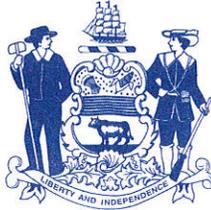


**REPORT ON EXAMINATION**  
**OF THE**  
**XL SPECIALTY INSURANCE COMPANY**  
**AS OF**  
**DECEMBER 31, 2010**

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, 2010 of the

**XL SPECIALTY INSURANCE COMPANY**

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

Attest By:

*Brantie Biddle*

Date: 28 Jun 2012



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 28<sup>th</sup> day of June, 2012.

  
\_\_\_\_\_  
Karen Weldin Stewart, CIR-ML  
Insurance Commissioner

Karen Weldin Stewart, CIR-ML  
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION  
OF THE  
XL SPECIALTY INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2010

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

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

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

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart", is written over a horizontal line.

Karen Weldin Stewart, CIR-ML  
Insurance Commissioner

Dated this 28<sup>th</sup> day of June, 2012

**TABLE OF CONTENTS**

**SALUTATION ..... 1**

**SCOPE OF EXAMINATION ..... 1**

**SUMMARY OF SIGNIFICANT FINDINGS ..... 3**

**COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS ..... 3**

**SUBSEQUENT EVENTS..... 6**

**COMPANY HISTORY ..... 6**

**CORPORATE RECORDS ..... 7**

**MANAGEMENT AND CONTROL ..... 7**

**AGREEMENTS ..... 10**

**TERRITORY AND PLAN OF OPERATION..... 13**

**GROWTH OF THE COMPANY ..... 16**

**LOSS EXPERIENCE ..... 18**

**REINSURANCE ..... 18**

**ACCOUNTS AND RECORDS..... 22**

**FINANCIAL STATEMENTS..... 22**

**ASSETS ..... 23**

**LIABILITIES, SURPLUS AND OTHER FUNDS..... 24**

**STATEMENT OF INCOME ..... 25**

**RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE LAST EXAMINATION ..... 26**

**ANALYSIS OF CHANGES IN THE FINANCIAL STATEMENTS ..... 27**

**NOTES TO THE FINANCIAL STATEMENTS..... 27**

**SUMMARY OF RECOMMENDATIONS..... 29**

**CONCLUSION ..... 29**

April 23, 2012

## **SALUTATION**

Honorable Karen Weldin-Stewart, CIR-ML  
Insurance Commissioner  
State of Delaware  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 11-013, an Association examination has been made of the affairs, financial condition and management of the

### **XL SPECIALTY INSURANCE COMPANY**

Hereinafter referred to as "Company" or "XL Specialty" incorporated under the laws of the State of Delaware as a stock company. The Company's statutory home address is 1209 Orange Street, Wilmington, Delaware. The examination was conducted at the administrative office of the Company located at Seaview House, 70 Seaview Avenue, Stamford, CT 06902.

The report of this examination is submitted herewith.

### **SCOPE OF EXAMINATION**

The last examination was as of December 31, 2005. This examination covered the period of January 1, 2006, through December 31, 2010, and encompasses a general review of transactions during the period, the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of the Company at December 31, 2010. Transactions subsequent to the examination date were reviewed where deemed necessary.

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (Handbook) and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

The examination was conducted concurrently with the states of New York and North Dakota. Reports of Examination for each of the seven U.S. domestic companies (four in Delaware) were filed separately.

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.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, PricewaterhouseCoopers LLP (PwC). Certain auditor work papers of their 2010 audit have been incorporated into the work papers of the examiners and have been utilized in determining the scope, areas of emphasis in conducting the examination and in the area of tests of controls, risk mitigation and substantive testing.

In addition to items hereinafter incorporated as a part of this report, the following were reviewed without exception and made part of the work papers of this examination:

- Fidelity Bonds and Other Insurance
- Pensions, Stock Ownership and Insurance Plans
- Statutory Deposits

### **SUMMARY OF SIGNIFICANT FINDINGS**

No significant findings were determined as a result of the examination.

### **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

#### Management and Control

It was recommended that the Company report all changes in directors and principal officers to the Delaware Insurance Department as required by 18 Del. C. § 4919.

The Company has complied.

#### LOC effect on Provision for Reinsurance

It was recommended that the Company comply with NAIC Annual Statement Instructions for Schedule F, Part 4 and age its paid loss recoverables in accordance with those instructions.

The Company has complied.

#### FIT Intercompany Settlement

It was recommended that the Company settle their Federal Income Tax related intercompany balances in accordance with the Company's Amended Tax Sharing and Payment Agreement.

The Company has complied.

#### Intercompany Balances

It was recommended that the Company implement comprehensive procedures to ensure that all intercompany balances are settled in accordance with the service agreements.

The Company has complied.

#### Aging Intercompany Balances

It was recommended that the Company develop the ability to age the intercompany items in the new general ledger and that any old intercompany balances be settled prior to the implementation of the new ledger so that initial balances in the new ledger are fully supportable.

The Company has complied.

External Custody Agreement

It was recommended that the Company amend its custody agreement to incorporate the appropriate covenants in accordance with Part 1 Section IV J of the NAIC Financial Condition Examiners Handbook.

The Company has complied.

Taxes, Licenses and Fees

It was recommended that the Company maintain supporting documentation for account balances. The Company is in violation of 18 Del. C. § 520(b)(3), which states in part "...or to produce its accounts, records and files for examination by the Commissioner when required."

The Company has complied.

Reclassification of Advance Premiums

It was recommended that the Company follow NAIC Annual Statement Instructions when completing both its quarterly and annual statements.

The Company has complied.

