

REPORT ON EXAMINATION
OF
CHARTIS INSURANCE COMPANY - PUERTO RICO
AMENDED

AS OF

DECEMBER 31, 2010

NAIC CODE 31674

BY THE
OFFICE OF THE COMMISSIONER OF INSURANCE OF PUERTO RICO

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GOVERNMENT OF PUERTO RICO
OFFICE OF THE INSURANCE COMMISSIONER

January 27, 2012

Mr. Ramón L. Cruz Colón, CPCU, AU, ARe
Commissioner of Insurance
Office of the Commissioner of Insurance
B5 Tabonuco Street - Suite 216
PMB 356
Guaynabo, PR 00968-3029

Dear Commissioner:

In compliance with your instructions and pursuant to the Order Number EX-2011-14 dated October 19, 2011, and the Puerto Rico Insurance Laws and Regulations, a comprehensive risk focused examination and financial affairs examination was made of the books, records, and financial condition of

Chartis Insurance Company - Puerto Rico
250 Muñoz Rivera Avenue
San Juan, PR 00918-1813

hereinafter referred to as CICPR or the Company.

Scope of Examination

The current examination was conducted at the home office of the Company located at 250 Muñoz Rivera Ave., San Juan, Puerto Rico. This examination covers the period of January 1, 2010 through December 31, 2010, including any material relevant transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

We conducted our examination in accordance with the *National Association of Insurance Commissioners Financial Condition Examiners Handbook* (Handbook). The Handbook requires that the examination be planned and performed 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, and evaluating system controls and procedures used to mitigate those risks. An examination also includes 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, as applicable to the Puerto Rico Insurance Laws and Regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

Summary of Significant Findings

Current Examination Findings

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during the examination.

Use of Unauthorized Reinsurers without Prior Approval

The Company improperly identified several unauthorized reinsurers as authorized on Schedule F-Part 3 of the 2010 annual statement and, in addition to two other properly identified unauthorized reinsurers, did not obtain prior approval from the Commissioner before their use. The Company failed to comply with Section 4.120(3) of the Insurance Code of Puerto Rico which requires insurers to obtain prior written approval before the use of an unauthorized reinsurer. The Company failed to comply with the instructions regarding the determination of the authorized status of reinsurers listed on Schedule F contained in the 2010 *NAIC Annual Statement Instructions for Property & Casualty Companies*.

Compliance with Prior Examination Findings

Reinsurance Recoverable Amounts

As of December 31, 2009, the Company reported \$989,732 in overdue reinsurance recoverable from an affiliate. Under these circumstances, for examination

purposes, surplus was adjusted in the amount of \$989,732 pursuant to Section 5.010 of the Insurance Code of Puerto Rico and SSAP 4 of the *NAIC Accounting Practices and Procedures Manual*. On July 20, 2011, the Company issued a response to the OCS, including supporting documentation, indicating the reinsurance recoverable had been settled for \$588,376.

History

The Company was incorporated in Puerto Rico on October 17, 1971, as American International Insurance Company of Puerto Rico and commenced operations on July 8, 1974. On September 30, 2009, the Office of the Commissioner of Insurance (OCI) approved a request to change the name of the Company to Chartis Insurance Company - Puerto Rico. CICPR is authorized to write property and casualty insurance, pursuant to Chapter 4 of the Insurance Code of Puerto Rico, and writes business in both Puerto Rico and the U.S. Virgin Islands. Business is produced through independent agents and brokers.

The Company is a subsidiary of Chartis Overseas Limited (COL), a company domiciled in Bermuda. COL is wholly owned by Chartis International, LLC, which in turn is an indirect subsidiary of the ultimate parent, American International Group, Inc.

Capital Stock

As of December 31, 2010, the Company had 260,000 common stock shares authorized, issued, and outstanding with a par value of \$10 per share. COL, the

direct parent, owns 259,993 shares. The remaining seven shares were issued equally to the following directors in compliance with Section 29.150(1) of the Insurance Code of Puerto Rico:

Francisco Díaz
Manuel Rodríguez
Carlos González Rodríguez
Alejandro Pedroza
Sean Cliford
Rene Pinto-Lugo
Agustin Montalvo

Dividends to Stockholders

Section 29.340 of the Insurance Code of Puerto Rico provides that a domestic stock insurer shall not pay any cash dividend to stockholders, except out of that part of its available surplus funds which is derived from any realized net profits on its business.

The following shows dividends paid to stockholders and the balance of unassigned surplus during the examination period:

<u>Year</u>	<u>Dividend Paid</u>	<u>Unassigned Surplus Previous Year</u>
2010	\$25,000,000	\$151,202,780

The Company was in compliance with the provisions of Section 29.340 of the Insurance Code of Puerto Rico.

