REPORT ON EXAMINATION

OF THE

LEXINGTON INSURANCE COMPANY

AS OF

DECEMBER 31, 2008

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

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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 1st day of July, 2010

841 Silver Lake Blvd., Dover, DE 19904-2465 • www.delawareinsurance.gov
(302) 674-7300 Dover • (302) 739-5280 fax • (302) 577-5280 Wilmington

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, 2008 of the

LEXINGTON INSURANCE COMPANY

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

Attest By: Sonia C. Harris

Date: 1 July 2010

Insurance Commissioner of the State of Delaware

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 1st day of July 2010.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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Honorable Karen Weldin Stewart, CIR-ML
Commissioner, Delaware Dept. of Insurance
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Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09.009, dated December 24, 2008, an Association examination has been made of the affairs, financial condition and management of

LEXINGTON INSURANCE COMPANY

hereinafter referred to as (Lexington), (Company), or (LIC) and incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 2711 Centerville Rd, Suite 400, Wilmington, Delaware. The examination was conducted at administrative offices of the Company, located at 175 Water Street, New York, NY 10038.

The report of this examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2005. This examination covers the intervening three (3) year period from January 1, 2006, through December 31, 2008, and encompasses a general review of the Company; key process activities and related controls; transactions during the period; business policies and practices, as well as management and relevant corporate matters; and a determination of statutory financial condition at December 31, 2008. Transactions and significant events subsequent to the examination date were also reviewed where deemed necessary.

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (Handbook). The NAIC Handbook requires that we plan and perform the examination to evaluate financial condition and identify Company prospective risks by obtaining and assessing information relevant to: corporate governance, inherent risks, key process activities, system and general controls, and other procedures used to mitigate risks identified. The examination also included assessing the principles used, and significant estimates made by management, as well as evaluating overall financial statement presentation. All accounts and activities of the Company were considered in accordance with the risk focused examination process.

The examination report addresses regulatory issues reviewed during the examination process. Its format will describe the Company and its operations in those areas detailed and explain findings and changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction, improvement, or in violation of Statements of Statutory Accounting Principles (SSAP), Annual Statement Instructions, or Delaware insurance laws and regulations. In such cases, these matters were thoroughly discussed with responsible personnel or officials during the course of the examination.

During the course of this examination, consideration was given to work performed by both the Company's Internal Audit Department (IAD) as regards their oversight of compliance with Sarbanes-Oxley (SOX), risk analysis, documentation, test work, remediation efforts over weaknesses identified, and by the Company's independent external accounting firm, PricewaterhouseCoopers, LLP (PWC). The 2008 workpapers of PWC were made available during the examination, extensively reviewed, and used as either original support, or additional support to analysis and procedures performed during the examination. Certain auditor work-papers have been incorporated into the workpapers of the examiners and were utilized in determining the scope and areas of emphasis in conducting the examination. In addition, the examiners met regularly with senior management and supporting staff of PWC throughout the planning phase and as needed during the field work phase in an effort to best leverage their work, analysis, and specific knowledge of critical areas under review.

This report of examination was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

The examination of the Company was performed concurrently with its affiliates AIG Excess Liability Insurance Company, Ltd (AIG Excess) n/k/a Chartis Select Insurance Company and Landmark Insurance Company (Landmark). Separate reports for each have been filed.

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

Corporate Records
Employee and Agents Welfare
Fidelity Bonds and Other Insurance
NAIC Ratios
Legal Actions
Regulatory Agency Correspondence
All Other Asset and Liability Items Not Mentioned

HISTORY

The Lexington Insurance Company was incorporated on March 31, 1965, under the laws of the State of Delaware and began business on April 1, 1965. The Company commenced business by assuming substantially all of the in-force business of the First State Insurance Company, also a Delaware corporation. At the time of incorporation, the Company was 100% owned by AIG, a Delaware Holding Company.

On December 31, 1985, AIG transferred its ownership of the Company as follows: 70% to National Union Fire Insurance Company of Pittsburgh, Pa. (NUFIC), 20% to The Insurance Company of the State of Pennsylvania (ICP), and 10% to Birmingham Fire Insurance Company of Pennsylvania (BFIC) (n/k/a Chartis Property Casualty Company), all of whom are subsidiaries of AIG.

CAPITALIZATION

Common Capital Stock

The Certificate of Incorporation, as amended, provides that the authorized capital stock of the Company shall be 5,000,000 shares of $5 par value common stock. At December 31, 2008, 1,000,000 shares were issued and outstanding, resulting in total capital stock of $5,000,000.

In 2007, the Company received contributions recorded to paid-in surplus totaling $104,903 from its owners to reimburse the Company for securities lending losses on sales of securities to third parties (AIG Securities Lending Pool).

During 2008, the Company received the following contributions recorded to paid-in surplus: $361,275 to reimburse the Company for additional losses related to the AIG Securities Lending Pool; $12,780,000 non-cash (in kind) related to the Tax Sharing Agreement; and $150,000,000 cash from its owners related to the reimbursement of dividends previously paid to the Company’s owners.

Dividends

The Company paid $400,000,000 and $300,000,000 in ordinary stockholder dividends in 2007 and 2008, respectively, to its parent companies, based on their percentage ownership.

Reconciliation of Capital and Surplus

The following reconciliation of capital and surplus for the period December 31, 2005 to December 31, 2008, was extracted from the Company's filed Annual Statements and does not reflect examination changes:

Capital and Surplus, December 31, 2005		$2,564,849,924
2006		
Net income	$ 895,991,016	
Change in net unrealized capital gains or (losses)	132,992,737	
Change in net deferred income tax	48,124,504	
Change in non-admitted assets	(128,631,117)	
Change in provision for reinsurance	(3,090,187)	
Aggregate write-ins for gains and losses in surplus:		
Unrealized foreign exchange adjustment	1,408,345	
	$ 946,795,298	
Capital and Surplus, December 31, 2006		$3,511,645,222
2007		
Net income	$1,206,405,799	
Change in net unrealized capital gains or (losses)	136,293,496	
Change in net deferred income tax	37,569,758	
Change in non-admitted assets	42,707,290	
Change in provision for reinsurance	16,921,287	
Surplus adjustment: Paid in	104,903	
Dividends to stockholders	(400,000,000)	
Aggregate write-ins for gains and losses in surplus:		
Unrealized foreign exchange adjustment	790,325	
Correction for error – Restatement	(1,407,436)	
	$1,039,385,422	
Capital and Surplus, December 31, 2007		$4,551,030,644
2008		
Net income	$ 208,534,746	
Change in net unrealized capital gains or (losses)	(305,601,572)	
Change in net deferred income tax	111,047,682	
Change in non-admitted assets	(189,367,900)	
Change in provision for reinsurance	24,020,602	
Surplus adjustments: Paid in	163,141,453	
Dividends to stockholders	(300,000,000)	
Aggregate write-ins for gains and losses in surplus:		
Unrealized foreign exchange adjustment	(23,026)	
	$(288,248,015)	
Capital and Surplus, December 31, 2008		$4,262,782,629

MANAGEMENT AND CONTROL

Stockholders

In accordance with Company bylaws, the annual meeting of the stockholders shall be held at such time and place as the Board of Directors shall designate. The Board of Directors may, in its sole discretion, determine that the meeting may be held solely by means of remote communication. The Stockholders or Board of Directors may call special meetings for any purpose or purposes when required by the General Corporate Law to do so. Minutes of meetings held by stockholders during the examination period were reviewed without material exception.

Board of Directors

The Company's amended Certificate of Incorporation provides that all corporate powers of the Company be managed by a Board of Directors. The Company's bylaws stipulate that the Board of Directors shall consist of not less than one (1) member or such number as may be determined from time to time by action of the stockholders or the Board of Directors. The term of office for all Directors shall be one (1) year and each Director shall hold office until his term has expired, his successor has been elected and qualified, or until his death, removal, or resignation.

At December 31, 2008, the nine (9) members of the Board of Directors together with their principal business affiliation were as follows:

Name and Date Elected	Principal Business Affiliation
John Quinlan Doyle (4), Chairman	President and CEO, AIG Commercial Insurance
Merton Bernard Aidinoff (1)	Retired Partner, Sullivan & Cromwell
Kristian Philip Moor (1)	President and CEO, AIG Property Casualty Group
Win Jay Neuger (1)	Executive Vice President and CIO, AIG
Charles Harry Dangelo (2)	Vice President, AIG
David Lawrence Herzog (2)	Senior Vice President and Comptroller, AIG
Robert Scott Higgins Schimek (2)	Senior Vice President, CFO/Treasurer, certain AIG subsidiaries including the Company
David Neil Fields (3)	President, AIG Risk Finance
Mark Timothy Willis (4)	Executive Vice President, AIG Commercial Insurance

(1) Elected prior to 2003
(2) First elected in 2005
(3) First elected in 2006
(4) First elected in 2008

Committees

In accordance with the Company's bylaws, the Board may designate committees by resolution that set forth the powers and authority of the committee. The bylaws, Article III, Section 1, state that, "The Board of directors shall have the power at any time to fill vacancies in, to change the membership of, to change the number of members of, or to dissolve the Executive Committee." On November 11, 2008, the Board approved a resolution to dissolve the Executive Committee.

There were no other operating committees appointed by the Board of Directors during the period under review.

Officers

In accordance with the Company's bylaws, the Board of Directors may elect a Chairman of the Board, a President, one or more Vice Presidents, one or more Assistant Vice Presidents, a Secretary, one or more Assistant Secretaries, a Treasurer, one or more Assistant Treasurers, and any other such officers as the Board deems necessary. Only the Chairman is required to be a

Director. At December 31, 2008, the Company's principal officers and their respective titles were as follows:

Officer	Title
John Q. Doyle	Chairman
Peter J. Eastwood	President, CEO
Amy M. Cinquegrana	Secretary
Nicholas E. Anselmo	Executive Vice President
David J. Bresnahan	Executive Vice President
Richard H. Bucilla	Executive Vice President
George R. Stratts	Executive Vice President
Robert S. Schimek	Senior Vice President, CFO/Treasurer
Andrew P. Archambault	Senior Vice President
John M. Artesani	Senior Vice President
Irene L. Carmody	Senior Vice President
Charles H. Dangelo	Senior Vice President
Frank H. Douglas, Jr.	Senior Vice President, Actuary
Frederik M. Fontein	Senior Vice President
Louis P. Frascotti	Senior Vice President
Andrew R. Holland	Senior Vice President
David A. Jordan	Senior Vice President
Anthony Mammolite	Senior Vice President
Edward G. Mazman	Senior Vice President
Mary E. McCoy	Senior Vice President
Gary E. Muoio	Senior Vice President
Brenda G. Osborne	Senior Vice President
Stephen J. Paris	Senior Vice President
Alan R. Perron	Senior Vice President
Richard T. Pisano	Senior Vice President
Matthew F. Power	Senior Vice President
Vincent N. Pugliese	Senior Vice President
Douglas G. Story	Senior Vice President
Ervino J. Valle	Senior Vice President
Nicholas C. Walsh	Senior Vice President
Richard C. Woollams	Senior Vice President

In addition to the above officers, additional vice presidents, assistant vice presidents and other assistant officers were also appointed.

Numerous changes in directors and officers occurred during the period under review. As required, proper notification was provided to the Delaware Department of Insurance.