Advance Premium

It was recommended that the Company comply with SSAP 53, paragraph 13 when recording advance premiums.

The Company has complied.

Unearned Premium Reserve

It was recommended that the Company comply with the recommended procedures contained within the NAIC's Accounting Practices and Procedures Manual, SSAP 53, paragraph 6 when calculating the Company's unearned premium reserve on "run-off" policies.

The Company has complied.

Unearned Premium Reserve

It was recommended that the Company set up estimated accruals for both Written Premium and Unearned Premium Reserve (UPR) that represent written premium and UPR from the cutoff dates to year end.

The Company has complied.

Commissions Payable

It was recommended that changes in contract terms be communicated timely to the accounting department so that the appropriate accounting entries can be made.

The Company has complied.

Escheatable Property

It is recommended that the Company comply with the various state laws regarding escheatable property.

The Company has complied.

Accounts Payable

It was recommended that the Company develop procedures to ensure that accruals are made for services performed in the current year that remains unpaid at year end.

The company has complied.

Deductible Recoverable

It was recommended that the Company research and clear the negative deductible balances including issuing a refund to the claimant if it is found that the Company has received deductible payments in excess of the recoverable. Additionally, it was recommended that the Company comply with SSAP 65, paragraph 37 and non-admit deductible recoverable balances over 90 days past their contractual due date or billing date if no contractual due date has been established.

The Company has complied.

Over 90 Day non-admit Receivables

It was recommended that the Company ensure that they post all non-admitted premium receivable balances in compliance with SSAP 6.

The Company has complied.

Non-admitted/Offset Calculation

It was recommended that the Company perform a calculation each year to determine if any accrued retrospective premiums should be non-admitted per the requirements of SSAP 66, paragraph 9.

The Company has complied.

Over Cession of Reserves

It was recommended that the Company ensure future cessions are allocated correctly and ensure that future financial statements are completed correctly in compliance with the NAIC Annual Statement Instructions.

The Company has complied.

IBNR Re-allocation

It was recommended that the Company comply with SSAP 62, paragraphs 17-20 by not taking credit in Schedule F for ceded recoverables due from insolvent reinsurers.

The Company has complied.

Developmental Deficiency on Loss Reserves

It was recommended that the Company use a more conservative approach when calculating their loss reserves.

The Company has complied.

Audited Financial Statements for MGAs

It was recommended that the Company obtain audited financial statements for all of its MGAs.

The Company has complied.

Actuarial Opinion of MGA Reserves

It was recommended that the Company comply with its agreements and 18 Del. C. § 1805(b) by annually obtaining the opinion of an actuary attesting to the MGA's adequacy of its established loss reserves for losses incurred and outstanding on business produced by the MGA. This is in addition to any other required loss reserve certification.

The Company has complied.

## **SUBSEQUENT EVENTS**

There were no significant events subsequent to the examination date.

## **COMPANY HISTORY**

The Company was originally incorporated under the laws of New Mexico as the International Cargo and Surety Insurance Company on November 14, 1979. The Company re-domesticated to the State of Illinois in 1989 and changed its name to Intercargo Insurance Company. On November 23, 1999, the Company changed its name to XL Specialty Insurance Company. On August 16, 2002, the Company re-domiciled from the State of Illinois to the State of Delaware. On June 30, 2003, the holding company of X.L. America, Inc., a Delaware Corporation was restructured. XL Reinsurance America Inc. (XLRA) contributed all of the issued and outstanding shares of Indian Harbor Insurance Company (Indian Harbor), a North Dakota domiciled insurer, to XL Specialty. There have been no changes during the current examination period.

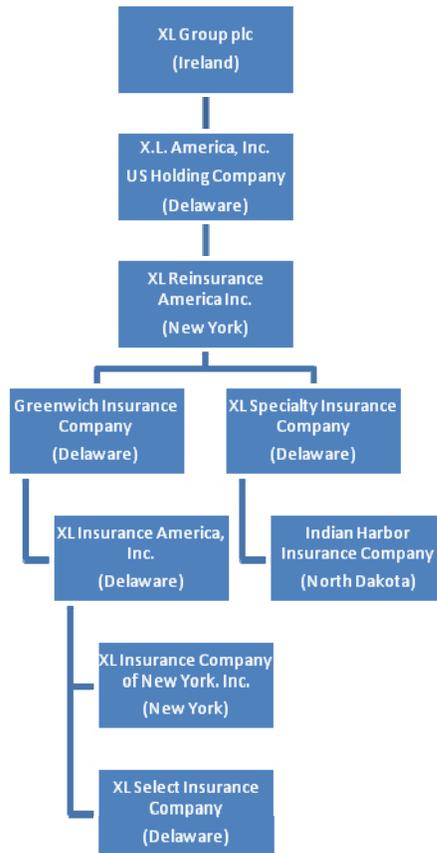
## **CORPORATE RECORDS**

The recorded minutes of the sole shareholder and Board of Directors (Board) of the Company were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events, including the authorization of investments as required by 18 Del. C. § 1304.

## **MANAGEMENT AND CONTROL**

XLRA is a wholly owned indirect subsidiary of X.L. America, Inc. (X.L. America), a Delaware domiciled corporation, which, in turn, is an indirect wholly owned subsidiary of XL Group plc (Ireland).

