

REPORT ON EXAMINATION

OF

AIX SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2014

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT OF EXAMINATION, made as of December 31, 2014 of the

AIX SPECIALTY INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

Attest By:  _____

Date: June 6, 2016



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 6th day of June, 2016.



Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT OF EXAMINATION
OF THE
AIX SPECIALTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2014

The above-captioned report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the company as reflected in the report.

This report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 6th day of June, 2016

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April 15, 2016

Honorable Karen Weldin Stewart, CIR-ML
Delaware Insurance Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Dear Commissioner,

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 15.038, NAIC # 12833 dated April 24, 2015, an examination has affairs, financial condition and management of

AIX SPECIALTY INSURANCE COMPANY

hereinafter referred to as “Company” or “ASIC”, incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 1209 Orange Street, Wilmington, Delaware 19801. The examination was conducted at the Company’s administrative office located at 5 Waterside Crossing, Suite 201, Windsor, Connecticut 06095. Concurrent with this examination, the following affiliated insurance companies within Hanover Insurance Operations (the “Group”) were also examined and separate Reports of Examination have been issued:

- Allmerica Financial Alliance Insurance Company
- Allmerica Financial Benefit Insurance Company
- Campmed Casualty & Indemnity Company, Inc.
- Citizens Insurance Company of America

- Citizens Insurance Company of Illinois
- Citizens Insurance Company of Ohio
- Citizens Insurance Company of the Midwest
- Hanover Lloyd's Insurance Company
- Massachusetts Bay Insurance Company
- NOVA Casualty Company
- Professionals Direct Insurance Company
- The Hanover American Insurance Company
- The Hanover Insurance Company
- The Hanover National Insurance Company
- The Hanover New Jersey Insurance Company
- Verlan Fire Insurance Company

The New Hampshire Department of Insurance (“Department”) facilitated this examination as the lead state with eight domestic insurers including, The Hanover Insurance Company (“Hanover”), which comprised the vast majority of the Group’s combined assets and surplus. Other participating states in the examination included Delaware, Illinois, Indiana, Michigan, New York, Ohio, and Texas.

SCOPE OF EXAMINATION

The last examination was as of December 31, 2011. This examination covered the period of January 1, 2012 through December 31, 2014, and encompasses a general review of transactions during the period, the Company’s business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of

the Company at December 31, 2014. Transactions subsequent to the examination date were reviewed where deemed necessary.

We conducted our examination in accordance with the *National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook* (Handbook) and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively. All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, pursuant to the General Corporation Law of the State of Delaware as required by 18 Del. C. §321, along with general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature, are not included within the examination report but separately communicated to other regulators and/or the Company.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, PricewaterhouseCoopers LLP (PwC). Certain auditor work papers of their 2014 audit have been incorporated into the work papers of the examiners and have been utilized in determining the scope, areas of emphasis in conducting the examination and in the area of risk mitigation and substantive testing.

SUMMARY OF SIGNIFICANT FINDINGS

There were no material adverse findings, adjustments to the financial statements, or specific recommendations as a result of this examination.

COMPANY HISTORY

The Company was incorporated under the laws of the State of Delaware on June 20, 2006, as a wholly-owned subsidiary of NCC. NCC is a wholly-owned subsidiary of NOVA American Group Inc., which is a wholly owned subsidiary of AIX Holdings, Inc. (AIX Holdings). In November of 2008, The Hanover Insurance Group, Inc. (THG) purchased all outstanding stock of AIX Holdings. Subsequently, in September of 2009, The Hanover Insurance Company (Hanover) purchased AIX Holdings and subsidiaries from THG in an intercompany sales transaction. On May 29, 2012 the Company converted to a Delaware Surplus Lines Insurance Company.

MANAGEMENT AND CONTROL

Corporate Governance

Governance of THG and the affiliated insurance companies is provided for by an independent Board of Directors and the respective management teams of the insurance companies. Ten of the eleven directors are independent with the only non-independent director being Frederick H. Eppinger, President and CEO of THG. Directors of THG are elected at the annual meeting of stockholders.

