

REPORT ON EXAMINATION

OF THE

ADIRONDACK INSURANCE EXCHANGE

AS OF

DECEMBER 31, 2008

DATE OF REPORT

JANUARY 29, 2010

EXAMINER

FE ROSALES, CFE

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

January 29, 2010

Honorable James J. Wrynn
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30361 dated June 24, 2009, and attached hereto, I have made an examination into the condition and affairs of Adirondack Insurance Exchange as of December 31, 2008, and submit the following report thereon.

Wherever the designation "the Exchange" appears herein without qualification, it should be understood to indicate Adirondack Insurance Exchange.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Exchange's attorney-in-fact's office at One Beacon Lane, Canton, MA 02021.

1. SCOPE OF EXAMINATION

The Department has performed a single-state examination of Adirondack Insurance Exchange. This is the first financial examination of the Exchange after the report on organization, which was conducted as of May 17, 2006. This examination covered the period from May 18, 2006 through December 31, 2008. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Exchange by obtaining information about the Exchange including corporate governance, identifying and assessing inherent risks within the Exchange 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 when applicable to domestic state regulations.

All accounts and activities of the Exchange were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Exchange’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

- Significant subsequent events
- Exchange history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Pensions, stock ownership and insurance plans
- Territory and plan of operation
- Growth of Exchange
- Loss experience
- Reinsurance
- Accounts and records
- Statutory deposits
- Financial statements
- Summary of recommendations

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF EXCHANGE

Adirondack Insurance Exchange was incorporated under the laws of the State of New York on May 25, 2006. It became licensed on May 25, 2006 and commenced business on the same date. The Exchange was organized by White Mountains Insurance Group, Ltd., Bermuda (“White Mountains”) with an initial surplus to policyholders of \$70,700,000. The initial surplus was provided by Homeland Insurance Company of New York, a subsidiary of White Mountains, pursuant to a loan agreement conforming to Section 1307 of the New York Insurance Law, which provides that such loan may only be repaid out of free and divisible surplus of such insurer with the approval of the superintendent.

A. Management

Pursuant to the Exchange’s declaration of initial subscriber and by-laws, management of the Exchange is vested in the advisory committee consisting of not less than nine members nor more than twelve members. The advisory committee meets annually during each calendar year. At December 31, 2008, the advisory committee was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
J. Paul Amaden, Sr. East Hampton, NY	President and Chief Executive Officer, Amaden Gay Agencies, Inc.
Louis Atti Angola, NY	Vice President, ENB Insurance Agency, Inc.
David R. Bauer Albany, NY	President, Capital Bauer Insurance Agency Inc.
Elizabeth M. Gardner South Hampton, NY	Operations Manager, Maran Corporate Risk Associates, Inc.
Thomas Scott McDaniel Williamsville, NY	President and Chief Executive Officer, Adirondack AIF, LLC

Name and ResidencePrincipal Business Affiliation

John Scherrer
Williamsville, NY

President,
The Northwoods Corporation,
Potter, Harris & Scherrer Agency, Inc.

John Vincent Stype
Aquebogue, NY

President,
Neefus Stype Agency, Inc.

Joseph Tedesco
Harrison, NY

Vice President,
DeRosa, Rockefeller, Sohigian, Werdal Agency

Michael Kelly Zimmerman
Williamsville, NY

Vice President, Claims
OneBeacon Insurance Company

A review of the minutes of the advisory committee's meetings held during the examination period indicated that the two annual meetings were generally well attended and each advisory committee member had an acceptable record of attendance.

However, the review of the minutes of the advisory committee revealed that the investment transactions for the years 2007 and 2008 were not formally voted upon and approved by the advisory committee during its annual meeting. It is important to note that materials which include the investment schedules (acquisitions & disposals report) were presented during the meeting; however, the minutes did not reflect that such materials were approved.

Therefore, it appears that the Exchange did not fully comply with the Section 1411(a) of New York Insurance Law which states in part that:

No domestic insurer shall make any loan or investment ... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan . . .

