

REPORT ON EXAMINATION

OF THE

XL REINSURANCE AMERICA INC.

AS OF

DECEMBER 31, 2005

DATE OF REPORT

APRIL 27, 2007

EXAMINER

JAMES CALL

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Appendix



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

April 27, 2007

Honorable Eric R. Dinallo  
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 22429 dated October 28, 2005 attached hereto, I have made an examination into the condition and affairs of XL Reinsurance America Inc. as of December 31, 2005, and submit the following report thereon.

Wherever the designations "the Company" or "XLRA" appear herein without qualification, they should be understood to indicate XL Reinsurance America Inc.

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 Company's main administrative office located at 70 Seaview Avenue, Stamford, CT 06902-6040.

## **1. SCOPE OF EXAMINATION**

The previous examination was conducted as of December 31, 1999. An examination was conducted as of December 31, 2002; however, it was decided to update the examination to as of December 31, 2005. This examination covered the six-year period from January 1, 2000 through December 31, 2005. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a verification of assets and liabilities as of December 31, 2005. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants ("CPA"). A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

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

## **2. DESCRIPTION OF COMPANY**

The Company was organized under the laws of New York on May 6, 1929, as a stock property and casualty company. It was licensed and began business in the same year. The original corporate name was Service Fire Insurance Company of New York. Effective April 1, 1974, the name was changed to North American Company for Property and Casualty Insurance. Effective February 10, 1989, the name was changed to NAC Reinsurance Corporation. The Department approved the Company's name change to XL Reinsurance America Inc. ("XLRA") on January 9, 2001.

From 1939 until 1984, the Company was a wholly owned subsidiary of CIT Financial Corporation ("CIT"). In 1984, CIT transferred ownership of the Company to RCA Corporation, the then parent of CIT. On May 24, 1984, all of the outstanding shares of the Company were purchased by Kramer Capital Corporation ("KCC"). Effective June 27, 1985, NAC Re Corporation, a Delaware corporation, was organized for the purpose of holding all the outstanding shares of common stock of the Company. The Company was controlled by NAC Re Corporation ("NAC Re"), a holding company, until NAC Re was purchased by X.L. America, Inc. ("XLA") on June 18, 1999. XLA is ultimately owned by XL Capital Ltd ("XL Capital"), a Cayman Islands holding company.

On June 18, 1999, XL Capital acquired NAC Re in a pooling of interest stock transaction. As part of the acquisition, XLA, a Delaware holding company, became the new United States holding company parent of NAC Re. Following the acquisition, NAC Re acquired 100% of the common stock of four XLA subsidiaries: XL Capital Assurance Inc. ("XLCA"), a New York financial guaranty insurer; XL Insurance Company of New York, Inc. ("XLINY"), a New York property & casualty insurer; Intercargo Corporation ("Intercargo"), a Delaware corporation and parent of XL Specialty Insurance Company ("XL Specialty"), an Illinois property & casualty insurer; and ECS, Inc. ("ECS"), a Pennsylvania corporation, which provides underwriting, claims and other services to the property and casualty insurance and reinsurance industry. NAC Re previously owned two other insurance companies: Greenwich Insurance Company and Indian Harbor Insurance Company.

In December 2002, all of the issued and outstanding shares of common stock of XL Insurance America, Inc. (formerly known as Winterthur International America Insurance Company), a Delaware domiciled insurer ("XLIA"), were contributed by XLA to XLRA, thereby making XLIA a wholly-owned subsidiary of XLRA. As a result of the contribution of XLIA to XLRA, XLIA's wholly-owned subsidiary, XL Select Insurance Company (formerly known as Winterthur International America

Underwriters Insurance Company), an Oklahoma domiciled insurer, is now an indirect wholly-owned subsidiary of XLRA.

In June 2003, XLRA contributed all of the issued and outstanding shares of XLIA to Greenwich Insurance Company. XLRA also contributed all of the issued and outstanding shares of Indian Harbor Insurance Company (“IHIC”) to XL Specialty Insurance Company, and all of the issued and outstanding shares of XLINY to XLIA.

At December 31, 2005 capital paid in was \$5,000,000 consisting of 40,000 shares of common stock at \$125 par value per share. Gross paid in and contributed surplus is \$1,854,742,562. Gross paid in and contributed surplus increased by \$1,391,133,600 during the examination period, as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
12/31/1999	Beginning gross paid in and contributed surplus		463,608,962
2000	Capital contribution from NAC Re	\$120,000,000	
2001	Capital contribution from NAC Re	186,000,000	
2002	Capital contribution from NAC Re	410,000,000	
2002	Capital contribution from X.L. America, Inc.	110,298,221	
2003	Capital contribution from X.L. America, Inc.	553,081,620	
2004	Capital contribution from X.L. America, Inc.	12,627,342	
2004	Capital Stock Dividend	(800,000)	
2005	Capital Stock Dividend	<u>(73,583)</u>	
	Net increase during exam period		<u>1,391,133,600</u>
12/31/2005	Ending gross paid in and contributed surplus		<u>\$1,854,742,562</u>

A. Management

Pursuant to the Company’s charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. The by-laws provide that the board shall meet at least four times during each calendar year. At December 31, 2005, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Steven Peter Agosta Rye, NY	Vice President, General Counsel and Secretary, XL Reinsurance America Inc.
	Director, Vice President and Secretary, NAC Re Corporation
Christopher Frederic Buse Wilton, CT	Senior Vice President and Manager, Casualty Treaty, XL Reinsurance America Inc.

Name and ResidencePrincipal Business Affiliation

Robert Moore Copp  
Locust Valley, NY

Senior Vice President and Manager, Ocean Marine,  
XL Reinsurance America Inc.

Gregory Alan Douglas  
Ridgefield, CT

Senior Vice President and Manager, Casualty Facultative,  
XL Reinsurance America Inc.

Robert Zygmunt Gorski  
Greenwich, CT

Vice President and Chief Information Officer,  
XL Reinsurance America Inc.

Brian Paul Greenspan  
Sandy Hook, CT

Senior Vice President and Chief Financial Officer,  
XL Reinsurance America Inc.

David John Hughes  
Orange, CT

Senior Vice President and Manager, Claims Management,  
XL Reinsurance America Inc.

Henry Charles Vaughan Keeling  
Smith's Parish, Bermuda

Executive Vice President and Chief Operating Officer,  
XL Capital Ltd

Director, President and Chief Executive Officer,  
EXEL Holdings Limited

Director,  
XL Insurance (Bermuda) Ltd.

Michael William Meyer  
Manhasset, NY

Senior Vice President,  
XL Reinsurance America Inc.

Thomas William Muller  
Monroe, CT

Senior Vice President and Manager, Property Facultative,  
XL Reinsurance America Inc.

Robert Louis Nason  
Shelton, CT

Executive Vice President,  
XL Reinsurance America Inc.

James Howell Veghte  
New Canaan, CT

Chairman, President and Chief Executive Officer,  
XL Reinsurance America Inc.

Executive Vice President and Chief Executive of  
Reinsurance General Operations,  
XL Capital Ltd

Director, Chairman and Chief Executive Officer,  
NAC Re Corporation

Director and President,  
X.L. America, Inc.

Name and ResidencePrincipal Business Affiliation

John Patrick Welch  
Trumbull, CT

Senior Vice President, Chief Actuary and Strategic  
Planning Officer,  
XL Reinsurance America Inc.

President and Chief Operating Officer,  
NAC Re Corporation

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

The Company was unable to provide signed statements from each of the members of its board of directors indicating that he or she had received and read the prior report on examination of the Company. Section 312(b) of the New York Insurance Law requires that a copy of the report on examination of the Company "shall be furnished by such insurer or other person to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's files confirming that such member has received and read such report."

It is recommended that the Company furnish each member of the board with a copy of the report on examination and retain a signed statement from each board member that he or she has received and read such report pursuant to the provisions of Section 312(b) of the New York Insurance Law.

As of December 31, 2005, the principal officers of the Company were as follows:

NameTitle

James H. Veghte  
Steven P. Agosta  
Gabriel G. Carino III  
Christopher F. Buse  
Robert M. Copp  
Gregory A. Douglas  
Brian P. Greenspan  
David J. Hughes  
Michael W. Meyer  
Thomas W. Muller  
Robert L. Nason  
John P. Welch

Chairman, President and Chief Executive Officer  
Vice President, General Counsel and Secretary  
Vice President and Treasurer  
Senior Vice President and Manager, Casualty Treaty  
Senior Vice President and Manager, Ocean Marine  
Senior Vice President and Manager, Casualty Facultative  
Senior Vice President and Chief Financial Officer  
Senior Vice President and Manager, Claims Management  
Senior Vice President  
Senior Vice President and Manager, Property Facultative  
Executive Vice President  
Senior Vice President, Chief Actuary and  
Strategic Planning Officer

B. Territory and Plan of Operation

As of December 31, 2005, the Company was licensed to write business in all fifty states, the District of Columbia, Puerto Rico, and Canada.

As of the examination date, the Company 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>
3	Accident and health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company is also authorized to write workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. as amended; 33 USC Section 901 et seq. as amended) and as authorized by Section 4102(c) of the New York Insurance Law, insurance of every kind or description outside of the United States and reinsurance of every kind or description.

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum policyholders surplus in the amount of \$35,000,000.

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

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premium</u>	<u>Premiums Written in New York State as a percentage of Total Premium</u>
2000	\$13,799	\$1,195,828	1.15%
2001	\$1,193	\$335,723	0.36%
2002	\$3,222	\$9,278	34.73%
2003	\$0	\$42,105	0.00%
2004	\$566	\$19,988,229	0.00%
2005	\$594	\$52,076,667	0.00%

The Company is primarily engaged in providing facultative and treaty reinsurance to primary insurers of casualty risks (principally general liability, automobile, aviation and workers' compensation) along with commercial property risks (including fidelity/surety and ocean marine). XLRA and its insurer subsidiaries, Greenwich Insurance Company, Indian Harbor Insurance Company, XL Specialty Insurance Company, XLINY, XLIA, and XL Select Insurance Company, are members of an intercompany reinsurance pooling agreement, which is more fully described in Section 2(C) "Reinsurance" of this report.

The Company operates both as a treaty reinsurer, producing business through brokers, as well as a facultative reinsurer, underwriting property and casualty business directly within the United States and Canada.

### C. Reinsurance

#### Assumed

Assumed reinsurance accounted for approximately 99% of the Company's gross premium written ("GWP") at December 31, 2005, with 74% of GWP attributed to business assumed via the Company's inter-company reinsurance pooling agreement and the remainder from non-affiliated ceding companies.

During the period covered by this examination, the Company's affiliated assumed business has increased by 454% while non-affiliated assumed reinsurance has increased 92%. The ratio of affiliated assumed business to GWP increased from 50% in 2000, to its present level while business assumed from

outside sources decreased from 50% to 25%. Direct business at the date of this exam made up less than 2% of gross written premium.

The Company's assumed reinsurance program consists mainly of property, casualty and multi-line coverage assumed on a quota share and excess of loss basis, pursuant to the terms of facultative and treaty agreements with both authorized and unauthorized cedants. Additionally, the Company's participation in various voluntary pools is reflected in its assumed reinsurance activity. The Company utilizes reinsurance accounting as defined in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62 for its assumed reinsurance business reviewed.