Management

Pursuant to the general Corporation Laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, all corporate powers of the Company and its business, property and affairs were managed under the direction of the Board. The bylaws require the Board of Directors consist of four directors but not more than eighteen.

The Directors are elected annually by the stockholder and hold office until the next annual election and until their successors are elected. Directors duly elected and serving as of December 31, 2014, are as follows:

<u>Name</u>	<u>Business Affiliation</u>
Frederick Henry Eppinger	President and CEO, THG
Mark Leo Berthiaume	Senior Vice President
Andrew Christopher Furman	Vice President and Treasurer (Hanover)
David Bruce Greenfield	Executive Vice President and Chief Financial Officer (Hanover)
J. Kendall Huber	Executive Vice President and General Counsel (Hanover)
Christine Biloti-Peterson	Senior Vice President

Andrew Scott Robinson	Executive Vice President, President Specialty Insurance, Chief Risk Officer (Hanover)
John Conner Roche	Executive Vice President (Hanover)
Robert Dean Schultz	Vice President
Ann Kirpatrick Tripp	Senior Vice President, Chief Investment Officer
Mark Joseph Welzenbach	Senior Vice President

Officers were elected in accordance with the bylaws during the period under examination. The bylaws require election of a President, and may elect one or more Vice Presidents, a Treasurer, a Secretary, one or more Assistant Vice Presidents and Assistant Secretaries. The Board of Directors may also elect a Chairman of the Board of Directors and a Chief Executive Officer at its discretion. The primary officers serving as of December 31, 2014 were as follows:

<u>Name</u>	<u>Title</u>
Frederick Henry Eppinger	President
Andrew Christopher Furman	Vice President, Treasurer
Charles Frederick Cronin	Secretary
Mark Leo Berthiaume	Senior Vice President
David Bruce Greenfield	Executive Vice President, CFO
J. Kendall Huber	Executive Vice President, General Counsel

Committee

The Company has one Committee, Investment Committee. THG's Audit Committee serves as ASIC's Audit Committee. In addition to the Audit Committee, the THG Board has established committees including: Compensation Committee, Nomination Committee and

Governance Committee. Each committee consists solely of independent directors. ASIC ultimately benefits from the functions of these committees and from the governance of the THG Board.

Conflicts of Interest

The Company maintains a formal written Conflict of Interest Policy outlined within Hanover's Code of Ethics policy. Officers and Directors were required to sign annual Conflict of Interest Statements.

Corporate Records

The minutes of the Stockholder and Board of Directors were reviewed for the period under examination. The recorded minutes documented activities and transactions of the Company.

The bylaws require the annual meeting of the stockholders of the Company to be held at the principal office of the Company or at such other place and at such hour as shall be designated in the notice thereof, on the third Thursday of June in each calendar year. The election of Directors shall be held at the annual meeting of stockholders.