It is therefore recommended that the advisory committee formally vote and approve the Exchange's investment transactions at every meeting and that the minutes indicate such approvals to ensure full compliance with Section 1411(a) of New York Insurance Law.

As of December 31, 2008, the principal officers of Adirondack AIF, LLC, the Attorney-in-Fact for the Exchange, were as follows:

<u>Name</u>	<u>Title</u>
Thomas S. McDaniel	President and Chief Executive Officer
Dennis Robert Smith	Secretary
Todd Colin Mills	Treasurer
Alexander Constantine Archimedes	Vice President
Bradford Whitman Rich	Vice President and General Counsel

B. Territory and Plan of Operation

As of December 31, 2008, the Exchange was licensed to write business in New York only.

As of the examination date, the Exchange was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
22	Residual value
26	Gap

Based on the lines of business for which the Exchange is licensed and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Exchange is required to maintain a minimum surplus to policyholders in the amount of \$9,900,000.

The following schedule shows the direct premiums written by the Exchange both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a Percentage of Total Premium</u>
2006	\$ 54,566,034	\$ 54,566,034	100.00%
2007	\$189,933,712	\$189,933,712	100.00%
2008	\$181,375,721	\$181,388,084	99.99%

The Exchange's primary focus is providing personal lines property and casualty insurance coverages including but not limited to: automobile, homeowners, personal umbrella and dwelling fire in New York. The Exchange sells these personal lines property and casualty insurance products through a network of independent agents targeting markets in the state of New York.

C. Reinsurance

The Exchange did not assume reinsurance business for the period under examination.

Ceded Reinsurance Program

The Exchange has structured its ceded reinsurance program to limit its maximum exposure on any one risk as follows:

Property

The Exchange's ceded reinsurance program for its property business is to limit its maximum exposure in any one risk to \$1 million. The Exchange maintains an excess of loss coverage for standard losses which consists of one layer. Reinsurers' single loss limit of liability is \$5 million and the total cumulative policy limit is \$20 million during any one contract year.

The Exchange also maintains excess of loss coverage for property loss resulting from catastrophe event consisting of the following four layers.

<u>Type of Treaty</u>	<u>Cession</u>
Property Catastrophe excess of loss – Four layers as follows:	\$290,000,000 excess of \$10,000,000 per occurrence
1 st Layer – 54% authorized	\$10,000,000 excess of \$10,000,000
2 nd Layer – 39% authorized	\$30,000,000 excess of \$20,000,000
3 rd Layer – 58% authorized	\$80,000,000 excess of \$50,000,000
4 th Layer – 56% authorized	\$170,000,000 excess of \$130,000,000

Casualty

The Exchange has structured its ceded reinsurance program for its casualty lines of business to limit its maximum exposure in any one risk to \$1 million. The Exchange maintains an excess of loss coverage for standard losses which consists of one layer. Reinsurers' single loss limit of liability is \$5 million and the total cumulative policy limit is \$15 million.

Personal Line Automobile Quota Share

The Exchange also maintains an 8% quota share program for its personal lines automobile business with the following maximum limits:

- Automobile bodily injury liability: \$500,000 each person, \$1 million each occurrence
- Automobile property damage liability: \$500,000 each occurrence
- Automobile bodily injury and property damage liability (combined single limit): \$1 million each occurrence
- Automobile medical payments: \$50,000 each person
- Automobile property damage: \$500,000 each vehicle
- Personal injury protection: \$100,000 each person

However, in the event that the limits outlined above are exceeded, the reinsurer's liability will not exceed its quota share portion of \$6,250,000 for all coverages, all policies, any one occurrence.

During the period covered by this examination, majority of the Exchange's ceded reinsurance treaties were with authorized reinsurers.