#### Inter-Company Pooling Agreement

Effective July 1, 1999, the Company participates in an inter-company pooling agreement with various affiliated companies, with the Company functioning as pool leader. Effective January 1, 2002, the pooling agreement was amended to provide that cessions to the pool would occur on a gross of external reinsurance basis. Effective January 1, 2003 the agreement was amended to change the pooling percentages. The agreement and subsequent amendments thereto were submitted to and non-disapproved by this Department.

Under the pooling agreement, 100% of all members' gross premium, losses, insurance expenses and other related underwriting activity of the pool members are ceded to XLRA, the pool leader, except for finite reinsurance produced by XLRA's finite reinsurance business unit and primary financial guaranty. XLRA purchases external reinsurance on behalf or itself and its pool members for business that was written by the pool members and XLRA. Seventy five percent of the premium and losses net of external reinsurance is then ceded to XL Re Ltd (an affiliate) under a quota share reinsurance treaty. The net after the cession to XL Re Ltd is then pooled and a retrocession made to each pool member in proportion to its pool year participation percentage.

All ceded reinsurance balances related to the external ceded reinsurance contracts are recorded in the statutory financial statements of XLRA, and all reinsurers, which are parties to the contracts, are included in XLRA's Schedule F. Only XLRA has a contractual right of direct recovery from non-affiliate reinsurers per the terms of the reinsurance agreements placed by XLRA on behalf of itself and its pool members. Any Schedule F penalty is shared by the pool members in accordance with their pool

year participation percentages. XLRA and each of the pool members have an option of establishing a “Funds withheld balance”, which may be maintained until cancellation of the agreement. The Funds withheld balance, pursuant to the pooling agreement, at any given time shall be equal to net premiums due, less net paid losses, and less net underwriting expenses, but exclusive of investment costs.

Pool membership and participation at the beginning and end of the exam period was as follows:

	<u>12/31/1999 –</u> <u>12/31/2002</u>	<u>1/1/2003 –</u> <u>12/31/2005</u>
XL Reinsurance America Inc.	76%	65%
Greenwich Insurance Company	5%	12%
XL Insurance America, Inc. (f/k/a Winterthur International America Insurance Company)		10%
XL Select Insurance Company		2%
XL Insurance Company of New York, Inc.	7%	3%
XL Specialty Insurance Company	7%	6%
Indian Harbor Insurance Company	5%	2%
Total	100%	100%

#### Ceded

The Company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows for its material lines of business:

- Property Lines

Reinsurance program provides for a structure of quota share and excess of loss layered coverage offering protection up to \$600 million per risk. The Company’s maximum net exposure was approximately \$80 million due to the \$15 million retention and the \$15 million annual aggregate deductible on the first layer, the \$15 million first layer only being 46% placed and the \$300 million fifth layer only being 86% placed.

Additionally, the Company has property per event coverage in place to provide protection for an accumulation of losses in the event of a large property catastrophe such as a windstorm or earthquake. The first layer, which was 91% placed covers \$100 million excess of a \$130 million net retention and is for losses occurring worldwide. The second layer, which was 95% placed covers \$150 million excess of \$230 million and is for United States all perils. The third layer, also 95% placed, covers \$60 million excess of \$380 million and pertains to US earthquake only.

The Company has a program of catastrophe coverage for business produced, underwritten and administered for and on behalf of the Company by International Catastrophe Insurance Managers, LLC consisting of a 75% excess of 25% of \$350 million CAT excess of loss contract, which was approximately 23% placed, and an uncapped CAT peril quota share

contract, which was only 23.75% placed. There is also an aggregate excess of loss \$100 million excess of \$100 million contract (\$5.7 million franchise deductible per event) net after the quota share that covers natural perils only, which was 67% placed.

- Casualty Lines

Reinsurance program provides primary casualty excess of loss layered coverage up to \$100 million with net exposure of approximately \$66 million due to a \$20 million retention, \$28.75 million annual aggregate deductible and only a 56% placement of its \$40 million excess \$60 million second layer.

The excess book is additionally protected per risk by two quota share treaties covering the global book of excess casualty business. One quota share is on a claim made/occurrence notification basis and was 57.5% placed with the other quota share written on an occurrence basis with 50% placed.

- Aerospace

The general aviation program provides excess of loss layered coverage for hull and liability. The program provides per risk coverage for damage to hull up to \$10 million with a \$2 million retention. The program provides per risk protection for liability loss with limits up to \$100 million and a maximum retention of \$10 million. There is an event cover in place that provides per occurrence protection to protect against a loss that involves both hull and liability in the same occurrence. The event coverage provides protection of up to \$8 million excess of \$4 million. In addition, there is a 20% quota share in place up to \$12 million.

The aviation program provides excess of loss layered protection against airline losses and includes coverage for hull, liability and products up to \$185 million with the Company retaining the first \$4 million.

Other Coverage

- Engineering – The Company’s engineering portfolio is protected by a per risk excess of loss program consisting of two layers (\$30 million excess of a \$10 million retention).
- Environmental – The Company has pollution covers providing per risk protection for pollution sites and services. There is a workers’ compensation \$5 million excess of \$5 million cover providing per occurrence protection for workers’ compensation coverage written for environmental customers. Additionally, the Company has a property cover in place as well as an umbrella quota share cover covering umbrella liabilities written for environmental customers.
- Professional – Per risk protection for professional liability risks including D&O, E&O, etc. The Company, for its design professional segment, has per risk protection for architects and engineers business and clash protection in the event multiple insureds are involved in the same loss occurrence.

- Marine and Offshore Energy – There are per risk excess of loss covers with various layers in place up to \$5 million for the Company’s hull/cargo and liability business (not all layers were fully placed). Above \$5 million up to \$50 million there are layered whole account covers in place covering the Company’s hull/cargo, liability and energy business. In addition, the Company has a 25% quota share agreement covering hull and a 42% quota share covering energy. Also, the Company has a Trident marine quota share agreement that protects the writings of the Trident Managing General Agency that writes low limit marine business on the Company’s behalf.
- Workers Compensation CAT – The treaty provides catastrophe protection for all workers compensation lines written by the insurance segment. The treaty consists of several layers providing protection up to \$150 million with a \$10 million retention. The second and third layers offering protection between \$20 million and \$100 million additionally offer terrorism protection on approximately 20% of their placement.
- Surety – For the Company’s surety lines, there is per risk coverage offering excess of loss protection up to \$55 million.
- Specie – Protects the global book of specie business, including U.S. business, against risk and event losses for both physical damage and terrorism risks, by way of a series of excess of loss placements offering protection up to \$150 million excess of \$2.5 million for other than natural catastrophe. For natural catastrophe, the retention is \$5 million.

After application of its external reinsurance program, the Company cedes 75% of its remaining net retention for all lines of business to its Bermuda based affiliate, XL Re Ltd, via a quota share treaty. Under the terms of the agreement, the Company cedes 75% of its net premiums and liabilities in return for commission income as determined by the agreement. The net amount owed pursuant to the agreement is determined on a quarterly basis. Settlement is to be made within 45 days from the end of the quarter. The agreement may be terminated by either party with 180 days written notice.

In order for the Company to obtain credit for reinsurance ceded under the agreement for the reinsurer’s share of losses and loss adjustment expenses that have not been recovered from the reinsurer and outstanding and incurred but not reported loss, unearned premium reserves and contingency reserves, the Company is entitled to withhold security from the reinsurer and/or the reinsurer may provide a letter of credit or trust account.

Non-objection to the agreement was obtained from the Department on October 04, 2002, providing certain amendments were included in the executed agreement, which were, and the agreement

became effective on April 01, 2003. On October 2, 2003, the Department non-objectioned to the Company changing the agreement's ceding commission from 36% to 33% effective July 1, 2003.

XL Re Ltd has established trust accounts for the benefit of XLRA totaling \$7,004,611,252 to support the recoverables owed under various contracts including amounts related to the above noted agreement. There are three trust agreements associated with this balance. The first trust agreement dated April 1, 2002, between XL Re Ltd, XLRA and Mellon Bank, N.A., London Branch, incorporates three separate trust accounts totaling \$6,004,611,252. The Company submitted a request for approval on March 26, 2002 and non-objection to the agreement was obtained from the Department on April 18, 2002. The second trust agreement, also between XL Re Ltd, XLRA and Mellon Bank, N.A., London Branch, was non-disapproved by the Department on February 25, 2003. There is one trust account totaling \$500,000,000 for this agreement. A third trust agreement was entered into July 11, 2003 between XL Re Ltd, XLRA and The Bank of New York, and was non-disapproved by the Department on March 23, 2003. There is one trust account totaling \$500,000,000 for this agreement.

Also in place with XL Re Ltd is an adverse development reinsurance agreement ("ADC") effective January 1, 2004, which provides protection on an aggregate excess of loss basis for adverse development (\$500,000,000 maximum coverage), net of all other available reinsurance, which occurred during the calendar period January 1, 2004 to December 31, 2005, on the Company's pre-pooled net retained reserves held at December 31, 2003 related to policies written or assumed during underwriting years 1985 through 2000. The Company received approval from the Department to treat the ADC cover as prospective reinsurance.

For the year ended December 31, 2005, the Company ceded out 88.2% of its gross written premium. 64.7% of the gross written premium was ceded to its affiliates via its pooling agreement and other affiliated reinsurance agreements approved by the Department. Of the total ceded premium, the Company ceded 81% to unauthorized reinsurers; 66.1% of the total ceded premium was to unauthorized affiliates.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. In addition to the letters of credit ("LOC") in place with individual reinsurers, the Company had two parental LOC's in place for the benefit of XLRA as of December 31, 2005, totaling \$329,727,522. The parental LOC's were submitted to the Department on December 22, 2005 and approved on January 13, 2006.

Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114, respectively.

Our review determined that several LOC's were not in compliance with Department Regulation No. 133. Various instances were noted where the LOC did not name XLRA as beneficiary or stated governance by a state other than New York. In one instance, the LOC was dated four days after the reporting date.

It is recommended that the Company take steps to ensure that all LOC comply with all of the required provisions of Department Regulation 133.

The Company identified an LOC on Schedule F, Part 5 as provided by Winterthur Swiss Insurance Company. Upon review it was determined that the applicant was XL Insurance (Bermuda) Ltd. Of the \$32 million total LOC balance listed for Winterthur Swiss Insurance Company, \$9 million of the LOC showed XL Insurance (Bermuda) Ltd., as applicant on behalf of XL Winterthur Int'l (Bermuda) Ltd. The remaining LOC showed XL Insurance (Bermuda) Ltd. as the applicant. The Company failed to provide notice to the Department as required by the New York Insurance Law Section 1505(d) of these affiliated transactions.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that the Company entered into several multiple cedant reinsurance contracts where various affiliates, (in addition to those participating in the inter-company pooling agreement), were also parties to the agreement. These agreements were not filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

It is recommended that the Company notify the superintendent of transactions with affiliates as required by Section 1505(d) of the New York Insurance Law.

