

**ORGANIZATIONAL EXAMINATION**  
**OF**  
**AIX SPECIALTY INSURANCE COMPANY**  
**AS OF**  
**NOVEMBER 30, 2006**

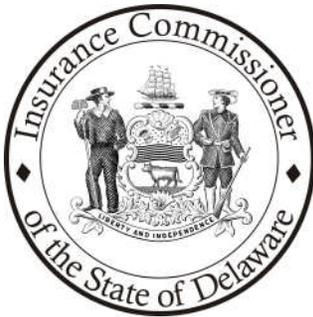
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached ORGANIZATIONAL REPORT ON EXAMINATION, made as of NOVEMBER 30, 2006 of the

**AIX SPECIALTY INSURANCE COMPANY**

is a true and correct copy of the document filed with this Department.

ATTEST BY: *Antoinette Handy*

DATE: 22 DECEMBER 2006



*In Witness Whereof,* I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 22ND DAY OF DECEMBER 2006.

*Matthew Denn*  
Insurance Commissioner

**REPORT ON ORGANIZATIONAL EXAMINATION**  
OF THE  
**AIX SPECIALTY INSURANCE COMPANY**  
AS OF  
**NOVEMBER 30, 2006**

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matthew Denn", written in a cursive style.

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MATTHEW DENN  
INSURANCE COMMISSIONER

DATED this 22ND day of DECEMBER, 2006.

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## **SALUTATION**

December 14, 2006

Honorable Matthew Denn  
Insurance Commissioner  
State of Delaware  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Commissioner:

In accordance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06.042, dated November 15, 2006, an Organizational Examination has been conducted of the

### **AIX SPECIALTY INSURANCE COMPANY**

hereinafter referred to as “AIX Specialty” or “the Company”, incorporated under the laws of the State of Delaware as a stock company with its statutory office located at 103 Foulk Road, Suite 202, Wilmington, Delaware 19803. The registered agent at such address is CSC Entity Services. The Company’s main administrative office is located at 726 Exchange Street, Suite 1020, Buffalo, NY 14210. This examination was conducted at the Company’s administrative office in Buffalo, NY.

The report of such examination is respectfully submitted herewith.

### **SCOPE OF EXAMINATION**

This organizational examination was conducted in conjunction with the Company's application for a domestic Certificate of Authority in the State of Delaware. I have reviewed the Company's Corporate Records, records applicable to and attendant with its application, as well as financial data as of November 30, 2006.

### **HISTORY**

AIX Specialty was incorporated on June 20, 2006, under the laws of the State of Delaware and authorized to issue five million (5,000,000) shares of \$1.00 par value shares. As evidenced by Certificate No. 1, all shares of the Company have been issued to NOVA Casualty Company, NY, giving the Company paid up capital of \$5,000,000.

### **MANAGEMENT AND CONTROL**

The Company's By-Laws, adopted July 26, 2006, state that the business and affairs of the Company shall be managed by a Board of Directors consisting of "not less than four (4) or more than eighteen (18) Directors", a majority of who shall be citizens and residents of the United States and at least eighteen years old. As of the November 30, 2006 examination date, the Company maintained five (5) Directors. The Directors are to be elected at the annual meeting of the Company's stockholder, to be held on the third Thursday of June, or, if any such day be a legal holiday, then on the next succeeding business day. The following individuals were elected and qualified members of the Board of Directors as of the November 30, 2006.

**Directors**

Stephen M. Mulready	Chairman, CEO, President
Craig M. Rappaport	
Christopher C. Hoover	
Richard D. Federico	
Robert D. Schultz	

**Committees**

Pursuant to Article IV of the By-Laws, the Board of Directors may designate one or more committees, each committee to consist of one or more Company directors. Any committee, to the extent allowed by law and provided in the resolution establishing such committee, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Company. As of November 30, 2006, no committees had been established.

**Officers**

In accordance with Article V of the Company's By-Laws, the officers of the Company shall be a Chairman of the Board and Chief Executive Officer (to be the same individual), a Vice Chairman (if the Board so determines), a President, one or more Vice Presidents, a Secretary and a Treasurer. Each officer shall be chosen by the Board of Directors at their first meeting after the election of the Board of Directors each year and shall hold office until their successor is chosen and qualified. Elected officers serving the Company as of November 30, 2006 were as follows:

<b><u>Officer</u></b>	<b><u>Position</u></b>
Stephen M. Mulready	Chairman of the Board, CEO and President
Christopher C. Hoover	Treasurer & CFO

Thomas F.X. Hodson	Secretary & General Counsel
Craig M. Rappaport	Senior Vice President, Operations
Robert D. Schultz	Senior Vice President, Marketing

The Board had not appointed a Vice Chairman as of the examination date. The NAIC Biographical Affidavits of the Company's Officers and Directors were reviewed during this examination. In addition, both the Conflict of Interest Disclosure Policy, as adopted by the Company's parent Board of Directors, and the signed Conflict of Interest Statements of the Company's Directors and Officers were read and accepted without exception.

