

REPORT ON EXAMINATION

OF THE

AIX SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2007

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
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The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly 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.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 9th day of July, 2010

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

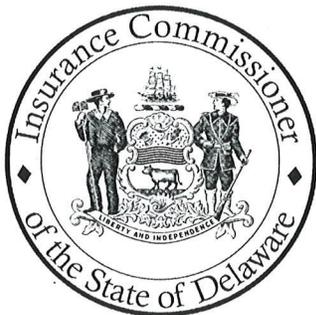
I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2007 of the

AIX SPECIALTY INSURANCE COMPANY

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

Attest By: Sonia C. Harris

Date: 9 July 2010



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 9th day of July 2010.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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SALUTATION

November 16, 2009

Honorable Karen W. Stewart, CIR-ML
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 letter 08.035, dated July 24, 2008, an examination was 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 examination was conducted at the Company’s administrative office located at 726 Exchange Street, Suite 1020, Buffalo, New York 14210.

The report of such examination is respectfully submitted herewith.

SCOPE OF EXAMINATION

An Organizational Examination was first performed on Company books and records, as of November 30, 2006. This examination covered the period December 1, 2006 through December 31, 2007, and included any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. A concurrent and coordinated examination of the Company’s parent, NOVA Casualty Company (NCC), was conducted by the New York

AIX Specialty Insurance Company

Department of Insurance (NYDOI). Under agreement, both companies participate in an intercompany quota share pooling arrangement whereby NCC retains 71.2% and the Company accepts the remaining 28.8%. We relied extensively upon the analysis and work completed by the examiners representing the NYDOI. Work relied on represented common pooled processes, the residual risk analysis of such, and resulting substantive procedures identified in order to address such risks. In addition, we relied upon their review of Corporate Governance, Consideration of Fraud and Loss Reserves.

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 current and prospective risks of the Company by obtaining information about the Company including corporate governance, assessment of management, identifying and assessing inherent risks within the Company, as well as the evaluation of both information systems technology and financial reporting system controls and procedures used to mitigate those risks. An 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, as well as compliance with Delaware laws and regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process. As part of this process, this examination included a review and assessment of the Company’s control environment assessment. The examiners also relied upon audit work performed by the Company’s independent auditors (KPMG), when appropriate.

In addition to noted items in this report, the following topics were reviewed and are included in the workpapers of this examination. No exceptions or errors were noted during our review of these items:

AIX Specialty Insurance Company

Fidelity Bond and Other Insurance
Employees and Agents Welfare
Legal Actions
Regulatory Agency Correspondence
All Asset and Liability Items Not Mentioned In This Report
Corporate Records
NAIC Ratios
Treatment of Policyholders

HISTORY

The Company was incorporated in the state of Delaware on June 20, 2006 as a wholly-owned insurance subsidiary of NOVA Casualty Company (NOVA or NCC). The Company operates as an excess and surplus lines carrier in states other than Delaware, with a focus on specialty commercial insurance business. The Company commenced writing premium on a direct basis in September of 2007.

As mentioned above, NCC and the Company entered into an intercompany reinsurance pooling agreement (the Pooling Agreement) effective January 1, 2007. Under the terms of the Pooling Agreement, the Company ceded 100% of its business to NCC (the pool leader). NCC, in turn, ceded 28.8% of the pooled results to the Company.

CAPITALIZATION

As of the examination date, the Company had authorized capital of 5,000,000 shares of \$1.00 par value common stock of which all shares were issued and outstanding, for a total of \$5,000,000 common stock. The Company has no preferred stock authorized, issued or outstanding. Nova Casualty Company owns 100% of the Company's common capital stock. The schedule below shows changes in Company capital and surplus accounts since its organization:

AIX Specialty Insurance Company

	<u>Year</u> 2006	<u>Year</u> 2007
Surplus as regards policyholders prior year	\$ 0	\$15,567,033
Net income	(1,744)	322,091
Change in net unrealized capital gains or losses		9,240
Changing that deferred income tax		950,998
Change in non-admitted assets		(333,560)
Capital changes:		
Paid in(1)	5,000,000	
Surplus adjustments:		0
Paid in: (2) (3)	<u>10,568,777</u>	<u>5,000,000</u>
Change in surplus as regards policyholders	<u>\$ 15,567,033</u>	<u>\$ 5,948,769</u>
Surplus as regards policyholders Dec. 31, current year	<u>\$ 15,567,033</u>	<u>\$ 21,515,802</u>

Dividends

The Company did not pay any dividends during this examination period.