The Company's ceded reinsurance contracts in effect in 2005 were reviewed to determine if they contained required clauses, including an insolvency clause, meeting the requirements of Section 1308 of the New York Insurance Law. It was noted that approximately 20% of the contracts reviewed included multiple cedants that are affiliates of the Company, but are not participants in the inter-company pooling agreement. Where a reinsurance agreement includes multiple cedants that are not participants in a

pooling agreement, it is the Department's position that such agreements must contain the following clause:

"Each party to this contract agrees to honor the terms set forth herein as if the contract were a separate agreement between the reinsurer and each individual named reinsured. Balances payable or recoverable by any reinsurer or each individual named reinsurer or individual named reinsured shall not serve to offset any balances payable or recoverable to or from any other reinsured party to the contract. Reports and remittances made to the reinsurer in accordance with the applicable articles are to be in sufficient detail to identify both the reinsurer's loss obligations due each reinsured and each reinsured's premium remittances under the report."

It is recommended that reinsurance arrangements, where the Company participated in coverage with other cedants, be amended to contain acceptable language for agreements with multiple reinsureds.

It was noted during examination that the Gentle Winds Trust Agreement did not contain a provision required by Part 126.3(g) of Department Regulation No. 114, stating that written notification of termination shall be delivered by the trustee to the beneficiary at least 30 days, but not more than 45 days, prior to termination of the trust account.

It is recommended that the Company review and amend any trust agreements that are not in compliance with Part 126.3(g) of Department Regulation No. 114.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to not accurately reflect its reinsurance transactions. Instances were noted where the Company re-allocated ceded incurred but not reported ("IBNR") recorded for insolvent reinsurers to solvent ones so as to take advantage of the reduction in reserves (see Section 12 of this report for information on an exam adjustment related to this matter). Additionally, the Company took credit for collateral held in the form of letters of credit against ceded recoverables due from unauthorized reinsurers, where the Company was not named as beneficiary. Finally, due to the decentralized and inconsistent nature of the operating business units' ("OBU") reporting structure, the Company was unable to aggregate its data into a cohesive company-wide report detailed by reinsurer and contract. This made verification of the underlying balances very difficult and time consuming.

It is recommended that the Company improve its capability of aggregating Schedule F data by reinsurer and contract at the legal entity level.

Management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by an attestation from the Company's chief executive officer and chief financial officer pursuant to NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was party to seven finite reinsurance agreements. The ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 17-26 of SSAP No. 62. The aforementioned finite reinsurance contracts were accounted for utilizing paragraph 2 of SSAP No. 75.

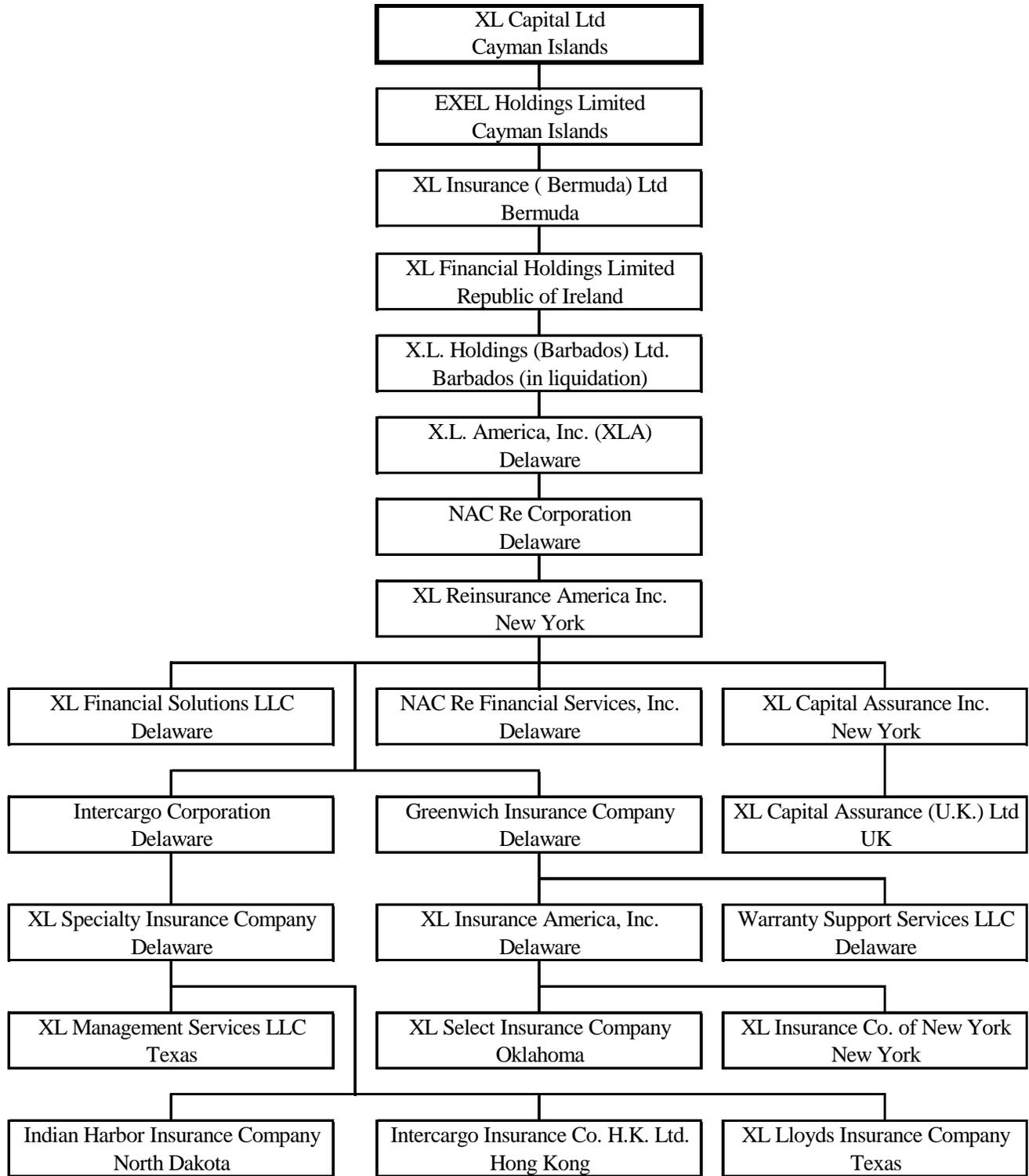
During the period covered by this examination, the company commuted various reinsurance agreements where it was the ceding company. These commutations resulted in a loss of \$20 million to the Company's surplus position. All but one of the commuted reinsurance agreements were with unaffiliated reinsurers.

D. Holding Company System

The Company is a member of the X.L. America, Inc. Group. The Company is a wholly owned subsidiary of NAC Re Corporation, a Delaware corporation, which is ultimately controlled by XL Capital Ltd, a Cayman Islands holding company.

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.

A complete organization chart as of December 31, 2005, which details members of the system, is shown in Appendix A. The following is an abridged chart of the holding company system at December 31, 2005:



In addition to the intercompany pooling arrangement previously discussed in the reinsurance section of this report, the Company was a party to the following agreements with other members of its holding company system at December 31, 2005:

Second Amended and Restated General Services Agreement

This agreement is between XLA, the service provider, XLRA and the pool companies, as well as various other affiliated insurance and non-insurance entities of XLA. XLA provides management and general services such as legal and auditing, data processing, and regulatory compliance to the affiliates. The effective date of the agreement is January 1, 2003. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and was non-disapproved.

Amended and Restated General Services Agreement

This agreement is between XL Global Services, Inc., as service provider, and XLA, with various insurance and non-insurance affiliates, including XL Reinsurance America Inc., and its pool companies. Per the agreement, XL Global Services, Inc. is to provide various information technology services, reinsurance services, actuarial services, human resource services and miscellaneous services. The agreement has an effective date of January 1, 2003. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and non-objected to on January 24, 2003.

Services Agreement

This agreement has an effective date of July 1, 2004, and is between XL Financial Solutions, LLC, the provider, and XL Reinsurance America Inc. Per the agreement, XL Financial Solutions, LLC provides technical, analytical and structuring services relating to insurance and reinsurance, structured finance and other financial reinsurance and alternative reinsurance transactions, actuarial, legal and financial services relating to such transactions, transaction maintenance and other administrative support, new product development, preparation of board presentations, agreements and other support materials, hiring and supervision of third party consultants, including professional advisors to XL Reinsurance America Inc. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and non-objected to on August 23, 2004.

### Management Agreement

XL Investment Management Ltd. provides investment management, financial advisory and related administrative services to XL Reinsurance America Inc. XL Investment Management Ltd. has the authority, subject to the terms of the agreement, to act on behalf of the Company in all such matters, including the power to retain and terminate investment managers, agents and subcontractors pursuant to an agreement substantially in the form of the master investment management agreement appended to this agreement. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law. The agreement was non-objected to on November 8, 2004, but did not become effective until July 26, 2005.

### Investment Advisory Agreement

XL Capital Investment Partners Inc., provides on-going due diligence with respect to investments in certain "Portfolio Companies", as identified on Exhibit A to the agreement, including the tracking of their actual financial performance, and advice, recommendations and actions to XL Reinsurance America Inc. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and was non-objected to on November 2, 2005. The executed agreement was submitted January 23, 2006 with an effective date of May 1, 2005.

### Fifth Amended Tax sharing and Payment Agreement

This tax sharing and payment agreement with an effective date of April 1, 2004 is between X.L. America, Inc. and XL Reinsurance America Inc. and its pool participants, and various insurance and non-insurance affiliates. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and non-objected to on April 8, 2004.

Department Circular Letter No. 33 (1979) states that intercompany tax settlements should be made within 30 days of the filing of the actual consolidated federal corporate income tax return. The Company filed its consolidated tax return on September 15, 2006 (after obtaining an automatic 6 month extension using form 7004). The Company is not in compliance with Circular Letter No. 33 (1979), as the balance was not settled with X.L. America, Inc. until December 2006. Additionally, the Company's fifth amended tax sharing and payment agreement calls for payments to be made by the subsidiary each year on or before the date on which the consolidated return of the affiliated group is required to be filed without regard to any extension of time that may be required for the filing of the consolidated return.

The Company is not in compliance with the agreement as settlement of the intercompany balances did not occur until December 2006.

It is recommended that the Company settle its federal income tax related intercompany balances in accordance with Department Circular Letter No. 33 (1979) and the Company's fifth amended tax sharing and payment agreement.

#### Amended and Restated Surplus Maintenance Agreement

This agreement with an effective date of February 20, 2004, is between XL Reinsurance America Inc. and XL Capital Assurance Inc. XLRA agrees to financially support XL Capital Assurance Inc., its subsidiary, as permitted by Sections 1408(a) and 1409(a) of the New York Insurance Law to maintain the subsidiary's surplus at a minimum of \$75,000,000. The agreement was filed with the Department pursuant to Section 1505 of New York Insurance Law and was non-objected to on April 12, 2004.