Enterprise Risk Management

Neither the Company, nor AIG Property Casualty Group, possessed a structured enterprise risk management function during the examination period. See the "Subsequent Events" section of this Report for information related to the appointment of a Chief Risk Officer during 2010. The management of general business and industry risks, however, is practiced informally and regularly by officers of the Company, both individually within their respective responsibilities, and collectively within regularly attended meetings held by senior officers and department managers. Current issues and emerging risks are discussed and plans developed to understand, manage, and mitigate risks identified. Management reports are reviewed regularly and contain sufficient detailed information to allow management to make sound decisions. Management uses various Company and industry resources such as: agents, brokers, underwriters, claims adjustors, both inside and outside counsel, investment advisors, actuaries, reinsurers, consultants, trade associations, and industry trade publications, to assist in its process of identifying and managing risks.

Corporate Governance

The examiner's assessment of Lexington's corporate governance was considered "weak – moderate" based on the following factors:

- A review of Lexington corporate governance noted that of its nine (9) Directors (while experienced), eight (8) have principal and interlocking business affiliations with other AIG affiliates as managers, officers, and directors.
- Its one Director identified as independent, Mr. Merton Aidinoff, was a retired partner of Sullivan & Cromwell, a law firm that provides legal services for the Company. Mr. Aidinoff resigned from the Board in the 2nd Quarter of 2009 and has not been replaced. No conflict of interest statement was available during his tenure as a Board member.
- The Board of Directors has no designated Committees.
- A review of Board minutes showed them to be of a general nature relative to: actions and discussions regarding AIG and the distribution of information concerning appointments, financial results, and approvals of management actions commonly

> regarding investments and new contracts. As it was not the nature of the meetings held, no comfort was gained from this review that Lexington Board members probed for explanations, challenged information presented, scrutinized activities, or presented alternative views.

During the examination, no review was made of corporate governance relative to the AIG Property Casualty Group, and the general failure of AIG corporate governance was noted and given material consideration in this assessment. It was noted during the review of AIG’s 2009 Form 10-K, that AIG’s risk management policies, tools and processes have in the past been ineffective and could be ineffective in the future.

However, it is acknowledged that Lexington management is knowledgeable, experienced, competent, and excluding the departures of Mr. Kevin Kelley, Board Chairman and CEO, and Mr. Shaun Kelly, President and COO, senior management and mid-management of the Company has remained relatively unchanged. It was noted that Lexington’s organizational structure possessed clear lines of understood responsibility and authority, that information was communicated both up and down the organizational structure of senior management as well as across related business activities on a regular basis. It was also noted that expectations and goals of senior management are discussed, established, evaluated on a regular basis, and that regular consideration is given to operational processes and the design and on-going monitoring of effective controls over those processes.

Conflict of Interest

AIG maintains a written conflict of interest policy that is found within the AIG Code of Conduct (Code). Annually, all officers and employees must acknowledge receipt and agree to comply with the policies described in the Code and acknowledge that they must report all violations of it to management or compliance. The acknowledgement also states that failure to comply with the Code may result in disciplinary action, up to and including termination and, if applicable, criminal or civil proceedings. This acknowledgement is not required for principals of managing general underwriters, third party administrators, or independent contractors.

Our review of the processes in place during the examination disclosed no conflicts of interest that appeared to adversely affect the Company, however, the Company failed to obtain and maintain a conflict of interest statement for one director, Mr. Merton Aidinhoff. It was noted that Mr. Aidinoff, listed as the one independent Board member, was a retired partner from Sullivan & Cromwell, a law firm that performed legal work for the Company. Mr. Aidinoff was not re-elected as a director in 2009. All other Board members are employees of AIG.

Certificate of Incorporation and Bylaws

By resolution of the Board of Directors dated May 21, 2007, the bylaws were amended and restated in their entirety. The restated bylaws were provided to the Delaware Department of Insurance.

HOLDING COMPANY SYSTEM

The Company is a member of the American International Group, Inc. Insurance Holdiing Company System. The immediate parents of the Company at December 31, 2008 were National Union Fire Insurance Company of Pittsburgh, Pa. – 70%, The Insurance Company of the State of Pennsylvania – 20%, and AIG Casualty Insurance Company (f/k/a Birmingham Fire Insurance

Company of Pennsylvania) – 10%, all of whom are subsidiaries of AIG. The Company has two insurance subsidiaries, Japan International Accident & Fire Insurance Company, Ltd., of which it has a 50% ownership interest, and AIG Centennial Insurance Company, of which it had a 100% ownership interest.

Refer to the "Subsequent Events" section of this Report for additional information regarding the Company's ownership of AIG Centennial Insurance Company.

The following presentation of the holding company system reflects only the identities and interrelationships between the Company and its immediate parent, affiliates and subsidiaries as of December 31, 2008:

Company	Domicile	% own
American International Group, Inc.	Delaware	
AIG Property Casualty Group, Inc.*	Delaware	100%
National Union Fire Insurance Company of Pittsburgh, Pa.	Pennsylvania	100%
National Union Fire Insurance Company of Vermont	Vermont	100%
National Union Fire Insurance Company of Louisiana	Louisiana	100%
American International Specialty Lines Insurance Company*	Illinois	70%
AIG Excess Liability Insurance Company Ltd.*	Delaware	100%
AIG Excess Liability Insurance International Limited*	Ireland	100%
Lexington Insurance Company	Delaware	70%
Japan International Accident & Fire Insurance Co., Ltd.	Japan	50%
AIG Centennial Insurance Company	Pennsylvania	100%
AIG Auto Insurance Company of New Jersey	New Jersey	100%
AIG Preferred Insurance Company	Pennsylvania	100%
AIG Premier Insurance Company	Pennsylvania	100%
AIG Indemnity Insurance Company	Pennsylvania	100%
The Insurance Company of the State of Pennsylvania	Pennsylvania	100%
Lexington Insurance Company	Delaware	20%
AIG Casualty Company (f/k/a Birmingham Fire Insurance Company of Pennsylvania)*	Pennsylvania	100%
Lexington Insurance Company	Delaware	10%
Landmark Insurance Company	California	100%

*Refer to the Report section "Subsequent Events" regarding rebranding of the Company's affiliates and or subsidiaries above.

AIG, a Delaware corporation, is a holding company which, through its subsidiaries, is engaged in a broad range of insurance, insurance-related, financial, and other non-insurance activities in the United States and abroad. AIG's primary activities include both general insurance and life insurance and retirement services. Other significant activities include financial services and asset management. As of December 31, 2008, AIG possessed assets totaling $860 billion, shareholder equity of $53 billion, and earned net income (loss) of ($99.3) billion on total reported revenues of $11.1 billion. In September 2008, the U.S. Department of the Treasury (U.S. Treasury) and the Federal Reserve Bank of New York (NY Fed) took a series of actions related to AIG in order to address liquidity and capital needs as a result of its derivative investment exposure through AIG's Financial Products division, which could have severely disrupted financial markets and contributed to a further worsening of economic conditions. For a complete discussion of the actions taken, refer to the Report section "Events Related to AIG".

A review of the Annual Form B and Form C filings made by American International Group, Inc. on behalf of the Company for all years under examination revealed that the Company had complied with the requirements of 19 Del. Admin. Code 1801 "Registration of Insurance Holding Companies".

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2008, the company was licensed to transact a multiple lines insurance business in the State of Delaware. The company is an eligible surplus lines insurer in the remaining forty-nine (49) states, the District of Columbia, the territory of Puerto Rico, and the U.S. Virgin Islands. The company is also registered to transact business in Great Britain, Bermuda, and Hong Kong. No new jurisdictions were added during this examination period.

Plan of Operation

At December 31, 2008, approximately 50.8% or $3,054,114,626 of the Company's direct written premium was in five states: California, 15.4%; New York, 11.1%; Florida, 10.2%; Texas, 8.9%; and Illinois, 5.2%. Direct written premiums of the Company's fifty-one (51) other jurisdictions amounted to approximately 49.2% or $2,962,476,124.

Lexington is a U.S. based surplus lines insurer. As a surplus lines insurer, Lexington provides flexibility in capacity, rate, and form that allow it to meet customer needs with insurance products for unique risks. The key to Lexington's success is new product development, risk management, and claim prevention services. The Company focuses on insuring those risks for which conventional insurance companies do not readily provide insurance coverage, either because of complexity or because the coverage does not lend itself to conventional insurance contracts.

Lexington offers products in the following business lines: Property, Casualty, Healthcare, Personal Lines, Program business, and Medical Stop Loss. Business comes into Lexington through diverse distribution sources, including brokers, retailers, wholesalers and Program Administrators (PAs). Business is underwritten by Lexington's London and US Branch offices, along with the Risk Specialist Companies, and PAs based on underwriting guidelines supplied by Lexington home office division heads and product line management.

Agency Relations and Third Party Administrators

Lexington markets its products through a diversified distribution system, selling 66% through retail producers, 16% through wholesale producers, 11% through PAs, and 3% through London producers, with the remaining 4% of the business generated internally.

The Company accepts business mainly from insurance brokers, enabling selection of specialized markets and retention of underwriting control. Any licensed insurance broker is able to submit business to the Company, but such broker usually has no authority to commit the Company to accept the risk. The Company utilizes the services of certain program administrators and third party administrators for policy issuance and administration, underwriting, and claims adjustment services.

Intercompany Pooling

Beginning December 31, 1998, Lexington entered into an intercompany pooling agreement with two AIG affiliates, Landmark and AIG Excess, collectively known as the AIG Surplus Lines Pool, the pooling percentages of which are as follows: Lexington - 80%, AIG Excess - 18%, and Landmark - 2%. The Company also assumes reinsurance from other carriers and AIG affiliates. The approach to reinsurance structure varies by line of business and size of portfolio. Retention under its “Program” portfolio is significantly lower than most of its directly written books of business. Traditionally, Lexington has been a significant purchaser of pro rata treaty reinsurance. Facultative reinsurance is purchased on all lines of business to provide capacity or to supplement treaty reinsurance. Refer to the “Intercompany Agreement” section of this Report, under the caption “Intercompany Pooling Agreement” for additional comments regarding the intercompany pooling arrangement. Refer to the “Reinsurance” section of this Report for details regarding the Company’s reinsurance program.

A. M. Best’s Rating

Based on A.M. Best’s opinion of the consolidated Financial Strength of the members of the AIG Surplus Lines Pool, each pool member was assigned a Best’s Financial Strength Rating of “A” (Excellent) for 2008.

GROWTH OF THE COMPANY

The following information was extracted from copies of the Company's filed Annual Statements for each year indicated, and covers the period from the Company's last examination.

Year	Net Admitted Assets	Surplus as Regards to Policyholders	Change in Capital and Surplus	Direct Premiums Written	Net Premiums Earned	Net Income
2008	$15,293,478,834	$4,262,782,631	(6.33%)	$6,016,590,749	$4,176,514,366	$ 208,534,746
2007	14,832,236,157	4,551,030,643	29.60%	6,619,453,912	4,015,725,110	1,206,405,799
2006	12,583,879,464	3,511,645,222	36.91%	6,273,352,387	3,797,608,971	895,991,016
2005	10,605,683,804	2,564,849,924	15.21%	5,020,961,382	3,199,681,398	315,820,837

From its last examination, the Company's total net admitted assets have increased 44.2%, principally due to net income from operations, reductions due to dividend payments during the examination period, and changes in net unrealized capital gains.

