

REPORT ON EXAMINATION
OF
HUDSON INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

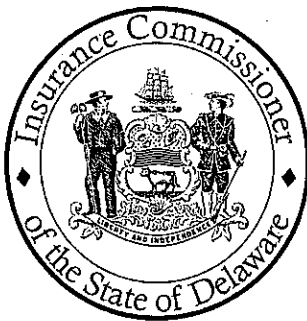
I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2007 of the

HUDSON INSURANCE COMPANY

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

Attest By: *Sonia C. Harris*

Date: 29 June 2009



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 29th day of June 2009.

[Handwritten signature]

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
OF THE
HUDSON INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

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.



Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 29th day of June, 2009

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SALUTATION

October 30, 2008

Honorable Alfred Gross, Chairperson
NAIC Financial Condition (E) Committee
State Corporation Commission
Bureau of Insurance
Post Office Box 1157
Richmond, VA 23218

Honorable Morris J. Chavez, Secretary
Western Zone (IV), NAIC
Department of Insurance
State of New Mexico
Post Office Box 1269
Santa Fe, NM 87504-1269

Honorable Joel Ario, Secretary
Northeastern Zone (I), NAIC
Pennsylvania Insurance Department
1326 Strawberry Square
Harrisburg, PA 17120

Honorable James J. Donelson, Secretary
Southeastern Zone (II), NAIC
Louisiana Department of Insurance
1702 North Third Street
Baton Rouge, LA 70802

Honorable Merle D. Scheiber, Secretary
Midwestern Zone (III), NAIC
South Dakota Division of Insurance
Department of Revenue and Regulation
445 East Capital Avenue
Pierre, SD 57501-3185

Honorable Karen W. Stewart, CIR-ML
Insurance Commissioner
Department of Insurance
State of Delaware
841 Silver Lake Blvd, Suite 100
Dover, DE

Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority Number 08.006, an examination has been made of the affairs, financial condition and management of

HUDSON INSURANCE COMPANY

hereinafter referred to as "Company" or "Hudson" incorporated under the laws of the State of Delaware, the statutory home office of which was located at The Corporation Trust Center, 1209 Orange St., Wilmington, DE, 19801. The main administrative offices of the Company were located at 17 State Street, 29th floor, New York, NY. The examination of the Company was conducted at the main administrative offices of both its immediate parent, Clearwater Ins. Co. (CIC) and its upstream parent, Odyssey Re Holdings Corp. (ORH), located at 300 First Stamford Place, Stamford, Connecticut 06902. The examination was

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conducted concurrently with that of both its affiliate, Clearwater Select Ins. Co. (CSIC), and its immediate parent, (CIC). Separate reports of examination were filed for each company.

The report of this examination is respectfully submitted.

SCOPE OF EXAMINATION

This financial condition examination of the Company, covered the period from January 1, 2005 through December 31, 2007 and consisted of a general survey of the Company's business policies and practices; management and any corporate matters incident thereto; a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed to the extent deemed necessary.

This report is presented on an exception basis. It is designed to set forth material facts with regards to adverse findings discovered during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible personnel and/or officials during the course of the examination.

The examination followed rules established by the National Association of Insurance Commissioners (NAIC) Committee on Financial Condition Examiners Handbook, as adopted by the Delaware Insurance Department under Delaware Insurance Code Section 526, and generally accepted statutory insurance examination standards. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc. reviewed and tested, in part, the Company's high level controls over Information Technology systems and control environment based on its responses to questions contained in the Evaluation of Controls in Information

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Systems Questionnaire – Exhibit C. Other planning exhibits were reviewed and tested, as needed, by the examiners.

Workpapers prepared by the Company's external accounting firm, PricewaterhouseCoopers, LLC, (PWC) New York, NY, in connection with its annual audit, were extensively reviewed in order to ascertain its analysis, review of controls, audit procedures, and conclusions. We relied upon and utilized PWC's work papers to the fullest extent possible. In addition, the Company's Sarbanes-Oxley (SOX), Section 404, compliance documentation related to the identification of financial reporting Key Activities and the attendant processes and controls maintained therein was also reviewed and relied upon to the fullest extent possible. Based upon the review of PWC work papers, SOX compliance documentation, as well as the performance of other examination planning procedures including: account analysis, the assessment of management and the ORH organization (as a whole), the assessment of account specific and cycle controls, and the assessment of the ORH control environment, an overall assessment was made determining: compliance risk, operational risk, financial reporting risk, and risk of material misstatement. In those areas in which a high reliance was placed on controls, and where we determined a low likelihood of material misstatement, limited examination procedures were performed. In other areas, we identified examination procedures to specifically address those concerns or risks noted, based on professional judgment.