The following is a partial organizational chart that reflects the identities and interrelationships between the Company, its ultimate Parent, its US parent and other pooled members of the system as of December 31, 2010:



A review of the Insurance Holding Company Annual Registration Statement filings (Form B and Form C) made by the Company for all years under examination revealed that the Company has complied with the requirements of 18 Del. Admin. Code § 1801

### **Board of Directors**

Pursuant to the general corporation laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, the business and affairs of the Company shall be managed by or under the direction of the Board of Directors (Board), which shall be determined by the shareholder. During the period under review, the Board met at least quarterly. Under the terms of the bylaws of the Company, as adopted by the Board, a majority of the entire Board shall constitute a quorum for the transaction of business. The number of directors fixed by the charter

or by the bylaws may, by the vote of a majority of the entire Board, be not less than one (1) and no more than twenty-one (21). As of the examination date the Company had eight (8) directors. Directors are elected at the annual meeting of the stockholder and each director serves until his successor shall have been elected and qualified or until he shall die or resign, or shall have been removed.

The minutes of the meetings of the stockholder and the Board which were held during the period of examination were reviewed. Attendance at meetings, election of directors and officers, approval of dividends, and approval of investment transactions were also noted.

Directors serving at December 31, 2010 were as follows:

<u>Name</u>	<u>Principal Occupation</u>
John Michael DiBiasi	Senior Vice President
Michael Joseph Garceau	Senior Vice President
Bernard Russell Horovitz	President and Chief Executive Officer
Seraina Maag	Executive Vice President
James Michael Norris	Senior Vice President
Robert Michael Shine	Senior Vice President
Paul Ivan Tuhy	Senior Vice President
Todd David Zimmerman	Senior Vice President

### Officers

The Company's bylaws state that the officers of the Company shall be chosen by the Board and shall be a Chairman of the Board, a President, one or more Vice Presidents, a Secretary and a Treasurer. One person may hold two positions with the exception of President and Secretary.

The following officers had been elected by the Board and were serving at December 31, 2010:

<u>Name</u>	<u>Title</u>
Bernard Russell Horovitz	President and Chief Executive Officer
Gabriel George Carino III	Treasurer
Toni Ann Perkins	Secretary
Andrew Robert Will	Vice President and Controller
Richard Thomas Corbett, Jr.	Executive Vice President

John Michael DiBiasi	Senior Vice President
David Brian Duclos	Executive Vice President
Michael Joseph Garceau	Senior Vice President
Joseph Christopher Henry	Executive Vice President
David Sherwood Hewett	Senior Vice President
Gary Steven Kaplan	Executive Vice President
Seraina Maag	Executive Vice President
William Joseph Mills	Senior Vice President
James Michael Norris	Senior Vice President
Robert Michael Shine	Senior Vice President
John Harold Sullivan	Senior Vice President
Paul Ivan Tuhy	Senior Vice President
Keith James Wagner	Senior Vice President
Todd David Zimmerman	Senior Vice President

## AGREEMENTS

### Affiliated Agreements

The Company is a participant of the XL America Group Reinsurance Pooling Agreement. The pool percentages for XL Specialty and its insurance company affiliates (together “the Pool members”) are as follows:

<u>NAIC #</u>	<u>Company</u>	<u>Pool Percentages</u> <u>As of Dec 31, 2010</u>
20583	XL Reinsurance America Inc. (NY)	65%
22322	Greenwich Insurance Company (DE)	12%
24554	XL Insurance America, Inc. (DE)	10%
19607	XL Select Insurance Company (DE)	2%
40193	XL Insurance Company of NY, Inc. (NY)	3%
37885	XL Specialty Insurance Company (DE)	6%
36940	Indian Harbor Insurance Company (ND)	2%

All ceded reinsurance balances related to external reinsurance contracts are recorded in the statutory financial statements of XLRA, and all reinsurers which are parties to such contracts are included in XLRA’s Schedule F. Any Schedule F penalty determined within XLRA’s Schedule F is shared by the Pool members in accordance with their Pooling Agreement participation percentages.

The Company also participates in a Quota Share Reinsurance Agreement (“QS Agreement”) with an affiliated Bermuda reinsurance Company, XL Insurance (Bermuda) Limited (XLIB), which is a subsidiary of XL Group plc, the ultimate parent of the Company. The QS Agreement was amended (Third Amended and Restated QS Agreement) effective January 1, 2008 whereby, after placement of specific unaffiliated reinsurance, the quota share percentage was changed from 75% to 50%. Under the terms of the Third Amended and Restated QS Agreement, as well as the terms of the XL America Group Reinsurance Pooling Agreement, all of the member companies cede 100% of their gross premiums, losses and related underwriting expenses to the Pool Leader. After placement of specific unaffiliated reinsurance, the Pool Leader reinsures 50% of the remaining post January 1, 2008 accident date-related pool results, and 75% of all accident date-related pool results from July 1, 1999 to December 31, 2007 under the terms of the Third Amended and Restated QS Agreement. The ceding commission earned by the Pool Leader under the agreement is 31% of premiums ceded. Effective October 1, 2009 an agreement to transfer by substitution and novation all past, present and future obligations under the QS Agreement between XLRA and XL Re Ltd (XLRE) to XLIB was executed.

### **Internal Allocation Agreement**

Effective January 1, 2010, XLRA as Pool Leader, on behalf of the Pool members, XL Insurance Company Limited, XL Insurance Switzerland Ltd., XL Re Ltd., XL Insurance (Bermuda) Ltd., XL London Market Ltd. on behalf of the Underwriting Members of Lloyds Syndicate Nos. 588, 861, 990 and 1209, XL Re Latin America Ltd., XL Insurance Mexico, XL Resseguros Brazil, XL Re Europe Limited, collectively known as the “Allocating Companies”, agreed to an internal reinsurance allocation. The Allocating Companies intend to purchase on behalf of themselves and their insurer affiliates and subsidiaries, various forms of reinsurance and retrocessional coverage. This agreement shall allocate the respective reinsurance premium costs

and reinsurance contract recoveries. The shared reinsurance and retrocessional contracts will be allocated in an equitable manner reflecting the relative exposures of each of the Allocating Companies.