Contributed Surplus

The following transactions related to the capitalization of the Company took place in 2006 and 2007:

(1) On November 22, 2006, NCC contributed \$5,000,000 of capital to the Company to purchase all shares of the Company's common stock.

(2) On December 28, 2006, NCC transferred bonds to the Company with a market value of \$9,181,425 as additional paid in surplus. There was also accrued interest income of \$99,490 contributed.

On December 31, 2006, NCC transferred cash to the Company in the amount of \$1,287,862 as additional paid in surplus. The December 28th and 31st contributions totaled \$10,568,777 in additional paid in surplus for 2006.

(3) On November 29, 2007, NCC contributed \$5,000,000 to the Company as additional paid in surplus.

MANAGEMENT AND CONTROL

The Company's Bylaws, 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. As of the examination date, the Company had five (5) directors. The directors are elected at the annual meeting of the shareholder and each director serves until their successor has been elected and qualified.

Directors

The following individuals comprised the Board of Directors serving the Company as of December 31, 2007.

<u>Name and Address</u>	<u>Primary Occupation</u>
Stephen Michael Mulready Windsor, CT	Chairman of the Board, President and Chief Executive Officer
Richard David Federico Northbrook, IL	Managing Director Sterling Partners
Christopher Carney Hoover Buffalo, NY	Chief Financial Officer and Treasurer
Craig Michael Rappaport Buffalo, NY	Senior Vice President
Robert Dean Schultz Windsor, CT	Senior Vice President

AIX Specialty Insurance Company

Officers

The following officers were appointed by the Board of Directors and were serving as of December 31, 2007.

<u>Name</u>	<u>Title</u>
Stephen Michael Mulready	Chairman of the Board, President and Chief Executive Officer
*Christopher Carney Hoover	Chief Financial Officer and Treasurer
Craig Michael Rappaport	Senior Vice President
Robert Dean Schultz	Senior Vice President
Thomas Francis Xavier Hodson	Secretary

*In February 2009, Mr. Christopher Carney Hoover resigned his position as Chief Financial Officer and Treasurer of the Company.