### **HOLDING COMPANY SYSTEM**

At formation, the Company became a member of an Insurance Holding Company System. Though not affiliated at the time, the Holding Company Registration Statement filed by the Company's parent, NOVA Casualty Company, with the New York Insurance Department on May 12, 2006 was reviewed for the purposes of this examination. The review was without exception. The ultimate controlling parent is AIX Holding, Inc. (AIX Holdings). The control of AIX Holdings is held by Sterling Capital Partners I, L.P. (SCP I) and Sterling Capital Partners II, L.P. (SCP II), partnerships managed by Sterling Capital Partners, LLC (Sterling Capital Partners), a private equity firm founded in 1983 for the purpose of investing in buyouts, venture capital, and real estate. As of December 31, 2005, and as obtained from their two respective financial statements, SCP I and SCP II, possessed aggregate portfolio investments totaling approximately \$260.8 million, other operating assets totaling approximately \$16.9 million, and total partners' capital of approximately \$230.9 million. No financial information was obtained

regarding Sterling Capital Partners, LLC. SCP I and SCP II acquired control of NOVA American Group, Inc. (NAGI), a privately held company and the parent of NOVA Casualty, on June 29, 2005. Subsequent to its acquisition, NOVA Casualty received a \$35 million capital contribution from NAGI. As of December 31, 2005, NOVA Casualty was rated A- (Excellent) by the rating agency A.M. Best.

The organizational chart of AIX Holdings, Inc. as of December 31, 2005 is presented below:

Sterling Capital Partners II, LP	51.2%
Sterling Capital Partners I, LP	33.7
Management Team and Board of Directors	13.9
Sterling Capital Partners, GmbH&C. KG	.5
Axiom Insurance Services, Inc.	.4
U.S. Risk of Connecticut, LLC	.3
AIX Holdings, Inc	100.0
AIX, Inc. (general agent)	100.0
NOVA American Group, Inc.	100.0
NOVA Alternative Risk, LLC	100.0
NOVA Insurance Group, Inc.	100.0
Professional Underwriters Agency, Inc.	100.0
Nova Casualty Company, NY	100.0
<b>AIX Specialty Ins. Co.</b>	<b>100.0</b>

As a part of the examination, the Company's signed NAIC Form 12 - Uniform Consent to Service of Process (power of attorney), dated 12-5-06 and effective 6-22-06, was reviewed.

### **FIDELITY BOND COVERAGES**

The Company was included as a named participant in the Fidelity Bond Coverage's of AIX Holdings along with other subsidiaries of the holding company. Additionally, AIX Holdings and its subsidiaries maintain coverage for Employee Dishonesty, D&O, D&O Excess,

E&O, E&O Excess, Fiduciary Liability and Property/Liability, with limits ranging from \$1,000,000 to \$5,000,000.

## **MANAGEMENT AND SERVICE AGREEMENTS**

### **Management and Expense Agreement:**

As represented by management, the Company has no employees. As also represented, pending approval of both the Delaware and New York Departments of Insurance, the Company and its' Parent, NOVA Casualty, plan on executing a Management and Expense Agreement. A review of that unexecuted agreement shows that the Company "hereby hires NOVA ... to take all actions and perform all services that are reasonably necessary and proper for the administration of all contracts and policies." The compensation to be paid NOVA Casualty in consideration for managing the Company's business is to be actual costs and expenses. The Record Retention policies and procedures of NOVA Casualty were reviewed without exception.

### **Consolidated Tax Agreement:**

Under Addendum No. 1, dated 12-7-06, the Company was added to the Amended and Restated Consolidated Tax Agreement, dated 12-28-05, between AIX Holdings, Inc. and all its subsidiaries, excluding NOVA Alternative Risks, LLC. Under the terms of the agreement, AIX Holdings and its subsidiaries constituting an "affiliated group" as defined by the IRS intend to file consolidated tax returns. Quarterly tax payments made to AIX Holdings are to equal those estimated net tax amounts due (inclusive of losses and loss carry-forwards) calculated as if each subsidiary were filing its own separate federal income tax return.

Investment Management Agreement:

Effective 11-22-06, the Company became a named participant in the Investment Management Agreement entered into between its parent, NOVA Casualty, and Gen Re – New England Asset Management, Inc. (NEAM), originally entered into 10-10-05. Under the terms of the agreement, NEAM agrees to manage on behalf of the Company and NOVA Casualty certain identified assets according to Investment Guidelines of both companies, also identified. Investment management services provided were considered all inclusive and annual fees charged (subject to an annual minimum of \$100,000) ranged from a high of .25% on the first \$25 million of managed investments to a low of .10% on managed investments over \$150 million.

