

REPORT ON EXAMINATION
OF
THE ACE CAPITAL TITLE REINSURANCE COMPANY
AS OF
DECEMBER 31, 2002

DATE OF REPORT

JULY 11, 2003

EXAMINER

MOSES EGBON, C.F.E.

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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

July 11, 2003

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, NY 12257

Sir:

Pursuant to instructions contained in Appointment Number 22005 dated February 10, 2003, I have made an examination into the condition and affairs of ACE Capital Title Reinsurance Company as of December 31, 2002, and submit the following report thereon.

The examination was conducted at the Company's office, located at 1325 Avenue of the Americas, New York, New York 10019.

Whenever the terms "the Company" or "ACE Capital Title" appear herein, without qualification, they should be understood to refer to the ACE Capital Title Reinsurance Company.

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

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1997. This examination covered the period January 1, 1998 through December 31, 2002. Transactions subsequent to this period were reviewed where deemed appropriate.

The examination comprised a complete verification of assets and liabilities as of December 31, 2002, a review of income and disbursements deemed necessary to accomplish such verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also conducted of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

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

A review was made to determine what action was taken by the Company with regard to recommendations in the prior report on examination.

This report on examination is confined to the 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 incorporated October 12, 1995, as a controlled insurer, under the laws of the State of New York. The Company was issued a license on March 6, 1996, by the New York Insurance Department.

The Company provides reinsurance protection against risk to primary title insurance companies. The Company currently provides coverage in the United States and the United Kingdom.

A. Management

Pursuant to the Company's charter and by-laws, management is vested in a board of directors consisting of not less than seven nor more than twenty-five members.

As of the examination date, the Company's board of directors consisted of the following seven members:

| <u>Name and Residence</u> | <u>Principal Affiliation</u> |
|--|--|
| Robert A. Bailenson Merrick, New York | Senior Vice President and Chief Financial Officer and Treasurer, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company |
| Lenore R. Bregman New York, New York | Executive Vice President, General Council and Secretary, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company |
| Carmel Caramagna Rutherford, New Jersey | Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company |

| <u>Name and Residence</u> | <u>Principal Affiliation</u> |
|--|--|
| Lawrence C. Donnelly Pelham, NY | President, Capital Title Reinsurance Company ACE Capital Mortgage Reinsurance Company |
| Jerome F. Jurschak Katonah, NY | Chairman and Chief Executive Officer, ACE Capital Title Reinsurance Company ACE Capital Mortgage Reinsurance Company |
| Richard W. Reese Cross River, New York | Senior Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company |
| Winston T. Wohr Staten Island, New York | Senior Vice President, ACE Capital Mortgage Reinsurance Company ACE Capital Title Reinsurance Company |

The principal officers of the Company at December 31, 2002, were as follows:

| <u>Name</u> | <u>Title</u> |
|----------------------|---|
| Lawrence C. Donnelly | President, |
| Lenore R. Bregman | Executive Vice President, General Counsel and Secretary |
| Robert A. Bailenson | Senior Vice President/Chief Financial Officer and Treasurer |

B. Territory and Plan of Operation

As of the examination date, the Company was authorized to transact business in the States of New York, Michigan, Texas, and California. According to its certificate of authority, the Company was empowered to transact the kinds of insurance as defined in paragraph 18 of Section 1113(a) of the New York Insurance Law.

The Company is a professional reinsurer and does not write direct business.

Based upon the line of business for which the Company is licensed, and pursuant to the requirements of Section 6402 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders of \$500,000.

C. Reinsurance

All of the Company's business is assumed reinsurance. It cedes a small portion of its business through a retrocession arrangement.

As of December 31, 2002, the Company had only one retrocession agreement in effect. The agreement covers a policy limit of \$195,000,000 excess of \$5,000,000 per risk and was ceded to ACE Capital Reinsurance International Limited of Bermuda, an affiliated company. The reinsurance treaty met the requirements of Section 1308 of the New York Insurance Law. The agreement was filed with the Department and approved in accordance with Section 1505(d)(2) of the New York Insurance Law.

