

REPORT ON EXAMINATION

OF THE

NORTH SEA INSURANCE COMPANY

AS OF

DECEMBER 31, 2008

DATE OF REPORT

OCTOBER 13, 2009

EXAMINER

IAN MARTIN

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

October 13, 2009

Honorable James J. Wynn  
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 30308 dated March 3, 2009, attached hereto, I have made an examination into the condition and affairs of North Sea Insurance Company as of December 31, 2008, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate North Sea Insurance Company.

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 home office located at 370 West Park Avenue, Long Beach, New York, 11561.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2003. This examination covered the five-year period from January 1, 2004 through December 31, 2008. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook, which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

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

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

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**

North Sea Insurance Company was incorporated under the laws of the State of New York on October 26, 1978. It became licensed on December 31, 1979 and commenced business on that date.

At December 31, 2008, capital paid in was \$1,600,000 consisting of 500,000 shares of common stock at \$3.20 par value per share common stock. Gross paid in and contributed surplus was \$1,900,000. There has been no change in the Company's capital and paid in and contributed surplus since the last examination.

### **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 or more than twenty-one members. The board meets four times during each calendar year. At December 31, 2008, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
David P. Delaney, Jr. Ponte Vedra, FL	President, Lancer Insurance Company
Timothy D. Delaney Islamorada, FL	Executive Vice President, Lancer Insurance Company
Wayne S. Ricci Lido, NY	Executive Vice President, Lancer Insurance Company
Gail W. Reilly Staten Island, NY	Senior Vice President, Lancer Insurance Company
Alistair Lind East Norwich, NY	Senior Vice President, Treasurer and Chief Financial Officer, Lancer Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John A. Petrilli Merrick, NY	Sr. Vice President, Secretary and General Counsel, Lancer Insurance Company
Shirley B. Ortego Garden City, NY	Vice President, Asst. Secretary and Associate General Counsel, Lancer Insurance Company
Robert F. Boyle Massapequa Park, NY	Executive Vice President and Chief Operating Officer, North Sea Insurance Company
Christine A. Farley Sayville, NY	Vice President, North Sea Insurance Company
George N. Cochran Kenilworth, IL	Co-chairman, Fox, Pitt, Kelton, Cochran, Caronia & Waller
Leonard S. Caronia Park Ridge, IL	Co-chairman, Fox, Pitt, Kelton, Cochran, Caronia & Waller
John N. Lombardo Naples, FL	Retired
Thomas A. Duffield Decatur, IL	Retired

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 had an acceptable record of attendance.

As of December 31, 2008, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
David P. Delaney	President
John A. Petrilli	Secretary
Alistair T. Lind	Treasurer
Robert F. Boyle	Executive Vice President and Chief Operating Officer
Christine A. Farley	Vice President

B. Territory and Plan of Operation

As of December 31, 2008, the Company was licensed to write business in seven states: Mississippi, New Jersey, New York, North Dakota, Pennsylvania, South Carolina and Texas. However, the Company only writes business in New York, New Jersey and Pennsylvania.

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>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
12	Collision
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine

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

DIRECT PREMIUMS WRITTEN

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a Percentage of United States Premium Written</u>
2004	\$6,067,567	\$6,522,023	93.03%
2005	\$6,609,028	\$7,149,589	92.44%
2006	\$6,416,034	\$6,929,699	92.59%
2007	\$5,483,003	\$6,043,481	90.73%
2008	\$4,892,583	\$5,504,591	88.88%

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 surplus to policyholders in the amount of \$800,000.

The Company writes commercial multiple-peril, general liability, fire and allied lines insurance to small and medium sized businesses in New York City and Long Island. The Company's business is produced by brokerage firms.

C. Reinsurance

Assumed

The Company does not assume any reinsurance business.

Ceded

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

<u>Type of treaty</u>	<u>Cession</u>
<u>Excess of Loss</u>	
Property (2 layers) 100% Authorized	\$925,000 per risk/\$1,975,000 each occurrence excess of \$75,000.
Casualty (2 layers) 100% Authorized	\$925,000 excess of \$75,000 each occurrence.
Property & casualty combined 100% Authorized	\$1,125,000 excess of \$75,000 each loss occurrence.
<u>Property Per Risk Excess of Loss</u>	
Property 100% Authorized	\$1,000,000 per risk / \$2,000,000 each occurrence limit excess of \$1,000,000 each loss, subject to \$2,000,000 terrorism annual aggregate.
<u>First Casualty Contingency Excess of Loss</u>	
Casualty 100% Authorized	\$2,000,000 loss occurrence / \$2,000,000 aggregate limit excess of \$1,000,000 each loss occurrence.