Management and Control

Section 29.150 of the Insurance Code of Puerto Rico states that not less than the majority of directors of an insurer shall be residents of, and actually reside in, Puerto Rico. The Company was in compliance with Section 29.150 of the Insurance Code of Puerto Rico and its own corporate bylaws.

As of the examination date, the directors of the Company, who were elected at the annual meeting of stockholders on May 26, 2010, were as follows:

<u>Directors</u>	<u>Principal Occupation</u>	<u>Resident</u>
Francisco Díaz	President, CICPR	San Juan, Puerto Rico
Manuel Rodríguez	Retired	Carolina, Puerto Rico
Agustin Montalvo	COO, CICPR	San Juan, Puerto Rico
Carlos González Rodríguez	CFO, CICPR	Guaynabo, Puerto Rico
Rene Pinto-Lugo (a)	Attorney	San Juan, Puerto Rico
Sean Clifford (b)	Regional Controller	Miami, Florida
Alejandro Pedroza	Regional General Counsel	Coral Gables, Florida

(a) Resigned as of September 14, 2011, and was replaced by John Slabbert on December 14, 2011.

(b) Resigned as of May 24, 2011, and was replaced by Eduardo Mena on May 24, 2011.

The officers of the Company, as appointed during the annual meeting of the Board of Directors on May 26, 2010, were the following:

Francisco Díaz	President
Carlos González Rodríguez	Senior Vice President & CFO
Brenda Gil	Secretary

Fernando Agosto
Ada Michelle Lugo
Miguel Díaz
Jacqueline Barros
Agustin Montalvo
Nayda Badillo
Pablo Monroy
Lourdes Pérez
Enrique Padiá
Gustavo Sarabia
Angel Torres

Treasurer
Assistant Secretary
Assistant Treasurer
Senior Vice President
Senior Vice President
Vice President
Vice President
Vice President
Vice President
Vice President
Vice President

Investment Plan

Section 6.040 of the Insurance Code of Puerto Rico provides, among other things, that the Board of Directors of the insurer shall adopt a written plan to acquire and maintain investments, and to outline their investment practices. The Company adopted a plan of investment, which was approved by the Board of Directors.

The Company's investment plan established the professional qualifications of the persons who will make routine decisions to ensure their investment competence and ethical conduct in compliance with the provisions of Section 6.040 of the Insurance Code of Puerto Rico.

Corporate Governance

The ultimate parent company, American International Group, Inc. (AIG), is a publicly traded corporation and, therefore, is subject to the Sarbanes-Oxley Act of 2002.

Conflict of Interest

The Company requires its directors, officers, and key employees to sign the conflict of interest questionnaires concerning items that could have an impact on the way they conduct the Company's business in accordance with Section 29.230 of the Insurance Code of Puerto Rico. The review of the conflict of interest questionnaires revealed that the Company was in compliance.

Corporate Records

The Articles of Incorporation, bylaws and all amendments thereto, and the minutes of the meetings of the Board of Directors, committees, and shareholders were reviewed for the period under examination. There were no changes made to the Articles of Incorporation or bylaws during the period under examination.

Board of Directors and Committee Minutes

The recorded minutes of the meetings of the Board of Directors and certain internal committees were reviewed for the period under examination. The recorded minutes adequately documented its meetings and approval of Company transactions and events in accordance with Chapter 29 of the Insurance Code of Puerto Rico.

The Board of Directors delegates the authority to make investment decisions to the Investment Committee. The Investment Committee held meetings during

the examination period to approve the purchases and sales of securities. The purchases and sales of securities were in compliance with the provisions of the Sections 6.080 and 6.090 of the Insurance Code of Puerto Rico.

The Company's overall investment procedures were in compliance with Section 6.040(2) of the Insurance Code of Puerto Rico because the Board of Directors ratified the investment transactions, which were approved by the Investment Committee.

Fidelity Bonds and Other Insurance

The Company, through the corporate insurance program managed by AIG, maintained fidelity bond coverage with a single loss limit of \$100 million and an aggregate loss limit of \$200 million. These amounts are in excess of the suggested minimum amount as recommended by the NAIC of \$84 million. The Company is also a named insured on various other policies providing directors and officers (D&O), errors and omissions (E&O), commercial property & liability, crime, and umbrella coverages.

Pension and Insurance Plans

Defined Benefits Plan

The parent sponsors a qualified, noncontributory defined benefit pension plan covering substantially all employees of the Company. Eligibility for participation in the various plans is based on either completion of a specified

period of continuous service or date of hire, subject to age limitation. The total net benefit obligation for vested employees for 2010 was \$303,731.