In addition to items noted in this report, the following topics were reviewed without material exception and are included in the work papers of this examination:

- Fidelity Bond and Other Corporate Insurance
- Corporate Records
- Legal Actions
- NAIC Ratios
- All Asset and Liability Items Not Mentioned

HISTORY

The Company was incorporated on January 16, 1918, and commenced business on December 14, 1918 as a stock multi-line insurer under the laws of the State of New York. The Company was a direct writer until 1932 and became a professional reinsurer in 1935.

Skandia Insurance Company Ltd. of Stockholm, Sweden (SICL) acquired Hudson on August 25, 1939. On July 1, 1974, ownership was transferred to CIC, formerly Odyssey Reinsurance Corporation, formerly Skandia America Reinsurance Corporation, the domesticated Company of the former United States branch of SICL.

On December 31, 1978, the Company re-domesticated from New York to Delaware by way of a merger into its wholly owned subsidiary, Hudson Insurance Company of Delaware. This subsidiary served as the corporate vehicle to accomplish the change of domicile. Subsequently, the certificate of incorporation was amended and the “of Delaware” was deleted from the corporate name with Hudson retaining all rights and privileges, powers and franchises of the former New York domiciled corporation.

The Delaware Insurance Commissioner, granting authority to conduct a multiple line insurance business, other than life, health, annuities and title, issued an amended Certificate of authority to the Company on February 26, 1979.

In 1981, the Company started to write excess and special risk business; however, in July 1985, the Company suspended writings.

In 1990, the Company resumed writing direct excess and surplus lines business through one managing general agent in the State of Texas. During 1997, the Company suspended writings with this agent.

Fairfax Inc., a Wyoming Corporation, purchased the Company along with CIC, its immediate parent, on May 31, 1996. The ultimate parent of Fairfax Inc. is Fairfax Financial Holdings Limited, (Fairfax) a Canadian financial services holding company.

At December 31, 2007, Hudson was owned 100% by CIC, an insurance company domiciled in the State of Delaware. The latter is owned 100% by Odyssey America Reinsurance Corporation, a Connecticut corporation, which is owned 100% by ORH, a publicly held holding company domiciled in Delaware. Fairfax owned approximately 61% of ORH at December 31, 2007.

CAPITALIZATION

The Company's authorized capital was \$7,500,000, consisting of 25,000 issued and outstanding shares of common stock at a par value of \$300 per share. Total Adjusted Capital of \$105,948,510 (per this examination) was approximately 360% over Adjusted Control Level risk based capital of \$29,325,596. The following changes occurred in the capital and surplus accounts since the prior examination and reflect changes made per this examination:

| | Common Capital Stock | Gross Paid-in and Contributed Surplus | Unassigned Surplus | Total |
|----------------------|-------------------------|---|-----------------------|----------------------|
| December 31, 2004 | \$7,500,000 | \$57,225,000 | \$14,351,284 | \$79,076,284 |
| Operations: (1) | | | | 16,027,121 |
| 2005 | | | 13,403,491 | |
| 2006 | | | (2,063,594) | |
| 2007 | | | 4,687,224 | |
| Capital changes: (2) | | | | |
| Surplus paid-in 2005 | _____ | 25,000,000 | _____ | 25,000,000 |
| December 31, 2007 | <u>\$7,500,000</u> | <u>\$82,225,000</u> | <u>\$30,378,405</u> | <u>\$120,103,405</u> |

1. Operations is defined as Net income, Change in net unrealized capital gains or (losses), Change in net unrealized foreign exchange capital gain (loss), Change in non-admitted assets, Change in net deferred income tax, and Change in provision for reinsurance.
2. Capital changes were due to surplus contributions by the Company's parent.

DIVIDENDS TO STOCKHOLDER

The Company paid no dividends to its stockholder during the examination period.