#### Contribution Agreement

This agreement effective December 31, 2005 between X.L. America, Inc. and XL Reinsurance America Inc., the subsidiary, provides for the contribution of cash and or readily marketable securities to ensure the subsidiary's risk based capital ratio is at approximately 275% of the authorized control level. The agreement was filed with the Department pursuant to Section 1505 of New York Insurance Law and non-objected to on January 9, 2006. No payments were made under this agreement. The Company had similar contribution agreements for each of the previous years covered by the examination that were non-objected to by the Department. Additionally, the Company had in place at December 31, 2005, separate contribution agreements between itself and two of its subsidiaries, one with Greenwich Insurance Company and one with XL Specialty Insurance Company. Both agreements are similar to the agreement between the Company and its parent as to maintaining the subsidiaries' risk based capital ratios at approximately 275% of the authorized control level. These two agreements were filed with Department pursuant to Section 1505 of New York Insurance Law and non-objected to on January 9, 2006.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2005, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	32%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	99%
Premiums in course of collection to surplus as regards policyholders	7%

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 six-year period covered by this examination:

	<u>Amount</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$2,162,184,443	102.13%
Other underwriting expenses incurred	410,368,168	19.38
Net underwriting gain	<u>(455,449,458)</u>	<u>(21.51)</u>
Premiums earned	<u>\$2,117,103,153</u>	<u>100.00%</u>

F. Accounts and Records

The Company reports all financial accounting transactions using the Peoplesoft General Ledger application. Statutory financial statements are prepared utilizing the Freedom software package. Enterprise Portfolio System ("EPS") is utilized for the Company's investments. The Company additionally utilizes WINS, Genius and Phoenix as its primary commercial insurance processing systems for U.S. business. The functions include policy and claim administration. These systems also serve as source systems for policy production, financial reporting, and statistical reporting. The systems for reinsurance accounting include Destiny and RSG. The standardized insurance accounting procedures are employed in transactions involving premiums, losses, expenses and valuation of assets and liabilities resulting from the operations of the Company.

During the course of the review of the Company's accounts and records the operational and organizational controls in place were analyzed. In general, it appears the Company has a sufficient level

of controls in place. However, the following record keeping deficiencies were noted during the course of the current examination:

i. December 31, 2005 Annual Statement Errors

Management incorrectly posted escheatable funds to “Amounts withheld or retained by company for the account of others.” The escheatable funds should have been reported as “Aggregate Write Ins for Liabilities.”

It was also noted during exam that one of the sixteen operating business units within the X.L. America, Inc. Group, the Global Risk operating business unit, had been incorrectly posting cash receipts and disbursements to “Advance premiums.” The Company should instead have been posting to “Remittances and items not allocated.”

The Company reported in the Notes to Financial Statements - Note 13(1) that, "The Company has 40,000,000 shares, authorized, issued and outstanding. All shares are Class A shares." According to the stock ledger and physical certificates, XLRA has only 40,000 shares issued and outstanding.

The Company's reconciliation of Schedule E - Part 3 - Special Deposits reflected \$12,660,000 in cash held for Markel Corp Grantor Trust. However, this cash was not confirmed by HSBC. The Company indicated that the Markel Trust amount was misstated and that the \$12,660,000 cash was a typo and should not have been reported. Additionally it was noted that the \$12.66 million balance was not reported on Schedule E - Part 1 or in the general ledger.

The Company's Annual Statement, Schedule D - Part 2 - Section 2 reflected three common stock investments in subsidiaries of the Company: Greenwich Insurance Company, Intercargo Corporation, and XL Capital Assurance.

The stock certificates for the Company's investments in Intercargo Corporation and XL Capital Assurance did not agree to the number of shares as reported on Schedule D - Part 2 - Section 2. The Intercargo Corporation stock certificate reflected 20,000 shares, while Schedule D reflected 7,293,581 shares. XL Capital Assurance's stock certificate reflected 2,000 shares while Schedule D reflected 5,000 shares.

In addition, it was noted that the number of shares (Column 5) multiplied by the rate per share used to obtain fair value (Column 7) did not equal fair value as reported on Schedule D - Part 2 - Section

2 for all three common stock investments as of December 31, 2005 in accordance with NAIC Annual Statement Instructions.

The Company's reported accrued retro premium amount in Footnote #24 does not agree with the amount reported on page 2 of the statement.

The examination performed an analytical review of the commission expense as a percentage of written premiums during the examination period. It was noted that in the Company's 2003 Annual Financial Statement, commissions of \$37,678,704 were reported as being paid on \$42,105 of direct premiums. The Company's management indicated that an error had occurred in the reporting of assumed commissions as direct.

It is recommended that the Company follow the NAIC Annual Statement Instructions when completing its Annual Statements and classify financial statement items into the proper account.

ii. Documentation Supporting Balance Sheet Amounts

During review of "Other expenses", it was noted that the Company did not provide the detail to support the banking fees accrual that was part of the Other Expenses accrual at December 31, 2005.

It is recommended that the Company maintain supporting detailed records and produce same upon examination for any amounts it reports in its financial statements, henceforth.

iii. Escheatable Funds

During review of the Company's escheatment process, it was noted that the Company did not have an operational system in place to capture information needed to correctly track and report escheatable property to the various states, nor could the Company provide a listing of payees showing name and last known address. Additionally, the Company was not able to provide documented control procedures, which ensure that voided and re-issued checks were eliminated from the list.

It is recommended that the Company maintain adequate records and controls in order to satisfy notification provisions relating to abandoned property and ensure that any unclaimed amounts are remitted to the appropriate state and accounted for properly.

iv. Settlement of Inter-Company Balances

The Company does not have a comprehensive process in place to age and settle intercompany balances in a timely manner. The detail data making up the intercompany balance transactions is maintained only in the source underwriting systems and the Company does not have a process in place within these subsystems to age the intercompany balances and the Company was unable to provide documentation to determine compliance with Department Circular Letter No. 15 (1975). The examination noted that balances outstanding with XL Capital, Ltd., ECS, Inc. and XL Re, Ltd were more than a year old. These balances each showed as a net payable by the Company. The Company indicated that it would be using a new general ledger system in 2007, which will allow for a greater level of detail to be captured within the general ledger. The Company has initiated a global task force to address the issue as the settlement process involves more than one intercompany account and more than one currency.

It is recommended that the Company develop and implement a comprehensive process to age and settle intercompany account balances in a timely manner and that it maintain and provide upon examination documentation sufficient to determine compliance with Department Circular Letter No. 15 (1975).

v. Classification of Expenses

The NAIC Property and Casualty Annual Statement Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers states the following:

- “Fees and expenses of examination by insurance departments or other governmental agencies are to be included in Taxes licenses and fees.” The Company recorded account #223018 - State Examination Fees under “Other expenses.”
- “Gross Guaranty Association Assessments should be recorded in Taxes, licenses and fees.” The Company reported the accrual for account #222150 - Central Guarantee Fund Control in “Other Expenses.”
- “Any other taxes not assignable under A, B, C and not otherwise excluded should be recorded in Taxes, licenses and fees.” The Company reported the accrual for account #234110 - Federal Excise Taxes in “Other Expenses.”

It is recommended that the Company properly classify expenses according to the NAIC's Property and Casualty Annual Statement Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers.

vi. Accounting Issues

During review of the Company's data files, it was noted that the Company uses various cutoff dates for recognizing written premiums from its operating business units. Although the Company uses the cutoff dates to recognize its written premium, the Company used the December 31, 2005 date in calculating its unearned premium reserve ("UPR"). This accounting underestimates the Company's year-end UPR for annual statement reporting purposes. The NAIC Accounting Practices and Procedures Manual, SSAP No. 53, paragraph 5 indicates that written premiums for all other written contracts, excluding workers' compensation contracts, shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve shall be established to reflect the amount of premium for the portion of the insurance coverage that has not expired.

It is recommended that the Company set up accruals for both written premium and unearned premium reserve that represent the written premium and the unearned premium reserve from the cutoff dates to year-end.

As part of the Company's early close process the Company posts claim payments made after the close of the claims subsystems, but before the reporting date, as "Remittances and items not allocated". According to SSAP No. 67, paragraph 9, the "Remittances and items not allocated" account is for unidentified cash receipts otherwise known as suspense accounts. Claim payments made subsequent to the subsystem closing, but prior to the reporting date should be recorded as adjusting entries to the claim reserves at year-end.

It is recommended that the Company properly classify claims paid after the early close as reductions to outstanding loss reserves and not as "Remittances and items not allocated."

Per results of the examination's premium data testing, it was noted that the Company incorrectly posted advanced premiums. Both the XL Global Risk and XL Programs operating business units record premium with effective dates after year-end as written premium. The written premium was offset by unearned premium for the same amount. SSAP No. 53, paragraph 13 states that:

“Advanced premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.”

It is recommended that the Company comply with SSAP No. 53, paragraph 13 when recording advance premiums.

vii. CPA Contract

The Company’s contract with its external auditors for 2005 was not in compliance with the requirements of Department Regulation 118, as it did not contain all the required language nor was it executed by both parties.

It is recommended that the Company ensure that all future contracts entered into with its independent certified public accountants comply with Department Regulation 118 and are properly executed.

viii. Directors & Officers Department (“D & O”) Coverage – Regulation 110

XL Capital Ltd, the ultimate parent company of XLRA has a D&O indemnity policy covering the Company. The certificate of insurance does not contain coinsurance amounts for directors and officers as required by Department Regulation 110.

The Company is subject to the requirements of Department Regulation 110 under Part 72.1(c) which states that:

"Retention amounts and coinsurance are both required, in accordance with this Part, for D&O indemnification policies issued to corporations formed under the Insurance Law, Religious Corporations Law, Cooperative Corporations Law, Transportation Corporations Law, or any other law of this state, where provisions of such laws make such corporations subject to Business Corporation Law (“BCL”) section 727 or N-PCL section 727."

The directors and officers policy covering the Company is not in compliance with Department Regulation 110 regarding the minimum coinsurance percentage amount specified in Part 72.4.

It is recommended that the directors and officers policy covering the Company be brought into compliance with Department Regulation 110 regarding the minimum coinsurance percentage for D&O indemnity coverage as specified in Part 72.4 as regards the New York domiciled insurers.

ix. Information Systems Review

The following weaknesses were noted during review of the Company's Information Technology ("IT") systems and controls:

- The Company's WINS IT system does not make use of automated tools to ensure that the source code used corresponds to the most recent version of the program; and, the Company's Financial Data Repository ("FDR") application does not use automated controls for checking out and checking in source code to ensure that only one programmer modifies a program's source code. Lack of strong controls around production source code increases the risk of unauthorized access and use of automated systems.
- During the period under examination, it was noted during review and testing, the Company had weak access controls. Weak access controls increase the risk of unauthorized access to computing resources that could result in compromising servers, storage tapes, and sensitive data that is present in the server room.
- Internal audit noted that the claims department maintains a manual diary, and recommended that the diary/log should be electronic to facilitate the consistent tracking of claims files for review, and to provide for the future expansion of the Department. Management indicated that an electronic diary is planned for implementation during the first quarter of 2006.
- During the review of documentation controls for one application, it was noted that the organization does not have a documentation standards manual; utilize a documentation check-off list and specify a minimum level of documentation to ensure that all required documentation is prepared, approved, and maintained for all systems and/or programs. Documentation controls help ensure that accurate and relevant documentation is prepared for all new systems and for changes to existing systems and/or programs.
- During the review of the Company's system security authorization process, it was noted that the Company does not use a system security authorization form, but alternatively relies on the new hire process to evidence initial access approval, and thereafter, on the periodic re-certification process to ensure user access is commensurate with job responsibilities. For 55 of 76 (72%) users tested, the Company could not provide supporting documentation to enable testing. Consequently, the sample error rate was too high to permit calculation of an upper error limit for the attributes associated with this test.
- Additionally, during the review of the Company's application security authorization process, it was noted that the Company does not use a standard process to document user application access. One application uses an application authorization form. Another application uses a different form to authorize initial access. No evidence was provided to indicate that six other applications use an

application authorization form. For 45 of 76 (59%) users tested, the Company did not provide supporting documentation to enable testing. Consequently, the sample error rate was too high to permit calculation of an upper error limit for the attributes associated with this test.

