

REPORT ON EXAMINATION

OF THE

NAVIGATORS SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2009

DATE OF REPORT

SEPTEMBER 24, 2010

EXAMINER

JOSEPH REVERS

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

September 24, 2010

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

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30436 dated December 8, 2009 attached hereto, I have made an examination into the condition and affairs of Navigators Specialty Insurance Company as of December 31, 2009, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Navigators Specialty 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 administrative office located at 6 International Drive, Rye Brook, NY 10573.

## **1. SCOPE OF EXAMINATION**

The Department has performed an association examination of Navigators Specialty Insurance Company. The previous examination was conducted as of December 31, 2004. This examination covered the five-year period from January 1, 2005 through December 31, 2009. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the 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 assessment and an evaluation based upon the Company’s Sarbanes Oxley documentation and testing. 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 that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on December 1, 1988 as the Pilot Insurance Company. It commenced business on October 17, 1989 and was renamed NIC Insurance Company effective January 23, 1990. The current name, Navigators Specialty Insurance Company, was adopted on January 4, 2007.

As of December 31, 2009, capital paid in was \$5,000,000 consisting of 250 shares of common stock at \$20,000 par value. Gross paid in and contributed surplus was \$86,000,000. Gross paid in and contributed surplus increased by \$50,000,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2005	Beginning gross paid in and contributed surplus	\$36,000,000
2005	Surplus contribution	<u>\$50,000,000</u>
	Total surplus contributions	<u>50,000,000</u>
2009	Ending gross paid in and contributed surplus	<u>\$86,000,000</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 board met four times during 2005 through 2008 and three times in 2009. At December 31, 2009, the board of directors was comprised of the following sixteen members:

Name and ResidencePrincipal Business Affiliation

H. Clay Basset, Jr.  
Pound Ridge, NY

Senior Vice President, Chief Underwriting Officer  
and Chief Risk Officer,

Michael L. Civisca  
West Nyack, NY

Navigators Insurance Company  
President,  
Marine & Energy  
Executive Vice President and Chief Operating  
Officer,  
Navigators Management Company, Inc.

Christopher C. Duca  
Rockville Centre, NY

President,  
Navigators Pro  
President & Chief Executive Officer,  
Navigators Management Company, Inc.

Richard S. Eisdorfer  
Trumbull, CT

Senior Vice President and Chief Administrative  
Officer,  
Navigators Insurance Company

Stanley A. Galanski  
Ridgefield, CT

President and Chairman,  
Navigators Insurance Company

Paul V. Hennessy  
Cheam, Surrey, UK

President,  
Navigators Holdings (UK) Ltd.  
Managing Director,  
Navigators Underwriting Agency Ltd.

Noel Higgitt  
Menlo Park, CA

Executive Vice President, Field Operations,  
Navigators Insurance Company

Christopher A. Johnson  
Oakland, CA

Senior Vice President,  
Marine & Energy,  
Navigators Insurance Company

Russell J. Johnson  
Seaford, NY

Senior Vice President,  
Marine & Energy,  
Navigators Insurance Company

John W. Jones  
Kingwood, TX

Senior Vice President,  
Marine & Energy,  
Navigators Insurance Company

Jane E. Keller  
Southport, CT

Senior Vice President and Chief Claims Officer,  
Navigators Insurance Company

Francis W. McDonnell  
Rye, NY

Senior Vice President and Chief Financial Officer,  
Navigators Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gregory D. Olson Seattle, WA	Senior Vice President, Marine & Energy, Navigators Insurance Company
Richard C. Rea Ockley, Surrey, UK	Managing Director, Navigators Management (UK), Ltd.
Jeff L. Saunders Hinsdale, IL	President, Excess Casualty, Navigators Insurance Company
Bradley D. Wiley Ringwood, NJ	Senior Vice President and Secretary, Navigators Insurance Company

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended.

As of December 31, 2009, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Stanley A. Galanski	President and Chief Executive Officer
Francis W. McDonnell	Senior Vice President & Chief Financial Officer
Thomas C. Connolly	Vice President & Treasurer
Emily Brennan Miner	Associate Counsel & Secretary

B. Territory and Plan of Operation

As of December 31, 2009, the Company was licensed in New York, but writes no business there. The Company underwrites its business on a surplus lines basis in the other 49 states and the District of Columbia.

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 & 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
29	Legal Services

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 \$4,400,000.

The Company did not write any business in New York during the exam period. The following schedule shows the direct premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Total United States</u>
2005	\$176,413,523
2006	\$231,718,424
2007	\$233,004,809
2008	\$149,140,616
2009	\$109,617,484

The Navigators Agencies produce business for the Company and Navigators Insurance Company ("Navigators"). They specialize in writing marine and related lines of business, specialty liability insurance and professional liability coverages. Navigators Management Company, Inc. manages the insurance business and operations of Navigators.