Post Retirement Benefits Other than Pensions

The Company provides health and life insurance benefits for retired employees and certain dependents when the employee becomes eligible for these benefits by satisfying plan provisions, which include certain age and/or service requirements. The Company does not pre-fund these plans. The vested postretirement obligation as of December 31, 2010 was \$3,529,000.

Intercompany Agreements

The Company has the following written agreements with affiliates.

Agency Agreement

This agreement, entered into on January 1, 2011, is between the Company and its wholly owned subsidiary Chartis Insurance Agency, Inc (CIA). Pursuant to the agreement, the Company appointed CIA as General Agent. The agreement gives CIA limited power and authority to receive and accept proposals for insurance, to charge the premiums for such proposals, to collect, receive and issue receipts for premiums on insurance tendered by CIA. CIA does not have any underwriting authority. Premiums are remitted to the Company no later than 60 days after each month's reporting.

Claims Services Agreement

This agreement, entered into on February 1, 2010, is between the Company and its affiliate Underwriters Adjustment Company, Inc. (UNACO). Pursuant to the agreement, the Company appointed UNACO to investigate and negotiate settlements of claims and perform all other services customarily performed by insurance adjusters. An estimated fee is paid on a monthly basis payable 15 days after receipt of invoice. True up between estimated fees and actual fees is charged or deducted from fees for the following quarter.

Intercompany Services Agreement

This agreement, entered into on December 1, 2008, is between various named affiliates of American International Group, Inc., including the Company. Pursuant to the agreement, the participating members and their respective non-U.S affiliates, subsidiaries and branches have entered into an agreement for the provision of services and the allocation of costs in order to meet U.S. and worldwide transfer pricing requirements. Each party to the agreement may ask another party to provide services, which include, but are not limited to, administration and other services associated with an insurance and financial services business. All services are provided at cost. However, any services that require a mark-up or other transfer pricing basis to comply with any applicable transfer pricing principles must use the cost schedule attached to the agreement. Each service provider will provide, on a quarterly basis, a written invoice to the

requesting company. The requesting company shall pay the invoice within (60) sixty days after receipt.

Administrative Agreements

The Company is party to four separate administrative agreements with affiliates including CIA, UNACO, New Hampshire Insurance Company and Chartis Caribbean. Pursuant to these agreements, the Company provides management services to the respective affiliate. These services include production administration, human resources, administration, accounting, executive, operations, marketing and client services. A fixed annual fee is paid in monthly installments due no later than thirty days after the conclusion of each month.

Management Agreements

The Company is party to two separate management agreements with affiliates including UNACO, Chartis Caribbean, and Chartis II. Pursuant to the agreements, the Company provides services in the areas of general business administration, human resources, operations, marketing, customer service, telephone system support and information systems services. A fixed annual fee is paid.

IT Agreements

The Company is party to three separate information technology agreements with affiliates including CIA, UNACO and Chartis Caribbean. Pursuant to the

agreements, the Company provides information technology services including data backup, application support, technical assistance, installation, and maintenance. A fixed annual fee is paid in quarterly installments, payable no later than thirty(30) days after the conclusion of each quarter.

Growth of the Company

The following data was obtained from the annual statements filed with the OCS:

Year	Admitted Assets	Liabilities	Company Capital Stock	Gross Paid Contributed Surplus	Unassigned Surplus
2010	\$209,149,388	\$61,830,381	\$2,600,000	\$17,512,000	\$79,055,243
2009	228,980,837	77,778,057	2,600,000	17,512,000	91,838,669

Insurance Products and Related Practices

The Company is authorized to write property and casualty insurance in conformity with Chapter 4 of the Insurance Code of Puerto Rico. For the period covered by this examination, the major kind of insurance and gross premiums written were as follows:

	2010	2009
Fire	\$10,556,764	\$8,788,760
Allied Lines	33,303,171	29,218,598
Homeowners Multiple Peril	857,464	860,664
Commercial Multiple Peril	8,456,335	7,317,684
Ocean Marine	1,226,720	508,424
Inland Marine	5,982,472	4,486,003
Earthquake	15,769,978	15,122,695
Group Accident & Health	3,166,887	3,279,499
Other Accident & Health	1,652,258	1,101,110

	2010	2009
Workers' Compensation	350,917	375,775
Other Liability - Occurrence	11,393,889	17,637,779
Other Liability - Claims-made	16,363,045	17,364,647
Products Liability - Occurrence	1,094,746	852,376
Private Passenger Auto Liability	391,985	492,956
Commercial Auto Liability	3,445,179	3,653,565
Auto Physical Damage	3,150,985	3,682,499
Fidelity	962,599	1,177,218
Surety	14,295	29,892
Burglary and Theft	20,368	16,974
Boiler and Machinery	1,193,747	1,027,069
TOTAL	\$119,353,804	\$116,994,187