- The review of the Company's Sarbanes Oxley ("SOX") testing revealed that weekly virus scans were not run for all weeks in a recent month for three of the ten users sampled. The Company could incur risks associated with the loss and corruption of data, disclosure of sensitive information, and productivity losses associated with reduced service levels, and platform and data recovery efforts.
- During the review of the Company's Business Contingency Plan, the IT examiners noted that the plans for a number of the Company's facilities are not current or complete. In one case, issues identified during 2003 walkthroughs of the plans remained open. In one other case, plans for that facility were not available. Without current and complete business continuity plans, the Company is at risk of being unable to recover and/or function in a timely manner from a disaster.
- During the review of the Company's documentation for disaster recovery, the IT examiners noted that the Company did not have a comprehensive, executable disaster recovery plan. Additionally, the list of applications to be recovered was incomplete, and did not contain data from four critical applications. The names of specific individuals authorized to declare a disaster on behalf of the Company was not documented in the plan and the Company's WAN was not tested in 2005. Review of Internal Audit reports revealed that one financially significant application disaster recovery plan was last tested two years ago and a formally documented disaster recovery plan was unavailable for another application.

It is recommended that the Company address the weaknesses noted in the IT review, as noted above, in order to strengthen controls and security within its IT environment.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2005 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u> <u>Assets Not</u> <u>Admitted</u>	<u>Net Admitted</u> <u>Assets</u>	<u>Company</u> <u>Net Admitted</u> <u>Assets</u>	<u>Surplus</u> <u>Increase</u> <u>(Decrease)</u>
Bonds	\$2,627,877,273	\$0	\$2,627,877,273	\$2,627,877,273	\$0
Preferred stocks	2,935,574	0	2,935,574	2,935,574	0
Common stocks	636,998,507	60,912,739	576,085,768	636,998,507	(60,912,739)
Cash, cash equivalents and short-term investments	104,432,883	5,438,572	98,994,311	104,432,883	(5,438,572)
Other invested assets	27,046,332	0	27,046,332	27,046,332	0
Receivable for securities	7,031,924	0	7,031,924	7,031,924	0
Investment income due and accrued	25,608,567	0	25,608,567	25,608,567	0
Uncollected premiums and agents' balances in the course of collection	156,020,025	39,791,269	116,228,756	119,192,975	(2,964,219)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	284,339,572	0	284,339,572	284,339,572	0
Accrued retrospective premiums	4,336,300	433,630	3,902,670	4,336,300	(433,630)
Amounts recoverable from reinsurers	413,783,754	0	413,783,754	360,334,894	53,448,860
Funds held by or deposited with reinsured companies	279,990,898	380,698	279,610,200	279,990,898	(380,698)
Current federal and foreign income tax recoverable and interest thereon	3,772,658	0	3,772,658	0	3,772,658
Net deferred tax asset	161,435,044	78,353,691	83,081,353	83,081,353	0
Guaranty funds receivable or on deposit	5,300,352	0	5,300,352	5,300,352	0
Receivables from parent, subsidiaries and affiliates	38,077,338	0	38,077,338	38,077,338	0
Aggregate write-ins for other than invested assets	<u>89,681,863</u>	<u>2,453,924</u>	<u>87,227,939</u>	<u>88,901,371</u>	<u>(1,673,432)</u>
Total assets	<u>\$4,868,668,864</u>	<u>\$187,764,523</u>	<u>\$4,680,904,341</u>	<u>\$4,695,486,113</u>	<u>\$(14,581,772)</u>

Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Losses and loss adjustment expenses	\$1,586,858,798	\$1,439,506,981	\$(147,351,817)
Reinsurance payable on paid losses and loss adjustment expenses	24,877,627	24,877,627	0
Commissions payable, contingent commissions and other similar charges	16,341,515	13,932,118	(2,409,397)
Other expenses (excluding taxes, licenses and fees)	49,493,143	49,493,143	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	17,902,250	17,902,250	0
Current federal and foreign income taxes	37,070,647	37,070,647	0
Unearned premiums	268,880,323	267,183,119	(1,697,204)
Advance premium	66,592,216	66,592,216	0
Ceded reinsurance premiums payable (net of ceding commissions)	610,224,492	610,224,492	0
Funds held by company under reinsurance treaties	132,120,571	132,120,571	0
Amounts withheld or retained by company for account of others	2,215,754	2,215,754	0
Remittances and items not allocated	(106,681,647)	(106,681,647)	0
Provision for reinsurance	84,668,592	76,209,332	(8,459,260)
Payable to parent, subsidiaries and affiliates	92,819,036	92,819,036	0
Payable for securities	23,157,612	23,157,612	0
Aggregate write-ins for liabilities	<u>93,408,082</u>	<u>92,711,446</u>	<u>(696,636)</u>
Total liabilities	<u>\$2,999,949,011</u>	<u>2,839,334,697</u>	<u>\$(160,614,314)</u>
<u>Surplus and Other Funds</u>			
Common capital stock	\$5,000,000	\$5,000,000	\$ 0
Gross paid in and contributed surplus	1,854,742,562	1,854,742,562	0
Unassigned funds (surplus)	<u>(178,787,232)</u>	<u>(3,591,146)</u>	<u>(175,196,086)</u>
Surplus as regards policyholders	<u>\$1,631,546,750</u>	<u>\$1,856,151,416</u>	<u>\$(175,196,086)</u>
Total liabilities, surplus and other funds	<u>\$4,680,904,341</u>	<u>\$4,695,486,113</u>	<u>\$ (14,581,772)</u>

**NOTE:** The Internal Revenue Service (“IRS”) has completed its audits of the Company’s consolidated Federal Income Tax returns through tax year 2002. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. There are no current IRS tax audits. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2003 through 2005. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$1,456,004,256 during the six-year examination period January 1, 2000 through December 31, 2005, detailed as follows:

Underwriting Income

Premiums earned		\$2,117,103,153
Deductions:		
Losses and loss adjustment expenses incurred	\$2,162,184,435	
Other underwriting expenses incurred	407,703,627	
Aggregate write-ins for underwriting deductions	<u>2,664,541</u>	
Total underwriting deductions		<u>2,572,552,603</u>
Net underwriting gain or (loss)		\$(455,449,450)

Investment Income

Net investment income earned	\$482,984,493	
Net realized capital gain	<u>45,659,825</u>	
Net investment gain or (loss)		528,644,318

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$296,904	
Finance and service charges not included in premiums	0	
Aggregate write-ins for miscellaneous income	<u>(7,948,547)</u>	
Total other income		<u>(7,651,643)</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$65,543,225
Dividends to policyholders		<u>150,775</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$65,392,450
Federal and foreign income taxes incurred		<u>26,584,433</u>
Net Income		<u>\$38,808,017</u>

Capital and Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 1999			\$175,542,494
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$ 38,808,017		
Net unrealized capital gains or (losses)	27,395,497		
Change in net unrealized foreign exchange capital gain (loss)	8,326,848		
Change in net deferred income tax	13,907,496		
Change in nonadmitted assets		39,901,937	
Change in provision for reinsurance	10,685,808		
Cumulative effect of changes in accounting principles		2,688,817	
Capital changes transferred from surplus (stock dividend)	800,000		
Surplus adjustments paid in	1,392,007,183		
Surplus adjustments transferred to capital (stock dividend)		873,583	
Aggregate write-ins for gains and losses in surplus	<u>56,946,324</u>	<u>0</u>	
Total gains or losses in surplus	<u>\$1,548,877,173</u>	<u>\$43,464,337</u>	
Net increase (decrease) in surplus			<u>1,505,412,836</u>
Surplus as regards policyholders per report on examination as of December 31, 2005			<u>\$1,680,955,330</u>

**4. COMMON STOCKS**

The examination admitted asset of \$576,085,768 is \$60,912,739 less than the \$636,998,507 reported by the Company as of December 31, 2005. The Company has several subsidiaries that participate in the Company's intercompany pooling agreement. These subsidiaries were examined in conjunction with the Company as part of this multi-state examination. The disallowance of \$60,912,739 represents the cumulative decrease in surplus of the subsidiaries as a result of this examination.

**5. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS**

The examination admitted asset of \$98,994,311 is \$5,438,572 less than the \$104,432,883 reported by the Company as of December 31, 2005. Examination review of the Scotia Bank reconciliation disclosed the Company overstated its reported balance as of December 31, 2005 by \$5,438,572. While the Company's bank reflected a balance of \$12,216,635, the Company's 2005

Annual Financial Statement, Schedule E – Part 1 reflected a balance of \$17,655,207. The misstatement was the result of 2004 third quarter adjustments, which were incorrectly posted. The Company corrected these entries in 2006. Cash was overstated by \$5,438,572. Funds held by or deposited with reinsured companies was overstated by \$380,698 and Federal income tax recoverable was understated by \$3,772,658. The overall surplus effect was a decrease of \$2,046,612. See sections 9 and 10 of this report for additional information.

It is recommended that the Company properly report its cash balances on Schedule E-Part 1 and on the Assets page of its filed financial statements as required by the NAIC Quarterly and Annual Statement Instructions.

#### **6. UNCOLLECTED PREMIUMS AND AGENTS' BALANCES IN THE COURSE OF COLLECTION**

The examination admitted asset of \$116,228,756 is \$2,964,219 less than the \$119,192,975 reported by the Company as of December 31, 2005. During the review of Agents' balances, it was noted that the Company failed to book \$2,857,495 for the XL Specie OBU as a 90 day overdue balance at December 31, 2005. This is a pooled amount of which XLRA had a 65% share, or \$1,857,372.

The Company was not able to age the agents' balance for Vianet Program in the OBU XL Programs due to a lack of policy level detail received from the MGA. Therefore, the total balance of \$1,702,841 for Vianet Program has been non-admitted. The Company's share of this pooled amount was \$1,106,847.

It is recommended that the Company ensure that they post all non-admitted premium receivable balances in compliance with SSAP No. 6.

#### **7. ACCRUED RETROSPECTIVE PREMIUMS**

The examination admitted asset of \$3,902,670 is \$433,630 less than the \$4,336,300 reported by the Company as of December 31, 2005. SSAP No. 66, paragraph 9 requires that the Company, at a minimum, non-admit either 10% or an amount calculated using factors listed under Section d of paragraph 9 of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss adjustment expense reserves), or collateral, not

otherwise used. It was noted during review that the Company could not provide documentation to determine if there were offsets. The examination has non-admitted 10% of the reported pool balance of \$6,671,231 to comply with the requirements of SSAP No. 66, paragraph 9. The Company's share of the pooled adjustment of \$667,123 is 65%, or \$433,630.