During 2008, Gross Written Premium (GWP) declined by $700.7 million or 9.0% while Net Written Premium (NWP) decreased from the 2007 levels by $289.5 million or 6.8% and Net Earned Premium (NEP) increased from the 2007 levels by $160.8 million or 4.0%.

During 2008 incurred losses and LAE increased by $988.7 million or 41.7%. The Company's Loss Ratio increased from 59.1% in 2007 to 80.5% in 2008, and was adversely impacted by catastrophes. The Company's combined ratio increased from 72.0% in 2007 to 97.2% in 2008.

REINSURANCE

The Company had the following reinsurance programs and agreements in effect as of December 31, 2008:

General

The Company assumes all authorized lines of business from affiliates and non-affiliates on a treaty and facultative basis. The largest net aggregate amount insured under any one risk, excluding workers' compensation, is limited to $713,600,000. Effective May 1, 2009, Lexington placed reinsurance reducing the largest net exposure under any one risk limit to $400,000,000. For 2008, the Company reported the following distribution of net premiums written:

Direct Business	$6,016,590,749
Reinsurance Assumed From Affiliates	653,078,623
Reinsurance Assumed From Non-Affiliates	412,075,837
Total Direct and Assumed	$7,081,745,209
Reinsurance Ceded to Affiliates	$1,896,883,736
Reinsurance Ceded to Non-Affiliates	1,185,590,696
Total Ceded	$3,082,474,432
Net Premiums Written	$3,999,270,777
Percentage Ceded of Gross	43.53%

Assumed

The Company reported 96.6% of assumed affiliated business of $653,078,623 in the following categories:

Intercompany pooling	$445,985,801
American International Life Assurance Co. of New York	112,524,209
Members of AIU Holdings (principally facultative)	72,373,316
Total	$630,883,326

The majority of the Company's non-affiliated assumed business is placed on a facultative basis.

In 1998, the Company joined with AIG Excess and Landmark to form the Lexington Pool. Lexington assumes 100% of all business written by AIG Excess and Landmark. The Company retains 80% of the pool, and cedes 18% of pooled business to AIG Excess, and 2% to Landmark.

The Company is a member of an AIG internal facility known as the Compulsory Cessions Auxiliary Account (CCAA). For certain new and renewal business, various member companies of AIG cede business to the CCAA program. Some of the business ceded to the CCAA is between different divisions of companies within the same Intercompany Pool. For example, any business written on the paper of members of the Lexington Pool stays within that pool without cession to American Home Assurance Company (American Home). American Home or Lexington (on behalf of their respective pools) retains 100% of the CCAA's participation.

Prior to the CCAA facility the Company was party to the Compulsory Cessions Account (CCA) facility that performed the same as the CCAA facility. However, with the CCA facility, Lexington, on behalf of the AIG Surplus Lines Pool, would retain 92% of the CCA participation with the balance being retroceded 8% to Transatlantic Reinsurance Company. As of December 31, 2004, the CCA facility was placed in run-off.

Ceded

The Company's reinsurance is coordinated and controlled by AIG's Global Reinsurance Division (GRD). The Company's Management, located in Boston, MA, is responsible for selection of the working and excess treaty reinsurance coverages. When purchased, facultative reinsurance is placed on an individual basis by the applicable underwriter. GRD in New York, NY, is responsible for placing catastrophe reinsurance. All reinsurance treaty contracts are centrally filed and automated by GRD.

Significant Reinsurance Program Details

The following reinsurance programs are presented on a 100% pooling basis. The Company's share is based on its 80% participation percentage as discussed in the "Intercompany Agreements" section of this Report, under the caption "Intercompany Pooling Agreement".

The Company has extensive property reinsurance which is placed through domestic and foreign reinsurers. The program consists of working and excess layers that cover all property business. In addition, Lexington is a named participant (with all other AIG domestic insurance subsidiaries) under AIG's "external" property catastrophe program. This excess protection covers all AIG property exposures. The summary details of this program are highlighted below.

Property

Major Working Reinsurance Layers

Property quota share coverage, Limit of $10 million, 1.80% placed
Property per risk excess of loss coverage, $15 million excess of $10 million, 64.21% placed
Property per risk excess of loss coverage, $75 million excess of $25 million, 70.00% placed
Property per risk excess of loss coverage, $150 million excess of $100 million, 90.50% placed
Property per risk excess of loss coverage, $250 million excess of $250 million, 95.00% placed
Property per risk excess of loss coverage, $500 million excess of $500 million, 95.00% placed
Property per risk excess of loss coverage, $500 million excess of $1.00 billion, 95.00% placed

7% Personal lines homeowners property quota share coverage, Limit of $5 million
40% Personal lines umbrella quota share coverage, Limit of $5 million

Property Catastrophe Reinsurance

1st layer property catastrophe coverage, 60% of $250 million in excess of $1.00 billion
2nd layer property catastrophe coverage, 60% of $250 million in excess of $1.250 billion
3rd layer property catastrophe coverage, 60% of $100 million in excess of $1.500 billion
4th layer property catastrophe coverage, 50% of $200 million in excess of $1.600 billion
5th layer property catastrophe coverage, 50% of $200 million in excess of $1.800 billion
6th layer property catastrophe coverage, 60% of $250 million in excess of $2.000 billion
7th layer property catastrophe coverage, 60% of $250 million in excess of $2.250 billion
8th layer property catastrophe coverage, 60% of $250 million in excess of $2.500 billion
9th layer property catastrophe coverage, 60% of $250 million in excess of $2.750 billion
10th layer property catastrophe coverage, 60% of $250 million in excess of $3.000 billion
11th layer property catastrophe coverage, 60% of $250 million in excess of $3.250 billion
12th layer property catastrophe coverage, 60% of $250 million in excess of $3.500 billion
13th layer property catastrophe coverage, 100% of $750 million in excess of $3.750 billion

Casualty

Primary Casualty Non-Professional (claims-made basis and occurrence basis) coverage, 0.5% quota share, maximum net $995,000, maximum ceded $5,000.

Employment Practices Liability (claims-made basis and claims-incurred basis) coverage, 10% quota share, maximum net $22,500,000, maximum ceded $2,500,000.

It should be noted that the previously placed (2004 and prior) Corporate Casualty, Casualty Aggregate Stop Loss and Supplemental Aggregate Stop Loss Agreements were not renewed for 2005.

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 automatic facultative 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, it is summarized in a 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.

When a risk transfer assessment is required, it must be included in the underwriting file no later than the effective date of the certificate 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.

Refer to the "Accounts and Records" section of this Report for a description of the Company's reinsurance processes and primary computer applications utilized. Refer to the "Subsequent Events" section of this Report, under the caption "Reinsurance" for details regarding significant reinsurance transactions subsequent to December 31, 2008.

INTERCOMPANY AGREEMENTS

The Company was party to the following intercompany agreements and arrangements as of December 31, 2008:

Amended AIG Service and Expense Agreement

Effective February 1, 1974, amended December 30, 1998 to include Lexington and Landmark, and subsequently amended January 1, 2002 to include AIG Excess, and further amended at subsequent times, the companies entered into a Service and Expense Agreement with AIG. AIG has agreed to provide at cost, services and facilities as required. Services include: Law, Investment, EDP, Internal Audit, Actuarial, Claims, Underwriting, Accounting, Tax, and Employee Benefits.

Investment Management Agreement between LIC and AIG Global Investment Corp.

Effective Janaury 1, 1991, the Company retained an affiliate, AIG Global Investment Corporation (AIGGIC) or (Manager) to provide investment advisory and investment management services with respect to its portfolio and the assets contained therein. 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 in its investment management guidelines provided to the Manager. In accordance with the guidelines, 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 deemed appropriate and without prior consultation with the Company. Investment management fees are billed annually at a rate of seventy-five cents ($0.75) per thousand dollars of assets under management, plus the pro-rated amount of AIG service fees billed to the Manager on behalf of the Company, allocated to the Company based on total invested assets under management. Total investment expenses incurred for 2008 amounted to $5,184,779.

<u>Tax Allocation Agreement between LIC, AIG Excess and AIG</u>

During November of 2008, Lexington and AIG Excess entered into amended tax allocation agreements. During April, 2009, Lexington and AIG Excess executed the amended tax allocation agreements that included statements clarifying the intent of the parties (collectively the "Amended Agreements"). The Amended Agreements replaced tax allocation agreements pursuant to which the tax liabilities of Lexington and AIG Excess were allocated at the level of their ultimate parent, AIG. Under the Amended Agreements, tax liability of Lexington and AIG Excess is allocated at the level of AIU Holdings. AIU Holdings will also hold all tax reserves, as defined in the Amended Agreements, and assume any existing tax reserves. This was reflected on the Registrants books as a deemed capital contribution. Subsequent changes in reserves will similarly be reflected as deemed capital contributions or deemed dividends, as the case may be. Finally, given that a number of the business units slated to be sold by AIG as part of its restructuring efforts are owned by the AIG Commercial Insurance companies, the Amended Agreements clarify that realized gains on any such sales will be excluded from the calculation of

Registrant's tax liability. The Amended Agreements are effective for the tax year commencing January 1, 2008. The agreement further provides that the Company 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.

Intercompany Pooling Agreement between Lexington, AIG Excess, and Landmark

Since December 31, 1998, Lexington has participated in an Intercompany Pooling Agreement with its affiliates, AIG Excess, and Landmark, collectively known as the AIG Surplus Lines Pool or Lexington Pool. In accordance with the terms of the agreement, each participant will share in the Lexington Pool based on the following percentages: the Company's participation is eighty percent (80%); the remaining participation of AIG Excess and Landmark is eighteen percent (18%) and two percent (2%), respectively. The pooling agreement has been properly filed and approved by the Delaware and California Insurance Departments.

Refer to the "Subsequent Events" section of this Report, under the caption "Lexington Pooling Agreement."

Securities Lending Agreement between LIC and AIG Global Securities Lending Corp.

Effective October 19, 2000, Lexington and AIG Global Securities Lending Corporation (AIGGSLC), entered into a Securities Lending Agency Agreement. Under the terms of the agreement, AIGGSLC acts as the Company's agent in connection with loans by the Company to third party borrowers of securities. During 2008, the Company terminated all of its securities lending positions and instructed AIGGSLC not to enter into a new transactions on its behalf. On August 14, 2008 and August 15, 2008, the Company purchased for cash, bonds from AIGGSLC for market value of $72,681,781 and $59,054,137, respectively, liquidating its participation in the securities lending program.

Capital Maintenance Agreement between LIC and AIG

Effective February 26, 2009, the Company entered into a Capital Maintenance Agreement (CMA) with its ultimate parent, AIG, which supersedes the certain letter agreement, dated January 16, 2008, between AIG and the Company regarding capital maintenance without any action. Similar agreements were entered into during 2006 and 2007. The CMA provides that in the event 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 2008 Annual Statement, together with any adjustments or modifications required by the Company's domiciliary regulator, AIG shall, within 30 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 capital contributions, with the prior approval of the Company's domiciliary regulator, AIG may provide a letter of credit naming the Company as beneficiary. The obligations under the CMA terminate without the need for any action twelve (12) months from the date of the CMA effective date, unless extended in writing prior thereto. Refer to the "Subsequent Events” section of this Report, under the caption “Capital Maintenance Agreement” regarding its subsequent renewal.