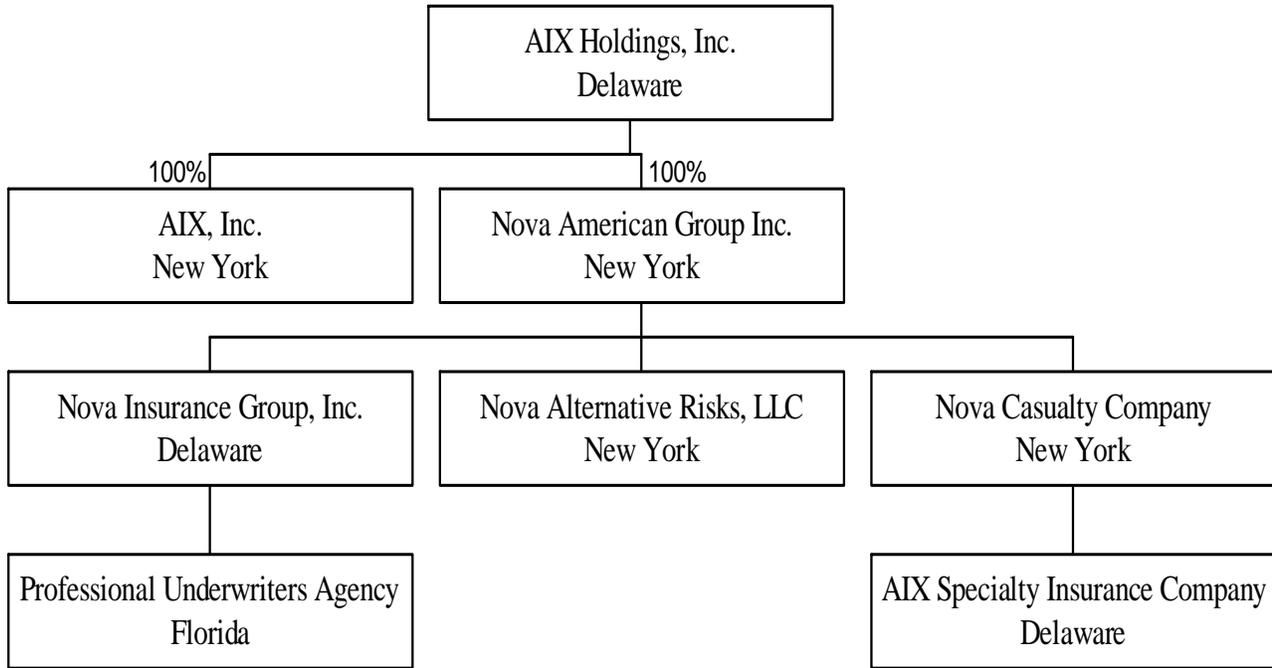
HOLDING COMPANY SYSTEM

The Company was a member of an insurance holding company system. As of December 31, 2007, the Company was a wholly-owned subsidiary of NOVA Casualty Company, a New York company. The ultimate controlling entity was AIX Holdings, Inc. (Holdings), a Delaware holding Company.

AIX Group (AIX), is a privately held insurance holding company with executive offices in Windsor, Conn. AIX was founded in 2005 by five insurance industry veterans to establish, build, and manage companies writing specialty program insurance business. This sector includes traditional first dollar programs, risk retention groups, rent-a-captive facilities, group and association captives, and hybrid collateral structures. AIX has an "A XIV" (Excellent) rating with A.M. Best Company. AIX employs approximately 150 people in four U.S. locations: California, Connecticut, Florida and New

AIX Specialty Insurance Company

York. The following organizational chart identifies members of the holding company system as of December 31, 2007.



AFFILIATED AGREEMENTS

Management and Expense Sharing Agreement

Effective January 1, 2007, the Company entered into a Management and Expense Agreement with its parent, NCC. The agreement was entered into in conjunction with its intercompany pooling agreement with NCC whereby NCC agreed to take all actions that are reasonably necessary and proper for the administration of all contracts and policies of insurance and reinsurance written by or for the Company. NCC agrees to assume full responsibility for the management, use, and disposition of the Company's non-investment type assets. The Company reimburses NCC for the actual cost of such services. The Company recorded \$565,712 of expense during 2007 related to this account.

Service Agreement

Effective April 1, 2007, the Company entered into a service agreement with an affiliate, NOVA American Group, Inc., (NAGI). The services provided by NAGI include the underwriting of proposals for insurance and when directed, to collect, receive and remit premiums. NAGI will order the motor vehicle reports, surveys and underwriting reports necessary to properly accept the underwriting proposals on behalf of the Company. In consideration of services performed, NAGI will receive a commission equal to 5% of annual written premium. Direct premiums written by the Company for which NAGI acted as servicing administrator totaled \$81,386 in 2007.

Consolidated Tax Agreement

Through Addendum No. 1, dated December 7, 2006, the Company was added to the Amended and Restated Consolidated Tax Agreement, dated December 28, 2005, between AIX Holdings, Inc. (Holdings), and all of its subsidiaries excluding NOVA Alternative Risks, LLC. Under the terms of the agreement, the subsidiaries paid to Holdings an amount equal to the federal income tax liability based on each subsidiary's current tax provision as if it were filing its own separate federal income tax return.

General Agency Agreement

Effective April 1, 2007, the Company entered into a General Agency Agreement with its affiliate, Professional Underwriters Agency, Inc., (PUA). Under the agreement, the Company appointed PUA as its managing general agent in the State of Florida. PUA will receive and transmit to the Company proposals for insurance covering the risks the Company is authorized to insure and to collect, receive and remit related premiums. PUA shall not have binding authority which is retained by the Company. In consideration for the services provided, the Company will pay PUA a commission

AIX Specialty Insurance Company

equal to 12.5% of the gross written premium produced by PUA. In addition, PUA may charge the insured a \$25 policy fee which will be retained by PUA. The Company recorded \$10,173 of commissions related to this agreement in 2007.

Expense Sharing Agreement

Effective July 16, 2007, the Company entered into an Expense Sharing Agreement with its affiliate, Professional Underwriters Agency, Inc., (PUA). Under the terms of this agreement, employees of either entity may provide services for the other and this agreement established procedures and guidelines for the reimbursement of shared expenses or actual expenses incurred by one entity on behalf of the other. The party receiving the services shall reimburse the other for actual expenses incurred. PUA did not provide any such services to the Company in 2007, nor did the Company provide any such services to PUA in 2007.