MANAGEMENT AND CONTROL

Pursuant to the General Corporation Law of the State of Delaware as implemented by the Company's Certificate of Incorporation and by-laws, all corporate powers of the Company and its business, property, and affairs are managed by or under the direction of its Board of Directors. The Board consists of not less than three and not more than nine members who serve until either resignation, removal, or until their successor is qualified and elected. Members of the Board of Directors serving as of December 31, 2007, were as follows:

Director's Name

| | | | |
|---------------------|--------------------|--------------------------|---------------------|
| Andrew A. Barnard * | Robert S. Bennett | Christopher L. Gallagher | James E. Migliorini |
| Donald L. Smith | Richard S. Donovan | Michael G. Wacek | Brian D. Young |

* Chairman of the Board of Directors

The Company's bylaws provide for the Board to designate one or more committees, each committee to consist of one or more of the directors of the corporation. As of December 31, 2007, the Board of Directors had appointed the following committees.

| <u>Investment Committee</u> | <u>Benefit Committee</u> | <u>Compensation</u> |
|-----------------------------|--------------------------|---------------------|
| Andrew A. Barnard | Andrew A. Barnard | Andrew A. Barnard |
| Richard S. Donovan | Donald L. Smith | Richard S. Donovan |
| Michael G. Wacek | Michael G. Wacek | Michael G. Wacek |

A review of corporate records showed that regular business of the Shareholder and Board of Directors was conducted via Written Consents in lieu of regular meetings.

The bylaws of the Company provide for a President, one or more Vice Presidents, one or more Secretaries, and such other officers, if any, as may be designated by the Board of

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Directors. At December 31, 2007, the Company's principal officers and their respective titles are as follows:

OfficerTitle

| <u>Name</u> | <u>Title</u> |
|--------------------------|--|
| Andrew A. Barnard | Chief Executive Officer |
| James E. Migliorini | President & Chief Operating Officer |
| Robert S. Bennett | Executive Vice President & Actuary |
| Christopher L. Gallagher | Executive Vice President |
| Scott F. Galiardo | Executive Vice President |
| Peter H. Lovell | Senior Vice President, General Counsel & Corp. Secretary |
| Anthony J. Slowski | Senior Vice President & Controller |
| John F. Verbich | Senior Vice President & Chief Financial Officer |
| Seymour L. Andrew | Senior Vice President |
| James J. Danbrowney | Senior Vice President |
| Michael P. Gleson | Senior Vice President |
| Stephen L. Porcelli | Senior Vice President |
| Jeffery M. Rubin | Senior Vice President |
| Gerald A. Dugan | Senior Vice President |
| Jean M. Willig | Senior Vice President |
| James A. Crowe | Senior Vice President |

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System under the ultimate parent company, Fairfax Financial Holdings Ltd, (Fairfax) a Canadian company. Fairfax is traded on the Toronto and New York stock exchanges under the ticker symbols "FFH.SV" and "FFH", respectively. Fairfax conducts insurance and reinsurance business globally in all segments of the property/casualty industries. At December 31, 2007, Fairfax owned 60.99% of Odyssey Re Holdings Corp., (NYSE "ORH") a publicly traded Delaware holding company that indirectly owns 100% of the Company. For the latest year ending, Fairfax realized a consolidated combined ratio of 94%, earned \$1.096 billion on revenues of \$7.484 billion, held assets totaling \$27.942 billion, and maintained total equity of \$5.843 billion. The Company was rated by AM Best as "A" (Excellent) and Standard & Poor's as "A-"(Strong).

For the year ending 2007, the organizational chart of Fairfax showed 196 separate legal entities, including the Company, chartered and/or domesticated globally. The following chart illustrates the relationships between the Company and its direct affiliates, its parent, and upstream parent companies, as of December 31, 2007:

| | |
|-------------------------------------|-----------------|
| Fairfax Financial Holdings Ltd. (1) | Canada |
| Fairfax, Inc. | Wyoming |
| TIG Holdings, Inc. | Delaware |
| TIG Insurance Group Inc. | California |
| Odyssey Re Holdings Corp. (60.99%) | Delaware |
| Odyssey America Rein. Corp. | Connecticut |
| Clearwater Ins. Co. | Delaware |
| Hudson Ins. Co. | Delaware |
| Clearwater Select Ins. Co. | Delaware |
| Hudson Specialty Ins. Co. | New York |

(1) V. Prem Watsa, through either himself, a Family Trust or other holding entities, controls 48.7% of the total votes attached to all shares of Fairfax.

