shown since, as noted above, the Company cedes all of its direct and assumed writings into the pool and does not assume any business from the pool.

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

	2010	2009	2008	2007	2006
Admitted assets	\$ 38,993,091	\$ 36,592,395	\$ 35,250,256	\$ 45,303,759	\$ 42,526,702
Liabilities	\$ 1,598,583	\$ 518,477	\$ 484,913	\$ 11,716,852	\$ 10,354,660
Surplus as regards policyholders	\$ 37,394,508	\$ 36,073,918	\$ 34,765,343	\$ 33,586,907	\$ 32,172,042
Gross premium written	\$ 393,184,874	\$ 441,425,445	\$ 797,771,583	\$ 1,036,801,008	\$ 823,478,149
Investment gain/(loss)	\$ 1,156,592	\$ 1,568,732	\$ 1,396,319	\$ 1,967,323	\$ 1,559,712
Other gain/(loss)	\$ 0	\$ 0	\$ 0	\$ (480,403)	\$ 0
Net income	\$ 937,126	\$ 1,444,786	\$ 1,253,210	\$ 1,480,061	\$ 1,388,252



## **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.

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

	2010	2009	2008	2007	2006
Bonds	\$ 29,574,499	\$ 30,636,853	\$ 28,531,854	\$ 29,081,569	\$ 38,929,857
Common stocks	1,039,984	624,286	1,193,213	1,151,849	1,164,569
Cash, cash equivalents, and short term investments	6,380,233	4,944,625	4,605,678	2,435,185	1,485,184
Other invested assets	400	400	400	400	400
Receivable for securities	5,625	5,625	5,343	5,343	8,718
Subtotals, cash and invested assets	37,000,741	36,211,789	34,336,488	32,674,346	41,588,728
Investment income due and accrued	324,825	352,731	383,805	392,952	455,844
Receivable from parent, subsidiaries and affiliates	1,663,724	27,875	529,963	12,236,461	0
Aggregate write-ins for other than invested assets	3,801	0	0	0	482,130
Total	<u>\$ 38,993,091</u>	<u>\$ 36,592,395</u>	<u>\$ 35,250,256</u>	<u>\$ 45,303,759</u>	<u>\$ 42,526,702</u>
Losses	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Current federal and foreign income taxes	204,727	193,285	350,755	54,215	42,735
Net deferred tax liability	105,690	121,918	106,177	102,382	101,918
Payable to parent, subsidiaries and affiliates	1,288,166	203,274	27,981	11,560,155	10,209,907
Total liabilities excluding protected cell liabilities	1,598,583	518,477	484,913	11,716,852	10,354,660
Total liabilities	<u>1,598,583</u>	<u>518,477</u>	<u>484,913</u>	<u>11,716,852</u>	<u>10,354,660</u>
Common capital stock	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Gross paid in and contributed surplus	1,175,129	1,175,092	1,175,092	1,175,092	1,175,089
Unassigned funds (surplus)	31,219,379	29,898,826	28,590,251	27,411,815	25,996,953
Surplus as regards policyholders	<u>37,394,508</u>	<u>36,073,918</u>	<u>34,765,343</u>	<u>33,586,907</u>	<u>32,172,042</u>
Totals	<u>\$ 38,993,091</u>	<u>\$ 36,592,395</u>	<u>\$ 35,250,256</u>	<u>\$ 45,303,759</u>	<u>\$ 42,526,702</u>

### Comparative Statement of Income For the Year Ended December 31,

	2010	2009	2008	2007	2006
<b>Underwriting Income</b>					
Premiums earned	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Net underwriting gain or (loss)	0	0	0	0	0
<b>Investment Income</b>					
Net investment income earned	1,155,023	1,549,111	1,388,240	1,971,763	1,521,151
Net realized capital gains or (losses)	1,569	19,621	8,079	(4,440)	38,561
Net investment gain or (loss)	1,156,592	1,568,732	1,396,319	1,967,323	1,559,712
<b>Other Income</b>					
Net gain or (loss) from agents' or premium balances charged off	0	0	0	(480,403)	0
Total other income	0	0	0	(480,403)	0
Net income before dividends to policyholders and before federal and foreign income taxes	1,156,592	1,568,732	1,396,319	1,486,920	1,559,712
Federal and foreign income taxes incurred	219,466	123,946	143,109	6,859	171,460
Net income	<u>\$ 937,126</u>	<u>\$ 1,444,786</u>	<u>\$ 1,253,210</u>	<u>\$ 1,480,061</u>	<u>\$ 1,388,252</u>

For Informational Purpose 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	\$ 36,073,918	\$ 34,765,343	\$ 33,586,907	\$ 32,172,042	\$ 30,927,948
Net income	937,126	1,444,786	1,253,210	1,480,061	1,388,252
Net unrealized capital gains or (losses)	420,157	(234,413)	(2,675)	(124,680)	8,622
Change in net deferred income tax	96,643	(15,741)	(3,795)	(464)	(48,792)
Change in nonadmitted assets	0	0	(112,344)	59,948	(103,988)
Surplus adjustments:					
Paid in	38	0	44,040	0	0
Dividends to stockholders	0	(1,543)	0	0	0
Aggregate write-ins for gains and losses in surplus	(133,374)	115,486	0	0	0
Change in surplus as regards policyholder for the year	1,320,590	1,308,575	1,178,436	1,414,865	1,244,094
Surplus as regards policyholders, December 31, current year	<u>\$ 37,394,508</u>	<u>\$ 36,073,918</u>	<u>\$ 34,765,343</u>	<u>\$ 33,586,907</u>	<u>\$ 32,172,042</u>