It is the Exchange's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. The examiner did not review these letters of credit for compliance with Department Regulation No. 133 since the amounts held under these letters of credit were not material.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

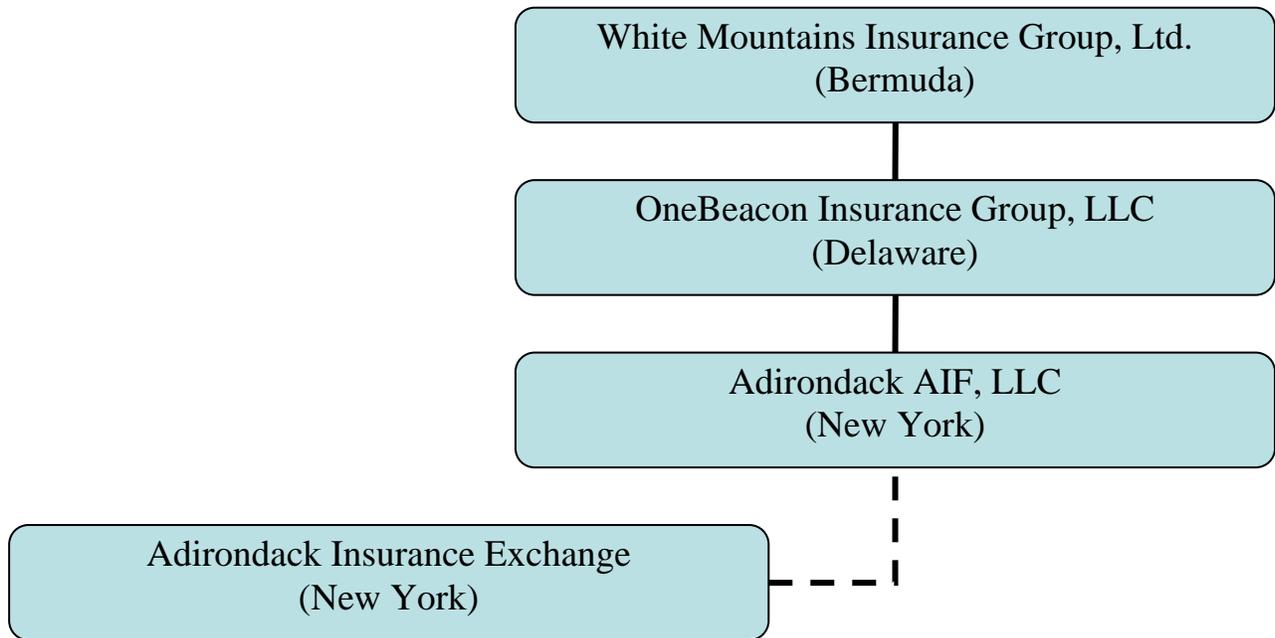
Examination review of the Schedule F data reported by the Exchange in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Exchange's chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Exchange was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

D. Holding Company System

The Exchange is controlled by Adirondack AIF, LLC ("AAIF"), its Attorney-in-Fact. AAIF is a wholly-owned subsidiary of OneBeacon Insurance Group, LLC, which is ultimately controlled by White Mountains Insurance Group, Ltd. of Bermuda.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2008:



At December 31, 2008, the Exchange was party to the following agreements with other members of its holding company system:

1. Insurance Management Service Agreement with Adirondack AIF, LLC.

The Exchange was a party to an insurance management agreement with Adirondack AIF, LLC pursuant to which, AAIF agreed to provide all necessary services for the operation of the Exchange including the right to perform solicitation, underwriting, classification of risk, rating of and premium determination for insurance contracts, adjusting of claims, collection of monies due to the Exchange; issuing, modifying and terminating insurance contracts, and the authority to determine appropriate premiums rates. The management fee is 14% of gross written premiums. It is noted that this agreement was non-objected to by the Department.