GROWTH OF THE COMPANY

The financial growth of the Company since its last examination (2004) is summarized as follows and was compiled from its filed Annual Statements, reflective of examination changes:

| <u>Year</u> | <u>Premiums Earned</u> | <u>Assets</u> | <u>Liabilities</u> | <u>Surplus as Regards Policyholders</u> | <u>Net Income</u> |
|-------------|------------------------|---------------|--------------------|---|-------------------|
| 2004 | \$89,055,365 | \$219,950,975 | \$140,874,691 | \$79,076,284 | \$3,670,164 |
| 2005 | 147,321,819 | 328,484,372 | 211,004,597 | 117,479,775 | 9,669,790 |
| 2006 | 191,533,659 | 371,337,988 | 255,921,807 | 115,416,181 | 1,100,973 |
| 2007 | 197,673,972 | 390,766,359 | 270,662,954 | 120,103,405 | 4,735,945 |

The changes over the examination period are as follows:

- A 122% increase in Premiums Earned
- A 78% increase in Assets
- A 92% increase in Liabilities
- A 52% increase in Surplus as Regards Policyholders

Assets increased due to premiums written and a surplus contribution of \$25,000,000 made in 2005. Net premiums earned increased due to an increase in direct premiums written. Liabilities increased as a result of reserves attendant with the increase in premiums written. Surplus increased due to the 2005 surplus contribution and net income. On-going net income was supported by net investment income off-setting net underwriting losses for the three years under examination.

TERRITORY AND PLAN OF OPERATION

Territory:

The Company is licensed to transact business in all states, except Maine, as well as the District of Columbia, Puerto Rico and the U.S. Virgin Islands. For the year ending 2007, the Company wrote 54.5% of its business in the states of California (28.9%), New York (7.1%), Washington (5.4%), Florida (5.1%), New Jersey (4.7%), and Nevada (3.3%).

Plan of Operation:

The Company operates as the primary admitted carrier of the Odyssey Re Holdings Corp. (ORH) U.S. insurance operations. The group provides a full range of property and casualty products on a world wide basis.

The Company participates in program business written through specialized agents and Managing General Agents (MGA). These contracted agents write on Company paper business that meets its underwriting guidelines. Claims and claims management of the Company are managed through Third Party Administrators (TPA), Claims Administrators, and Company personnel who specialize in the business managed.

Program Business:

The following table lists the five largest programs, representing 52.7% by premiums, in the year 2007 followed by a brief synopsis of their respective agreement:

| Program | Gross Premium Written | Program Coverage | Territory |
|------------------------|-----------------------|--|-------------|
| Alliant Ins. Services | \$47,687,417 | Indian Sovereign Nation – Workers Compensation | Other Alien |
| US Risk Underwriters | 28,573,787 | Sovereign Nation Commercial Ins. | Other Alien |
| Arrowhead Design Ins. | 25,610,765 | Architects and Engineers Prof. Lia. | USA |
| Hooghius Group, LLC | 17,617,073 | Primary & Excess D&O Lia. Ins. | USA |
| Native American Indian | 13,217,269 | Gen. Lia. including Workers Comp. | Other Alien |

Alliant Insurance Services

Effective April 1, 2005, Alliant Specialty Insurance Services, Inc. and Alliant Insurance Services entered into a Program Administrators (PA) Agreement with the Company to write Indian Nation Workers Compensation business, with policy effective dates on or after that of the PA Agreement. The PA Agreement stipulates the full duties, responsibilities, compensation, confidentiality, arbitration, and other general provisions protecting the Company. Claims and claim management attendant with this business is handled by Alliant Specialty Insurance Services, Inc.

US Risk Underwriters

Effective September 1, 2004, U.S. Risk Underwriters, LP, (mutually known as the Tribal First Liability Program) entered into a PA agreement with the Company to write Automobile and General Liability risks associated with Native American tribal operations (except for occupational benefits, which are written separately), with policy effective dates on or after that of the PA Agreement. The PA Agreement stipulates the full duties, responsibilities, compensation, confidentiality, arbitration, and other general provisions protecting the Company.

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Claims and claim management attendant with this business is handled under separate agreement with Alliant Specialty Insurance Services, Inc.

Arrowhead General Insurance Agency

Effective September 1, 2004, Arrowhead General Insurance Agency entered into a PA Agreement with the Company to write Architects and Engineers Professional Liability, with policy effective dates on or after that of the PA Agreement. The PA Agreement stipulates the full duties, responsibilities, compensation, confidentiality, arbitration, and other general provisions protecting the Company. The PA Agreement was amended July 2007 to add Company affiliates, CIC, and Hudson Specialty Insurance Company (HSIC). Claims and claim management attendant with this business was handled under separate agreement by Murdock Claim Management Company until July 1, 2006, after which time claims and claims management have been handled by the Company.