**Expense Sharing Agreement**

The Pool members entered into an expense sharing agreement effective July 1, 2001, and most recently amended January 1, 2009, with X.L. America and X.L. Global Services, Inc., and certain affiliated companies. The agreement calls for X.L. Global Services, Inc. to provide information and technology services, planning, expense management and budget support, project management and application development support, reinsurance services, actuarial services, human resource services and other services. The services are to be charged on a cost basis. A report covering all the items and incurred charges and/or credits is furnished quarterly with the final payment being remitted within thirty days upon receipt of the quarterly report.

**Tax Sharing and Payment Agreement**

Effective September 1, 2001 and, most recently amended October 1, 2008, X.L. America maintains a tax sharing agreement with its subsidiaries (including the Company), whereby the members of the group agree to pay an amount equal to the federal income tax liability which such member would have incurred if such member had filed a separate federal income tax return. For each estimated tax period of any year, the estimated federal income tax liability of each member shall be determined and shall be paid within 10 days of receipt of notice. The final amount required to be paid for any taxable year shall be paid on or before the date on which the consolidated return of the group is required to be filed determined without regard to any extension of time to file.

## **Investment Management Agreement**

Effective January 1, 2005, the Company appointed XL Investment Management Limited (XLIML), a Bermuda Company, to provide investment management, financial advisory and administrative services as required. XLIML shall act in accordance with investment laws in Delaware and in accordance to the overall investment policy established by the Company under the direction of the Board. XLIML shall have the authority to negotiate, contract and terminate investment fund managers for each portfolio, in accordance with the overall investment policy guidelines. Fees for this service are .06% (or 6 basis points) of total assets under management.

## **TERRITORY AND PLAN OF OPERATION**

### **Territory**

As of December 31, 2010, the Company is licensed in 50 states, the District of Columbia, Guam, Puerto Rico and the U. S. Virgin Islands.

### **Plan of Operation**

In 2010, XL Specialty's major product lines were professional liability (primarily D&O), aviation, satellite, marine and energy, workers compensation, general liability, and property. For 2010, the Company's premium by Operating Business Unit ("OBU") was as shown in the table below:

<u>Operating Business Unit</u>	<u>Direct Written Premium</u> <u>(pre-intercompany</u> <u>pooling, rounded)</u>
Environmental	20,000,000
Middle Market	3,000,000
Programs	26,000,000
Risk Management	82,000,000
Surety	3,000,000
Design Professional	131,000,000
Hartford Professional	607,000,000
Aerospace	131,000,000
Equine	10,000,000
Fine Art & Specie	32,000,000
Marine & Energy	53,000,000
<b>TOTAL</b>	<b>\$ 1,098,000,000</b>

**XL Hartford Professional** specializes in professional indemnity, directors and officers liability insurance, employment practices liability, and management liability on both a primary and excess basis. XL Professional is based in Hartford, Connecticut. Their clients are mostly Fortune International 1000 companies.

**XL Aerospace** is an insurance specialist in the space and aviation classes of business. Their underwriting operations write policies through regional brokers and independent agents. Their clients are corporations in the aviation and space industries, airports, airlines, telecommunications firms and corporate jet fleets. XL Aerospace underwrites US aviation risks and space risks for Africa, Asia, Australia, Europe, North America and South America. Their products include aviation insurance, comprehensive airline hull & liability, airport liability, aviation manufacturers' products liability, aviation ground handlers liability, airport service providers, fixed based operators, contingent aircraft liability, repossessed aircraft hull & liability, large aircraft hull & liability, space third party liability, corporate non-owned aircraft liability, rotor wing operators, deductible buyback, non-owned aircraft liability, space insurance, launch,

post-separation, in-orbit, transponder coverage, satellite incentive coverage, and launch risk guarantee.

**XL Design Professional**, established in 2004, offers professional liability insurance and risk management solutions to targeted architects and engineers. The programs are marketed and delivered by a dedicated group of specialists that belong to the Professional Liability Agents Network. These independent agencies have exclusive arrangements to deliver the Company's products and services within their territories.

**XL Programs** partner with insurance program administrators to offer specialized insurance coverage to distinct market segments. The business units provide specialty, property & casualty and warranty coverage to various industries, including habitational real estate, auto and construction. XL Programs is based in Exton, Pennsylvania.

**XL Marine and Offshore Energy** provide insurance for clients with special coverage needs for their marine or offshore energy exposures. The products are distributed through licensed brokers who offer specific expertise in this area. Product offerings of XL Marine and Offshore Energy include cargo, blue-water hull, brown-water hull and P&I, primary marine liabilities, excess marine liabilities, and offshore energy insurance. The US Marine and Offshore Energy operation is headquartered in New York City.

**XL US Primary Risk Management** offers risk transfer and risk management programs for major corporations and institutions operating in the United States. The business unit provides a wide range of solutions to customers with needs for primary programs requiring workers' compensation, general liability and automobile liability. The target customers are small and middle market businesses. The US Primary Risk Management operation is headquartered in New York City.

**XL Specie** offers specialized solutions for fine art, jewelers block, cash in transit, and financial institutions. Their clients include museums, private and corporate art collections, dealers, auction houses, and jewelry related companies from mining to retail. In the general specie product area, coverage includes banks, financial institutions, miners and refiners, providing them with coverage for cash, negotiable, non-negotiable documents of value and precious metals.