2. Investment Management Agreement with White Mountains Advisors, LLC

The Exchange was also a party to an investment management agreement with White Mountains Advisors, LLC ("WMA") pursuant to which, WMA provides investment research and advice, including the execution of orders for the purchase and sale of securities. The agreement states that WMA will act as a discretionary advisor with respect to the assets of the Exchange and supervise the investments as described in the investment guidelines. WMA agrees to provide the Exchange with reports containing the status of the investment account at least monthly, and will

provide written advisory report letters to the Exchange on a quarterly basis. It is noted that this agreement was non-objected by the Department.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2008, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	239%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	75%
Premiums in course of collection to surplus as regards policyholders	23%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the two-year and seven-month period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$182,683,400	60.87%
Other underwriting expenses incurred	140,228,751	46.73
Net underwriting loss	<u>(22,804,111)</u>	<u>(7.60)</u>
Premiums earned	<u>\$300,108,040</u>	<u>100.00%</u>

F. Accounts and Records

A review of the Exchange's accounts, records and annual statement reporting revealed the following:

1. Annual Statement Preparation

During this examination, the following errors in reporting certain items in the filed 2008 Annual Statement have been identified:

- i. In Schedule E – Part 1 – Cash, the Exchange incorrectly identified the bank holding its cash deposit of \$6,144,098 as Bank of America. The correct bank should have been Bank of New York Mellon.

It is recommended that the Exchange exhibit greater care in the preparation of its filed annual statement.

2. Uncollected Premiums Over 90 days Past Due

A review of the filed annual statements as of December 31, 2006, 2007 and 2008 revealed that the Exchange reported “zero” amount under non-admitted assets – (over 90 days past due for the uncollected premiums and agents’ balances in the course of collection - annual statement line 13.1). However, based upon the review of the information provided by the Exchange for uncollected premiums and agents’ balance in course of collection, it was noted that uncollected premiums over 90 days past due amounted to \$174,233.

Section 1301(a)(6) of the New York Insurance Law states in part:

In determining the financial condition of a domestic insurer ... there may be allowed as an admitted assets of such insurer ... Premiums in course of collection ... not more than ninety days past due ...

Based on the above-noted information, the Exchange did not comply with the above-referenced section of the law because it included uncollected premiums over 90 days past due as admitted assets in its 2008 filed annual statement.

It is recommended that the Exchange comply with Section 1301(a)(6) and going forward report all uncollected premiums over ninety days past due as non-admitted assets in future annual statement filed with the Department.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2008 as determined by this examination and as reported by the Exchange:

Assets	<u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$160,012,569	\$ 0	\$160,012,569
Cash, cash equivalents and short-term investments	32,969,774	0	32,969,774
Investment income due and accrued	1,562,903	0	1,562,903
Uncollected premiums and agents' balances in the course of collection	15,349,606	0	15,349,606
Deferred premiums, agents' balances and installments booked but deferred and not yet due	22,495,605	0	22,495,605
Amounts recoverable from reinsurers	944,148	0	944,148
Net deferred tax asset	1,504,309	0	1,504,309
Sundry balances	<u>1,645,533</u>	<u>107,547</u>	<u>1,537,986</u>
Total assets	<u>\$236,484,447</u>	<u>\$107,547</u>	<u>\$236,376,900</u>

<u>Liabilities, Surplus and Other Funds</u>			Surplus
<u>Liabilities</u>	<u>Examination</u>	<u>Exchange</u>	<u>Increase</u> <u>(Decrease)</u>
Losses and Loss adjustment expenses	\$ 66,038,199	\$ 64,102,199	\$(1,936,000)
Commissions payable, contingent commissions and other similar charges	9,061,889	9,061,889	0
Other expenses (excluding taxes, licenses and fees)	2,107,309	2,107,309	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	(1,112,395)	(1,112,395)	0
Unearned premiums	80,154,082	80,154,082	0
Advance premium	1,908,277	1,908,277	0
Ceded reinsurance premiums payable (net of ceding commissions)	1,228,447	1,228,447	0
Amounts withheld or retained by company for account of others	549	549	0
Drafts outstanding	3,139,286	3,139,286	0
Payable to parent, subsidiaries and affiliates	3,164,317	3,164,317	0
Aggregate write-ins for liabilities	<u>4,853,658</u>	<u>4,853,658</u>	<u>0</u>
Total liabilities	<u>\$170,543,618</u>	<u>\$168,607,618</u>	<u>\$(1,936,000)</u>
<u>Surplus and Other Funds</u>			
Surplus notes	\$ 70,700,000	\$ 70,700,000	\$ 0
Unassigned funds (surplus)	<u>(4,866,718)</u>	<u>(2,930,718)</u>	<u>(1,936,000)</u>
Surplus as regards policyholders	\$ <u>65,833,282</u>	\$ <u>67,769,282</u>	\$ <u>(1,936,000)</u>
Total liabilities, surplus and other funds	<u>\$236,376,900</u>	<u>\$236,376,900</u>	