Territory and Plan of Operations

For the period covered under this examination, the Company was licensed to transact insurance business in the following territories with the corresponding written gross premiums:

	2010	2009
Puerto Rico	\$119,275,563	\$116,866,226
USVI	78,242	127,962
TOTAL	\$119,353,805	\$116,994,188

Statutory Deposits

As of December 31, 2010, the Company maintained the following statutory deposits with the OCS in compliance with Section 3.151 of the Insurance Code of Puerto Rico.

Description	Maturity Date	Par Value	Amortized Value
Commonwealth Public Improvement	07/01/12	\$400,000	\$416,678
PR Electric Power Authority	07/01/15	400,000	442,389

Description	Maturity Date	Par Value	Amortized Value
PR Commonwealth	07/10/14	475,000	522,105
PR Electric Power Authority	07/01/14	350,000	383,412
TOTAL		\$1,625,000	\$1,764,584

Section 3.151 of the Insurance Code of Puerto Rico requires that a domestic insurer shall not be authorized to transact insurance in Puerto Rico, unless it deposits and maintains on deposit, assets with a value not less than fifty percent (50%) of the amount of the paid-in capital. The deposit is held to protect the Puerto Rico insurance policyholders and creditors.

Section 3.090 of the Insurance Code of Puerto Rico requires the Company to maintain minimum paid-in capital of \$2,600,000 and statutory deposit of not less than \$1,300,000 of amortized value. The Company was in compliance with Section 3.090 of the Insurance Code of Puerto Rico as of December 31, 2010.

Section 3.160 of the Insurance Code of Puerto Rico requires that fifty percent (50%) of the minimum paid in capital be in Puerto Rico securities. The Company maintained investments in Puerto Rico securities in excess of \$1,300,000 at amortized cost. The Company was in compliance with Section 3.160 of the Insurance Code of Puerto Rico as of December 31, 2010.

Unclaimed Funds

The Company complied with Section 26.040 of the Insurance Code of Puerto Rico by reporting unclaimed funds to the OCS, on or before May 1 for the years under examination.

The Company submitted to the OCS the notice of unclaimed funds owed and the payment of the unclaimed funds and was in compliance with Sections 26.050 and 26.060 of the Insurance Code of Puerto Rico.

Reinsurance

Reinsurance Assumed

The Company did not assume any risks during the examination period.

Reinsurance Ceded

As of December 31, 2010, the Company maintained several reinsurance contracts with affiliated and non-affiliated reinsurers. The Company ceded business to six reinsurers which were not authorized by the Commissioner before their use as required by Section 4.120 of the Insurance Code of Puerto Rico.

The reinsurance contracts reviewed complied with NAIC guidelines with respect to the insolvency clause, arbitration clause, transfer of risk, and settlement information deadlines as stated in SSAP No. 62 of the *NAIC Accounting Practices and Procedures Manual*.

Accounts and Records

The Company maintained its principal operational offices in San Juan, Puerto Rico where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements for the year 2010 in compliance with Rule 14a of the Regulations of the Insurance Code of Puerto Rico. Supporting work papers were prepared by the CPA as required by Rule 14a of the Regulations of the Insurance Code of Puerto Rico. The actuarial study and opinion for the period under examination was prepared by Jay B. Morrow, MAAA, FCAS.

Financial Statements

Below are the financial statements of the Company:

- Assets
- Liabilities, Surplus, and Other Funds
- Summary of Operations
- Capital and Surplus Account

Chartis Insurance Company - Puerto Rico

Assets

As of December 31, 2010

	Annual Statement	Examination Adjustments	Examination Balance
Bonds	\$161,259,050		\$161,259,050
Common stocks	15,559		15,559
Cash and short-term investments	27,694,060		27,694,060
Investment income due and accrued	1,416,089		1,416,089
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	13,116,714		13,116,714
Amounts recoverable from reinsurers	5,609,000		5,609,000
Electronic data processing equipment and software	38,916		38,916
Total Assets	<u>\$ 209,149,388</u>		<u>\$ 209,149,388</u>