**XL Equine** specializes exclusively in bloodstock insurance. Products are distributed through a select number of independent agents as well as brokers. The products offered include equine mortality, theft, named perils, stallion permanent disability, stallion first season infertility, stallion availability, stallion loss of income, barrenness (prospective foal), and major medical and surgery coverage.

**XL Environmental** provides integrated environmental risk management solutions incorporating insurance, consulting and claims management to environmental and non-environmental businesses and industries worldwide. They offer insurance solutions for the following industries: chemical facilities, construction, environmental facilities, environmental services, industrial and commercial facilities, public entities, water and wastewater facilities, real estate and transportation. XL Environmental is headquartered in Exton, Pennsylvania with regional employees located throughout the United States.

### **GROWTH OF THE COMPANY**

The following information was extracted from the Company's filed Annual Statements and covers the five (5) years from its last examination as of December 31, 2005, through this examination, as of December 31, 2010:

XL Specialty Insurance Company

Year	Net Admitted Assets	Liabilities	Surplus as Regards Policyholders	Gross Premium Written	Net Premiums Earned	Net Income/(Loss)
2010	\$ 498,918,153	\$ 320,168,786	\$ 178,749,367	\$ 1,174,465,732	\$ 69,542,479	\$ 11,858,791
2009	\$ 541,124,990	\$ 369,216,660	\$ 171,908,330	\$ 1,256,246,742	\$ 75,930,807	\$ (64,042)
2008	\$ 577,093,085	\$ 395,342,932	\$ 181,750,153	\$ 1,458,935,285	\$ 88,886,825	\$ 15,086,275
*2007	\$ 555,492,269	\$ 403,897,138	\$ 151,595,131	\$ 1,502,353,375	\$ 47,209,847	\$ 11,422,033
*2006	\$ 432,856,446	\$ 271,257,841	\$ 161,598,605	\$ 1,604,306,101	\$ 49,958,450	\$ 11,829,082
2005	\$ 523,786,873	\$ 381,553,190	\$ 142,233,683	\$ 1,658,106,992	\$ 46,940,599	\$ 4,147,900

\*The Company filed Amended Annual Statement for 2006 and 2007.

The changes from 2005 to 2010 in the examination period are as follows:

- 4.7 % decrease in Net Admitted Assets
- 16.1 % decrease in Liabilities
- 25.7 % increase in Surplus as Regards Policyholders
- 29.2% decrease in Gross Premium Written
- 48.1% increase in Net Premiums Earned
- 185.9 % increase in Net Income/(Loss)

The decreases during the exam period in Net Admitted Assets, Liabilities and the increase in Surplus as Regards Policyholders of 4.7%, 16.1% and 25.7% respectively, are considered reasonable based on the long-term tail lines of the business being written by the Company and the increase in Net Income during the period. Also, significant decreases in both Net Admitted Assets and Liabilities in 2009 and 2010 were the result of settlements of reinsurance balances that were made prior to year-end.

The Gross Written Premiums listed above are comprised of direct business, plus reinsurance assumed from affiliates under the Pooling Agreement, plus reinsurance assumed from non-affiliates. During the period covered by this examination some of the products being sold by the Company were experiencing a “soft market” where obtaining sufficient rates was difficult due to increased competition in the market. The Company has tried to minimize its exposure to these less profitable lines and focus on those lines that are more profitable. As a result, the gross written premiums by the Pool have decreased during the period covered by this examination. Net income

was considered reasonable given the cyclical nature of the business and the market conditions during that period.

For the pooled business, net of external reinsurance, the percentage ceded to XLIB was changed from 75% to 50% effective January 1, 2008. Thus, the business retained and shared amongst the Pool members increased. This resulted in the significant increase in the net premiums earned beginning in 2008.

### **LOSS EXPERIENCE**

Net loss and loss expenses unpaid reserves as of December 31, 2010 were \$184,096,331. During 2011, unfavorable development of \$1,513,000 was incurred for loss and loss adjustment expense attributable to insured events of prior years. Strengthening of reserves occurred within direct operations due to workers' compensation guaranteed cost business, excess and surplus casualty business, chemical related to general liability claims, credit business and reinsurance due to the Deepwater Horizon event in 2010. These amounts were partially offset by releases within direct operations, including space accounts, marine hurricane and catastrophe losses, standard professional liability and within reinsurance operations.

### **REINSURANCE**

#### Assumed

Assumed reinsurance accounted for 1 percent of our Company's gross written premiums ("GWP") at December 31, 2010, excluding business assumed from the Inter-Company Reinsurance Pooling Agreement.

#### Inter-Company Reinsurance Pooling Agreement

The Company participates, as Pool member, in an inter-company pooling agreement with various affiliated companies as disclosed within the related party agreement section.

Any Schedule F penalty is shared by the Pool members in accordance with their pool participation percentages. Each of the Pool members has an option of establishing a Funds Withheld Balance, which may be maintained until cancellation of the agreement.

### Ceded

The Company has structured its ceded reinsurance program into two segments: Insurance and Reinsurance. Exclusive of the businesses ceded under the terms of the XLIB Third Amended and Restated QS Agreement, the majority of the business is ceded to authorized reinsurers.

The Company's ceded reinsurance program for its property business consists primarily of excess of loss, treaty and facultative coverage on both per risk and occurrence basis. The insurance segment has specific reinsurance programs for specific classes of business (ex. Professional and Environmental). Material coverage for Global Marine and Offshore Energy, Aerospace, Workers Compensation and significant programs are outlined below. Additionally, the insurance segment and reinsurance segment provide coverage for all property and casualty business with specific territorial exclusions, noted below.