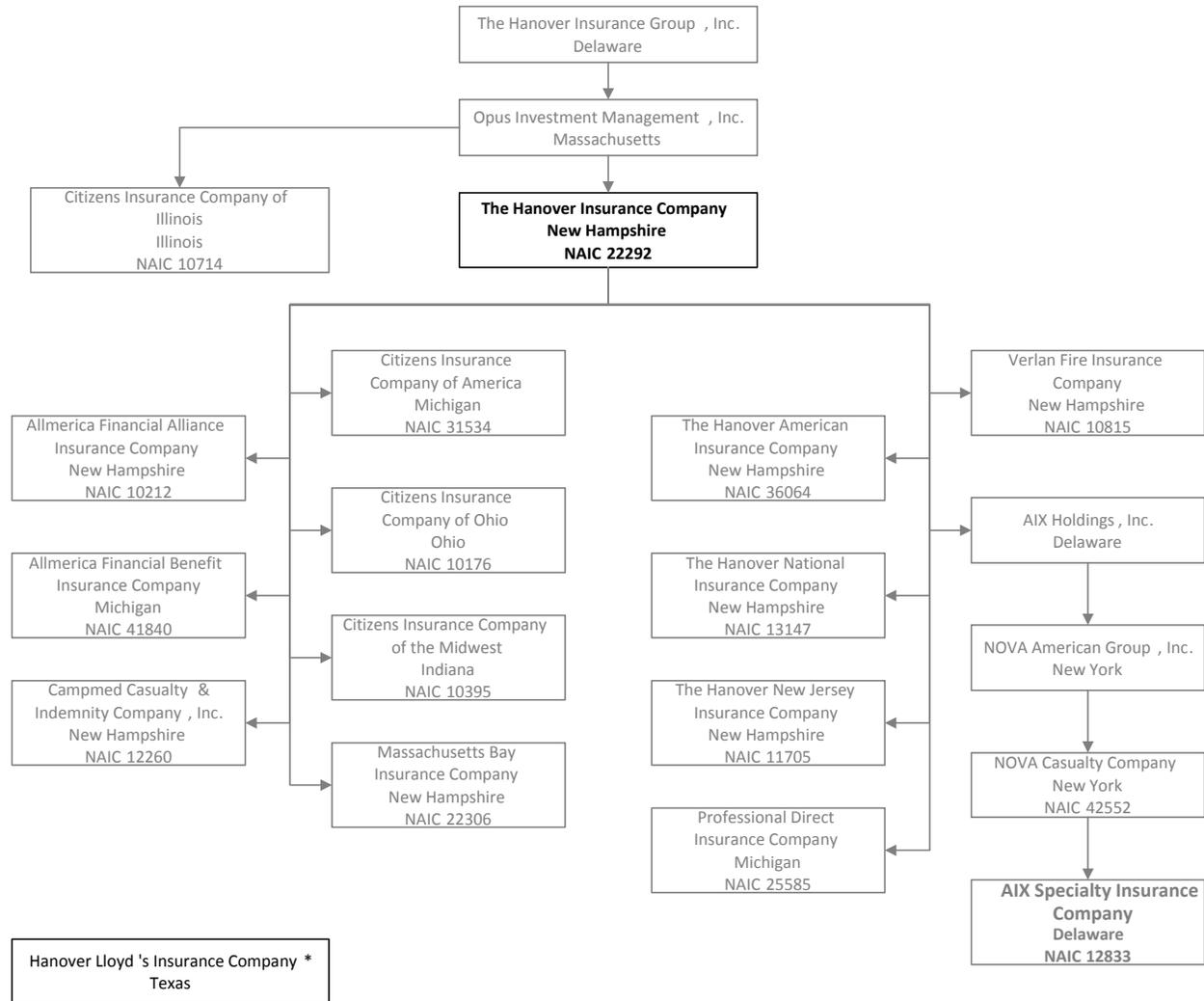
All applicable agreements were filed with and approved by the Delaware Department of Insurance in accordance with 18 Del. C. § 5005 (a)(2) of the Delaware Insurance Code.

Insurance Holding Company System

The Company is a member of an insurance holding company system known as The Hanover Group, Inc. as defined under 18 Del. C. §5001 of the Delaware Insurance Code. The Hanover Insurance Group, Inc. is a public company whose shares are traded on the NYSE under the ticker symbol THG. The Company is a 100% owned subsidiary of NOVA Casualty Company a New York domestic property and casualty insurer.

AIX Specialty Insurance Company

An organizational chart of The Hanover Insurance Group as of December 31, 2014, is presented below:



* Affiliated Lloyd's plan company, controlled by Underwriters for the benefit of The Hanover Insurance Company .

Affiliated Agreements:

The Company has entered into various agreements with members of the affiliated group in an effort to obtain efficiencies in operations and limit cost. The Company had the following material intercompany agreements in effect as of December 31, 2014:

Consolidated Service Agreement

Effective on January 1, 2010, ASIC became party to a Consolidated Service Agreement between The Hanover Insurance Group and a group of companies known collectively as the “Affiliated Group”. The Consolidated Service Agreement includes any services that would be required by the operations of the affiliates. Each of the affiliate companies may provide services to any of the other companies. Under the Consolidated Service Agreement, legal entities will be charged for the cost of the service provided or expenses paid by the entity providing the service or paying the expense. Hanover provides the companies with management, space, and other services including accounting, electronic data processing, human resources, legal and other staff functions.