Joint Asset Advisory Agreement

Effective August 12, 1998, the Company joined the Joint Asset Advisory Agreement with affiliated AIG companies. The Joint Asset Advisory Agreement outlines the appointment of AIG Capital as the administrator of the AIG Domestic Fund. The AIG Domestic fund pools all subsidiary funds to maximize investment yields on short-term funds. There are no assets governed by this agreement, which was terminated on January 27, 2010.

Premium and Collection Agreement between LIC, China America and AI Credit Corp.

Effective October 15, 1997, Lexington Insurance Company and China America Insurance Company (CAIC) entered into a Premium and Collections Agreement for installment premium policies with AI Credit Corp. (AICC). Under the terms of the agreement, AICC serves as the billing and collecting agent for certain policies issued on an installment premium basis. In addition, AICC, at its option, may offer to purchase all rights, title and ownership interest in non-defaulted and defaulted premium collectibles without recourse. The companies maintain the option to accept or reject AICC's offer to purchase any premium collectibles. The agreement may be terminated at the end of any calendar month with sixty (60) days notice to the other party. CAIC was dissolved in 2004; however, this agreement remained in effect between LIC and AICC. As of December 31, 2008, AICC’s Direct Bill Services unit no longer performs premium collection services for the Company. The Agreement was terminated on September 10, 2009.

Premiums Receivable Sale Agreement between AIG Funding, Inc. and LIC

Effective September 4, 1998, Lexington Insurance Company entered into a Premium Receivables Sale Agreement with AIG Funding, Inc. Under terms of the agreement, beginning September 7, 1998, and from time to time thereafter upon fifteen (15) days notice, Lexington shall sell and assign to AIG Funding, Inc., all rights, title, absolute ownership, and interest, except for the right to cancel an insurance contract. AIG Funding, Inc. appoints Lexington as its agent and attorney-in-fact for the purpose of collecting each account purchased by AIG Funding, Inc. AIG Funding, Inc. in turn receives a purchase discount based upon outstanding uncollected balances from the date of purchase to the date of collectability or the date an account is marked off as uncollectible. Settlement of the purchase discount is on the last day of the calendar month. Remittance of funds due Lexington for purchased accounts are due within five (5) days of AIG Funding, Inc.'s assignment acceptance. Purchase of accounts is absolute and without recourse to Lexington for accounts which may ultimately become uncollectible. Uncollectible accounts are defined as those accounts which have not been collected within six (6) months. The agreement may be terminated at the end of any calendar month by either party giving sixty (60) days prior written notice to the other party. The Company is still a party to the agreement with AIG Funding, Inc. There has not been any payment or activity since 2005. As such, this is an inactive agreement that has not been formally terminated.

Guarantee Agreements with Acquired General Electric (GE) Companies

Effective August 20, 2003, the Company issued guarantees whereby it unconditionally and irrevocably guaranteed all present and future obligations and liabilities of any kind arising from the policies of insurance issued by the guaranteed companies (see below). These guarantees were provided to maintain the guaranteed company’s rating status issued by certain rating agencies. The guaranteed entities and effective periods of the guarantees are as follows:

Guaranteed Company	**Date Guarantee Issued**	**Date Guarantee Terminated**
AIG Preferred Company	8/20/2003	8/31/2009
AIG Premier Insurance Company	8/20/2003	8/31/2009
AIG Indemnity Insurance Company	8/20/2003	8/31/2009
AIG Centennial Insurance Company	8/20/2003	8/31/2009
AIG Edison Life Insurance Company	8/20/2003	3/14/2004

The Company remains contingently liable for all policyholder obligations in effect as of the date of termination. The Company believes that the likelihood of a payment under the guarantee is remote, as the guaranteed companies have admitted assets in excess of policyholder liabilities. Additionally, the Company is party to an agreement with AIG whereby AIG has agreed to make any payments due under the guarantees in place and stead of the Company, as described below. The following related agreements were also entered into with the applicable companies:

- Reinsurance Payment Guarantee between LIC and AIG Centennial Insurance Company in favor of the Heritage Casualty Insurance Company (f/k/a Montgomery Ward Insurance Company)
- Intellectual Property Agreement between LIC, the acquired GE companies, and GE Financial Assurance Holdings, Inc.

See "Subsequent Events" section of this Report for related transactions subsequent to the examination date.

Guarantee Agreement between AIG and LIC

Effective August 20, 2003, Lexington entered into an agreement with AIG, whereby AIG will promptly pay any and all obligations of the Company under any guarantee (current and any future guarantees) issued by the Company in connection with the rating of an affiliated insurance company. This agreement may not be terminated unless and until the Company has terminated each and every guarantee agreement. Thereafter, AIG shall have the right to terminate this Agreement upon ninety (90) days written notice to the Company. Notwithstanding amendment to or the termination of this agreement, the right of the Company to demand payment of the obligations by AIG on its behalf and the obligation of AIG to make such payments on behalf of the Company shall survive until such time as all obligations under all guarantees which remain outstanding on the date of such amendment or termination shall have been finally and irrevocably satisfied in full.

EXTERNAL AGREEMENTS

In addition to the above intercompany agreements, the Company had the following external agreements in effect as of the previous examination and remained in effect at December 31, 2008:

- Custodial agreement with Mellon Bank N. A. amended July 27, 2007
- Various Program Administrator (PA) Agreements
- Various Broker Agreements
- Various Third Party Administrator (TPA) Agreements
- Other Vendor Contracts

The agreements were reviewed without exception.

ACCOUNTS AND RECORDS

Accounting System and Information/IT Process Flows

All necessary accounting records of the Company are maintained on electronic data processing equipment (EDP), made available to the Company under its Service and Expense Agreement with AIG. The general ledger is maintained on a statutory basis with additional accounts used to convert to the accrual basis suitable for Generally Accepted Accounting Principles. AIG's EDP equipment and information technology control environment was tested as part of the examination by INS Services, Inc., and given a control risk assessment of "strong".

As part of this examination, INS Services, Inc., and examination staff reviewed the information/accounting and information technology 'process flow' interface of the Company's premium, policy management, and reinsurance cycles as managed in its Boston, MA facilities. The review and assessment of information technology and information/accounting process flow was reviewed by INS Services, Inc. and other examiners regarding (in part) loss, investment accounting, and financial reporting cycles of AIG. The testing of manual or "Non-machine" data and transactions regarding the Lexington Pool was performed by the Delaware examiners, without material exception.

General Background and Overview

Lexington's accounting and financial reporting areas (both in Boston) report up to New York. Financial reporting is located in Boston and generates the amounts contained in the Statutory Annual Statement, which is reviewed and prepared in New York. This process is unchanged from the 2005 exam.

The reinsurance unit located in Boston, MA, reports to Lexington's reinsurance function in New York. Reinsurance is purchased by the group in Boston in coordination with the New York reinsurance department. This process is unchanged from the 2005 exam.

Regarding investments, every statutory entity has an agreement with AIG Global Investment Corp. (AIGGIC) to handle this area; this process is also unchanged from the 2005 exam.

Loss reserving is handled in a similar fashion to financial reporting. There is a team of actuaries in Boston that determine the numbers at the profit center level and report up through the Company's Chief Actuary in New York.

The accounting and financial reporting function located in Boston, MA, was responsible for reporting all results up to the AIG parent company in New York as part of the Lexington Pool structure. The Accounting and Financial Reporting function at Lexington is responsible for non-machine journal entries, deferred acquisition charges, closing processes, report creation, and balance sheet account reconciliations.

The following narratives describe the key processes owned by the Accounting and Financial Reporting Department in Boston, as well as the primary computer applications utilized to perform its key processes:

Journal Entries – Non-Machine
Non-machine (journal) entries in relation to the financial reporting and balance sheet reconciliation process are prepared by the Lexington Home Office in Boston. All entries are processed through the Non-Machine Journal Portal system (NMJE Portal). NMJE Portal is a corporate mandated system designed to control and monitor all journal activity for business units within AIG's Commercial Insurance Group (CIG).

Deferred Acquisition Charges (DAC)
Deferred Acquisition Charges (DAC) calculation worksheets are prepared quarterly out of the Lexington office in Boston. These calculations are discussed with the Corporate Office in New York during the quarterly status meetings. The methodologies involved with the DAC are updated annually. The current methodology for DAC calculations is designed so that the calculation is performed at a company-wide level out of the corporate office in New York.

Closing Process
A Sarbanes-Oxley quarterly closing worksheet is prepared that details all quarterly processes and actions that need to be performed for every close. This worksheet outlines the key financial reporting lines as well as the source of data and overall monitoring controls. The Financial Reporting Unit maintains a Lexington Consolidation as well as individual Divisional report package to monitor financial performance. The financial package consists of monthly and quarterly gross and net premium activity reports, quarterly Reinsurance Segmentation report, Cash Flow and Profit/Loss statements.

Risk Specialist Offices (RSOs)
Risk Specialist Offices (RSOs) are consolidated at the Risk Specialists Home Office in Boston on a company-level and are monitored by both Risk Specialists and AIG CIG Corporate management. Flux analyses are prepared prior to the review and are used to identify any large or unusual changes to the operating performance of the RSOs. The consolidated totals are compiled in a quarterly Standard Internal (SI) package and delivered to the New York office.

Gross and Net Written Premiums
To assist in the monitoring of Gross and Net Written Premiums, a Monthly Estimated Premium report is used, which forecasts the premium amounts for all divisions of Lexington weekly. The estimate and actual results are compared to budgeted amounts, prior year numbers, and to estimates by field representatives. Actual numbers are also included for

prior periods to assist in improving the estimation process and as part of the review performed by management as to the reasonableness of the current period estimates. The PREMLEX Access database is used to compile and summarize all GWP and NWP information.

Cash Flows

There are a number of cash flow reports used by Lexington for forecasting and budgeting purposes. A daily Cash Flow Analysis report is used to reconcile the opening cash balance to the ending cash balance. This is performed by the Cash Supervisor, by identifying related cash receipts and cash disbursements. Monthly, the Cash Manager uses this report to generate the Summary Analysis and Comparison of Cash Flow Projections report, which is used to assess the monthly and year-to-date cash numbers. On this report, budgets and prior year actual are utilized as a means to monitor the cash balances to ascertain any unusual variances that may appear.

P&L Forecasts

Another significant report used by Lexington Management is the Quarterly P&L Forecast. This report identifies various estimate detail, based off of the significant P&L accounts. Some of the forecasts included in the report are estimates to budgets and estimates to prior year actual. This report is reviewed and discussed during the quarterly meeting with the AIG CIG's office in New York.

Reconciliations

A new reconciliation policy established by the AIG Corporate office was effective as of September 30, 2006. All Lexington reconciliations performed out of the Home Office in Boston are listed on an excel spreadsheet, updated quarterly. The spreadsheet details the completion status of the reconciliations, corresponding G/L account numbers, and an aging analysis. The aging section identifies the dollar amounts that have not reconciled for various periods of time, from under 90 days to over five years. This spreadsheet is used to identify those accounts that have large differences as well as to understand which reconciliations have not been completed to date. Quarterly, a meeting is held to review new G/L accounts and determine the reconciliation owners for each new account. All system-related reconciliations are prepared and reviewed in New York, and a quarterly quality review is performed by AIG CIG Corporate management. Reconciliations are performed on balance sheet accounts only. Management gains comfort over the P&L accounts through review of the two estimates performed prior to the quarter close against the actual results.