C. Reinsurance

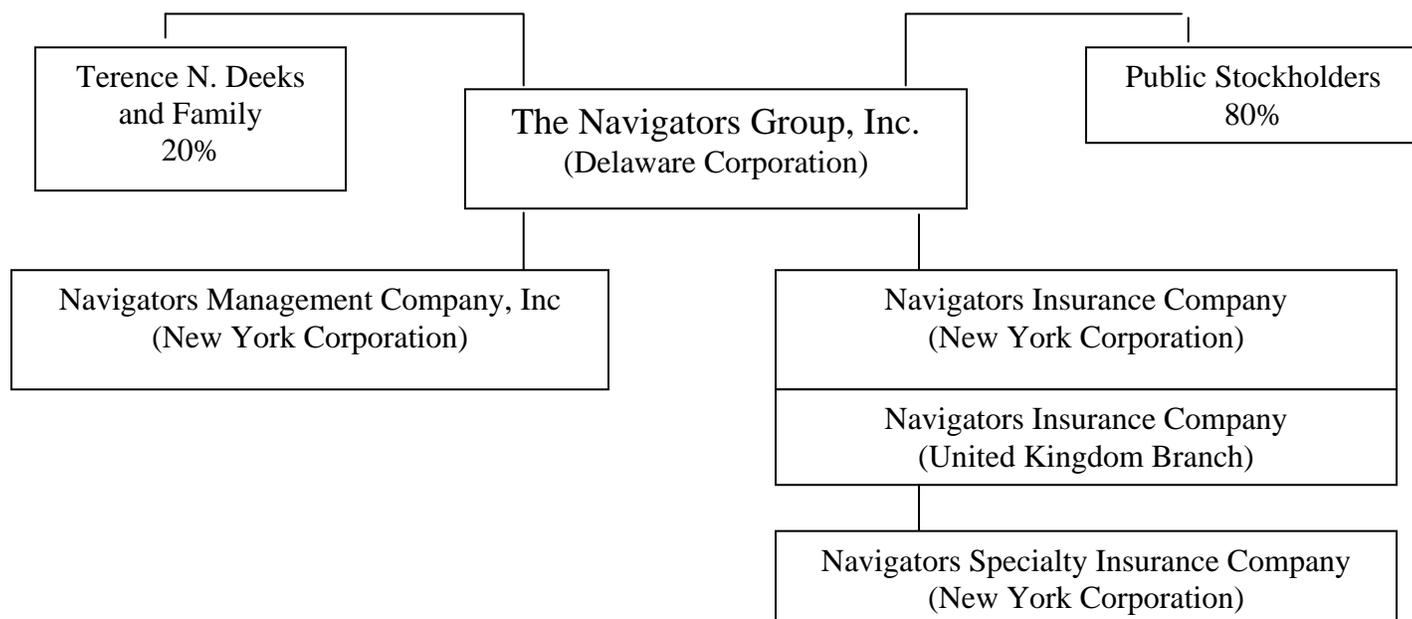
The Company did not assume any business during the examination period. The Company cedes 100% of its business to its parent, Navigators Insurance Company, pursuant to the terms of an inter-company reinsurance agreement. Effective January 1, 1999, the Company transferred all of its outstanding losses, loss adjustment expenses and unearned premiums to Navigators Insurance Company pursuant to a commutation agreement. The agreement was approved by the Department.

D. Holding Company System

The Company is a member of the Navigators Group, Inc. The Company is a wholly-owned subsidiary of Navigators Insurance Company, a New York corporation, which is ultimately controlled by the Navigators Group, Inc., a publicly traded holding company domiciled in the State of Delaware, which in turn is 20% owned by Terence N. Deeks and family. Mr. Deeks has been deemed to be the ultimate controlling person, as set forth in Section 1501 of the New York Insurance Law.

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 abbreviated chart of the holding company system at December 31, 2009:



At December 31, 2009, the Company was party to the following agreements with other members of its holding company system:

#### Tax Allocation Agreement

The Company participates in a tax allocation agreement with its parent company and members of its holding company group. A formal agreement was executed and submitted to the Department pursuant to the provisions of Department Circular Letter No. 33 (1979). The agreement was effective December 31, 1983, and was amended numerous times to add various participants and to amend various terms and conditions.

#### Agency Agreement

The Company participates in an agency agreement with Navigators Management Company (“NMC”). Pursuant to the terms of the agreement NMC underwrites and services various lines of business on behalf of the Company. The agreement was effective January 1, 2002, and was approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law.