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

	2010	2009	2008	2007	2006
<b>Cash from Operations</b>					
Net investment income	\$ 1,285,990	\$ 1,670,202	\$ 1,478,561	\$ 2,163,024	\$ 1,497,239
Miscellaneous income	0	0	0	(480,403)	0
Total income	1,285,990	1,670,202	1,478,561	1,682,621	1,497,239
Federal and foreign income taxes paid (recovered)	212,251	274,468	(149,059)	(111,000)	408,196
Total deductions	212,251	274,468	(149,059)	(111,000)	408,196
Net cash from operations	1,073,739	1,395,734	1,627,620	1,793,621	1,089,043
<b>Cash from Investments</b>					
Proceeds from investments sold, matured or repaid:					
Bonds	1,275,000	3,038,628	676,500	23,378,667	9,315,566
Stocks	63	450,000	0	1,338,311	0
Miscellaneous proceeds	0	0	0	3,375	104,643
Total investment proceeds	1,275,063	3,488,628	676,500	24,720,353	9,420,209
Cost of investments acquired (long-term only):					
Bonds	304,576	5,220,972	195,507	13,665,580	18,789,613
Stocks	(4,459)	0	0	1,494,311	0
Miscellaneous applications	0	282	0	0	0
Total investments acquired	300,117	5,221,254	195,507	15,159,891	18,789,613
Net increase (or decrease) in policy loans and premium notes	0	0	0	0	0
Net cash from investments	974,946	(1,732,626)	480,993	9,560,462	(9,369,404)
<b>Cash from Financing and Miscellaneous Services</b>					
Other cash provided (applied):					
Capital and paid in surplus, less treasury stock	37	0	0	3	0
Dividends to stockholders (paid)	0	(1,543)	(112,344)	0	0
Other cash provided or (applied)	(613,114)	677,382	174,224	(10,404,085)	7,113,839
Net cash from financing and miscellaneous sources	(613,077)	675,839	61,880	(10,404,082)	7,113,839
<b>Reconciliation of cash and short-term investments:</b>					
Net change in cash and short-term investments	1,435,608	338,947	2,170,493	950,001	(1,166,522)
Cash and short-term investments:					
Beginning of the year	4,944,625	4,605,678	2,435,185	1,485,184	2,651,706
End of the year	\$ 6,380,233	\$ 4,944,625	\$ 4,605,678	\$ 2,435,185	\$ 1,485,184

## 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	\$ 29,574,499	79.93%
Common Stock	1,039,984	2.81%
Cash	4,635,301	12.53%
Cash equivalents	75,003	0.20%
Short-term investments	1,669,929	4.51%
Other invested assets	400	0.00%
Receivables for securities	5,625	0.02%
Subtotals; cash and invested assets	<u>\$ 37,000,741</u>	<u>100%</u>

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

	1 yr or less	through 5 yr	through 10 yr	through 20 yr	Over 20 yr	Current Year
Class 1	6,744,536	13,365,494	5,196,624	1,758,055	3,042,935	30,107,644
Class 2		1,211,784				1,211,784
Class 3						-
Class 4						-
Class 5						-
Class 6						-
Total	6,744,536	14,577,278	5,196,624	1,758,055	3,042,935	31,319,428
% of						
Total	21.5%	46.5%	16.6%	5.6%	9.8%	100.0%

The Company's investment portfolio consists of mix of securities with the highest concentration in municipals (64%) and treasuries (27%). The rest of the investments are almost divided between short term and equities. All securities are of high quality and the short term securities and treasury 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."

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 cedes all loss and loss adjustment expense reserves to the Commercial Lines Pool and does not assume any amounts from the pool.

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	\$37,394,508
Adjustments:	
Asset Realization	-
Liability correction	-
Income Taxes	110,467
Total Adjustments to beginning Capital & Surplus	110,467
<b>Balance at 01/01/2011</b>	<b>\$37,504,975</b>
Percentage increase in beginning surplus	0.30%

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 18).

The Company has materially complied with this recommendation.

2. It is recommended the Company continue their remediation efforts and regularly update the Pennsylvania Insurance Department of the remediation status and milestones as they are achieved. (See Premium Key Functional Activity Machine only page 30, Non Machine Key Functional Activity page 33, Domestic Brokerage group – Fusion page 35, 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 39).

The Company has complied with this recommendation.

## CURRENT EXAMINATION

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

## CONCLUSION

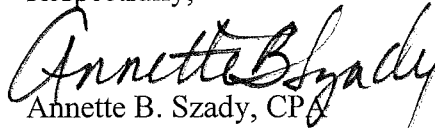
As a result of this examination, the financial condition of the Company, as of December 31, 2010, was determined to be as follows:

	<b>Amount</b>	<b>Percentage</b>
Admitted assets	<u>\$ 38,993,091</u>	<u>100.0%</u>
Liabilities	<u>\$ 1,598,583</u>	<u>4.1%</u>
Surplus as regards policyholders	<u>37,394,508</u>	<u>95.9%</u>
Total liabilities and surplus	<u>\$ 38,993,091</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.



Respectfully,



Annette B. Szady, CPA  
Director, Bureau of Financial Examinations



William M. Fedak, CFE  
Examination Manager



Gerald J. Hickey, CFE  
Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of performing statutory examinations of insurance companies