Investment Management Agreement

Through an amendment dated November 10, 2006, the Company became a named participant in the Investment Management Agreement between its parent, NOVA, and General Re-New England Asset Management, Inc. (NEAM), a Delaware Corporation. The original agreement was entered into on October 10, 2005 and NEAM agreed to manage certain identified assets on behalf of NCC and the Company in accordance with the investment guidelines of both companies. The investment management fee was based on the market value of the assets under management and ranged from a high of .25% on the first \$25 million to a low of .10% on managed investments over \$150 million. The asset management fee was subject to a \$100,000 annual minimum which is evaluated on a quarterly basis.

TERRITORY AND PLAN OF OPERATION

The Company was licensed only in the state of Delaware as of December 31, 2007. The Company was formed primarily to serve as a surplus lines insurer for 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 will begin writing commercial property and liability coverages, excluding wind and water surge, in the major metropolitan markets in Florida that are outside of the Florida “Wind Pool” area. The Company’s entire direct premium written in 2007 was written in the state of Florida. Policy distribution, underwriting, claims handling, and general policy maintenance are managed by NCC and affiliates, through agreements (see above) using existing; systems, agents, underwriters, and claims handling offices and facilities. Advertising is limited and directed to surplus lines brokers, and not the general public. See the Management and Expense Agreement detailed above for information related to the operations and management of the Company by its parent.

GROWTH OF COMPANY

Comparative financial data since its organization, as reported in the Company’s financial statements, was as follows:

<u>Year</u>	<u>Admitted Assets</u>	<u>Surplus as Regards to Policyholders</u>	<u>Net Written Premiums</u>	<u>Net Income (Loss)</u>
2006	\$15,601,784	\$15,567,033	\$ 0	(1,744)
2007	47,722,121	21,515,802	32,819,141	322,091

The Company was incorporated on June 20, 2006 and did not write or assume any business in 2006. The 2007 increase in net written premiums consisted of direct writings of \$81,386 and assumed business of \$32,819,141 from a pooling agreement with its parent, NCC.

AIX Specialty Insurance Company

The 2007 increase in surplus as regards policyholders resulted primarily from a \$5,000,000 cash contribution the Company received from NCC. See Capitalization.

The increase in admitted assets reflects the monies received from premium writings and the cash contribution from NCC.

REINSURANCE

Effective January 1, 2007, the Company entered into a quota share reinsurance pooling agreement with NCC, its parent and pool lead company. Under terms of the agreement, the Company ceded 100% of net written premiums to NCC, who in turn retroceded back to the Company 28.8% of net pooled premiums and related liabilities. The pooled balance of 71.2% is retained by NCC. In 2007, the Company recorded the following activity:

Direct premiums written	\$ 81,386
Reinsurance assumed pooling	<u>32,819,141</u>
Total direct and assumed	<u>\$ 32,900,527</u>
Reinsurance ceded-pooling	\$ 56,033
Reinsurance ceded-non pooling	<u>25,353</u>
Total ceded	<u>\$ 81,386</u>
Net premium written	<u>\$ 32,819,141</u>

Of the Company's eleven (11) assumed pooled lines of business, approximately 80% were represented by commercial multiple peril (45%), other liability (18%), and workers compensation (17%).

ACCOUNTS AND RECORDS

In accordance with the service agreements previously discussed under the section captioned "Affiliated Agreements," the Company receives all service and personnel necessary for it to conduct operations. The accounts and records reviewed included a review and evaluation of the Company's operational structure. The Company's accounts and records are maintained at its home office in

AIX Specialty Insurance Company

Buffalo, NY. The Company utilizes the NCC mainframe located in Buffalo for processing, updating and storing its primary records. Personal computers and file servers support financial reporting and analysis. In general, it has been determined that the Company has a sufficient level of controls in place for all of the above areas. The Company performs full system backups and rotates copies of programs and data files to its off-site storage facility on a weekly basis. The Company has a disaster recovery plan that covers its mainframe operations that is periodically tested.