Stat-to-GAAP

The processing of Stat-to-GAAP accounting differences is performed at the Division level, with any variances sent directly to the New York office for review, rather than going through a consolidating process at Lexington. Typically, no separate entries are made for Stat and GAAP transactions. Stat-to-GAAP entries are identified by AIG CIG's Statutory Accounting Unit in NY who is responsible for the preparation of the annual statement for Lexington. All identified differences are identified in NY and communicated to Lexington.

Primary Computer Applications for Premiums

The primary computer applications used by LIC for premium transactions are “LEXIS” (through December 31, 2007), “e-Surplus” (replaced LEXIS January 1, 2008) and Premium Processing System (PPS).

LEXIS was the Company’s former application to create reservations, quote, bind, book, issuance, post-bind transactions, and create bills. The LEXIS system processed less than 1% of Lexington’s GWP through December 31, 2008.

e-Surplus was implemented January 1, 2008 and replaced LEXIS with its primary function also being to create reservations, quote, bind, book, issuance, post-bind transactions, and create bills. The e-Surplus system processed approximately 48% of LIC’s GWP through December 31, 2008.

PPS is utilized for premium generation, booking and collection. PPS is an AIU Holdings company-wide system. PPS processed approximately 34% of the Company’s GWP through December 31, 2008.

<u>Primary Computer Applications for Investments</u>

The Company’s investment processes are managed by two different operations, (1) Investment Operations and (2) Investment Accounting.

Investment Operations functions are performed at the AIG level through an Investment Management Agreement between the Company and AIGGIC. AIGGIC maintains a general ledger which interfaces with CIG’s (which includes the Company) AXS One general ledger. CIG's Financial Accounting group is responsible for performing reconciliations.

Investment Accounting functions are performed at the CIG level. As the name infers, investment accounting accounts for all the investments.

<u>Primary Computer Applications for Reinsurance</u>

("E-Treaty") is an AIG mainframe tool for capturing all treaty contract data and for housing all business rules governing how AIG underwriters invoke treaty coverages, when performing day to day tasks. The underwriter is required to access the Reinsurance Entry Module (REM) that is fed by the E-Treaty to complete the policy issuance process. The REM confirms the need for reinsurance coverage and the rate information, if treaty business.

"Treaty History" is an AIG document management tool.

Primary Computer Applications for Disbursements (Claims)

Disbursements for the payment of claims are performed through the "Check-Warehouse 2000 system". LIC also issues manual checks for claims. A separate checking account is set up for manual checks issued. Manual checks are issued in an emergency when it is not possible to process system checks.

Independent Accountants

The Company's financial statements are audited each year by PWC of New York, NY. The Examiners reviewed the audited statutory financial statements for all years under examination. For all years under review, PWC issued an unqualified opinion. In connection with its 2008 audit of the Company, PWC identified two material weaknesses in the Company's internal control environment that related to its statutory financial close process and its accounting for income taxes.

On October 2, 2009, management reported to the Board of Directors that it agreed with the external auditor's observations and detailed specific measures that have been implemented to remediate the material weaknesses.

As noted in the "Scope of Examination" section of this Report, the examiners reviewed PWC's 2008 workpapers, and incorporated their work and findings as deemed applicable to the current examination.

Actuarial Opinion

The Company's loss reserves and related actuarial items were reviewed by Frank Douglas, ACAS, MAAA, Chief Actuary of the Company, who issued a statement of actuarial opinion based on the financial information presented by the Company. The opinion stated that the reserves and related actuarial values carried on the balance sheet were computed in accordance with accepted loss reserving standards and principles and are reasonable in the aggregate for unpaid loss and loss expense obligations and all unearned premium obligations of the Company related to long duration contracts under the terms of its contracts and agreements and met the requirements of the insurance laws of the state of Delaware.

The consulting firm of INS Consultants, Inc. was contracted to do an independent loss reserving review, performed by James R. Neidermeyer, FCAS, MAAA. The findings from that review are discussed in Note 2 of the "Notes to Financial Statements" section of this Report.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2008, as determined by this examination, along with supporting exhibits as detailed below:

Analysis of Assets, December 31, 2008

Statement of Liabilities, Surplus and Other Funds, December 31, 2008

Underwriting and Investment Exhibit, Statement of Income, December 31, 2008

Capital and Surplus Account, Statement of Income, December 31, 2008

Schedule of Examination Adjustments

Slight differences noted in the following schedules are due to rounding.

Analysis of Assets

	Assets	Non admitted Assets	Net Admitted Assets	Notes
Bonds	$10,754,356,903		$10,754,356,903	1
Preferred stocks	359,556,459		359,556,459	1
Common stocks	716,970,856		716,970,856	1
Cash and short-term investments	689,674,902		689,674,902	1
Other invested assets	960,516,341		960,516,341	1
Receivable for securities	2,354,695		2,354,695	
Aggregate write-ins for				
invested assets: Swaps	(1,223,714)		(1,223,714)	
Investment income due and accrued	152,185,650		152,185,650	
Uncollected premiums and agents'				
balances in course of collection	420,495,466	65,372,475	355,122,991	
Premiums deferred and not yet due	226,115,479		226,115,479	
Amounts recoverable				
from reinsurers	276,060,721		276,060,721	
Funds held by or deposited				
with reinsured companies	811,940		811,940	
Federal and foreign income				
tax recoverable	369,758,250		369,758,250	
Net deferred tax asset	631,143,536	369,201,389	261,942,147	
Furniture and equipment	405,453	405,453	-	
Receivables from parent,				
subsidiaries and affiliates	128,780,729	7,008,217	121,772,512	
Aggregate-Write-ins:				
Outstanding loss drafts	117,559,966		117,559,966	
Loss Funds on Deposit	3,571,953		3,571,953	
Loss Clearing	769,421		769,421	
Allowance Provision - FAS 5	(76,184,686)		(76,184,686)	
Remaining items from overflow page	1,786,048		1,786,048	
Total Assets	$15,735,466,368	$441,987,534	$15,293,478,834	

Statement of Liabilities, Surplus and Other Funds

		Notes
Losses	$ 6,928,649,646	2
Reinsurance payable on paid losses and	35,647,748	
Loss adjustment expenses	1,166,586,224	2
Commissions payable, contingent commissions		
and other charges	(14,472,620)	
Other expenses	35,757,942	
Taxes, licenses and fees	11,975,706	
Current federal and foreign income taxes	(11,985,728)	
Unearned premiums	2,395,318,686	
Ceded reinsurance premiums payable	265,550,514	
Funds held by company under reinsurance treaties	16,876,980	
Amounts withheld or retained by company	(928,066)	
Remittances and items not allocated	33,250,789	
Provision for reinsurance	45,526,493	
Payable to parent, subsidiaries and affiliates	60,166,695	
Aggregate write-ins for liabilities:		
Deposit accounting liability	53,598,545	
Other liabilities	6,352,781	
Deferred Commission Earnings	4,211,632	
Items from overflow page	(1,387,762)	
Total Liabilities	$11,030,696,205	
Common Capital Stock	$ 5,000,000	
Gross Paid in and Contributed Surplus	497,562,341	
Special surplus fund	292,111	
Unassigned Funds	3,759,928,177	
Total Capital and Surplus	$ 4,262,782,629	
Total Liabilities, Capital and Surplus	$15,293,478,834	

Underwriting and Investment Exhibit - Statement of Income

UNDERWRITING INCOME	
Premiums earned	$4,176,514,369
DEDUCTIONS	
Losses incurred	$2,803,366,793
Loss adjustment expenses incurred	557,460,410
Other underwriting expenses incurred	622,510,320
Total underwriting deductions	3,983,337,523
Net underwriting gain or (loss)	$ 193,176,846
INVESTMENT INCOME	
Net investment income earned	$ 634,182,241
Net realized capital gains or (losses)	(393,921,681)
Net investment gain or (loss)	$ 240,260,560
OTHER INCOME	
Net gain or (loss) from agents' or premium balances charged off	$ (48,451,894)
Aggregate write-ins for miscellaneous income	2,990,048
Total other income	(45,461,846)
Net income after dividends to policyholder but before federal income taxes	387,975,560
Federal and foreign income taxes incurred	179,440,814
Net income	$ 208,534,746

Capital and Surplus Account – Statement of Income

CAPITAL AND SURPLUS ACCOUNT	
Surplus as regards policyholders, December 31, 2007	$4,551,030,644
GAINS AND (LOSSES) IN SURPLUS	
Net income	208,534,746
Change in net unrealized capital gains or (losses)	(305,601,572)
Change in net deferred income tax	111,047,682
Change in non-admitted assets	(189,367,900)
Change in provision for reinsurance	24,020,602
Surplus adjustments:	
Paid in	163,141,453
Dividends to stockholders	(300,000,000)
Aggregate write-ins for gains and losses in surplus	(23,026)
Change in surplus as regards policyholders for the year	(288,248,015)
Surplus as regards policyholder, December 31, 2008	$4,262,782,629

SCHEDULE OF EXAMINATION ADJUSTMENTS

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

NOTES TO FINANCIAL STATEMENTS

Assets
(1) Investments

Investment Operations functions are performed on the AIG level through an Investment Management Agreement between AIGGIC and the Lexington Pool Companies.

Total invested assets as of December 31, 2008 were comprised of the following:

	2008 A/S	% of Admitted Assets
Bonds	$10,754,356,903	70%
Preferred Stocks	359,556,459	2%
Common Stocks	716,970,856	5%
Cash & Short-term investments	689,674,902	5%
Other Invested Assets	960,516,341	6%
Receivable for Securities	2,354,695	<1%
Swaps	(1,223,714)	<1%
Total Invested Assets	$13,482,206,442	88%

The following reflects the changes in invested assets from the prior examination:

	2008 A/S	2005 A/S	Amount Change	% Change
Bonds	$10,754,356,903	$7,775,398,893	$2,978,958,010	38%
Preferred stocks	359,556,459	338,477,204	21,079,255	6%
Common Stocks	716,970,856	723,358,828	(6,387,972)	-1%
Cash & Short-term investments	689,674,902	90,981,010	598,693,892	658%
Other Invested Assets	960,516,341	591,216,182	369,300,159	62%
Receivable for Securities	2,354,695	0	2,354,695	n/a
Swaps	(1,223,714)	2,231,273	(3,454,987)	-155%
Total Invested Assets	$13,482,206,442	$9,521,663,390	$3,960,543,052	42%

The Company’s bonds represented 79.8% of invested assets and 70.3% of admitted assets as of December 31, 2008 and were comprised primarily of tax-exempt securities. The Company’s strategy is to invest in high quality fixed-income investments while maintaining sufficient diversification to avoid inappropriate exposure to any one issuer and/or industry.

The carrying values of the Company's bond portfolio as of December 31, 2008, by contractual maturity, are shown in the table below:

Duration	Carrying Value	% of Bonds
One year or less	$ 243,793,000	2%
Over one year through five years	873,056,000	8%
Over five years through ten years	2,156,554,000	20%
Over ten years	6,976,926,000	65%
Mortgage backed securities	504,028,000	5%
Total Bonds	$10,754,357,000	100%

The maturity schedule was designed to match the estimated pay-out pattern associated with the Company's loss and LAE reserves. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The Company's bond portfolio increased by $339.1 million, or 3.3%, to $10,754.4 million as of December 31, 2008, compared to the corresponding 2007 amount. This increase was primarily due to net acquisitions during the year, partially offset by a decrease of $64.2 million in unrealized appreciation.