Consolidated Tax Agreements

All the United States domestic companies in the THG are part of a Consolidated Tax Agreement. The Company is a party to a tax allocation agreement with THG and affiliates. The Parent, the Company and affiliates constitute an affiliated group and have elected to file a consolidated return under the provisions of §1501 of the Internal Revenue Code of 1986. Pursuant to the terms of the tax allocation agreement, no party will be required to pay more in taxes or receive a lesser payment of a refund than it would have paid or received if it computed its taxes independently and filed a separate tax return.

Investment Advisory Agreement

ASIC and all THG insurance affiliates were part of an Investment Advisory Agreement with Opus Investment Management Inc., (OPUS). ASIC was added to the preexisting Investment Advisory Agreement on February 1, 2009. As noted previously, OPUS is a member of THG. Expenses and fees paid by ASIC under the Investment Advisory Agreement were established on both a direct cost basis and on allocation basis in accordance with Statement of Statutory Accounting Principles No.70, "Allocation of Expenses". Under the Investment Advisory Agreement OPUS agrees to follow the investment guidelines supplied by and approved by the ASIC Board.

Quota Share Reinsurance Agreement

The Company is a party to a quota share reinsurance agreement effective January 1, 2009 with Hanover. The Cedant (ASIC) cedes and transfers to the Reinsurer (Hanover), one hundred percent (100%) of all of the Cedant's liabilities, and obligations based upon or arising out of any contracts, policies, binders or endorsements of insurance and reinsurance on the Initial Effective Date or issued or entered into by the Cedant after the Effective Date.

Service and General Agency Agreement

Effective July 16, 2007, the Company was party to a Service Agreement with NOVA American Group, Inc. (NAGI) and a General Agency Agreement with Professional Underwriters Agency, Inc. (PUA). Under the terms of the Service Agreement, NAGI performs various underwriting and collection services for the Company. NAGI receives a 5% commission on annual written premium. The General Agency Agreement with PUA was terminated on July 17, 2015.

TERRITORY AND PLAN OF OPERATION

The Company is part of a national group of multi-line carrier's that underwrite commercial and personal property coverages primarily through independent agents. As of December 31, 2014, the Company was licensed to write in the state of Delaware and is eligible to do business in 49 other states and the District of Columbia as an excess surplus lines carrier.

The Company primarily serves as a writer of niche specialty programs, specifically property and liability coverage risks generally not insured in the admitted market.

The Company writes business pursuant to the Service Agreement with NAGI, using licensed surplus agents who have the authority to underwrite and bind the business on ASIC's behalf. Program Managers oversee classes of business with supporting agents within the programs.

The Company benefits from cross-over business where The Hanover Group uses the Company's paper to provide policies to clients on risks that fit ASIC's profile. These policies are managed through the Hanover's systems and are not managed by the Company out of the Windsor, Connecticut office.

On the filed Annual Statement for 2014, the Company reported the following distribution of Direct Premiums Written:

Allied lines	\$ 3,059,227	3.57%
Commercial multiple peril	19,988,853	23.34%
Inland marine	6,926,290	8.09%
Medical professional liability- claims-made	3,118,714	3.64%
Other liability - occurrence	34,021,542	39.73%
Other liability – claims-made	10,657,915	12.44%
Product liability - occurrence	3,503,933	4.09%
All other lines	<u>4,364,919</u>	<u>5.10%</u>
Total	\$ 85,641,393	100.00%

REINSURANCE

Effective January 1, 2009, the Company entered into a 100% Quota Share Reinsurance Agreement with Hanover. All business is ceded to Hanover.