### **Insurance Segment**

#### Property

Property Per Risk Excess of Loss 2 Layers	\$270,000,000 excess of \$30,000,000
Property Per Risk Excess of Loss Facility	\$300,000,000 excess of \$300,000,000

#### Property - Catastrophe

1 <sup>st</sup> Layer (Worldwide excluding US)	\$100,000,000 excess of \$75,000,000
2 <sup>nd</sup> Layer US (all perils)	\$150,000,000 excess of \$150,000,000
3 <sup>rd</sup> Layer US (all perils)	\$175,000,000 excess of \$300,000,000

XL IPC Middle Market_1 <sup>st</sup> Layer (US)	\$15,000,000 excess of \$15,000,000
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#### Casualty

General Liability Quota Share I – Claims Made/Occ. Notified (65.5% Placed)	It covers losses up to \$50,000,000
General Liability Quota Share II - Occurrence Quota Share (64.5% Placed)	It covers losses up to \$50,000,000

General Liability Quota Share III – Excess Cession (46.5% Placed) \$50,000,000 excess of \$50,000,000

Specialty Lines with Material Coverage:

*Global Marine and Offshore Energy*  
 Global Marine-Equine Excess of Loss \$2,500,000 excess of \$2,500,000 not to exceed \$2,500,000

Cargo & Marine Liability Excess of Loss \$5,000,000 excess of \$5,000,000 not to exceed \$5,000,000 in the aggregate  
 These are the underlying layers excluding Energy and IGP

Marine Hull, Ports, Construction & Marine War Excess of Loss \$5,000,000 excess of \$5,000,000

Worldwide Global Marine Excluding Energy “Gulf of Mexico (GOM) Wind Physical Damage” Excess of Loss-7 Layers \$202,500,000 excess of \$10,000,000

Worldwide Global Marine - Gulf Of Mexico (GOM) Wind Energy Physical Damage (50% Placed) \$20,000,000 excess of \$30,000,000

Global Marine: Fine Arts and Specie- Excess of Loss Core Program \$15,000,000 excess of \$10,000,000

Global Marine- Species- Excess of Loss \$10,000,000 excess of \$10,000,000  
 Loss due to Terrorism acts

Global Marine – Species- Excess of Loss Written on a Facultative basis \$130,000,000 excess of \$20,000,000  
 It covers losses due to terrorism acts.

Inland Marine 50% Quota Share Subject to a limit of \$20,000,000

*Aerospace*

General Aviation-Hull Risks XOL \$13,000,000 excess of \$2,000,000

General Aviation- Liability Risk XOL Section A \$140,000,000 excess of \$10,000,000

Section B \$300,000,000 excess of \$20,000,000

General Aviation Per Occurrence XOL 1<sup>st</sup> Layer-80% Placed \$4,000,000 excess of \$4,000,000 excess of \$1,000,000 AAD

2<sup>nd</sup> Layer \$4,000,000 excess of \$8,000,000

Global Aviation Program 6 Layers \$190,000,000 excess of \$10,000,000

Aviation-Third Party War 2 Layers \$30,000,000 excess of \$10,000,000

Aviation – Airline Products- Variable Quota Share Not to exceed \$200,000,000

Aviation-Space 40% Quota Share

*Workers Compensation*

Workers Compensation Industrial Aid XOL \$19 million excess of \$1 million covers losses as a result of riding as a passenger in an aircraft

Workers Compensation Catastrophe Quota The treaty provides catastrophe protection for

Share all workers compensation lines written by the Insurance Segment, and consists of two layers:  
 1) 50% of \$20 million excess of \$20 million and;  
 2) 80% of \$85 million excess of \$40 million.

Programs

The Company has various program specific reinsurance programs. The largest is the Multi-Peril Crop Insurance (MPCI) and the Crop Hail Government sponsored program. It covers business produced/written/managed by Heartland Crop Insurance and reinsured through the Federal Crop Insurance Corporation. In addition to the 62.5% Quota Share additional protection is provided through three layers of stop loss coverage for MPCI and two layers of stop loss coverage for Crop Hail.

**Reinsurance Segment**

The XL Re group has a “Core” Catastrophe program under which XLRA and its Toronto Branch are covered. This coverage insures to the benefit of the insurance segment catastrophic program. A description of this coverage is as follows:

<u>Type of Treaty</u>	<u>Cession</u>
Property Catastrophe Coverage Excess of Loss – Peak Coverage	\$82,500,000 excess of \$200,000,000 This coverage has 6 layers and has several participation percentages.
Property Catastrophe Coverage Excess of Loss- Non-Peak Coverage	\$50,000,000 excess of \$60,000,000
Property Excess of Loss Replicate Catastrophe Coverage- US Wind	100% of \$68,250,000 excess of various attachment points.
Replicate Catastrophe- Europe Wind	100% of \$47,895,000 excess of various attachment points
Property Facultative Excess of Loss:	
1 <sup>st</sup> Layer	58.0% of \$15,000,000 excess of \$10,000,000
2 <sup>nd</sup> Layer	100% of \$25,000,000 excess of \$25,000,000
3 <sup>rd</sup> Layer	82.0% of \$25,000,000 excess of \$50,000,000

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions.

Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements.

### **ACCOUNTS AND RECORDS**

The accounts and records review included an evaluation of the Company's operational and organizational controls. The areas evaluated included computer systems, accounting systems, organizational structures, and the processing structure. The Company's information technology control environment was tested as part of the examination by RSM McGladrey Inc. The accounts and records review also included an assessment of the Company's risk management process in identifying and controlling risks in the key operational areas of the Company. In making the assessment in each key area, processes were reviewed, risks were identified, operational and organizational controls were identified and tested and the Company's methodology for assessing the effectiveness of the established mitigation factors was evaluated.