The Company's investment in preferred and common stock represented 8.0% of invested assets and 7.0% of admitted assets as of December 31, 2008, and were comprised of equities in affiliated and unaffiliated companies of $428.1 million and $648.4 million, respectively as of December 31, 2008. Stocks decreased by $556.1 million, or 34.1%, to $1,076.5 million as of December 31, 2008, compared to the corresponding 2007 amount primarily due to other than temporary impairments during the year.

The Company's other invested assets represented 7.1% of invested assets and 6.3% of admitted assets as of December 31, 2008 and were comprised of investments in partnerships and joint ventures. Other invested assets decreased by $158.7 million, or 14.2%, to $961.7 million as of December 31, 2008 compared to the corresponding 2007 amount primarily due to $203.4 million decrease in unrealized appreciation partially offset by $97.6 million increase in net acquisition activity as of December 31, 2008 as compared to 2007.

Cash and short-term investments increased by $368.3 million, or 114.6%, to $689.7 million as of December 31, 2008 compared to the corresponding 2007 amount as a result of an increase in short-term investments of $316.3 million due to the purchase of holdings in the AIG Money Market Fund and Dreyfus Management Fund, also including an increase in cash on hand of $52.0 million.

Net Investment Gains

Net investment gains decreased by $311.3 million, or 56.4%, to $240.3 million for the year ended December 31, 2008, compared to the corresponding 2007 amount. This decrease was caused by a $377.3 million decrease in net realized capital losses primarily relating to preferred stock due to other than temporary impairments.

Loaned Backed Securities

At December 31, 2008, the Company had elected to use the book value as of January 1, 1994 as the cost for applying the retrospective adjustment method to loan-backed securities purchased prior to that date. Prepayment assumptions for single class and multi-class mortgage-backed/asset-backed securities were obtained from third party vendors. These assumptions are consistent with the current interest rate and economic environment. The retrospective adjustment method is used to value all loan-backed securities. The Company used Interactive Data Corp. and Bloomberg (pricing services) in determining the market value of its loan-backed securities.

Affiliated Investments

From time to time, the Company may own investments in partnerships across various other AIG affiliated entities with a combined percentage greater than 10.0%. As of December 31, 2008, the Company's total investments in partnerships with affiliated entities, where AIG interest was greater than 10.0%, was $470,296,663. In addition to the subsidiaries set forth in the Holding Company Section of this Report, the Company has $47,744,138 invested in the common stock of other affiliates.

Affiliated Securities Lending

The Company is party to a Securities Agency Lending Agreement with AIGGSLC, a Delaware registered company. During 2008, the Company terminated all of its securities lending positions and instructed AIGGSLC not to enter into any new transactions on its behalf. As a result, the Company had no loaned securities as of December 31, 2008.

Securities borrowers provided cash collateral in an amount in excess of the fair value of the securities loaned. AIGGSLC monitored the daily fair value of loaned securities relative to the collateral fair value. Additional collateral was obtained as necessary to ensure that collateral was maintained at a minimum of 102% for domestic transactions and 105% for cross-border transactions of the value of the securities loaned. The collateral was not available for the general use of the Company (restricted) and the securities lending transactions were accounted for as secured borrowings as required by SSAP No. 91.

In response to the potential lack of liquidity for certain reinvested collateral, the Company's ultimate parent, AIG, agreed to make the Company whole for any pretax realized losses due to sales of reinvested collateral during the period August 1, 2007 through August 1, 2008. As a result, during 2008, the Company received funds of $361,275 from AIG. This amount was reported as a capital contribution.

Private Equity Investment Portfolio

As of December 31, 2008, the Company's estimated possible additional capital investment related to their private equity portfolio investments reported in the 2008 Annual Statement Schedule BA was $446,953,229. The Company's 2009 Schedule BA reflects that $93,183,276 in additional capital investments were subsequently made related to the private equity investments.

As of December 31, 2009, Schedule BA reported estimated possible additional capital investment related to their private equity portfolio investments reported at $388,968,044. The Company reported they expect only a small portion will be called during 2010.

Subprime Mortgage Related Risk Exposure

At December 31, 2008, the Company had no direct exposure through investments in subprime mortgage loans. The Company had no direct exposure to subprime mortgage loans through other investments. The Company has no direct underwriting exposure to subprime mortgage risk through Mortgage Guaranty or Financial Guaranty insurance coverage.

Liabilities

(2) Losses	$6,928,649,646
Loss Adjustment Expenses	$1,166,586,224
Total	$8,095,235,870

The above-captioned amount, which is the same as that reported by the Company in its' Annual Statement, has been accepted for purposes of this report.

The Delaware Department of Insurance retained the services of INS Consultants, Inc. (INS), to conduct an independent review of the Lexington Pool's loss and loss adjustment expense reserves as of December 31, 2008. The Consulting Actuary's analysis was performed on a pooled basis using a risk-focused approach according to the guidelines contained in the NAIC Handbook – 2008 Edition. The review does not address the collectability of reinsurance recoverables. Should any of Lexington Pool's reinsurers fail to fulfill obligations as stated in their contracts, a contingent liability would need to be established.

The conclusions set forth in the Consulting Actuary's report are based on information provided by the Lexington Pool, including the 2008 Annual Statements, the related 2008 Statements of Actuarial Opinion signed by Frank Douglas, ACAS, MAAA of Lexington and the actuarial report that accompanied the opinions as well as workpapers prepared by Lexington's actuarial staff.

As a result of the risk assessment process utilized by INS, it was determined that substantive testing of the loss and LAE reserves was warranted. The Consulting Actuary performed an analysis on Lexington's book of business by segment of business on both a gross and a net basis for loss, defense and cost containment (DCC) expense and adjusting and other (A&O) expense. Procedures undertaken by the examination staff on control testing and accuracy testing indicate that the underlying loss and LAE data provided to the Consulting Actuary was reliable.

The Consulting Actuary also reviewed the Lexington Pool's exhibit which balances the year-end 2008 data to Schedule P, on an all-lines total basis. The exhibit showed that the year-end amounts were closely reconciled to the Schedule P amounts.

The review by INS concluded that on a pooled net basis, total loss and LAE reserves are $10.112 billion. This is $7.428 million less than the Pool's held amount of $10.119 billion. On a gross basis, the INS estimate is $13.573 billion which is $65.646 million less than the Lexington Pool's held amount, $13.638 billion.

Based on work performed, the Consulting Actuary found the Lexington Pool's carried December 31, 2008 net and gross loss and LAE reserves to be reasonably stated, and as such, no financial adjustment was required for examination purposes.

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

A review was performed of appropriate balance sheet and forepart files to verify corrective action had been taken with regard to prior examination report comments and recommendations.

Gross Paid-in and contributed Surplus

Prior Recommendation #1: It is recommended that the Company report EDP equipment in accordance with NAIC Annual Statement Instructions, 18 Del.C. §1101(13), SSAP 4(3)(a), and SSAP 16.

Current Exam Finding: A review of Capital Contributions during this examination period did not reveal any contributions consisting of EDP Equipment. Exception is deemed to be cleared.

Bylaws

Prior Recommendation #2: It is recommended that the Company comply with its bylaws regarding the role of its President and the Executive Committee.

Current Exam Finding: The Company dissolved its Executive Committee in November 2008. Exception is deemed cleared.

Conflict of Interest

Prior Recommendation #3: It is recommended that the Company ensure that procedures requiring the execution of conflict of interest statements for Officers, Directors and key employees be updated yearly in accordance with AIG's Code of Conduct and AIG's Code of Conduct Re-Certification and Questionnaire. Further, it is recommended that the Company maintain copies of all completed conflict of interest questionnaires on-site and available for future examination in accordance with NAIC Annual Statement Instructions and 18 Del.C. §526(a).

Current Exam Finding: It is again noted that the Company did not obtain a Conflict of Interest Statement from Bernard Aidinoff, the sole Non-AIG Director of The Company. However, it is also acknowledged that Mr. Aidinoff was not re-elected in the second quarter of 2009, and was not replaced.

Custodial Agreement

Prior Recommendation #4: It is recommended that the Custodial Agreement with Mellon Bank be amended to incorporate required clauses which must be included in Custodial or Safekeeping Agreements in accordance with the NAIC Examiners Handbook. In addition, the laws under which the agreement is governed should be changed to the laws of the state of Delaware.

Current Exam Finding: As of March 31, 2007, an amended Custodial Agreement was accepted by the Delaware Department of Insurance. Exception is deemed cleared.

Other Vendor Contracts

Prior Recommendation #5: It is again recommended that the Company comply with 18 Del.C. §320(c), and maintain / retain all records necessary for the performance of Delaware's tri-annual examinations.

Current Exam Finding: The level of cooperation and speed of delivery of requested documentation has been greatly improved since the prior exam. Exception is deemed cleared.

General Ledger Detail

Prior Recommendation #6: It is recommended that the Company complete its annual statement blank in accordance with NAIC Annual Statement Instructions and 18 Del.C. §526(a), verifying that all financial and non-financial data is reported accurately, completely, and appropriately.

Current Exam Finding: During the course of this Examination, the Examiners did not note any materially misstated line items, or propose any financial adjustments. Exception is deemed to be cleared.

Sub-ledgers

Prior Recommendation #7: It is recommended that the Company ensure that sub-ledger detail reconciles to the General Ledger, and that any unidentifiable differences are reconciled in a timely manner.

Current Exam Finding: Through the risk mitigation strategies and related control testing performed for each of the key activities, it was determined that account reconciliations were being maintained on a current basis. Exception is deemed cleared.

Miscoded Direct Written Premiums

Prior Recommendation #8: It is recommended that the Company implement controls to ensure proper coding of direct written premium to the appropriate insured state or territory. Miscoded premiums can result in the over payment of premium taxes to some jurisdictions, and an under payment of premium taxes to others.

Current Exam Finding: Examiners performed substantive testing over the coding of premiums without exception. Therefore, exception is deemed cleared.

Reinsurance Payable on Paid Loss and LAE

Prior Recommendation #9: It is again recommended that the Company report assumed reinsurance payable on paid losses and loss adjustment in compliance with SSAP 62 paragraph 40, NAIC Annual Statement Instructions, and 18 Del.C. §526(a).

Current Exam Finding: Based on a review of Annual Statement, Assumed Reinsurance Payable is now being separately recorded in compliance with SSAP 62, Paragraph 40. Exception is deemed cleared.

Reinsurance balances with affiliates

Prior Recommendation #10: It is recommended that the Company accurately report reinsurance balances with affiliates in its Annual Statement Schedule F in accordance with 18 Del.C. §526(a), NAIC Annual Statement Instructions, and that all inter-company balances mirror the associated affiliate balances.

Current Exam Finding: During the course of this Examination, the Examiners did not note any material exceptions with regards to the accuracy of schedule F. Exception is deemed cleared.

Reinsurance remediation

Prior Recommendation #11: It is recommended that the Company correct reinsurance control inadequacies that have been identified during its remediation process, and continue to identify, quantify and correct misstated balances.

Current Exam Finding: The Company has made significant progress in remediation efforts since the last examination; however, due to the complexity, full system integration is not anticipated until 2009. Exception is, however, deemed cleared.