D. Holding Company System

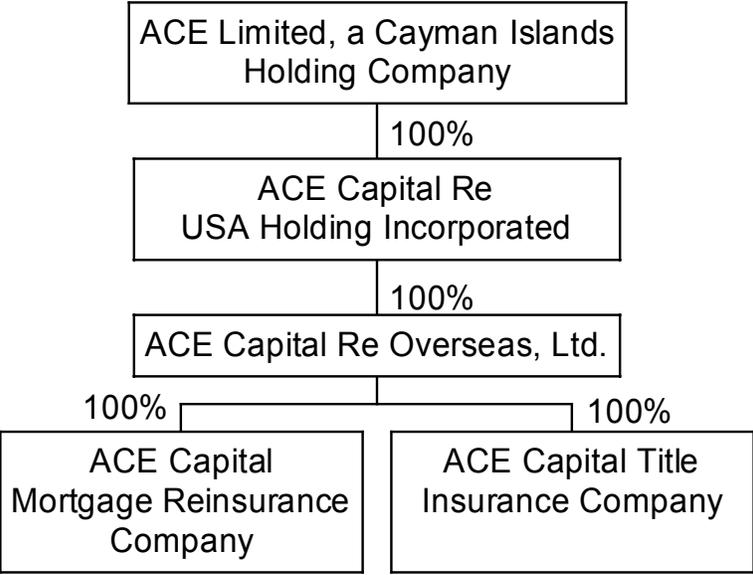
The Company (formerly called Capital Title Reinsurance Company), and all of its outstanding common stock were owned by KRE Reinsurance Limited, a Bermuda company, which was owned by Capital Mortgage Reinsurance Company (now known as ACE Capital Mortgage Reinsurance Company), a New York company.

As a result of the acquisition of Capital Mortgage Reinsurance Company on December 30, 1999, by ACE Limited, a Cayman Islands holding company, the Company's holding company structure was reorganized, and a new name was adopted, ACE Capital Title Reinsurance Company.

The Company is a direct wholly-owned by ACE Capital Re Overseas Ltd., (“ACRO”), a Bermuda domiciled reinsurance company. ACRO is 100% owned by ACE Capital Re USA Holdings Incorporated, which is ultimately owned by ACE Limited.

The Company has filed annual reports in accordance with the requirements of Article 15 of the New York Insurance Law and Department Regulation 52.

The following is the organization chart of the holding company system.



As of the examination date, the Company was a party to the following agreements with affiliated entities:

1. Service and Reimbursement Agreement with ACE Guaranty Inc. (“AGRE”), ACE Capital Re Overseas Ltd., (“ACRO”) and ACE Capital Mortgage Reinsurance Company

The Company is a party to a service and reimbursement agreement with its affiliates, whereby the ACE Guaranty Inc. provides certain support services to ACRO and subsidiaries, including the Company. ACRO pays AGRE for the services, and ACRO is reimbursed by its subsidiaries. On February 20, 2001, the Department approved the agreement pursuant to Section 1505(d)(3) of the New York Insurance Law.

2. Investment Advisory Service Agreement with ACE Asset Management Inc.

The Company is a party to an investment advisory service agreement with ACE Asset Management Inc. The agreement was filed and approved on July 16, 2002, in accordance with Section 1505(d)(3) of New York Insurance Law.

- E. Contingent Commissions Payable

The Company discounts the profit commissions payable from assumed reinsurance contracts. Since the profit commissions are not due immediately, the Company discounts the amount to determine the present value of such liability. The accounting treatment of this liability is not in compliance with statutory accounting, and the Department does not permit the discounting of such liability. Currently, the amount involved appears to be immaterial; however, it is recommended that the Company report this liability at its undiscounted value in future statements filed with this Department.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002 based upon the results of this examination:

| | |
|--|----------|
| Net premiums written in 2002 to surplus as regards policyholders | .17 to 1 |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 41.66% |
| Premiums in course of collection to surplus as regards policyholders | N/A* |

*As of the examination date, the Company did not report any amounts due as agents' balances, which is the numerator for calculating this ratio.