It is recommended that the Company perform a review each year to determine if any accrued retrospective premiums should be non-admitted per the requirements of SSAP No. 66, paragraph 9 and that the Company retain the necessary documentation to substantiate the recorded balance.

## **8. AMOUNTS RECOVERABLE FROM REINSURERS**

The examination admitted asset of \$413,783,754 is \$53,448,860 more than the \$360,334,894 reported by the Company as of December 31, 2005. During the exam period, XL Reinsurance America Inc. over-ceded a total of \$172,486,819 in reserves (on a pooled basis) that was associated mainly with the 2003 accident year, to XL Re Ltd., an affiliate. The over-cession pertained to a 75% quota share agreement in effect between XL Re Ltd. and XL Reinsurance America Inc. on behalf of itself and its pool members. Part of the correcting entries made by the Company in 2006 was to increase Amounts recoverable from reinsurers by \$82,229,016, of which XLRA has a 65% pooling share. Overall surplus effect to the pool was a decrease of \$90,257,803. See Section 12 "Losses and loss adjustment expenses" for additional information.

It is recommended that the Company take steps to implement controls to ensure future cessions are allocated correctly and ensure that future financial statements are completed correctly in compliance with the NAIC Annual Statement Instructions.

## **9. FUNDS HELD BY OR DEPOSITED WITH REINSURED COMPANIES**

The examination admitted asset of \$279,610,200 is \$380,698 less than the \$279,990,898 reported by the Company as of December 31, 2005. As noted in section 5, the Company overstated this asset as a result of 2004 third quarter adjustments, which were incorrectly posted. The Company corrected these entries in 2006.

**10. CURRENT FEDERAL AND FOREIGN INCOME TAX RECOVERABLE AND INTEREST THEREON**

The Company reported no admitted asset under this caption as of the examination date. This examination has established the captioned admitted asset in the amount of \$3,772,658. As noted in section 5, the Company understated this asset as a result of 2004 third quarter adjustments, which were incorrectly posted. The Company corrected these entries in 2006.

**11. AGGREGATE WRITE-INS FOR OTHER THAN INVESTED ASSETS**

The examination admitted asset of \$87,227,939 is \$1,673,432 less than the \$88,901,371 reported by the Company as of December 31, 2005. It was noted during the review of deductible recoverables that thirty-four of the balances had negative receivable amounts. Twelve of these were in the Genius system and twenty-two were from the old GAIN system. The Company acknowledged that the negative recoverable balances occur when the cash received does not exactly match the balance outstanding or where there needs to be additional investigation and clean-up done as it appears that cash may have been applied to the wrong claim number or the company has received cash that was applied in Genius when the corresponding claim entry was made in GAIN.

The examination also noted that the Company had balances in Genius of \$2,496,493 and in GAIN of \$195,463.79, which were over 90 days past due. These amounts were non-admitted for examination purposes in accordance with SSAP No. 65, paragraph 37, which states that:

"Deductible recoverables that are greater than ninety days old shall be non-admitted."

After application of cash received that was not processed against these balances of \$117,447, the non-admitted portion for the pool was \$2,574,510. The Company's portion of this balance was \$1,673,432.

It is recommended that the Company comply with SSAP No. 65, paragraph 37, and non-admit uncollateralized recoverables with balances over 90 days past their contractual due date, or billing date if no contractual due date has been established.

## 12. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$1,586,858,798 is \$147,351,817 more than the \$1,439,506,981 reported by the Company in its December 31, 2005, filed annual statement. The examination change is due to the following:

As noted in Section 8 “Amounts recoverable from reinsurers” above, during the exam period, XL Reinsurance America Inc. over-ceded a total of \$172,486,819 in reserves (on a pooled basis), to XL Re Ltd., an affiliate. The over-cession pertained to a 75% quota share agreement in effect between XL Re Ltd. and XL Reinsurance America Inc. on behalf of itself and its pool members. The Company made correcting entries in 2006. The Company’s share of the \$172,486,819 was \$112,116,432.

As disclosed in Notes to Financial Statements No. 25 of the Company’s 2006 Annual Statement, the Company reserves showed a deficiency after taking into account the one time adjustment associated with the over-cession. Based on a review of the deficiency, the examination has increased the liability for losses for the pooled companies by \$32,325,000. The Company’s portion of the increase was \$21,014,000.

Review of XL Capital Group internal audit department reports noted a finding relating to re-allocation of ceded IBNR, disclosed in a report dated July 6, 2005. This finding described a Company practice of re-allocating the portion of ceded IBNR attributable to insolvent reinsurers, to solvent reinsurers, thereby taking credit in Schedule F and as part of this captioned liability for IBNR recoverables due from insolvent reinsurers.

Further examination inquiry into this issue resulted in the Company providing supporting documentation detailing re-allocated IBNR totaling \$21,879,054 in the 2005 Annual Statement Schedule F, and \$13,435,545 in the 2004 Schedule F. The Company stated that no re-allocation was made in 2003. The recognition of reinsurance recoverable assets or recoverable liabilities due from insolvent reinsurers is contrary to the requirements of SSAP No. 62, paragraphs 17, 26 and 58.

The Company provided a schedule detailing the ceded IBNR balances due from insolvent reinsurers at December 31, 2005 and December 31, 2004, along with a listing of solvent reinsurers to whom balances were re-allocated. According to management, the Company wrote off IBNR balances due from insolvent reinsurers in the amount of \$29,190,276 in 2006 and discontinued this practice. The write-off included the reallocated balances carried at December 31, 2005 as well as current balances

reported in the first six months of 2006. The Company's portion of the \$21,879,054 for 2005 was \$14,221,385.

It is recommended that the Company comply with SSAP No. 62, paragraphs 17, 26 and 58 by not taking credit in Schedule F and the loss reserve liability for ceded IBNR recoverables due from insolvent reinsurers.

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 Company's internal records and in its filed annual statements.

### **13. COMMISSIONS PAYABLE**

The examination liability of \$16,341,515 is \$2,409,397 more than the \$13,932,118 reported by the Company in its December 31, 2005, filed annual statement. XLRA was unable to provide valid support for general ledger account No. 208723 - Ceded profit commission (debit balance) in the amount of \$3,287,498 as of December 31, 2005. The Company's portion of this pooled account was \$2,136,874.

Also, the Company did not accrue for the profit sharing commission payable to Heartland Crop for the Crop Hail and MPC I business written in 2005. Heartland Crop had a 45% profit sharing commission on the business. The estimated liability for the profit sharing commission due on 2005 business was \$11,180,443 before reinsurance. After the 85% quota share and the 75% quota share with XL Re Ltd, the net liability for the pool should have been \$419,266. The Company's portion of this pooled account was \$272,523.

It is recommended that the Company establish proper procedures to ensure that it record proper accruals for its obligations and maintain adequate records to support account balances recorded in the general ledger and in financial statements filed with this Department.

#### **14. UNEARNED PREMIUMS**

The examination liability of \$268,880,323 is \$1,697,204 more than the \$267,183,119 reported by the Company in its 2005 filed annual statement. It was noted during examination that the Company incorrectly calculated unearned premium reserves (“UPR”) for the XL Professional OBU on "run-off" policies. The Company underwrites directors’ & officers’ liability, employment practices liability and insurance agents/brokers/company errors and omissions coverages. Run-off policies occur when an event changes the original make-up of the company (i.e. acquisition, change of board members or merger), which causes the original board of directors to be left without D&O coverage. The original D&O policy goes into run-off upon the trigger event and the unearned premium is returned to the client. A run-off premium is charged to provide an extended reporting period normally for three to six years, for coverage to the directors for the original policy period up to the date of the event. This is done because the exposure period is in the past, and the policy premium received for the run-off policy is not subject to the return premium process. The run off endorsement states that the premium is fully earned on the date of the event and will not be returned to the client if the endorsement is cancelled. The Company was not carrying any UPR on this type of policy. This is contrary to the requirements of SSAP No. 65, paragraph 7 that states:

“When a reporting entity issues an extended reporting endorsement or contract and the preceding claims made policy terminates, the reporting entity assumes liability for unreported claims and expense.” It further states that “For coverage for a fixed period, premium shall be earned over the term of the fixed period, the reporting entity shall establish an unearned premium reserve for the unexpired portion of the premium and shall record losses as reported.”

The Company provided the examination with its underwriting and actuarial pricing assumptions, which showed a six-year earnings pattern that earns premiums 90% in the first year, 6% in the second year, and 1% per year in each of the remaining four years. The Department’s consulting actuary reviewed the Company's earning pattern and the examination has accepted the assumptions for examination purposes. This treatment was also found to be consistent with the guidance in SSAP No. 53, paragraph 6, Property and Casualty Contracts. Based on the Company’s assumptions, the recalculated UPR, after taking into account the 75% quota share was \$2,611,083 higher than what the Company had booked on a pooled basis. The Company’s portion of the \$2,611,083 amount was \$1,697,204.

It is recommended that the Company comply with SSAP No. 65, paragraph 7 and SSAP No. 53, paragraph 6 in the calculation of unearned premium reserve for its “run off” policies.

## **15. PROVISION FOR REINSURANCE**

The examination liability of \$84,668,592 is \$8,459,260 more than the \$76,209,332 reported by the Company in its 2005 filed annual statement. Reinsurance recoverables for all X.L. America pool members are reported in the Company’s Schedule F, in accordance with the X.L. America Group reinsurance pooling agreement. In the case of the AAU voluntary pool, which the Company’s affiliate Greenwich Insurance Company is a member, ceded reinsurance contracts for AAU accounts name Associated Aviation Underwriters or Associated Aerospace Underwriters as the named reinsured. Letters of credit securing loss recoverable due from unauthorized reinsurers of the AAU pool similarly name Associated Aviation Underwriters or Associated Aviation Underwriters, Inc. (pool manager) as the beneficiary.

The Company reported paid loss recoverables due from authorized reinsurers of Associated Aviation Underwriters (“AAU”), totaling \$18,247,000 as of December 31, 2005. These balances were reported as current receivables in the Company’s Schedule. F, Part 4. Examination of the Company’s monthly recoverable roll forward reports and AAU account statements, determined that the entire amount was over 90 days old at December 31, 2005.

The Company reported total reinsurance recoverables for authorized and unauthorized AAU reinsurers of \$121,598,106 in its 2005 annual statement Schedule F, Part 3. No provision for reinsurance for the AAU account was included in its 2005 Annual Statement since it considered all authorized balances to be current and unauthorized balances to be covered by LOC. Re-calculation of the aging of paid recoverables determined that 100% of the balance was over 90 days old. Taking these factors into account, recalculation of the provision for reinsurance for AAU accounts resulted in an addition to the provision of \$13,014,246. This recalculation included provisions for overdue authorized reinsurance and unsecured unauthorized balances. XLRA’s pooled portion of this balance was \$8,459,260.

It is recommended that the Company comply with NAIC Annual Statement Instructions for Schedule F, Part 4 in the aging of its paid losses and loss adjustment expenses recoverables.

## **16. AGGREGATE WRITE-INS FOR LIABILITIES**

The examination liability of \$93,408,082 is \$696,636 more than the \$92,711,446 reported by the Company in its December 31, 2005, filed annual statement.