Hooghius Group, LLC

Effective January 1, 2005, Hooghius Group, LLC entered into a PA Agreement with the Company, CIC and, HSIC to write Primary and Excess Directors and Officers Liability Insurance and related coverages with policy effective dates on or after that of the PA Agreement. The PA Agreement stipulates the full duties, responsibilities, compensation, confidentiality, arbitration, and other general provisions protecting the Company. Claims attendant with this business are handled by the Company.

Native American Indian (NAI) All Lines Aggregate

Under a Producer Agreement executed June 2, 2005, Alliant Specialty Insurance Services, Inc. is an exclusive agent for NAI All Lines Aggregate business, with policy effective dates on or after that of the Agreement. The Agreement stipulates the full duties, responsibilities, compensation, and other general provisions protecting the Company. Claims

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within the Insured's Self Insurance Retention (SIR) are administered by Alliant Specialty Insurance Services. Claims in excess of the SIR are administered by the Company.

INTERCOMPANY AGREEMENTS

Expense Sharing Agreement

Effective January 1, 2000, Fairfax Inc., Odyssey America Reinsurance Corporation, Clearwater, and Hudson entered into an expense sharing agreement. Under provisions of this agreement, each company is to make available to the others: management, underwriting, claims, accounting, financial, legal, personnel, data processing services and consulting, to be used at times and in amounts determined necessary or appropriate by the managing officers of each company. The Company reported that \$576,397 was paid for services received in 2007.

Tax Services Agreement

Effective January 1, 2002, the Company is party to a Tax Services Agreement with Fairfax Inc. Under the provisions of this agreement, Fairfax Inc. provides the Company with tax consulting and compliance services. The Company reported that \$90,375 was paid to ORH in 2007 for services rendered pursuant to this agreement, which amount was then paid by ORH to Fairfax Inc.

Tax Allocation Agreement

Effective June 19, 2001, Fairfax Inc., Odyssey Re Holdings Corp., Odyssey America Reinsurance Corp., Clearwater, Hudson, Clearwater Select Insurance Company and Hudson Specialty Insurance Company entered into a tax allocation agreement. Under terms of the agreement, the affiliated group exercises the privileges granted under IRS Code Section 1501 to file a consolidated return. Each company's tax liability is calculated based upon its

Hudson Ins. Co.

respective share of consolidated income. The agreement further provides that each member shall receive reimbursement to the extent that its losses and other credits result in a reduction of the current year's consolidated tax liability, not to exceed its liability as if filed on an individual basis. The Company reported \$6,543,223 was paid to ORH in connection with the tax allocation agreement during 2007.

Investment Management Agreement

Effective January 1, 2003, the Company entered into an investment agreement with Hamblin Watsa Investment Counsel, Ltd (Hamblin Watsa) and Fairfax. Under terms of the agreement, Hamblin Watsa is to manage on a continuous basis the Company's investment account in accordance with investment objectives communicated in writing by Company management. For services received, the Company pays a base fee of .20% per annum of marketable securities managed, plus a graduated incentive fee for investment performance greater than the S&P 500 + 200 basis points. The Company reported \$545,317 in administrative fees paid to Fairfax during 2007.

REINSURANCE

A schedule of the Company's premiums written follows:

| | | |
|--------------------|-------------------|----------------------|
| Direct | | \$251,496,768 |
| Ceded: | | |
| Affiliates | 19,868,788 | |
| Non-Affiliates | <u>39,388,150</u> | |
| Total ceded | | <u>59,256,938</u> |
| Total net premiums | | <u>\$192,239,830</u> |

Assumed Reinsurance

The Company does not assume any business.

Ceded Reinsurance

The Company reinsures its specific underlying program business and cedes, per various excess of loss and quota share policies, amounts up to \$10 million. For amounts greater than \$10 million facultative reinsurance is used.

The Company cedes to CIC 100% of its crop insurance business. This business is retro-ceded to the Federal Crop Insurance Company ("FCIC"), a federally run program that has a blend of quota share and stop loss elements tailored to the crop market.