On a monthly basis, the Company prepares internal financial statements for review, and analysis. During month end close, Accounting Department personnel each have various journal entries assigned to them to post summary activity to the general ledgers. Various summary reports are generated from the Inspire premium/claims system and from New England Asset Managers, which are used to book the journal entries to the general ledgers. To post specialty program business activity to the general ledger, journal entries are derived from program specific premium and loss data entered into program specific Excel spreadsheets that contain all of the direct and ceded parameters unique to that program. Premium and loss data for the programs comes from several sources including the Cover all policy rating and issuance system, claims bordereaux from third party administrators and data provided by the program managers directly. Many of the journal entries recorded by the Accounting Staff are recurring in nature. Journal entries are reviewed and approved by the Director of Accounting, the Controller, the Accounting Manager or the Director of Statutory Accounting and are entered into EAS, the general ledger system installed in 2007. All journal entries are filed in a central location in the Accounting Department.

Monthly general ledgers for NCC and the Company are reviewed by the Controller. Once ledgers are complete they are forwarded to the Director of Accounting, who prepares statutory financial statements for both NCC and the Company and consolidated and consolidating GAAP

AIX Specialty Insurance Company

financial statements for all entities. All STAT to GAAP and consolidating journal entries prepared by the Director of Accounting are reviewed and approved by the CFO, the Controller, or the Director of Statutory Accounting. Also, all general ledger data input is reviewed by the CFO, the Controller, or the Director of Statutory Accounting. Both the statutory and GAAP FS compare actual results to budget and prior year. The CFO reviews the financial results each month and prepares a report (CFO Letter) that, together with the Presidents Letter and various financial and operational reports, is shared with Senior Management and the Board of Directors.

FINANCIAL STATEMENTS (PER EXAMINATION)

The financial statements as determined by this examination are presented as follows:

Analysis of Assets, as of December 31, 2007

Liabilities, Capital and Surplus, as of December 31, 2007

Statement of Income, for the period January 1, 2007 to December 31, 2007

Statement of Capital and Surplus, for the period January 1, 2007 to December 31, 2007

ASSETS

As of December 31, 2007

	Assets	Non- admitted Assets	Net admitted Assets	Notes
Bonds	\$36,662,513	\$0	\$36,662,513	Note 1
Preferred stocks	514,000	0	514,000	
Cash and short-term investments	<u>2,108,939</u>	<u>0</u>	<u>2,108,939</u>	
Subtotal cash and invested assets	\$39,285,452	\$0	\$39,285,452	
Investment income due accrued	349,370		349,370	
Uncollected premiums and agents balances in the course of collection	3,704,547	0	3,704,547	
Agents balances booked but deferred and not yet due	35,649	0	35,649	
Funds held by or be deposited with reinsured companies	276,131	0	276,131	
Net deferred tax asset	946,243	333,560	612,683	
Guaranty funds receivable or on deposit	20,421	0	20,421	
Receivables from parent, subsidiaries and affiliates	3,303,679	0	3,303,679	
Aggregate write-ins for other than invested assets	<u>134,189</u>	<u>0</u>	<u>134,189</u>	
Total assets	<u>\$48,055,681</u>	<u>\$333,560</u>	<u>\$47,722,121</u>	

LIABILITIES, CAPITAL AND SURPLUS

Losses	\$13,194,314	Note 2
Reinsurance payable on paid losses and loss adjustment expenses	561,128	
Loss adjustment expenses	2,453,947	
Commissions payable contingent commissions and other similar charges	38,818	
Other expenses	873,300	
Taxes, licenses and fees	268,919	
Current federal and foreign income taxes	1,565,102	
Unearned premiums	6,471,282	
Advanced premiums	10,326	
Ceded reinsurance premiums payable	16,876	
Funds held by company under reinsurance treaties	47,779	
Remittances and items not allocated	673,115	
Aggregate write-ins for liabilities	<u>31,413</u>	
Total liabilities	<u>\$26,206,319</u>	
Common capital stock	\$5,000,000	
Gross paid in and contributed surplus	15,568,776	
Unassigned funds	<u>947,026</u>	
Surplus as regards policyholders	<u>\$21,515,802</u>	
Total liabilities and surplus	<u><u>\$47,722,121</u></u>	