The Company did not accrue for services rendered by KPMG at December 31, 2005. KPMG was engaged in 2005 to perform audits of claims processing and procedures. KPMG was paid \$1,071,748 for the services in March 2006. The accrual is on a pooled basis, of which the Company's portion amounted to \$696,636.

## **17. SUBSEQUENT EVENTS**

On August 1, 2006, the Company disposed of its wholly-owned subsidiary, XL Capital Assurance Inc., ("XLCA") a mono-line writer of financial guaranty insurance. The transaction was completed via the sale of all of XLCA's shares to an XL Capital affiliate. The Company received \$275 million in exchange for the shares of XLCA. The Company recorded a realized gain of \$18.3 million upon completion of the sale. Simultaneous with the sale of XLCA, the Company entered into an adverse development reinsurance agreement ("ADC") with XLCA. Under the terms of the ADC, in exchange for receipt of contractual installment premium, the Company has provided the aggregate excess of loss coverage for adverse development up to a specified limit of liability on risk attached under two financial guaranty insurance policies issued by XLCA. The Company has no amounts receivable or payable under the agreement as of December 31, 2006. The Company plans to obtain indemnification from its parent, X.L. America, for reimbursement of any and all potential liabilities incurred under the ADC with its previous owned subsidiary, XLCA. If such recoveries were to occur, the Company would reflect a capital contribution under this gain contingency equivalent to losses sustained under the ADC. In July 2008, the Company entered into a Commutation Agreement with XLCA with respect to the Second Amended and Restated Master Facultative Certificate effective as of March 1, 2007, pursuant to which the Company agreed to reinsure certain liabilities of XLCA. In addition, the Company commuted the terms of the ADC and the related indemnification agreement became a nullity.

The Company purchased a 100% interest in the Canadian Branch of XL Re Europe Ltd. on July 01, 2006. The branch was then fully merged with the existing XLRA Canadian branch and will operate

as a single entity writing property and casualty business throughout Canada. The transaction was accounted for as a statutory purchase, with a purchase price of U.S. \$46.8 million.

On November 13, 2006, the Company completed the dissolution of its wholly-owned subsidiary, Intercargo Corporation, a Delaware corporation, resulting in a realized loss of \$7.4 million.

On January 31, 2007, the Company closed a purchase and sale agreement between the Company as seller and its affiliate XL SGS Holdings Inc., a Delaware corporation, as purchaser pursuant to which the purchaser received all the Company's membership interests in Stanfield Global Strategies LLC, an unaffiliated Delaware limited liability company, and in return the Company received \$36,045,455.

## **18. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report on examination contained fifteen recommendations as follows (page numbers refer to the prior report):

<u>ITEM:</u>	<u>PAGE NO.</u>
<b>A. <u>Reinsurance</u></b>	
i. It is recommended that the Company submit all amendments to the pooling agreement to the Department for approval, in accordance with Section 1505(d)(2) of the New York Insurance Law.	9
The Company has complied with this recommendation.	
ii. It is recommended that the Company account for all reinsurance cessions that have not been signed within nine months as deposit accounting as set forth in Chapter 22 of the NAIC Accounting Practices and Procedures Manual.	13
The Company has complied with this recommendation.	
iii. It is also recommended that the Company comply with Section 1308(a) of the New York Insurance Law and maintain full and complete reinsurance agreements with insolvency clauses.	13
The Company has complied with this recommendation.	
iv. It is recommended that the Company exercise due care in maintaining sufficient documentation and records to support the amounts reported in Schedule F of future filed annual statements.	13
The Company has complied with this recommendation.	
<b>B. <u>Holding Company System</u></b>	
i. It is recommended that the Company follow the Annual Statement Instructions when completing Schedule Y of the annual statement and include all required affiliates.	14
The Company has complied with this recommendation.	
ii. It is recommended that the Company comply with Section 1603(a) of the New York Insurance Law and notify the Department prior to making an acquisition of a majority of a corporation's outstanding shares.	15
The Company has complied with this recommendation.	

<u>ITEM:</u>	<u>PAGE NO.</u>
iii. It is recommended that the Company enter into written agreements that provide for all expenses to be properly allocated among members of the holding company system.	16
The Company has complied with this recommendation.	
C. <u>Abandoned Property Law</u>	
i. It is recommended that the Company retain copies of all abandoned property filings until the examination report for those years has been filed.	17
The Company has complied with this recommendation	
D. <u>Section 310 of the New York Insurance Law</u>	
i. It is recommended that the Company comply with Section 310(a)(3) of the New York Insurance Law.	18
The Company has complied with this recommendation.	
ii. It is further recommended that the Company take the following corrective action to facilitate future examinations:	18
a. The role of the Company contact person is to facilitate the examination. Individuals assigned to this function must have broad authority and appropriate knowledge;	
b. Responses should be qualitatively reviewed before submission to examiners;	
c. Sufficient human resources must be committed to facilitate the examination process.	
The Company has complied with this recommendation.	
E. <u>Accounts and Records</u>	
1. <u>Annual Statements</u>	
i. It is recommended that the Company take proper care when completing the annual statement and classify all balances correctly.	18
The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.	
ii. It is recommended that the Company maintain support for all annual statement balances.	19

ITEM:PAGE NO.

The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.

2. Reinsurance Payable On Paid Losses & Loss Adjustment Expenses

- i. It is recommended that the Company report accurate amounts in its filed annual statements. 19

The Company has complied with this recommendation.

- ii. It is recommended that the Company comply with Section 1505(b) of the New York Insurance Law and maintain support for all transactions with affiliates. 20

The Company has complied with this recommendation.

3. Interest and Dividend Income Due and Accrued

- i. It is recommended that the Company use a more accurate system for calculating interest and dividend income due and accrued. 20

The Company has complied with this recommendation.

## 19. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A	
<u>Management</u>	
It is recommended that the Company comply with Section 312(b) of the New York Insurance Law by furnishing each member of the board a copy of the report on examination and retaining a signed statement from each board member that he or she has received and read such report.	6
B.	
<u>Reinsurance</u>	
i.	
It is recommended that the Company take steps to insure that all letters of credit comply with all of the required provisions of Department Regulation 133.	14
ii.	
It is recommended that the Company notify the superintendent of transactions with affiliates as required by Section 1505(d) New York Insurance Law.	14
iii.	
It is recommended that reinsurance arrangements, where the Company participated in coverage with other cedants, be amended to contain acceptable language for agreements with multiple reinsureds.	15
iv.	
It is recommended that the Company review and amend any trust agreements that are not in compliance with Part 126.3(g) of Department Regulation No. 114.	15
v.	
It is recommended that the Company develop a uniform reporting structure for all OBU that will facilitate the aggregation of Schedule F data by reinsurer and contract at the legal entity level.	15
C.	
<u>Holding Company</u>	
It is recommended that the Company settle its federal income tax related intercompany balances in accordance with the Department Circular Letter No. 33 (1979) and the Company's fifth amended tax sharing and payment agreement.	20
D.	
<u>Accounts and Records</u>	
i.	
It is recommended that the Company follow the NAIC Annual Statement Instructions when completing its Annual Statements and classify financial statement items into the proper account.	23
ii.	
It is recommended that the Company maintain supporting detailed records and produce same upon examination for any amounts it reports in its financial statements, henceforth.	23

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It is recommended that the Company maintain adequate records and controls in order to satisfy notification provisions relating to abandoned property and ensure that any unclaimed amounts are remitted to the appropriate state and accounted for properly.	23
iv. It is recommended that the Company develop and implement a comprehensive process to age and settle intercompany account balances in a timely manner and that it maintain and provide upon examination documentation sufficient to determine compliance with Department Circular Letter 15 (1975).	24
v. It is recommended that the Company properly classify expenses according to the NAIC Property and Casualty Annual Statement Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers.	25
vi. It is recommended that the Company set up accruals for both written premium and unearned premium reserve that represent the written premium and unearned premium reserve from the cutoff dates to year-end.	25
vii. It is recommended that the Company properly classify claims paid after the early close as reductions to outstanding loss reserves and not as “Remittances and items not allocated”.	25
viii. It is recommended that the Company comply with SSAP No. 53, paragraph 13 when recording advance premiums.	26
ix. It is recommended that the Company ensure that all future contracts entered into with its independent certified public accountants comply with Department Regulation 118 and are properly executed.	26
x. It is recommended that the directors and officers policy covering the Company be brought into compliance with Department Regulation 110 regarding the minimum coinsurance percentage for D&O indemnity coverage as specified in Part 72.4 as regards the New York domiciled insurers.	26
xi. It is recommended that the Company address the weaknesses noted in the IT review in order to strengthen controls and security within its IT environment.	28
E. <u>Cash, Cash Equivalents and Short Term Investments</u>	
It is recommended that the Company properly report its cash balances on Schedule E-Part 1 and on the Assets page of its filed financial statements as required by the NAIC Quarterly and Annual Statement Instructions.	33

<u>ITEM</u>	<u>PAGE NO.</u>
F. <u>Uncollected Premiums and Agents' Balances in the Course of Collection</u>	
It is recommended that the Company ensure that they post all non-admitted premium receivable balances in compliance with SSAP No. 6. A similar recommendation was included in the prior report on examination.	33
G. <u>Accrued Retrospective Premiums</u>	
It is recommended that the Company perform a review each year to determine if any accrued retrospective premiums should be non-admitted per the requirements of the NAIC Accounting Practices and Procedures Manual, SSAP No. 66, Paragraph 9 and that the Company retain the necessary documentation to substantiate the recorded balance.	34
H. <u>Amounts Recoverable from Reinsurers</u>	
It is recommended that the Company take steps to implement controls to ensure future cessions are allocated correctly and ensure that future financial statements are completed correctly in compliance with the NAIC Annual Statement Instructions.	34
I. <u>Aggregate Write-ins for Other than Invested Assets</u>	
It is recommended that the Company comply with SSAP No. 65, paragraph 37 and non-admit uncollateralized recoverables with balances over 90 days past their contractual due date, or billing date if no contractual due date has been established.	35
J. <u>Losses and Loss Adjustment Expenses</u>	
It is recommended that the Company comply with SSAP 62, paragraphs 17, 26 and 58 by not taking credit in Schedule F and the loss reserve liability for ceded IBNR recoverables due from insolvent reinsurers.	37
K. <u>Commission Payable</u>	
It is recommended that the Company establish proper procedures to ensure that it records proper accruals for its obligations and maintain adequate records to support account balances recorded in the general ledger and in financial statements filed with this Department.	37
L. <u>Unearned Premiums</u>	
It is recommended that the Company comply with the NAIC Accounting Practices and Procedures Manual, SSAP No. 65, paragraph 7 and SSAP No. 53, paragraph 6 in the calculation of unearned premium reserve for	39

ITEMPAGE NO.

its “run off” policies.

M. Provision for Reinsurance

It is recommended that the Company comply with NAIC Annual Statement Instructions for Schedule F, Part 4 in the aging of its paid losses and loss adjustment expenses recoverables.