The Company can write up to \$11 million in limits on hospital medical malpractice (\$1 million primary, \$10 million umbrella). Reinsurance protection maintained under various treaties limits its exposure to \$800 thousand, for a maximum recovery of \$10.2 million on a single event.

The Company's highest net line is on Directors and Officers insurance where it has a \$3 million net retention, after a 70% quota share.

ACCOUNTS AND RECORDS

The accounts and records reviewed included an evaluation of the Company's operation and organization controls. The areas evaluated included computer systems, financial reporting processes and controls, its organizational structure, compliance, management, and operations. The Company operates in a computer dominated environment. All services and operational needs of the Company are provided under its Expense Sharing Agreement with ORH and affiliates.

PricewaterhouseCoopers, LLC (PWC) audits the statutory-basis financial statements of ORH and its subsidiaries, including the Company, annually. PWC reviewed the internal control structure of ORH in order to establish necessary audit procedures required to express an opinion

on the December 31, 2007 financial statements. No material qualifying deficiencies were found to exist in either the design or oversight of the internal control structure of ORH. Based on the examination review of the Company's accounts and records related to its filed Annual Statements, discussions with management, and our review of financial reporting processes and controls, the accounting systems, processes, and procedures (excluding findings and recommendations made in this report, see below) were found to conform to required insurance accounting practices.

During the examination, the following three findings were noted and considered material:

The Company was unable to provide detailed inception-to-date policyholder aging reports for agents' balances receivables, which reflect effective and expiration dates of a policy for most of its Program Administrators. The Company maintained instead, year-to-date reports, and also excluded future booked installment premiums from their listings. Therefore, the Company's general ledger amounts were not able to be reconciled to any policyholder receivable reports.

It is recommended that the Company maintain detailed policyholder information supporting all receivable and not-admitted asset balances that are aged on an inception-to-date basis.

It is recommended that the Company timely reconcile its agents balances policyholder listings to amounts reported in its general ledger to support its Annual and Quarterly Statement filings.

The net amount of these errors was not considered material to the financial position of the Company and no financial adjustment has been made. As represented by management, the Company agrees with these recommendations. As further represented, management is working towards having resident policy level accounts receivable information available by program.

This information will include the appropriate aging of balances, the reporting of future installments not yet due and a timely reconciliation of amounts to the general ledger.

Due to Company methodology used in determining reserves for certain Program Administrators, recorded written premiums and other accounting transactions included in the Annual Statement represent business that was reported to the Company through October and/or November due to the lag in receiving financial bordereaux from its Program Administrators. However, when preparing Annual and Quarterly Statements for these Program Administrators, the accounting period used by the Company to book its written premiums differs from the accounting period that was used as a basis in calculating unearned premium reserves. These reserves were calculated as if two (2) or one (1) month of written premiums had already expired or was earned in advance.

SSAP No. 53 Paragraph 7 states;

Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired.

Thereby, the Company's accounting is inconsistent and not in compliance with SSAP No. 53 as the reporting period used to calculate the unearned premium reserves was not based on the amount of written premiums as reported in the financial statements.

It is recommended that the Company comply with SSAP No. 53 Paragraph 7 by calculating its unearned premium reserves based on the same amount of its recorded written premiums in its financial statements.

The net amount of this error was not considered material to the financial position of the Company and no financial adjustment has been made. As represented by management, the Company agrees with this recommendation. As further represented and to be made effective for 2009 and future reporting periods, the Company will change its accounting treatment of unearned

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premiums for the applicable Program Administrators to be consistent with all other programs.

FINANCIAL STATEMENTS

The following financial statements as determined by this examination are presented herein:

Analysis of Assets, as of December 31, 2007
Liabilities, Surplus and Other Funds, as of December 31, 2007
Statement of Income, for the year ended December 31, 2007
Capital and Surplus Account, December 31, 2004 to December 31, 2007
Schedule of Examination Adjustments