Reinsurance

Prior Recommendation #12: It is recommended that the Company properly allocate and record all contingent reserves or adjustments associated with the reinsurance contracts in dispute or where collection has not occurred in accordance with the contract terms and/or regulatory requirements, as well as SSAP No. 62, paragraphs 54-56, NAIC Annual Statement Instructions, and 18 Del.C. §526(a).

Current Exam Finding: The DBG Companies (now referred to as the Chartis U.S. Companies), excluding the Surplus Lines Pool Companies, voluntarily set up a FAS 5 reserve for disputed reinsurance receivables in 2005. During the examination of risk mitigation strategies and test of controls performed for the reinsurance key activity it was determined that significant progress had been made in the Company's reinsurance remediation efforts. As a result, the prior examination exception is deemed cleared.

Reinsurance Recoverable

Prior Recommendation #13: It is recommended that the Company establish complete and adequate credit exposure reserves for reinsurance recoverable exposures.

Current Exam Finding: As previously stated, significant progress had been made in the Company's reinsurance remediation efforts. As a result, the prior examination exception is deemed cleared.

Reinsurance – Schedule F Reporting

Prior Recommendation #14: It is recommended that the Company report in Schedule F its respective summary of reinsurers with balances less than $100,000 in Schedule F in accordance with NAIC Annual Statement Instructions and 18 Del.C. §526(a), rather than booking the aggregate total to LIC.

Current Exam Finding: Examiners reviewed Schedule F and noted that the Company is now reporting amounts less than $100,000 by the Reinsurer they are due from. Therefore, exception is deemed cleared.

Uncollected Premiums & Agents Balances

Prior Recommendation #15: It is recommended that the Company report cash received but not allocated to a specific policy as "Remittances and items not allocated" in accordance with NAIC Annual Statement of instructions, SSAP 67, paragraph 9, and 18 Del.C. §526(a).

Current Exam Finding: The examiner reviewed the general ledger and noted that the Company has placed the unapplied cash into the proper account for "Remittances and items not allocated". Therefore, exception is deemed to be cleared.

Outstanding Loss Drafts ("OLD")

Prior Recommendation #16: It is recommended that the Company reconcile its OLD G/L account, and properly report balances in appropriate balance sheet line items in accordance with NAIC Annual Statement Instructions, and 18 Del.C. §526(a).

Current Exam Finding: The examiner reviewed the general ledger and noted that the Company now reports this item as "A2301 Write in Outstanding loss drafts". Therefore, exception is deemed cleared.

OLD – Checks under $50

Prior Recommendation #17: It is recommended that Management expand its operational guidelines to encompass adequate tracking of outstanding loss checks $50 and under, and facilitate appropriate contact with the Payee via phone or mail.

Current Exam Finding: During this examination, a review was performed of outstanding checks as of December 31, 2008 and noted that the Company was tracking outstanding checks of $50 and under. Exception is deemed cleared.

Escheat

Prior Recommendation #18: It is recommended that the Company commit resources to provide the following with regards to escheating uncashed checks:

- Develop written procedures for escheating checks $50 and under, when these are determined escheatable under state time tables;
- Undertake procedures to track outstanding checks ($50 and under), and include these checks in the Abandoned Property Reports;
- Review its escheat system for proper tracking and reporting of Escheatable funds, as a means to locate checks that have not been or remain unremitted to the appropriate states;

- Verify that remittance of all outstanding loss checks from 1996 and prior (over and under $50) have been escheated to the appropriate state. If the applicable state cannot be determined, the escheatable item should be escheated to the Company's state of domicile.

<u>Current Exam Finding:</u> A review was performed of the Company’s Escheat guidelines, and was found to be comprehensive and adequate. A review of the December 2008 Abandoned Property Report and listing of outstanding checks as of December 31, 2008 by bank account did not note any items in excess of three (3) years old. Exception is deemed cleared.

Uncollected Premiums & Agents Balances

<u>Prior Recommendation #19:</u> It is recommended that the Company properly age agents' balances and determine the Over 90 non-admitted portion in accordance with 18 <u>Del.C.</u> §1101 (5) and SSAP 6, paragraph 9, but in particular ensuring that the Over 90 is calculated in compliance with SSAP 6, paragraph 9(c). Netting of debits and credits between agents and between unrelated policies is not allowed in accordance with SSAP 6.

<u>Current Exam Finding:</u> During the current examination, substantive testing was performed on the aging of Uncollected Premiums as of December 31, 2008 with no material exceptions being noted. Exception is deemed cleared.

Uncollected Premiums & Agents Balances

<u>Prior Recommendation #20:</u> It is recommended that the Company report amounts unrelated to agents’ balances, i.e., Cash Loss Advances (CLA), in accordance with NAIC Annual Statement Instructions, 18 <u>Del.C.</u> §526(a) and SSAP 6, verifying that all financial and non-financial data is reported accurately, completely, and appropriately.

Current Exam Finding: Through the risk mitigation strategies and related control testing performed for the Financial Reporting key activity, it was determined that the Company was correctly reporting amounts unrelated to agents' balances, i.e., Cash Loss Advances (CLA), in accordance with NAIC Annual Statement Instructions, 18 Del.C. §526(a) and SSAP 6. As a result, exception is deemed cleared.

Receivable from parent, subsidiaries & affiliates

Prior Recommendation #21: It is recommended that in future periods the Company non-admit the intercompany recoverable established under GL 12700373 for cash paid in bulk to AI Facilities for future (furniture, rent and other office) expenses it will incur in accordance with SSAP 20, paragraph 2 of SSAP 29, NAIC Annual Statement Instructions, and 18 Del.C. §526(a).

Current Exam Finding: Through the risk mitigation strategies and related control testing performed for the Financial Reporting key activity, it was determined that the Company had taken corrective action regarding the reporting of its intercompany recoverable under GL 12700373. Exception is deemed cleared.

Related party transactions

Prior Recommendation #22: It is recommended that the Company ensure compliance with settlement terms of the Inter-company Pooling Agreement and (AIG) Service and Expense Agreement, by settling intercompany balances in accordance with its Intercompany Pooling and Service and Expense Agreements.

Current Exam Finding: Substantive test work was performed on the settling of Intercompany balances without exception. Exception is deemed cleared.

Reinsurance – Profit & Sliding Scale Commission

Prior Recommendation #23: It is recommended that the Company properly accrue for all profit and sliding scale commission that may be contained in the Company's executed reinsurance contracts.

Current Exam Finding: During the examination risk mitigation strategies and test of controls performed for the reinsurance key activity, it was determined that significant progress had been made in the Company's reinsurance remediation efforts. As a result, the prior examination exception is deemed cleared.

Provision for reinsurance

Prior Recommendation #24: It is recommended that the Company categorize the authorized and unauthorized reinsurance in accordance with the authorized reinsurer listings of the Delaware Department of Insurance. Any changes in the security mechanisms that support the Delaware rating should also be considered in the assignment of the authorized status.

Current Exam Finding: Examiner traced a sample of Reinsurers listed as "Authorized" on Schedule F, Part 3 to Delaware's approved list without exception. Exception is deemed cleared.

Drafts outstanding

Prior Recommendation #25: It is recommended that the Company report issued, but uncashed checks, as well as other liabilities and assets which do not meet the definition of Drafts Outstanding, in appropriate balance sheet line items in accordance with NAIC Annual Statement Instructions, SSAP 2, and 18 Del.C. §526(a).

Current Exam Finding: Through a review of the General Ledger accounts, Examiner verified that the Company is now reporting these items on line A2301 Outstanding Loss Drafts. Exception is deemed cleared

Other assets

Prior Recommendation #26: It is recommended that the Company ensure balances classified as Receivables/Payables for Securities are classified in accordance with NAIC Annual Statement Instructions and SSAP 21.

Current Exam Finding: Through risk mitigation strategies and testing of controls for the Investment key activity, it was determined that the Company was properly classifying Receivables/Payables for Securities in accordance with NAIC Annual Statement Instructions and SSAP 21. Exception is deemed cleared.

Other liabilities

Prior Recommendation #27: It is recommended that the Company implement policies, procedures and controls to ensure timely reconciliation, and accurate reporting of financial information.

Current Exam Finding: Through risk mitigation strategies and testing of controls for the Investment key activity, it was determined that the Company had implemented procedures and controls to ensure timely reconciliation, and accurate reporting of financial information. Exception is deemed cleared.

SUMMARY OF RECOMMENDATIONS

There were no specific recommendations as a result of this examination. Any recommendations have been made in the Exit Conference Memo.

CONCLUSION

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

Description	December 31, 2005	December 31, 2008	Increase (Decrease)
Assets	$10,439,966,005	$15,293,478,834	$4,853,512,829
Liabilities	8,053,587,209	11,030,696,205	2,977,108,996
Aggr. Write-in: Special Surplus Fund	3,055,132	292,111	(2,763,021)
Common Capital Stock	5,000,000	5,000,000	0
Gross Paid In and Contributed Surplus	333,819,957	497,562,341	163,742,384
Unassigned Funds (Surplus)	2,044,503,707	3,759,928,179	1,715,424,472
Total Surplus as Regards Policyholders	2,386,378,796	4,262,782,631	1,876,403,835
Totals	$10,439,966,005	$15,293,478,834	$4,853,512,831

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc., and its Information Technology consulting firm, INS Services, Inc. is acknowledged. In addition, the assistance and cooperation of examiners representing the state of California, as well as the Company's outside audit firm, PWC, and the Company's management and staff was appreciated and is acknowledged.

Respectfully submitted,

Donald Hollier

Don Hollier, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC

SUBSEQUENT EVENTS

AIG's Chairman & CEO Changes

In May 2009, AIG's Chairman and CEO Edward Liddy resigned pending the appointment of a replacement. Mr. Liddy was appointed as AIG's Chairman and CEO in September 2008. In August 2009, AIG's Board of Directors elected Robert Benmosche as AIG's President and CEO.

AIG General Insurance Operations Rebranding

In July 2009, AIG rebranded its General Insurance Operations as "Chartis". Chartis consists of Commercial Insurance (operating as Chartis U.S.), Foreign General Insurance (operating as Chartis International) and Private Client Group (part of Chartis U.S.). Through this rebranding, the following name changes were made to members of the Holding Company listed in the organizational chart under the preceding Report section "Holding Company System."

Original Company Name	New Company Name	Jurisdiction
AIU Holdings, Inc. (f/k/a AIG Property and Casualty Group, Inc.)	Chartis Inc. (Chartis)	Delaware
AIG Casualty Company	Chartis Property Casualty Company	Pennsylvania
AIG Excess Liability Insurance Company Ltd.	Chartis Select Insurance Company (Chartis Select) or (CSIC)	Delaware
AIG Excess Liability Insurance International Limited	Chartis Excess Limited	Ireland
American International Specialty Lines Insurance Company	Chartis Specialty Insurance Company (Chartis Specialty) or (CSLIC)	Illinois

Capital Maintenance Agreements

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 Company’s domiciliary insurance department, AIG may provide a letter of credit naming the Company as beneficiary. The current CMA supersedes and replaces a similar agreement that related to the Company’s December 31, 2008 surplus position.

Lexington Pooling Agreement

During 2009, an Amended Pooling Agreement between Lexington, Chartis Select, Chartis Specialty, and Landmark was submitted to the Delaware, Illinois, and California Departments for approval.

Under the agreement, Chartis Specialty was added to the existing AIG Surplus Lines Pool and would cede 100% of its existing policyholder assets and liabilities to Lexington. In turn, CSLIC will assume a 10% share of the Lexington Pool and Lexington's participation will be reduced from 80% to 70%. Landmark's and Chartis Select’s participation percentage is not affected.