Custodial Agreement:

A Custodial Agreement dated 10-5-06, made effective 10-15-06, between the Company and Wells Fargo Bank was reviewed without exception and included the NAIC's indemnification clause. Under this agreement, Wells Fargo Bank agrees to act on the Company's behalf in providing custodial services for certain assets under the owner's management or the management of Gen Re - New England Asset Management. The agreements schedule of fees (calculated and paid quarterly) were reviewed and considered reasonable.

**PLAN OF OPERATION**

As obtained from its' Plan of Operation and pending approval, the Company has been formed primarily to serve as the surplus lines insurer for the NOVA Casualty group, writing similar niche specialty programs, specifically property and liability coverage risks not generally

insured in the admitted market. As represented by Management, it is intended that the Company, when properly licensed, will begin writing commercial property and liability coverage's, excluding wind and water surge, in the major metropolitan markets in Florida that are outside of the Florida 'Wind Pool' area. It is intended that policy distribution, underwriting, claims handling and general policy maintenance will be managed by its parent, NOVA Casualty, through its existing systems, agents, underwriters, and claims handling offices and facilities. Advertising is to be limited and directed to surplus lines brokers, not the general public. See the Management and Expense Agreement detailed above for information related to the operations management of the Company by its parent.

### **REINSURANCE**

As represented by management, and pending proper licensing and approval from both the New York and Delaware Departments of Insurance, it is intended that both the Company and its Parent, NOVA Casualty, will enter into a reinsurance pooling arrangement. A review of the proposed pooling arrangement stipulates that NOVA Casualty, acting as the pool leader accepts a 100% quota share participation in the net written premiums and liabilities of the Company. The Company in turn agrees to accept its retrocession quota share percentage participation in the pool leader's net written premium and liabilities. As presented, the Company's initial pool percentage is 28.8%. As represented by management, each company's respective quota-share pool participation is subject to change, by amendment to the agreement, given the capital positions of each company for any proceeding year-end while the agreement is in affect.

**CAPITAL AND SURPLUS REQUIREMENTS**

Section 511 (a) of the Delaware Insurance Code requires the following minimum capital and surplus amounts for a stock multiple line insurance company:

Common Capital Stock	\$500,000
Surplus as Regards Policyholders	<u>250,000</u>
Total Capital and Surplus	<u>\$750,000</u>

As shown in the section Financial Data, the Company possessed Capital of \$5,000,000 and Surplus as Regards Policyholders of approximately \$5,006,376.

**FINANCIAL DATA**

The financial position of the Company as of November 30, 2006, as determined by this examination was as follows:

<u>Assets</u>		
<b>note 1</b>	Bonds	\$ 248,627.25
<b>note 2</b>	Short Term Investments	5,000,000.00
	Interest Income Due	<u>7,853.87</u>
	Total Admitted Assets	<u>\$ 5,256,481.12</u>
 <u>Liabilities, Surplus and Other Funds</u> 		
<b>note 1</b>	Payable for Securities	\$ <u>250,104.68</u>
	Total Liabilities	\$ <u>250,104.68</u>
	Common Capital Stock	\$5,000,000.00
	Current Period Interest Income	<u>6,376.44</u>
	Surplus as Regards Policyholders	<u>\$ 5,006,376.44</u>
	Total Liabilities and Surplus as Regards Policyholders	<u>\$ 5,256,481.12</u>

**NOTES TO FINANCIAL STATEMENTS**

Note 1: Bonds		\$ 248,627.25
	Payable for Securities	250,104.68

These accounts represented the pending settlement of the Company's required statutory deposit with the Delaware Department of Insurance. As evidenced by both the custodial trade ticket and settlement notification received from the Department's service bureau, M&T Bank, the \$250,000,000 trade made on November 30, 2006 of a Fannie Mae bond, yielding 4.625% and maturing 10-15-13, settled on 12-5-06 in the investment amount of \$249,220.00.

Note 2: Short Term Investments

\$5,000,000

The Short Term Investments reported of \$5,000,000 as of November 30, 2006 was confirmed with Wells Fargo Bank, NA.

**CONCLUSION**

Based on the organizational examination conducted as of November 30, 2006, the financial condition of the AIX Specialty Insurance Company was found to be as follows:

Assets	<u>\$5,256,481.12</u>
Liabilities	\$ 250,104.68
Total Surplus as Regards Policyholders	<u>5,006,376.44</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$5,256,481.12</u>

Upon completion of the organizational examination, the Company has complied with the capitalization requirements for the State of Delaware.

The examination was conducted by the undersigned.

Respectfully Submitted,



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Steven E. Guest, CPA, CFE  
Supervising Insurance Examiner  
Department of Insurance  
State of Delaware