Analysis of Assets
As of December 31, 2007

| | <u>Assets</u> | Non- Admitted <u>Assets</u> | Net Admitted <u>Assets</u> | <u>Note</u> |
|---|----------------------|-----------------------------------|-------------------------------|-------------|
| Bonds | \$233,628,449 | | \$ 233,628,449 | 1 |
| Cash, cash equivalents and short-term investments | 62,035,144 | | 62,035,144 | |
| Receivable for securities | <u>44,341</u> | | <u>44,341</u> | |
| Subtotals, cash and invested assets | <u>\$295,707,934</u> | | <u>\$295,707,934</u> | |
| Investment income due and accrued | 2,302,885 | | 2,302,885 | |
| Premiums and considerations: | | | | |
| Uncollected prem. & agents' balances in course of collection | 8,030,254 | 1,876,133 | 6,154,121 | |
| Deferred prem. & agents' balances booked but deferred and not yet due | 37,062,151 | | 37,062,151 | |
| Amounts recoverable from reinsurers | 10,035,667 | | 10,035,667 | |
| Federal income tax recoverable | 4,717,023 | | 4,717,023 | |
| Net deferred tax asset | 13,011,000 | 4,597,868 | 8,413,132 | |
| EDP equipment & software | 1,012,704 | 896,791 | 115,913 | |
| Furniture & equipment | 82,796 | 82,796 | | |
| Receivable from parent | 4,228,832 | | 4,228,832 | |
| Aggregate Write-ins for other than invested Assets | <u>22,694,866</u> | <u>666,165</u> | <u>22,028,701</u> | |
| Totals | <u>\$398,886,112</u> | <u>\$8,119,753</u> | <u>\$390,766,359</u> | |

Liabilities, Surplus and Other Funds
As of December 31, 2007

| | | Note |
|---|-----------------------|------|
| Losses | \$ 146,780,677 | 2 |
| Loss adjustment expenses | 8,665,334 | 2 |
| Commissions payable | 6,948,119 | |
| Other expenses | 3,801,501 | |
| Taxes, licenses and fees | 551,503 | |
| Unearned premiums | 80,868,258 | |
| Ceded reinsurance premiums payable | 15,838,915 | |
| Funds held by company under reinsurance treaties | 20,000 | |
| Amounts withheld or retained by company for account of others | 22,845 | |
| Provision for reinsurance | 3,206,287 | |
| Drafts outstanding | 7,135 | |
| Payable to parent, subsidiaries and affiliates | <u>3,952,380</u> | |
| Total Liabilities | \$ <u>270,662,954</u> | |
| Common capital stock | 7,500,000 | |
| Gross paid in and contributed surplus | 82,225,000 | |
| Unassigned funds (surplus) | <u>30,378,405</u> | |
| Surplus as regards policyholders | \$ <u>120,103,405</u> | |
| Total | \$ <u>390,766,359</u> | |

Underwriting and Investment Exhibit: Statement of Income
For the Year Ended December 31, 2007

Underwriting Income

| | |
|--------------------------------------|-----------------------|
| Premiums earned | \$ 197,673,972 |
| Deductions: | |
| Losses incurred | \$ 107,795,336 |
| Loss expenses incurred | 23,105,043 |
| Other underwriting expenses incurred | <u>71,468,259</u> |
| Total underwriting deductions | \$ <u>202,368,638</u> |
| Net underwriting gain or (loss) | \$ <u>(4,694,666)</u> |

Investment Income

| | |
|--|----------------------------|
| Net investment earned | \$ 12,586,758 |
| Net realized capital gains or (losses) | <u>13,395</u> |
| Net investment gain (loss) | \$ 12,600,153 |
| Net income before federal income taxes | \$ 7,905,487 |
| Federal and foreign income taxes | <u>3,169,542</u> |
| Net income | \$ <u><u>4,735,945</u></u> |

Capital and Surplus Account

| | |
|---|------------------------------|
| Surplus as regards policyholders December 31, 2004 | \$ <u>79,076,284</u> |
| Net income | \$ 15,506,708 |
| Change in net unrealized capital gains or (losses) | (87,288) |
| Change in net deferred income tax | 7,562,679 |
| Change in non-admitted assets | (4,715,642) |
| Change in provision for reinsurance | (2,239,336) |
| Surplus adjustments: | |
| Paid in | <u>25,000,000</u> |
| Change in surplus as regards policyholders | \$ <u>41,027,121</u> |
| Surplus as regards policyholders, December 31, 2007 | \$ <u><u>120,103,405</u></u> |

SCHEDULE OF EXAMINATION ADJUSTMENTS

No financial adjustments were made as a result of this examination.

NOTES TO THE FINANCIAL STATEMENTS

Note 1

Bonds

\$233,628,449

Investments in bonds are reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. As of the examination date, 99.8% of the Company's Bond investments were designated by the SVO with the highest quality of "1". The remaining 0.2% were rated "2". Bonds with carrying values of \$12.7 million were on deposit with various states, or governmental insurance departments in compliance with insurance laws. The Company did not have any securities on loan.