Chartis Insurance Company - Puerto Rico
Liabilities, Surplus and Other Funds

As of December 31, 2010

	Annual Statement	Examination Adjustments	Examination Balance
Losses	\$ 17,031,889		\$ 17,031,889
Loss adjustment expenses	7,121,496		7,121,496
Commissions payable, contingent commissions and other similar charges	2,459,344		2,459,344
Other expenses	4,767,336		4,767,336
Taxes, licenses and fees	148,281		148,281
Unearned premiums	19,698,767		19,698,767
Advanced premiums	121,321		121,321
Ceded reinsurance premiums payable	6,267,000		6,267,000
Amounts withheld or retained by company for account of others	1,052,320		1,052,320
Provision for reinsurance	2,329,108		2,329,108
Payable to parent, subsidiaries and affiliates	552,269		552,269
Aggregate write-ins for liabilities	281,250		281,250
Total Liabilities	<u>\$61,830,381</u>		<u>\$61,830,381</u>
Aggregate write-ins for special surplus funds	\$48,151,764		\$48,151,764
Common capital stock	2,600,000		2,600,000
Gross paid in and contributed surplus	17,512,000		17,512,000
Unassigned funds (surplus)	79,055,243		79,055,243
Total Surplus	<u>\$147,319,007</u>		<u>\$147,319,007</u>
Total Liabilities and Surplus	<u>\$ 209,149,388</u>		<u>\$ 209,149,388</u>

Chartis Insurance Company - Puerto Rico
Statement of Income

As of December 31, 2010

Underwriting Income

Premiums earned	\$29,312,839
Deductions:	
Losses incurred	
Loss expenses incurred	4,365,021
Other underwriting expenses incurred	3,442,057
Total underwriting deductions	16,169,591
Net underwriting gain or (loss)	<u>\$23,976,669</u>
	\$5,336,170

Investment Income

Net investment income earned	
Net realized capital gains or (losses)	\$5,366,464
Net investment gain or (loss)	6,656.00
	<u>\$5,373,120</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$10,709,290
Dividends to policyholders	<u>0</u>
Net income, after dividends to policyholders, but before federal & foreign income taxes	\$10,709,290
Federal & foreign income taxes incurred	<u>3,062,708</u>
Net Income	<u><u>\$7,646,582</u></u>

Chartis Insurance Company - Puerto Rico
Capital and Surplus Account

As of December 31, 2010

Capital and surplus, December 31, prior year	<u>\$151,202,780</u>
Net income (loss)	\$7,646,582
Change in net realized capital gains or (losses)	(255,055)
Change in net deferred income tax	326,565
Change in non-admitted assets	6,007,496
Change in provision for reinsurance	329,720
Dividends to stockholders	(25,000,000)
Aggregate write-ins for gains and losses in surplus	<u>7,060,918</u>
Net change in capital and surplus for the year	<u>\$(3,883,774)</u>
Capital and surplus, December 31, current year	<u>\$147,319,007</u>

Chartis Insurance Company - Puerto Rico
Reconciliation of Capital and Surplus Account

As of December 31, 2010

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

Capital and Surplus Account
December 31, 2010, per Annual Statement \$147,319,007

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustments proposed			
LIABILITIES:			
No adjustments proposed			
Net Change in Surplus:			<u>0</u>
Capital and Surplus Account			
December 31, 2010, Per Examination			<u><u>\$147,319,007</u></u>

Comments on the Financial Statements

There were no comments regarding the financial statements.

Subsequent Events

The following changes to the Board of Directors occurred subsequent to December 31, 2010:

- Board of Director member Rene Pinto Lugo resigned as of September 14, 2011 and was replaced by John Slabbert on December 14, 2011.
- Board of Director member Sean Clifford resigned as of May 24, 2011 and was replaced by Eduardo Mena on May 24, 2011.

A Form D was filed on November 4, 2011. The Company plans to issue a loan totaling \$26,000,000 to a London affiliate Chartis EMEA Transaction Execution Limited. The affiliate is a newly formed entity, for which financial statements will not be prepared until 2012.

Summary of Examination Recommendations

Use of Unauthorized Reinsurers without Prior Approval

We recommend that the Company properly identify unauthorized reinsurers on the annual statement and obtain prior authorization from the Commissioner before their use as required by Section 4.120 of the Insurance Code of Puerto Rico.

Conclusion

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Chartis Insurance Company - Puerto Rico** as of December 31, 2010, consistent with the insurance laws of Puerto Rico.

In addition to the undersigned, Patricia Casey Davis, CPA, CFE, Manager; John V. Normile, CFE, Staff Examiner, all of InsRis-PR, LLC; Paul Berkebile, CFSA, CISA, Senior Manager and Kevin Ralston, IT Specialist, both of INS Services, Inc.; and James Neidermyer, FCAS, MAAA, Actuary, of INS Consultants, Inc.; participated in the examination.


Patrick White, CFE
Examiner-in-Charge