### **FINANCIAL STATEMENTS**

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2010.

- Assets
- Liabilities, Surplus and Other Funds
- Statement of Income
- Capital and Surplus Account
- Reconciliation of Surplus for the Period since the Last Examination
- Analysis of Financial Statement Changes resulting from Examination

**ASSETS**  
**DECEMBER 31, 2010**

	<u>Assets</u>	<u>Non-Admitted Assets</u>	<u>Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 261,107,664		\$ 261,107,664	1
Common Stocks	68,908,583		68,908,583	
Cash, cash equivalents and short-term investments	123,186,838		123,186,838	
Subtotals, cash and invested assets	<u>\$ 453,203,085</u>		<u>\$ 453,203,085</u>	
Investment income due and accrued	2,281,167		2,281,167	
Uncollected premiums and agents' balances in the course of collection	14,494,060	\$ 4,589,766	9,904,294	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	9,327,551		9,327,551	
Accrued retrospective premiums	1,239,052	15,380	1,223,672	
Other amounts receivable under reinsurance contracts	71,854		71,854	
Net deferred tax asset	11,858,216	1,843,474	10,014,742	
Guaranty funds receivable or on deposit	49,756		49,756	
Receivables from parent, subsidiaries and affiliates	5,299,580	942,351	4,357,229	
Aggregate write-ins for other than invested assets	9,081,028	596,225	8,484,803	
<b>Totals</b>	<u><u>\$ 506,905,349</u></u>	<u><u>\$ 7,987,196</u></u>	<u><u>\$ 498,918,153</u></u>	

**LIABILITIES, SURPLUS AND OTHER FUNDS  
DECEMBER 31, 2010**

		<u>Note</u>
Losses	\$ 159,642,135	2
Reinsurance payable on paid losses and LAE	695,607	
Loss adjustment expenses	24,454,196	
Commissions payable, contingent commissions and other similar charges	(130,920)	
Other expenses	4,996,996	
Taxes, licenses and fees	637,985	
Current federal and foreign income taxes	1,233,620	
Unearned premiums (after deducting unearned premiums for ceded reinsurance of \$487,293,616)	34,049,302	
Advance premiums	1,328,672	
Funds held by company under reinsurance treaties	76,604,647	
Amounts withheld or retained by company for account of others	27,084	
Remittances and items not allocated	(12,409,736)	
Provision for reinsurance	5,628,400	
Payable to parent, subsidiaries and affiliates	11,900,273	
Aggregate write-ins for liabilities	11,510,525	
<b><i>Total Liabilities</i></b>	<u>\$ 320,168,786</u>	
Aggregate write-ins for special surplus funds	\$ 2,838,516	
Common capital stock	5,812,500	
Gross paid in and contributed surplus	131,798,019	
Unassigned funds (surplus)	38,300,332	
Surplus as regards policyholders	<u>\$ 178,749,367</u>	
<b><i>Totals</i></b>	<u><u>\$ 498,918,153</u></u>	

**STATEMENT OF INCOME****STATEMENT OF INCOME**  
FOR THE YEAR ENDING DECEMBER 31, 2010

Premiums earned	\$ 69,542,479
<b>DEDUCTIONS:</b>	
Losses incurred	\$ 40,933,654
Loss adjustment expenses incurred	8,388,023
Other underwriting expenses incurred	23,297,835
Aggregate write-ins for underwriting deductions	(57,327)
<b>Total underwriting deductions</b>	<u>\$ 72,562,185</u>
Net underwriting loss	<u>\$ (3,019,706)</u>
<b>INVESTMENT INCOME</b>	
Net investment income earned	\$ 12,255,674
Net realized capital gains	3,272,663
<b>Net investment gain (loss)</b>	<u>\$ 15,528,337</u>
<b>OTHER INCOME</b>	
Net loss from agents' or premium balances charged off	\$ (281,242)
Aggregate write-ins for miscellaneous income	(866,204)
<b>Total other income</b>	<u>\$ (1,147,446)</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	<u>\$ 11,361,185</u>
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 11,361,185
Federal and foreign income taxes incurred	(497,606)
Net Income	<u><u>\$ 11,858,791</u></u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>	
Capital and surplus, December 31, 2009	\$ 171,908,330
Net income (loss)	\$ 11,858,791
Change in net unrealized capital gains or (losses) less capital gains tax of (\$2,417,779)	10,535,281
Change in net unrealized foreign exchange capital gain (loss)	(246,085)
Change in net deferred income tax	(7,076,622)
Change in non-admitted assets	4,042,925
Change in provision for reinsurance	3,621,180
Dividends to stockholders	(17,000,000)
Aggregate write-ins for gains and losses in surplus	1,105,567
Change in surplus as regards policyholders for the year	<u>\$ 6,841,037</u>
Capital and surplus, December 31, 2010	<u><u>\$ 178,749,367</u></u>

## RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE LAST EXAMINATION

The following reconciliation of capital and surplus for the period as of December 31, 2005 to December 31, 2010, was extracted from the Company's filed Annual Statements.