Note 2

Loss Reserves

\$146,780,677

Loss Adjustment Expense Reserves

8,665,334

Loss and loss adjustment expense reserves represent 55.6% of the Company's liabilities as of December 31, 2007. Incurred but not reported reserves (IBNR) constituted approximately 59% of loss reserves.

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a review of the Company's reserve methodologies and adequacy. INS evaluated the Company's book of business by line of business for loss and allocated loss adjustment expenses. The conclusions reached by INS are largely based upon information supplied by the Company's staff, which included an in-depth actuarial analysis. The INS reserve analysis was performed on

both a gross and net basis of reinsurance and did not address the collectability of reinsurance recoverables. The INS reserve review found the Company's combined net loss and loss adjustment expense reserves were adequate to support the business underwritten.

The underlying data was tested through a review of open and paid claim files and actual payments made with no exceptions noted. The aggregated actuarial data provided by the Company was verified and reconciled to Schedule P of the Company's filed Annual Statement.

Caveat

Loss and LAE reserves are subject to 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. As a result of this study, the reserves were accepted.

COMPLIANCE WITH PRIOR RECOMMENDATIONS

The following recommendation was made in the prior examination report:

It was recommended that the Company properly disclose the Holding Company voting structure in the filed Annual Statement. **The Company has complied.**

SUMMARY OF RECOMMENDATIONS

The Company was unable to provide detailed inception-to-date policyholder aging reports for agents' balances receivables, which reflect effective and expiration dates of a policy for most of its Program Administrators. The Company maintained instead, year -to-date reports,

and also excluded future booked installment premiums from their listings. As such, the Company's general ledger amounts were not able to be reconciled to any policyholder receivable reports.

It is recommended that the Company maintain detailed policyholder information supporting all receivable and not-admitted asset balances that are aged on an inception-to-date basis. Pg. 15

It is recommended that the Company timely reconcile its agents' balances policyholder listings to amounts reported in its general ledger to support its Annual and Quarterly Statement filings. Pg. 15

It is recommended that the Company comply with SSAP No. 53 Paragraph 7 by calculating its unearned premium reserves based on the same amount of its recorded written premiums in its financial statements. Pg. 16

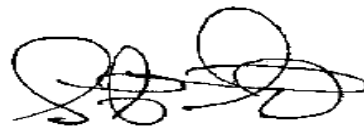
CONCLUSION

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

| Description | 12-31-07 Current Examination | 12-31-04 Prior Examination | Changes Increase (Decrease) |
|--|------------------------------------|----------------------------------|-----------------------------------|
| Assets | <u>\$390,766,359</u> | <u>\$219,950,975</u> | <u>\$170,815,384</u> |
| Liabilities | 270,662,954 | 140,874,691 | 129,788,263 |
| Common capital stock | 7,500,000 | 7,500,000 | 0 |
| Gross paid in and contributed surplus | 82,225,000 | 57,225,000 | 25,000,000 |
| Unassigned funds (surplus) | <u>30,378,405</u> | <u>14,351,284</u> | <u>16,027,121</u> |
| Total surplus as regards policyholders | <u>120,103,405</u> | <u>79,076,284</u> | <u>41,027,121</u> |
| Totals | <u>\$390,766,359</u> | <u>\$219,950,975</u> | <u>\$170,815,384</u> |

Since the last examination, the Company's assets increased \$170,815,384, liabilities increased \$129,788,263 and capital and surplus increased \$41,027,121. In addition to the undersigned, acknowledgement is made of the assistance provided by the Delaware Insurance Department, INS Consultants Inc. and INS Insurance Services.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven E. Guest". The signature is stylized with large loops and a horizontal line across the middle.

Steven E. Guest, CFE
Examiner-in-Charge
State of Delaware

SUBSEQUENT EVENTS

Acquisition of CropUSA Insurance Agency

On September 2, 2008, the Company announced it had purchased certain assets pertaining to the crop insurance business of CropUSA Insurance Agency, Inc. (CropUSA). CropUSA has acted as the Managing General Underwriter for the Hudson Group's crop insurance business since 2006. As represented by management, the Company has acquired the crop insurance business and hired related staff of Crop USA. Going forward, this business will operate under the brand Hudson Crop and will be led by the previous president of CropUSA. Hudson Crop intends to write multi peril and related products, including crop hail and named crop peril insurance.