The Company does not assume any reinsurance.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2014, as determined by this examination, along with supporting exhibits as detailed below:

- Assets
- Liabilities, Surplus and Other Funds
- Statement of Income
- Capital and Surplus Account
- Reconciliation of Surplus since Last Examination
- Schedule of Examination Adjustments

Assets

As of December 31, 2014

	<u>Assets</u> <u>Current Year</u>	<u>Nonadmitted</u> <u>Assets</u>	<u>Net Admitted</u> <u>Assets</u>	<u>Note</u>
Bonds	\$51,192,256		\$51,192,256	1
Short-term investments	25,818		25,818	
Cash	1,008,852		1,008,852	
Receivables for securities	3,525		3,525	
Investment income due and accrued	544,266		544,266	
Net deferred tax asset	280,873		280,873	
Electronic data processing equipment and software	51,544	\$51,544	0	
Aggregate write-ins for other-than-invested assets	941,352	941,352	0	
Total assets	<u>\$54,048,486</u>	<u>\$992,896</u>	<u>\$53,055,590</u>	

Liabilities, Surplus and Other Funds

As of December 31, 2014

Liabilities, Surplus and Other Funds

	<u>Current Year</u>	<u>Note</u>
Losses	\$0	2
Loss adjustment expenses	0	2
Current federal and foreign income taxes (including \$0 on realized capital gains (losses))	1,765	
Ceded reinsurance premiums payable (net of ceding commissions)	3,157,195	
Payable to parent; subsidiaries and affiliates	7,091	
Total liabilities	<u>\$3,166,051</u>	
Common capital stock	\$5,000,000	
Gross paid in and contributed surplus	40,568,776	
Unassigned funds (surplus)	4,320,763	
Surplus as regards policyholders	<u>\$49,889,539</u>	
Total Liabilities, Capital and Surplus	<u>\$53,055,590</u>	

Statement of Income
As of December 31, 2014

Investment Income	
Net investment income earned	\$1,944,756
Net realized capital gains (losses)	<u>83,298</u>
Net investment gain (loss)	<u>\$2,028,054</u>
Net income before dividends to policyholders and before federal income taxes	\$2,028,054
Dividends to policyholders	<u>0</u>
Net income after dividends to policyholders but before federal income taxes	\$2,028,054
Federal and foreign income taxes incurred	<u>666,493</u>
Net income	<u><u>\$1,361,561</u></u>

Capital and Surplus Account
As of December 31, 2014

Capital and Surplus Account	
Surplus as regards policyholders; December 31 prior year	<u>\$51,352,345</u>
Net income	\$1,361,561
Change in net deferred income tax	(138,922)
Change in nonadmitted assets	314,555
Dividends to stockholders	<u>(3,000,000)</u>
Change in surplus as regards policyholders for the year	<u>(\$1,462,806)</u>
Surplus as regards policyholders; December 31, 2014	<u><u>\$49,889,539</u></u>

**Reconciliation of Capital and Surplus from the Prior Examination
From December 31, 2010 to December 31, 2014**

	Aggregate Write-ins for Surplus Funds	Common Capital Stock	Gross Paid-In & Contributed Surplus	Unassigned Funds (Surplus)	Total
December 31, 2011	\$0	\$5,000,000	\$40,568,776	\$3,414,251	\$48,983,027
2012 Operations				\$1,777,689	\$1,777,689
December 31, 2012	\$0	\$5,000,000	\$40,568,776	\$5,191,940	\$50,760,716
2013 Operations				\$591,629	\$591,629
December 31, 2013	\$0	\$5,000,000	\$40,568,776	\$5,783,569	\$51,352,345
2014 Operations				\$1,537,194	\$1,537,194
Dividends				(\$3,000,000)	(\$3,000,000)
December 31, 2014	<u>\$0</u>	<u>\$5,000,000</u>	<u>\$40,568,776</u>	<u>\$4,320,763</u>	<u>\$49,889,539</u>

(1) Operations is defined as: net income, change in net unrealized capital gains or (losses), change in net deferred income tax, change in non-admitted assets, change in provision for reinsurance, and aggregate write-ins for gains and losses to surplus.

Dividends

The Company paid dividends to its parent of \$3,000,000 in 2014. Payment was approved by the Delaware Department of Insurance.