NOTE: The Internal Revenue Service has never audited of the Exchange's Federal Income Tax returns.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$4,866,718 during the two-year and seven-month period examination period May 18, 2006 through December 31, 2008, detailed as follows:

Underwriting Income

Premiums earned		\$300,108,040
Deductions:		
Losses incurred	\$ 53,649,011	
Loss adjustment expenses incurred	29,034,389	
Other underwriting expenses incurred	<u>140,228,751</u>	
Total underwriting deductions		<u>322,912,151</u>
Net underwriting gain or (loss)		\$ (22,804,111)

Investment Income

Net investment income earned	\$16,603,107	
Net realized capital gain	<u>(548,427)</u>	
Net investment gain or (loss)		16,054,680

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (217)	
Finance and service charges not included in premiums	186,323	
Aggregate write-ins for miscellaneous income	<u>405,249</u>	
Total other income		<u>591,355</u>
Net income before dividends to policyholders and before federal and foreign income taxes		<u>\$ (6,158,076)</u>
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ (6,158,076)
Federal and foreign income taxes incurred		<u>(28,943)</u>
Net income		<u>\$ (6,129,133)</u>

Surplus as regards policyholders per report on examination as of May 17, 2006			\$70,700,000
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$ 0	\$6,129,133	
Net unrealized capital gains or (losses)	0	88,080	
Change in net deferred income tax	1,458,042		
Change in nonadmitted assets	<u>0</u>	<u>107,547</u>	
Total gains and losses	<u>\$1,458,042</u>	<u>\$6,324,760</u>	
Net increase (decrease) in surplus			<u>(4,866,718)</u>
Surplus as regards policyholders per report on examination as of December 31, 2008			<u>\$65,833,282</u>

NOTE: This is the first examination of the Exchange.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$66,038,199 is \$1,936,000 more than the \$64,102,199 reported by the Exchange in its December 31, 2008, filed annual statement. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Exchange's internal records and in its filed annual statements.

It is noted that the Exchange has recognized approximately \$970,000 of the estimated deficiency in its 2009 annual statement.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

There is no prior report on examination as this is the first examination of the Exchange.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Advisory Committee formally vote and approve the Exchange's investment transactions at every meeting and that the minutes indicate such approvals to ensure full compliance with Section 1411(a) of New York Insurance Law.	4
B. <u>Accounts and records</u>	
i. It is recommended that the Exchange exhibit greater care in the preparation of its filed annual statement.	11
ii. It is recommended that the Exchange comply with Section 1301(a)(6) and going forward report all uncollected premiums over ninety days past due as non-admitted assets in future annual statement filed with the Department.	11

Respectfully submitted,

_____/s/_____
Fe Rosales, CFE
Associate Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

FE ROSALES, being duly sworn, deposes and says that the foregoing report, subscribed by her,
is true to the best of her knowledge and belief.

_____/s/_____
Fe Rosales

Subscribed and sworn to before me
this _____ day of _____, 2010.

Appointment No. 30361

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, ERIC R. DINALLO, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Fe Rosales

as proper person to examine into the affairs of the

ADIRONDECK INSURANCE EXCHANGE

and to make a report to me in writing of the condition of the said

Exchange

with such other information as she shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of New York,*

this 24th day of June, 2009



A handwritten signature in black ink that reads "Eric R. Dinallo".

ERIC R. DINALLO
Superintendent of Insurance