	Aggregate Write-ins for Special Surplus Funds	Common Capital Stock	Gross Paid-in and Contributed Surplus	Unassigned Funds (Surplus)	Surplus as Regards Policyholders
December 31, 2005 (1)		\$ 5,812,500	\$ 131,798,019	\$ 4,623,164	\$ 142,233,683
Operations 2006 (2)				19,364,922	19,364,922
Operations 2007 (2)				5,996,526	5,996,526
Dividends to stockholders (3)				(16,000,000)	(16,000,000)
Operations 2008 (2)				30,155,021	30,155,021
Operations 2009 (2)				6,425,229	6,425,229
Dividends to stockholders (3)				(18,000,000)	(18,000,000)
Aggregate write-ins for gains and losses in surplus (4)	\$1,732,949				1,732,949
Operations 2010 (2)				22,735,470	22,735,470
Dividends to stockholders (3)				(17,000,000)	(17,000,000)
Aggregate write-ins for gains and losses in surplus (4)	\$1,105,567				1,105,567
December 31, 2010	<u>\$ 2,838,516</u>	<u>\$ 5,812,500</u>	<u>\$ 131,798,019</u>	<u>\$ 38,300,332</u>	<u>\$ 178,749,367</u>

1. The prior examination unassigned surplus and surplus as regards policyholders are not reflective of prior examination adjustments. The prior examination adjustments are included in operations subsequent to the prior examination.
2. Operations is defined as net income (loss), change in net unrealized capital gains or (losses), change in unrealized foreign exchange capital gain (loss), change in net deferred income tax, change in non-admitted assets, change in provision for reinsurance, and cumulative effect of changes in accounting principles.
3. Dividends have been properly authorized by the Board and the Department of Insurance if required.
4. The Company recorded its SSAP 10R Deferred Tax Adjustment.

As of December 31, 2010, the Company had 387,500 issued and outstanding shares of common stock with a par value of \$15.00 per share, for common capital stock totaling \$5,812,500. All of the common stock of the Company is issued to XLRA.

### **ANALYSIS OF CHANGES IN THE FINANCIAL STATEMENTS**

There were no changes to the Company's financial statements as a result of this examination.

### **NOTES TO THE FINANCIAL STATEMENTS**

Note 1 - Bonds \$261,107,664

The categories of bonds at December 31, 2010 include U.S. Government Bonds, \$141,375,092 or 54.1%, US States and territories, guaranteed, \$747,522 or .3%, U.S. Special Revenue & Special Assessment Obligations- non guaranteed, \$47,837,128 or 18.3% and Industrial and Miscellaneous \$71,147,922 or 27.3%. All of the Companies securities are rated as Class 1 or 2 by the NAIC Securities Valuation Office (SVO).

Note 2  
Losses \$159,642,135  
Loss adjustment expenses \$ 24,454,196

The above-captioned amounts, which are the same as those reported by the Company in its Annual Statement, have been accepted for purposes of this report. The balance reported by the Company was comprised of the following:

Losses

<u>Reported Losses (Case)</u>	
Direct	\$ 835,495,080
Reinsurance Assumed	63,938,639
Reinsurance Ceded	(843,953,283)
Net Reported Losses	<u>\$ 55,480,436</u>
<u>Incurred but not reported (IBNR)</u>	
Direct	\$ 1,918,636,109
Reinsurance Assumed	108,869,195
Reinsurance Ceded	(1,923,343,605)
Net IBNR	<u>\$ 104,161,699</u>
<u>Net Losses Unpaid</u>	<u>\$ 159,642,135</u>
<u>Loss Adjustment Expenses</u>	<u>\$ 24,454,196</u>

The examination retained the firm of Milliman, Inc. (“Milliman” or “Consulting Actuary”) to review the Company’s stated reserves. The Consulting Actuary was provided with the Company’s statement of actuarial opinion and an actuarial report as supporting documentation of the actuarial opinion with loss and loss adjustment expense reserves evaluated as of December 31, 2010. In addition, Milliman was provided with other reports, schedules, exhibits and relevant information as requested.

The Consulting Actuary’s review of loss and allocated loss adjustment expenses (ALAE) reserves consisted of separately analyzing the Company’s property and casualty books of business on a gross and net basis. In addition, for unallocated loss adjustment expenses (ULAE), the consulting actuary reviewed the methodology employed by the Company’s actuaries. Milliman accepted the methodology and factor selections utilized by the Company’s actuaries and ultimately found the Company’s reserves to be reasonable.

In conjunction with the actuarial review, the examination team validated loss data used by the Company without material exception.

**SUMMARY OF RECOMMENDATIONS**

No significant recommendations were determined as a result of the examination.

**CONCLUSION**

The following schedule shows the changes from the previous examination and the financial condition of the Company, as of December 31, 2010:

Description	12/31/2005 <u>Prior Examination</u>	12/31/2010 <u>Current Examination</u>	Increase <u>(Decrease)</u>
Assets	\$ 528,252,497	\$ 498,918,153	\$ (29,334,344)
Liabilities	\$ 399,349,888	\$ 320,168,786	\$ (79,181,102)
Aggregate write-ins for special surplus funds	\$ -	\$ 2,838,516	\$ 2,838,516
Common capital stock	5,812,500	5,812,500	-
Gross paid in and contributed capital	131,798,019	131,798,019	-
Unassigned funds (surplus)	<u>(8,707,910)</u>	<u>38,300,332</u>	<u>47,008,242</u>
Total surplus as regards policyholders	\$ <u>128,902,609</u>	\$ <u>178,749,367</u>	\$ <u>49,846,758</u>
Totals Liabilities and Surplus	\$ <u>528,252,497</u>	\$ <u>498,918,153</u>	\$ <u>(29,334,344)</u>

Respectfully submitted,

  
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 Joseph A. Rome, CFE  
 Examiner-In-Charge  
 State of Delaware  
 Northeastern Zone, NAIC