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APPENDIX A

	JURISDICTION
XL Capital Ltd	Cayman
EXEL Holdings Limited	Cayman
EXEL Acquisition Ltd.	Cayman
GCR Holdings Limited ( <i>in liquidation</i> )	Cayman
Reeve Court Holdings Ltd	Bermuda
X.L. Property Holdings Limited	Bermuda
XL Insurance (Bermuda) Ltd	Bermuda
XL Weather & Energy Ltd ( <i>formerly Element Reinsurance Ltd</i> )	Bermuda
XL PP Limited	UK
InQuisCapital Holdings (Bermuda) Limited	Bermuda
InQuisLogic (Bermuda) Limited	Bermuda
RiskConnect Limited	Bermuda
Sovereign Risk Insurance Ltd. (50%)	Bermuda
XL International (Bermuda) Ltd ( <i>formerly XL Winterthur International (Bermuda) Ltd</i> ) (91%)	Bermuda
XL International Services Ltd ( <i>formerly XL Winterthur International Services Ltd</i> )	Bermuda
International Insurance Consulting Services Limited	Bermuda
XL (Brazil) Holdings Ltda ( <i>formerly Winterthur Administracao e Participacoes Ltda</i> )	Brazil
XL Insurance (Brazil) Seguradora S/A ( <i>formerly Winterthur International Brasil Seguradora S/A</i> )	Brazil
XL Capital Products Ltd	Bermuda
XL Financial Assurance Ltd. (87%)	Bermuda
Reformation Group, Ltd. ( <i>In Members' Voluntary Liquidation</i> )	Bermuda
XL Financial Solutions Ltd	Bermuda
XL Services (Bermuda) Ltd	Bermuda
XL Life Ltd	Bermuda
Reeve Court General Partner Limited	Bermuda
Reeve Court 4 Limited Partnership	Bermuda
Reeve Court 6 Limited Partnership	Bermuda
XL Gracechurch Limited	UK
XL Insurance (UK) Holdings Limited ( <i>formerly XL Winterthur (UK) Holdings Limited</i> ) (42.33%)	UK
XL Financial Holdings (Ireland) Limited	R of Ireland
X.L. Holdings (Barbados) Ltd. ( <i>In Liquidation</i> )	Barbados
X.L. America, Inc. (*)	Delaware
XL Capital Investment Partners Inc.	Delaware
XLCA Admin LLC	New York
XLCDL LLC	New York
XL Weather & Energy Advisors Inc. ( <i>formerly Element Re Advisors Inc.</i> )	Delaware
XL Weather & Energy Inc. ( <i>formerly Element Re Capital Products Inc.</i> )	Delaware
XLA Garrison L.P.	Delaware
Global Credit Analytics, Inc.	Delaware
NAC Re Corporation	Delaware
XL Reinsurance America Inc. *(A-65%) - NY	New York
XL Financial Solutions, LLC	Delaware
Greenwich Insurance Company *(A-12%)	Delaware
Warranty Support Services LLC	Delaware
XL Insurance America, Inc. *(A-10%)( <i>formerly Winterthur International America Insurance Company</i> )	Delaware
XL Select Insurance Company *(A-2%)( <i>formerly Winterthur International America Underwriters Insurance</i> )	Oklahoma

	<i>Co.)</i>	
	XL Insurance Company of New York, Inc. (A-3%)	New York
	Intercargo Corporation	Delaware
	XL Specialty Insurance Company *(A-6%)	Delaware
	Intercargo Insurance Company H.K. Ltd.	Hong Kong
	Indian Harbor Insurance Company *(A-2%)	North Dakota
	XL Management Services, LLC	Texas
	XL Lloyds Insurance Company	Texas
	NAC Re Financial Services, Inc.	Delaware
	XL Capital Assurance Inc.	New York
	XL Capital Assurance (U.K.) Limited	UK
	37 Lambert Road LLC	Delaware
	XL Financial Administrative Services, Inc.	Delaware
	XL Portfolio Advisors Inc.	Delaware
	XL Global, Inc.	Delaware
	XL Insurance, Inc.	Delaware
	X.L. Global Services, Inc.	Delaware
	XL Investment Management (USA) LLC	Delaware
	Eagleview Insurance Brokerage Services, LLC	Delaware
	XL Life and Annuity Holding Company	Delaware
	XL Life Insurance and Annuity Company ( <i>formerly Lyndon Life Insurance Company</i> )	Illinois
	XL Asset Funding Company I LLC	Delaware
	ECS, Inc. (In Liquidation)	Pennsylvania
	ECS Child Care Center, Inc.	Pennsylvania
	ECS Risk & Insurance Services, Inc.	Barbados
	XL Environmental Ltd	UK
XL Investments Ltd		Bermuda
	First Cumberland Bank, Inc. ( <i>In Liquidation</i> )	Barbados
	Garrison Investments Inc. (**)	Barbados
	InQuisLogic Ltd.	Barbados
	InQuisLogic Inc. ( <i>In Liquidation</i> )	Delaware
	Kensington Investments Inc.	Barbados
	XLB Partners Inc.	Barbados
	Cumberland Holdings, Inc.	Delaware
	Cumberland California, Inc.	Delaware
	Cumberland New York, Inc.	Delaware
	RiskConnect Ltd	Barbados
	RiskConnect Inc. ( <i>In Liquidation</i> )	Delaware
	X.L. Investment Private Trustee Ltd.	Bermuda
	X.L. Investments (Barbados) Inc.	Barbados
	Cybersettle, Inc. (56%)	Delaware
	Cybersettle Insurance Brokerage Services LLC	Delaware
	Cybersettle Financial Services LLC	Delaware
	InsuranceNoodle, Inc.	Delaware
	TAM Investment Holdings Inc.	Delaware
	ClearWater Opportunity Fund Ltd.	Cayman
XL (LUXEMBOURG) S.a.r.l.		Luxembourg
	XL (FINANCE) S.a.r.l.	Luxembourg
	XL (INTERNATIONAL) S.a.r.l.	Luxembourg

XL (SERVICES) S.a.r.l.	Luxembourg
XL (SPECIALTY) S.a.r.l.	Luxembourg
XL (WESTERN EUROPE) S.a.r.l.	Luxembourg
XL Re Europe ( <i>formerly Le Mans Re</i> )	France
XL Re Europe Services AG ( <i>fka Le Mans Re Deutschland AG</i> )	Germany
XL Re Europe Management Company Ltd	Canada
XL Swiss Holdings Ltd	Switzerland
XL Re Latin America Ltd	Switzerland
XL Latin America Investments Ltd	Bermuda
XL Re Latin America (Argentina SA)	Argentina
XL Re Latin America Servicios Ltda	Brazil
XL Insurance Switzerland ( <i>fka XL Winterthur International Insurance Switzerland</i> )	Switzerland
Vitodurum Reinsurance Company ( <i>fka XL Winterthur International Re</i> )	Switzerland
XL Services Switzerland	Switzerland
XL India Business Services Private Limited	India
XL Insurance Mexico	Mexico
XL Insurance (UK) Holdings Limited ( <i>fka XL Winterthur (UK) Holdings Limited</i> ) (57.67 %)	UK
XL Insurance Argentina S.A. Compañía de Seguros ( <i>fka Winterthur International Argentina SA Compañía de Seguros</i> ) (90%)	Argentina
XL Insurance Company Limited ( <i>fka XL Winterthur International Insurance Company Limited</i> )	UK
XL Magyarorszag Biztosito Reszvenytársasag	Hungary
XL Insurance Argentina S.A. Compañía de Seguros ( <i>fka Winterthur International Argentina SA Compañía de Seguros</i> ) (10%)	Argentina
XL Holdings (Proprietary) Limited ( <i>fka XL Winterthur Holdings (Proprietary) Limited</i> )	South Africa
XL Winterthur Properties (Proprietary) Limited	South Africa
XL Insurance Company Limited ( <i>fka XL Winterthur International Insurance Company Limited</i> )	South Africa
XL Services UK Limited	UK
XL Trading Partners Ltd	Bermuda
XL Europe Holdings Ltd ( <i>formerly X.L. Two Ltd.</i> )	Bermuda
XL Treasury Europe Limited	R of Ireland
XL Europe Ltd	R of Ireland
XL Financial Services (Ireland) Ltd	R of Ireland
Mid Ocean Limited	Cayman
Mid Ocean Holdings Limited	Bermuda
Ridgewood Holdings Limited	Bermuda
XL London Market Group plc	UK
Brockbank Holdings Limited	UK
Baltusrol Holdings Limited	Bermuda
County Down Limited	UK
Dornoch Limited	UK
Stonebridge Underwriting Limited	UK
XL London Market Services Ltd	UK
Brockbank Personal Lines Limited – ( <i>Dormant</i> )	UK
Cassidy Brockbank Limited - ( <i>Dormant</i> )	UK
Denham Syndicate Management Limited	UK
Denham Direct Underwriters Ltd	UK

Denham Legal and Professional Risks Ltd	UK
Denham Tower Underwriting Agents (PTY) Limited	South Africa
XL London Market Ltd- Syndicates 588/861/990/1209	UK
Brockbank Syndicate Services Limited	UK
XL Capital International Limited	UK
XL Capital Finance (Europe) plc	UK
XL Financial Products Ltd.	UK
XL Re Ltd	Bermuda
ECS Reinsurance Company Inc.	Barbados
Global Capital Underwriting Ltd.	UK
NAC Re International Holdings Ltd	UK
NAC Reinsurance International Limited	UK
XL BCM Limited	UK
XL Mid Ocean Re Limited	UK
XL Investment Management Ltd	Bermuda
XL Capital Partners Corporation	Cayman
XL Capital Partners I, L.P.	Cayman
XL Capital Principal Partners I, L.L.C. (50%)	Delaware
XL Principal Partners I, L.P.	Cayman
XL Capital Principal Partners I, L.L.C. (50%)	Delaware

*\*A = Company is a member of NAC Reinsurance, Intercargo Pooling Agreement with individual company pooling % noted*

(\*) - General Partner of XLA Garrison L.P.

(\*\*) - Limited Partner of XLA Garrison L.P.

Respectfully submitted,

\_\_\_\_\_  
James Call, CFE  
Examiner-in-Charge

STATE OF NEW YORK     )  
  )SS:  
  )  
COUNTY OF NEW YORK    )

JAMES CALL, being duly sworn, deposes and says that the foregoing report, subscribed by  
<him/her>, is true to the best of <his/her> knowledge and belief.

\_\_\_\_\_  
James Call,

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_, 2008.

Appointment No 22429

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**James Call**

*as proper person to examine into the affairs of the*

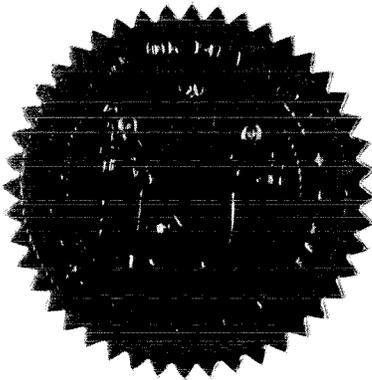
**XL REINSURANCE AMERICA INC.**

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

**Incorporated**

*with such other information as he 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 28th day of October, 2005*

A handwritten signature in cursive script, appearing to read "Howard Mills". The signature is written in black ink and is positioned above a horizontal line.

HOWARD MILLS  
Superintendent of Insurance