#### Inter-Company Reinsurance Agreement

As noted in Section 2C of this report, the Company participates in an inter-company reinsurance agreement whereby the Company cedes 100% of the premiums written to Navigators. The agreement was effective January 1, 1999, and was approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law.

#### E. Significant Operating Ratios

These ratios were not calculated because the Company cedes 100% of its business to its parent, Navigators Insurance Company. Therefore these ratios are not relevant.

F. Accounts and RecordsCertified Public Accountant (“CPA”) Engagement Letter

The engagement letter between the Company and its independent CPA firm, dated December 4, 2009, does not include a provision requiring the CPA firm to retain the audit work papers and communications for six calendar years from the date of the audit report or until the filing of the report on examination covering the period of the audit, whichever is longer, as required by Part 89.2(c) of Department Regulation 118. It is recommended that the Company ensure that all future contracts with its independent CPA include all of the required provisions in Department Regulation 118.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2009 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	\$113,487,986	\$ 0	\$113,487,986
Cash, cash equivalents and short-term investments	421,604		421,604
Receivable for securities	969,484		969,484
Investment income due and accrued	1,015,834		1,015,834
Uncollected premiums and agents' balances in the course of collection	8,938,381		8,938,381
Net deferred tax asset	<u>1,084,763</u>	<u>264,953</u>	<u>819,810</u>
Total assets	<u>\$125,918,052</u>	<u>\$264,953</u>	<u>\$125,653,099</u>

#### Liabilities, Surplus and Other Funds

##### Liabilities

Losses and loss adjustment expenses	\$ 0
Other expenses (excluding taxes, licenses and fees)	32,310
Current federal and foreign income taxes	244,755
Ceded reinsurance premiums payable (net of ceding commissions)	8,938,381
Payable to parent, subsidiaries and affiliates	<u>12,899</u>
Total liabilities	\$ 9,228,345

##### Surplus and Other Funds

Common capital stock	\$ 5,000,000
Gross paid in and contributed surplus	86,000,000
Unassigned funds (surplus)	<u>25,424,754</u>
Surplus as regards policyholders	<u>116,424,754</u>
Total liabilities, surplus and other funds	<u>\$125,653,099</u>

**NOTE:** The Internal Revenue Service has not audited the Company's consolidated tax returns covering tax years 2005 through 2009. 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. Statement of Income

Surplus as regards policyholders increased \$64,832,865 during the five-year examination period January 1, 2005 through December 31, 2009, detailed as follows:

Underwriting Income

Premiums earned		\$	0
Deductions:			
Losses incurred	\$	0	
Loss adjustment expenses incurred		0	
Other underwriting expenses incurred		<u>0</u>	
Total underwriting deductions			<u>0</u>
Net underwriting gain or (loss)		\$	0

Investment Income

Net investment income earned	\$24,273,458		
Net realized capital gain	<u>(3,533,024)</u>		
Net investment gain or (loss)			20,740,434

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$	0	
Finance and service charges not included in premiums		<u>0</u>	
Total other income			<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes			\$20,740,434
Federal and foreign income taxes incurred			<u>8,419,715</u>
Net income			<u><u>\$12,320,718</u></u>

Surplus as regards policyholders per report on examination as of December 31, 2004			\$ 51,591,887
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$12,320,718		
Net unrealized capital gains or (losses)		218,570	
Change in net deferred income tax	1,308,688		
Change in non-admitted assets		264,953	
Cumulative effect of changes in accounting principles	1,686,982		
Surplus adjustments paid in	<u>50,000,000</u>	_____	
Total gains and losses	<u>\$65,316,388</u>	<u>\$483,523</u>	
Net increase (decrease) in surplus			<u>64,832,865</u>
Surplus as regards policyholders per report on examination as of December 31, 2009			<u>\$116,424,752</u>

#### **4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$0 is the same as reported by the Company as of December 31, 2009. As noted in Section 2C of this report, the Company cedes 100% of its business to its parent company, Navigators Insurance Company.

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

The prior report on examination contained no recommendations.

**6. SUMMARY OF COMMENTS AND RECOMMENDATIONS**ITEMPAGE NO.A. Accounts and Records

It is recommended that the Company comply with Department Regulation No. 118 by entering into future contracts with its independent certified public accountant that contain the requisite provisions.

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Respectfully submitted,

\_\_\_\_\_  
/s/  
Joseph Revers, CFE  
Senior Insurance Examiner

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

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

\_\_\_\_\_  
/s/  
Joseph Revers

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_, 2011.

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Joseph Revers**

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

**NAVIGATORS SPECIALTY 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 8th day of December, 2009*



A handwritten signature in cursive script, appearing to read "James J. Wrynn".

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JAMES J. WRYNN  
Superintendent of Insurance