Type of treatyCessionFirst Property Catastrophe Excess of Loss

Property  
100% Authorized

95% of \$400,000 excess of \$100,000 each loss occurrence.

Second Property Catastrophe Excess of Loss

Property  
100% Authorized

95% of \$2,250,000 excess of \$500,000 each loss occurrence.

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

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 42 of SSAP No. 62.

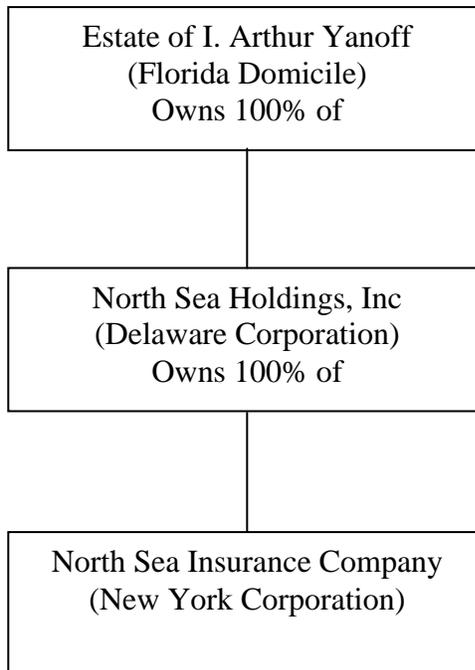
#### D. Holding Company System

For the period under examination, the Company had been a wholly-owned subsidiary of North Sea Holdings, Inc., a Delaware corporation, which in turn had been wholly-owned by the estate of Mr. I Arthur Yanoff.

However, effective January 1, 2009, Lancer Financial Group Inc., an Illinois corporation, acquired North Sea Holdings Inc.

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

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



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

The Company participates in a tax allocation agreement with the members of the holding company system. Under the agreement, Federal income tax is computed as if the Company were filing a separate federal income tax return, except that income tax benefits are recognized to the extent utilized in a consolidated federal income tax return. The tax allocation agreement provides for the establishment of an escrow account by the parent for the benefit of the Company in order to maintain the Company's rights to recoup federal income taxes paid to the parent in the event of future net losses. This agreement was filed pursuant to Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

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

Net premiums written to surplus as regards policyholders	67%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	55%
Premiums in course of collection to surplus as regards policyholders	4%

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 five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$8,306,133	43.36%
Other underwriting expenses incurred	9,055,144	47.27
Net underwriting gain	<u>1,796,474</u>	<u>9.38</u>
Premiums earned	<u>\$19,157,751</u>	<u>100.00%</u>

F. Accounts and Records

. Filed Financial Statements

During the examination, significant differences were noted in comparing the amounts reported in the Company's Schedule P with the amounts reported in the related underwriting and investment exhibits. Specifically, the calendar year 2008 net losses paid reported in Schedule P Part 1 did not equal the net losses paid reported in the Underwriting and Investment Exhibit Part 2 (Losses Paid and Incurred), and the calendar year 2008 net loss adjustment expenses paid reported in Schedule P Part 1 did not equal the loss adjustment expenses paid reported in the Underwriting and Investment Exhibit Part 3 (Expenses).

Upon being advised of the abovementioned discrepancies, and at the Department's request, the Company prepared corrected Schedule P pages, which agreed with the amounts reported in the

related underwriting and investment exhibits. The Company's actuary did not believe that these adjustments necessitated a change to the filed Statement of Actuarial Opinion.

It is noted that the inconsistencies in Schedule P occurred before the recent change in ownership of the Company and that corrected Schedule P pages for 2008 were prepared by new management.

It is imperative that all schedules in the Company's annual statements contain accurate financial data. It is recommended that the Company exercise greater care in preparing Schedule P for future annual statement filings.