STATEMENT OF INCOME
For the Year Ending December 31, 2007

Premiums earned	\$26,347,859
Deductions	
Losses incurred	\$16,799,623
Loss expenses incurred	4,046,238
Other underwriting expenses incurred	<u>5,544,489</u>
Total underwriting deductions	<u>\$26,390,350</u>
Net underwriting gain or loss	<u>\$ (42,491)</u>
Investment income	
Net interest income earned	\$ 1,381,715
Net realized capital gains	<u>(590)</u>
Net investment gain	<u>\$ 1,381,125</u>
Other income	
Net gain from agents or premium balances charged off	\$ (17,480)
Finance and service charges not included in premiums	280,435
Aggregate writing for miscellaneous income	<u>286,806</u>
Total other income	<u>\$ 549,761</u>
Net income before dividends to policyholders	\$ 1,888,395
Federal and foreign income taxes incurred	<u>1,566,304</u>
Net income	<u>\$ 322,091</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders Dec. 31, prior year	<u>\$15,567,033</u>
Net income	\$ 322,091
Change in net unrealized capital gains or losses	9,240
Change in net deferred income tax	950,998
Change in non-admitted assets	(333,560)
Surplus adjustments:	0
Paid in:	<u>5,000,000</u>
Change in surplus as regards policyholders	<u>\$ 5,948,769</u>
Surplus as regards policyholders Dec. 31, current year	<u><u>\$21,515,802</u></u>

NOTES TO FINANCIAL STATEMENTS

Note 1: Bonds \$36,662,513

Bonds, comprising 76.82 % of total admitted assets, were determined to be the same amount as reported by the Company in its Annual Statement. Of the Company's investments in bonds, 98.88% were classified by the NAIC SVO as class 1 or 1FE and 1.12% were classified as class 2 or 2FE.

Note 2: Losses \$13,194,314
Loss Adjustment Expenses \$ 2,453,947

The Company's Losses and Loss Adjustment Expense reserves were examined in conjunction with the New York Department of Insurance examination of Nova Casualty Insurance Company. The New York Department's Actuary examined the pooled losses for NCC and the Company, and reviewed the methodology used by the Pool to arrive at its 2007 loss and loss adjustment reserves. As a result of this review and independent tests conducted regarding this analysis, the Actuary accepted the Pooled reserve amounts established by the Company.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company's previous examination was an organizational examination. No recommendations were included in the examination report.

EXAMINATION FINDINGS AND RECOMMENDATIONS

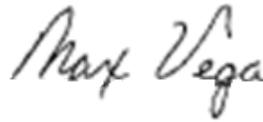
No exceptions, errors, or problems were noted by the examination team.

CONCLUSION

As of our December 31, 2007 examination, we determined the Company to have admitted assets of \$47,722,121, liabilities of \$26,206,319, and capital and surplus of \$21,515,802.

The cooperation and assistance extended by the officers and employees of the Company in the conduct of the examination was appreciated.

Respectfully submitted,

A handwritten signature in cursive script that reads "Max Vega".

Max P. Vega, CFE
Examiner-in-Charge
Delaware Department of Insurance

SUBSEQUENT EVENTS

The Hanover Insurance Group, Inc. (THG) purchased all of the outstanding stock of AIX Holdings, Inc in November 2008. The purchase created new officers and directors of the Company. The new Officers of the Company as of December 31, 2008 are:

Marita Zuraitis	President
Eugene Bullis	Executive VP, CFO & Assistant Treasurer
Robert Myron	Treasurer
Charles Cronin	Secretary

The new Directors of the Company as of December 31, 2008 are:

Eugene Bullis
David Firstenberg
Andrew Robinson
Marita Zuraitis
Frederick Eppinger
J. Kendall Huber
Robert Schultz

Effective November 28, 2008, the intercompany Tax Sharing Agreement was terminated. Effective January 1, 2009, the pooling agreement between Nova and the Company was terminated by mutual consent. Also effective January 1, 2009, the Company entered into a reinsurance agreement with The Hanover Insurance Company (Hanover), an affiliated insurer. Upon transition, all insurance-related liabilities will be ceded 100% to Hanover and will be settled by transferring cash and securities to Hanover. As of that date, all new and renewal business will be reinsured with Hanover. Subsequent to the acquisition of AIX, the Company was added as a participant to existing Intercompany Consolidated Tax, Investment Management, and Intercompany Consolidated Services agreements with various members of The Hanover Insurance Group.