SCHEDULE OF EXAMINATION ADJUSTMENTS

No examination changes were made as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

Note 1:**Schedule D - Bonds****\$ 51,192,256**

As of December 31, 2014, the Company reported total bond investments on Schedule D- Part 1 with book adjusted carrying values in the amount of \$51.2 million and fair market values of \$53.8 million. Bonds were comprised of the following classes:

	Statement Value	% of Total
Schedule D - Part 1		
U.S. Government Bonds	\$747,966	1.46%
U.S. States, Territories and Possession Obligations	1,944,679	3.80%
U.S. Political Subdivisions of States; Territories; Possessions	3,769,865	7.36%
U.S. Special Revenue - Issuer Obligations	11,706,373	22.87%
Industrial and Miscellaneous Bonds	33,023,373	64.51%
 Total Bonds	 \$51,192,256	 100.00%

Of the Company's total bond holdings, 100% were categorized as class 1 or 2 with respect to NAIC credit quality standards and 97.6% were publically traded securities. Bond maturities were structured with maturities of 6.2%, 53.1%, 34.6%, 4.0% and 2.1% maturing in less than one year, one to five years, five to ten years, ten to twenty years and over twenty years, respectively.

Note 2:**Losses****\$ 0****Loss Adjustment Expenses****\$ 0**

INS Consultants, Inc. (Consulting Actuary) performed a review of the inherent risks, management oversight and other mitigating controls over the Company's actuarial processes and procedures. The Consulting actuary performed an analysis of the gross loss and LAE reserves as of December 31, 2014 using data and information as presented in the lead

states actuarial report. The Company's actuarial staff provided the Consulting Actuary its Statement of Actuarial Opinion. The Consulting Actuary determined the Company's loss and loss adjustment expenses reserves were sufficient on both a gross and net basis as of December 31, 2014.

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a limited review of the information contained in the lead states actuarial report provided by AGI Actuarial Group Inc. The INS reserve analysis was performed on both a gross and net of reinsurance basis and did not address the collectability of reinsurance recoverables. The INS reserve review found the Company's combined net loss and LAE reserves were reasonably stated.

Loss and LAE reserves are subject to statistical errors of estimation arising from the fact that the ultimate liability for claims evaluated as of the valuation date are dependent on future contingent events which cannot always be anticipated. The possible occurrence of such events, as well as the inherent uncertainty associated with statistical estimates, allows no guarantee that the actual ultimate liabilities will be the same as the reserve levels described in this examination report. The review was conducted in conjunction with the current financial examination. Based on the review, INS has accepted the conclusion that additional actuarial reserves were not required as of December 31, 2014.

SUBSEQUENT EVENTS

On July 17, 2015 the Company terminated its General Agency Agreement with Professional Underwriters Agency, Inc. which had an effective date of April 1, 2007.

The Company declared an ordinary common stock dividend to the Parent Company NOVA Casualty Company (NCC) on November 25, 2015 totaling \$3,000,000. The dividend was settled on December 22, 2015, by transferring cash in the amount of \$3,000,000.

PRIOR EXAM COMMENTS AND RECOMMENDATIONS

There were no recommendations made in the prior examination report.

SUMMARY OF RECOMMENDATIONS

There were no recommendations made in the examination report.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 2011</u>	<u>December 31, 2014</u>	<u>Increase (Decrease)</u>
Assets	<u>\$49,893,373</u>	<u>\$53,055,590</u>	<u>\$3,162,217</u>
Liabilities	<u>\$910,346</u>	<u>\$3,166,051</u>	<u>\$2,255,705</u>
Common capital stock	5,000,000	5,000,000	0
Gross paid in and contributed surplus	40,568,776	40,568,776	0
Unassigned funds (Surplus)	<u>3,414,251</u>	<u>4,320,763</u>	<u>906,512</u>
Total surplus as regards policyholders	<u>\$48,983,027</u>	<u>\$49,889,539</u>	<u>\$906,512</u>
Totals	<u>\$49,893,373</u>	<u>\$53,055,590</u>	<u>\$3,162,217</u>

AIX Specialty Insurance Company

The assistance of the Delaware Insurance Department's consulting actuarial firm, INS Consultants, Inc., is acknowledged.

Respectfully submitted,

A handwritten signature in black ink that reads "Richard Randour". The signature is written in a cursive style with a large, prominent initial "R".

Richard Randour, CFE
Examiner-In-Charge
Delaware Department of Insurance