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

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

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 8,891,509	\$ 0	\$ 8,891,509
Preferred stocks	75,000	0	75,000
Common stocks	272,472	0	272,472
Cash, cash equivalents and short-term investments	2,070,933	0	2,070,933
Investment income due and accrued	136,014	0	136,014
Uncollected premiums and agents' balances in the course of collection	225,247	2,877	222,370
Other amounts receivable under reinsurance contracts	502,593	0	502,593
Net deferred tax asset	382,203	113,811	268,392
Other Fair Plan assets	42,345	0	42,345
Miscellaneous receivable	<u>9,299</u>	<u>0</u>	<u>9,299</u>
Total assets	<u>\$12,607,615</u>	<u>\$116,688</u>	<u>\$12,490,927</u>

Liabilities, Surplus and Other FundsLiabilities

Losses		\$ 3,459,328
Loss adjustment expenses		827,421
Other expenses (excluding taxes, licenses and fees)		5,764
Current federal and foreign income taxes		192,374
Unearned premiums		1,610,669
Ceded reinsurance premiums payable (net of ceding commissions)		210,204
Other fair plan liabilities		<u>3,297</u>
Total liabilities		\$ 6,309,057

Surplus and Other Funds

Common capital stock	\$ 1,600,000	
Gross paid in and contributed surplus	1,900,000	
Unassigned funds (surplus)	<u>2,681,868</u>	
Surplus as regards policyholders		<u>6,181,868</u>
Total liabilities, surplus and other funds		<u>\$12,490,925</u>

NOTE: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2004 through 2008. 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 \$2,333,566 during the five-year examination period January 1, 2004 through December 31, 2008, detailed as follows:

Underwriting Income

Premiums earned		\$19,157,751
Deductions:		
Losses incurred	\$4,825,795	
Loss adjustment expenses incurred	3,480,338	
Other underwriting expenses incurred	<u>9,055,144</u>	
Total underwriting deductions		<u>17,361,277</u>
Net underwriting gain or (loss)		\$ 1,796,474

Investment Income

Net investment income earned	\$1,797,437	
Net realized capital gain	<u>(369,634)</u>	
Net investment gain or (loss)		1,427,803

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (89,248)	
Finance and service charges not included in premiums	48,950	
Flood program miscellaneous. income	<u>82,077</u>	
Total other income		<u>41,779</u>
Net income before federal and foreign income taxes		\$ 3,266,056
Federal and foreign income taxes incurred		<u>848,066</u>
Net income		<u>\$ 2,417,990</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2003			\$3,848,302
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$2,417,990		
Net unrealized capital gains or (losses)		\$140,158	
Change in net deferred income tax	382,203		
Change in non-admitted assets		111,512	
Dividends to stockholders		73,372	
Aggregate write-ins for gains and losses in surplus	<u>0</u>	<u>141,585</u>	
Total gains and losses	<u>\$2,800,193</u>	<u>\$466,627</u>	
Net increase (decrease) in surplus			<u>2,333,566</u>
Surplus as regards policyholders per report on examination as of December 31, 2008			<u>\$6,181,868</u>

**4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$4,286,749 is the same as reported by the Company as of December 31, 2008. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

**5. SUBSEQUENT EVENT**

Effective January 1, 2009, Lancer Financial Group Inc., an insurance holding company domiciled in the State of Illinois, purchased all outstanding shares of North Sea Holdings Inc., North Sea Insurance Company's parent company, thereby becoming the ultimate parent of the Company. The Department approved the acquisition on December 28, 2008 and the transaction was closed on January 27, 2009, effective as of January 1, 2009.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Fidelity Bond Coverage</u> It is recommended that the Company maintain adequate fidelity bond coverage.</p> <p>The Company complied with this recommendation.</p>	11
<p>B. <u>Accounts and Records</u> It is recommended that the Company exercise care in preparing Schedule P in its future filed annual statements.</p> <p>The Company did not comply with this recommendation. A similar recommendation can be found in this report on examination.</p>	12
<p>C. <u>Corporate Emergency Measures</u> It is again recommended that the Company adopt a formal disaster recovery plan and make systematic preparation for the conduct of business and for the continuity of management in case of a catastrophic fire or other disaster.</p> <p>The Company complied with this recommendation.</p>	13

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Accounts and Records</u> It is recommended that the Company exercise greater care in preparing Schedule P for future annual statement filings.</p>	10

Respectfully submitted,

\_\_\_\_\_/s/  
Ian Martin, CFE  
Senior Insurance Examiner

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

IAN MARTIN, being duly sworn, deposes and says that the foregoing report, subscribed by him,  
is true to the best of his knowledge and belief.

\_\_\_\_\_/s/  
Ian Martin, CFE

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

Appointment No. 30308

STATE OF NEW YORK  
INSURANCE DEPARTMENT

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

**Ian Martin**

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

**NORTH SEA INSURANCE COMPANY**

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

**Company**

*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 3rd day of March, 2009*



A handwritten signature in black ink, appearing to read "Eric Dinallo", written over a horizontal line.

ERIC R. DINALLO  
Superintendent of Insurance