The remaining ratios fall within the benchmark ranges as set forth by 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:

| | Amounts | Ratios |
|--------------------------------------|---------------------|----------------|
| Losses incurred | \$6,873,272 | 50.49% |
| Other underwriting expenses incurred | 6,187,470 | 45.45 |
| Other operating deductions | 3,870,887 | 28.43 |
| Net underwriting gain | <u>(3,318,036)</u> | <u>(24.37)</u> |
| Premiums earned | <u>\$13,613,593</u> | <u>100.00%</u> |

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2002. This statement is the same as the balance sheet filed by the Company.

| <u>Ledger Assets</u> | <u>Non-Admitted Assets</u> | <u>Net-Admitted Assets</u> | <u>Assets</u> |
|---|----------------------------|----------------------------|-------------------------|
| Bonds | \$43,338,398 | \$ | \$43,338,398 |
| Short-term investment | 3,938,735 | | 3,938,735 |
| Cash | 19,923 | | 19,923 |
| Title insurance premiums and fees receivable | (567,697) | | (567,697) |
| Interest, dividends and real estate income due and accrued | 649,317 | | 649,317 |
| Foreign exchange adjustment | <u>407</u> | <u> </u> | <u>407</u> |
| Total assets | <u>\$47,379,083</u> | <u>\$ 0</u> | <u>\$47,379,083</u> |
| Liabilities | | | |
| Statutory premium reserve | | | \$13,722,553 |
| Other expenses | | | 270,696 |
| Federal and foreign income taxes | | | 328,223 |
| Amounts withheld or retained by company for account of others | | | 25,092 |
| Payable to parent, subsidiaries and affiliates | | | 225,646 |
| Contingent commissions payable | | | <u>5,221,082</u> |
| Total liabilities | | | \$19,793,292 |
| Common capital stock | | \$2,000,000 | |
| Gross paid in and contributed surplus | | 23,000,000 | |
| Unassigned funds | | <u>2,585,791</u> | |
| Surplus as regards policyholders | | | <u>27,585,791</u> |
| Total liabilities and surplus | | | <u>\$47,379,083</u> |

Note: The Internal Revenue Service has examined the consolidated income tax returns through tax year 1998. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$1,306,001 during the five-year examination period, January 1, 1998 through December 31, 2002, detailed as follows:

Statement of Income

Operating Income

| | | |
|--|------------------|-------------------|
| Title insurance premiums earned | | \$13,613,593 |
| Deductions: | | |
| Loss and loss adjustment expenses incurred | \$6,873,272 | |
| Operating expenses incurred | 6,187,470 | |
| Contingent commission expenses incurred | <u>3,870,887</u> | |
| Total operating deductions | | <u>16,931,629</u> |
| Net operating gain or (loss) | | \$(3,318,036) |

Investment Income

| | | |
|--|----------------|--------------------|
| Net investment income earned | \$10,139,361 | |
| Net realized capital gains | <u>105,927</u> | |
| Net investment gain | | <u>10,245,288</u> |
| Net income before federal income taxes | | \$6,927,252 |
| Federal income taxes incurred | | <u>2,096,154</u> |
| Net income | | <u>\$4,831,098</u> |

Capital and Surplus Account

| | | | |
|---|-----------------------------|------------------------------|---------------------|
| Surplus as regards policyholders, per report on examination as of December 31, 1997 | | | \$26,279,794 |
| | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income | \$4,831,098 | | |
| Change in non-admitted assets | 52,500 | | |
| Change in foreign exchange adjustment | 403 | | |
| Dividends to stockholders | <u> </u> | <u>\$3,578,000</u> | |
| Total gains and losses | <u>\$4,884,001</u> | <u>\$3,578,000</u> | |
| Net increase in surplus as regards policyholders | | | <u>1,306,001</u> |
| Surplus as regards policyholders, per report on examination as of December 31, 2002 | | | <u>\$27,585,795</u> |

4. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|-----------------|
| A. <u>Management</u> | |
| i. It is recommended that the Company comply with its by-laws regarding the frequency of board of directors' meetings. | 4 |
| ii. It is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law. | 5 |

The Company has complied with these recommendations.

5. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| <u>ITEM</u> | <u>PAGE NO.</u> |
|---|-----------------|
| A. <u>Contingent Commissions Payable</u> | |
| It is recommended that the Company report contingent commissions payable at current value, and not discount for future value. | 8 |

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Moses Egbon

as proper person to examine into the affairs of the

ACE CAPITAL TITLE REINSURANCE COMPANY

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

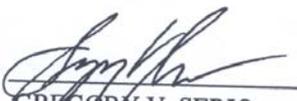
Company

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 10th day of February, 2003




GREGORY V. SERIO
Superintendent of Insurance