The Amended Pooling Agreement changes the Lexington Pool participants' percentages as follows:

70% - Lexington
18% - Chartis Select (CSIC)
10% - Chartis Specialty (CSLIS)
2% - Landmark

The amended agreement, with an effective date of January 1, 2010, was approved by the Delaware Department of Insurance.

Contribution of Chartis to newly-formed SPV

On April 21, 2009, AIG announced its intent to contribute Chartis Inc., the Company's intermediate parent company (formerly AIU Holdings, Inc.), and Chartis International, LLC (formerly AIU Holdings, LLC) to a newly-formed special purpose vehicle (SPV) in exchange for membership interests in the SPV, subject to receipt of applicable regulatory approvals. On July 27, 2009, AIG announced the formation of the SPV, and on January 29, 2010, AIG contributed Chartis Inc. to the SPV. AIG contributed Chartis International, LLC to the SPV on March 12, 2010.

Sale of 21st Century Personal Auto Group

Effective July 1, 2009, the 21st Century Personal Auto Group (PAG) was sold to Farmers Group, Inc. (FGI), a subsidiary of Zurich Financial Services Group for $1.9 billion. American International Insurance Company (AIIC) was the lead company in the Personal Lines Pool which was the mechanism for sharing the PAG and the Private Client Group (PCG) business among the Personal Line Pool members. PCG business was underwritten directly by member companies of the Personal Lines Pool as well as members of Chartis U.S. The PCG business written by Chartis U.S. companies was ceded 100% to AIIC as the pool lead. The net PCG business, as well as the PAG business retained by AIIC, was then subject to a 50% quota share to National

Union Fire Insurance Company of Pittsburgh, Pa. (National Union). National Union is the lead member of the Chartis U.S. Commercial Pool (Commercial Pool). The Commercial Pool members participated in this PCG business assumed by National Union at their stated pool percentages.

The Chartis U.S. companies that were parties to these transactions are:

Commercial Pool Members	**Non-Commercial Pool Members**
-American Home Assurance Company	-Audubon Indemnity Company
-American International South Insurance Company (k/n/a Chartis Casualty Company)	-Audubon Insurance Company
-Chartis Property Casualty Company (f/k/a AIG Casualty Company)	-Chartis Specialty Insurance Company (f/k/a American International Specialty Insurance Company)
Commerce and Industry Insurance Company	-Lexington Insurance Company
-Granite State Insurance Company	-National Union Fire Insurance of Louisiana
-Illinois National Insurance Co.	
-National Union Fire Insurance of Pittsburgh, Pa.	
-New Hampshire Insurance Company	
-The Insurance Company of the State of Pennsylvania	

In connection with this sale, various reinsurance agreements between the PAG companies and other affiliated Chartis U.S. companies (including the Company) were partially or fully commuted as of June 30, 2009. The major transactions are summarized below:

1. The quota share reinsurance agreement between National Union and AIIC under which AIIC ceded 50% of the net business of the Personal Lines Pool to National Union was commuted as of June 30, 2009.
2. All liabilities relating to existing PCG business that was written on a direct basis by members of the Personal Lines Pool were transferred to National Union under the terms of the PCG Business Reinsurance and Administration Agreement, effective June 30, 2009.
3. All obligations and liabilities relating to the PCG business that was directly written and ceded by Chartis U.S.'s insurance companies to AIIC under various quota share reinsurance agreements were commuted as of June 30, 2009.

The impact of these transactions on the Chartis U.S. companies, net of inuring reinsurance and prior to pooling, was an increase in outstanding losses and loss adjustment expenses of $612.4 million and an increase to unearned premiums of $65.6 million. The net settlement amount payable to PAG was $871.9 million of which $23.3 million was unpaid as of September 30, 2009.

A new reinsurance agreement was established to cede all of the PCG obligations and liabilities written by the non-Commercial Pool members to Chartis Property Casualty Company (f/k/a AIG Casualty Company). Additionally, this agreement covers new PCG business written directly by the non-Commercial Pool members.

Sale of AIG Personal Lines Division

As part of the sale of 21st Century Personal Auto Group, effective July 1, 2009, Lexington sold its affiliated investment in AIG Centennial Insurance Company as part of AIG's divestiture of its Personal Lines Division. As part of the sale, the reinsurance payment guarantee between LIC and AIG Centennial Insurance was terminated on August 31, 2009. Additionally, Zurich Financial Services Group provided the Company with a hold harmless agreement for guarantees issued by the Company to AIG Preferred Company, AIG Premier Insurance Company, AIG Indemnity Insurance Company and AIG Centennial Insurance Company.

Limits Greater Than 10% of Policyholder Surplus

It was discovered in management's year-end review of operations that embedded terrorism was not covered under its reinsurance purchases resulting in a handful of accounts where the largest net exposure was greater than 10% of policyholder surplus just on the embedded terrorism portion of the policy. In 2009, Lexington purchased a reinsurance cover with an affiliated company thereby reducing the largest net exposure to under 10% of surplus. This transaction was approved by the Delaware Department of Insurance.

Material Affiliated Transactions

The Company has disclosed in its December 31, 2009 annual statement the following material (within the Examination's tolerable error) transactions made with affiliates in 2009:

			Amount Received by Lexington		**Amount Transferred from Lexington**	
Event Date	Explanation	Affiliate Member	Statement Value	Consideration	Statement Value	Consideration
10/30/09	Purchase of Securities	AIG Securities Lending Corp.	$129,204,196	Bonds	$129,204,196	Cash
1/14/09	Purchase of Securities	National Union Fire Ins. Co.	$101,485,578	Bonds	$101,485,578	Securities

Correction of Errors

During 2009, the Company identified additional corrections related to its remediation efforts that resulted in an after-tax statutory income charge of ($31,703,332). In accordance with SSAP 3 entitled "Accounting Changes and Corrections of Errors", the corrections of errors have been reported in the 2009 Annual Statement as an adjustment to unassigned funds. The five-year historical data summaries have not been restated.

The impact of these corrections on surplus, assets and liabilities as of January 1, 2009 is as follows:

	Annual Statement Classification		
	Policyholders Surplus	Admitted Assets	Liabilities
Capital and surplus, as of 12/31/08	$4,262,782,631	$15,293,478,834	$11,030,696,203
Adjustments to beginning capital and surplus:			
1. Asset Realization	(8,772,232)	(8,772,232)	
2. Liability Correction	(38,525,717)		(38,525,717)
3. Federal Income Taxes	15,594,617	15,594,617	
Total adjustment to beginning balances	(31,703,332)	6,822,385	(38,525,717)
Balance at January 1, 2009, as adjusted	$4,231,079,299	$15,300,301,219	$11,069,221,920

1. Asset realization - The decrease in net admitted assets is primarily attributable to the correction of overstated reinsurance recoverable balances.
2. Liability correction - The increase in total liabilities is primarily attributable to the write-off of unsupportable balances and the correction of various reinsurance balances
3. The adjustment in Federal Income Taxes is due to the corrections above.

Appointment of Chief Risk Officer

On January 19, 2010, Chartis Inc. (f/k/a AIU Holdings, Inc.) announced that Samir Shah had been named Senior Vice President and Chief Risk Officer for Chartis, responsible for the organization's worldwide Enterprise Risk Management strategies.

EVENTS RELATED TO AIG

Federal Government's Ongoing Role and Summary of Support of AIG

Beginning in September 2008, the U.S. Department of Treasury (U.S. Treasury) and the Federal Reserve Bank of NY (NY Fed) began taking a series of actions related to AIG in order to address liquidity and capital needs as a result of its derivative investment exposure through AIG's Financial Products division. These actions helped to stabilize AIG and prevent a disorderly failure, which could have severely disrupted financial markets and contributed to a further worsening of economic conditions. As a result of these concerns, the NY Fed authorized debt and equity assistance totaling approximately $87.5 billion, and $25.0 billion, respectively. The U.S. Treasury provided equity assistance totaling approximately $69.835 billion. Assistance provided by both federal entities totaled approximately $182.335 billion.

As of December 31, 2009, AIG reflected total outstanding balances to both the NY Fed and U.S. Treasury of approximately $94.759 billion. As a significant creditor, the NY Fed monitors the implementation of AIG's restructuring and divestiture plan and participates as an observer in the corporate governance of AIG. As a significant stockholder, the U.S. Treasury has appointed three (3) trustees to the AIG Credit Facility Trust (Trust), which holds the approximately 79.77% controlling equity interest in AIG for the sole benefit of the U. S. Treasury. The trustees have absolute discretion and control over the AIG stock and exercise all rights, powers and privileges of a shareholder of AIG, all in the best interest of the U.S. taxpayers and with a view towards maximizing the value of the AIG stock held by the Trust.

AIG - Formation of AIU Holdings, Inc. (k/n/a Chartis Inc.)

On March 2, 2009, AIG announced that it intended to form a General Insurance holding company, including its Commercial Insurance Group (including the Company), Foreign General unit, and other property and casualty operations, to be called AIU Holdings, Inc., with a board of directors, management team, and brand distinct from AIG.

Sale of ALICO to Metlife, Inc.

In March 2010, AIG announced the sale of ALICO to MetLife, Inc. (MelLife) for approximately $15.5 billion. The transaction has been approved by the boards of directors of both MetLife and AIG, and is expected to close by the end of the year. The transaction is subject to certain domestic and international regulatory approvals and customary closing conditions.

Transatlantic Stock Offering

As part of their restructuring plan, in March 2010, AIG announced the closing of the public offering for approximately 8 million shares of Transatlantic stock owned by American Home Assurance Company, for aggregate gross proceeds of approximately $452 million.

U.S. Treasury Appointment of Independent Directors to the AIG Board of Directors

On April 10, 2010, pursuant to terms of certain preferred equity interest agreements with AIG, the U.S. Treasury has appointed two independent directors to the AIG Board of Directors. The U.S. Treasury had the right to appoint directors if AIG did not pay required quarterly dividends for a total of four periods. AIG failed to make the required dividend payments and as a result, the U. S. Treasury made appointments accordingly.

AIG as a Going Concern

As reflected in the Company's 2009 Annual Statement "Notes to Financial Statement" (#10), and in connection with AIG and subsidiaries preparation of its 2009 annual report on

Form 10-K, AIG management assessed whether AIG has the ability to continue as a going concern with the following statement:

"Based on the U.S. government's continuing commitment, the already completed transactions and the other expected transactions with the NY Fed, AIG management's plans to stabilize AIG's businesses and dispose of certain assets, and after consideration of the risks and uncertainties of such plans, AIG management believes that it will have adequate liquidity to finance and operate AIG's businesses, execute its asset disposition plan and repay its obligations for at least the next twelve months. It is possible that the actual outcome of one or more of AIG management's plans could be materially different, or that one or more of AIG management's significant judgments or estimates about the potential effects of these risks and uncertainties could prove to be materially incorrect or that the transactions with the NY Fed fail to achieve the desired objectives. If one or more of these possible outcomes is realized and financing is not available, AIG may need additional U.S. government support to meet its obligations as they come due. If additional support is not available in such circumstances, there could be substantial doubt about AIG's ability to operate as a going concern. If AIG were not able to continue as a going concern, it would not be expected to have a material effect on the Company's ability to continue as a going concern."