

REPORT ON EXAMINATION
OF THE
AIX SPECIALTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

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, 2011 of the

AIX SPECIALTY INSURANCE COMPANY

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

Attest By: *Brandi Biddle*

Date: May 30, 2013



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 30th day of May, 2013.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
OF THE
AIX SPECIALTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

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.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart", is written over a horizontal line.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 30th day of May, 2013

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SALUTATION

March 8, 2013

Honorable Karen Weldin-Stewart-CIR-ML
Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 12.037, an Association examination has been made of the affairs, financial condition and management of the

AIX SPECIALTY INSURANCE COMPANY

hereinafter referred to as (Company or ASIC) incorporated under the laws of the State of Delaware as a stock company. The Company's statutory home address is 103 Foulk Road, Suite 202, Wilmington, Delaware 19803-3742. The examination was conducted at the administrative office of the Company located at 440 Lincoln Street, Worcester, Massachusetts 01653.

The report of this examination is submitted herewith.

SCOPE OF EXAMINATION

A full scope risk-based financial examination was conducted on ASIC, a Delaware domestic. The examination was conducted in accordance with the Examination guidelines established by the National Association of Insurance Commissioners (NAIC). Delaware Insurance Examiners performed procedures in accordance with the NAIC *Financial Condition*

Examiners Handbook (Handbook) and Delaware Insurance Code. The last examination was conducted as of December 31, 2007. This examination is a comprehensive risk-focused examination which covers the three year period from January 1, 2008 to December 31, 2011, and encompassed a general review of the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of financial condition at December 31, 2011. Transactions and operations subsequent to the examination date were reviewed where deemed necessary.

The NAIC Handbook requires that examiners plan and perform the examination to assess financial condition and identify prospective risks by evaluating Company information including operations, corporate governance, identifying and assessing material inherent risks to which, the Company is considered exposed and evaluating processes, systems, controls and other procedures used to mitigate those risks. The examination also included assessing principles used and significant estimates made by management, as well as evaluating overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, PricewaterhouseCoopers, LLP (PwC). Certain auditor work papers of their 2011 audit have been incorporated into the work papers of this examination and have been utilized principally in the area of tests of controls, risk mitigation and substantive tests of account balances.

A coordinated examination was conducted by Michigan, Ohio and Indiana as of December 31, 2011, on Citizens Insurance Company, Allmerica Financial Benefits Insurance Company, Citizens Insurance Company of the Midwest and Citizens Insurance Company of Ohio (collectively referred to as "Citizens"). The coordinated examination was performed for

the period from January 1, 2008 through December 31, 2011 and was concluded on September 24, 2012. During the course of the examination consideration was given to the work performed by the Citizens examination. Certain examiner work papers of their examination conducted as of December 31, 2011, have been incorporated into the work papers of this examination and have been utilized principally in the areas of claims, actuarial reserves, investments and information technology.

In addition to items hereinafter incorporated as a part of this report, the following were reviewed without material exception and made part of the work papers of this examination:

- NAIC Ratios
- Legal Actions
- Regulatory Agency Correspondence
- All other Assets and Liabilities not mentioned
- Special Deposits

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings as a result of this examination.

SUBSEQUENT EVENTS

There were no significant subsequent events that occurred after the examination period for ASIC. However, The Hanover Group, Inc. (THG) released a statement during the second quarter of 2012 that reserves would increase due to increased automobile and surety, and catastrophe losses.

COMPANY HISTORY

ASIC was incorporated in the state of Delaware on June 20, 2006, as a wholly-owned subsidiary of Nova Casualty Company (NCC). NCC is a wholly-owned subsidiary of AIX Holdings, Inc (AIX Holdings). In November of 2008, THG purchased all outstanding stock of AIX Holdings. Subsequently, in September of 2009, The Hanover Insurance Company

(Hanover) purchased AIX Holdings and subsidiaries from THG in an intercompany sales transaction.

The Company is licensed in the state of domicile, Delaware, but eligible to do business in 49 other states and the District of Columbia. The Company operates as an excess surplus lines carrier in states other than Delaware, with a focus on specialty commercial insurance business.

The Company entered into an Intercompany Reinsurance Agreement with Hanover effective February 26, 2009. Under the terms of the Intercompany 100% Quota Share Reinsurance Agreement, all business is ceded 100% to Hanover.

CAPITALIZATION

At December 31, 2011, the Company had 5,000,000 shares of authorized and issued common stock with a par value of \$1 per share for a total capitalization of \$5 million. All issued shares were owned by AIX Holdings. On November 28, 2008, THG purchased all outstanding stock of AIX Holdings. Subsequently, in September of 2009, Hanover purchased all outstanding stock of AIX Holdings from THG.

CORPORATE RECORDS

The recorded minutes of the sole shareholder and Board of Directors (Board) were reviewed for the period under examination. The recorded minutes of the Board adequately documented meetings of the Board and approval of Company transactions and events, including the authorization of investments as required by 18 Del.C. § 1304.

MANAGEMENT AND CONTROL

Management

Pursuant to the General Corporation Laws of Delaware as implemented by the Company's Certificate of Incorporation and Bylaws, all corporate powers of the Company and its business, property, and affairs were managed under the direction of the Board.

Board of Directors

In accordance with Article III, Section 1 of the Bylaws, the number of Directors shall be no less than four (4) and no more than eighteen (18) Directors. Furthermore, pursuant to Article II Section 5 of the Bylaws, the Directors shall be elected at the annual meeting of the Shareholder. Each Director serves a term of one year. The following ASIC Directors served as of December 31, 2011:

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Fredrick H. Eppinger Worcester, MA	President and CEO The Hanover Insurance Group, Inc.
David B. Greenfield Worcester, MA	Executive Vice President and CFO The Hanover Insurance Group, Inc.
J. Kendall Huber Worcester, MA	Executive Vice President and General Counsel The Hanover Insurance Group, Inc.
Andrew S. Robinson Worcester, MA	President of Specialty Lines The Hanover Insurance Group, Inc.
John C. Roche Worcester, MA	President of Business Insurance The Hanover Insurance Group, Inc.
Robert D. Schultz Windsor, CT	President of AIX Holding Companies The Hanover Insurance Group, Inc.
Marita Zuraitis Worcester, MA	President of the P&C Companies The Hanover Insurance Group, Inc.

Officers

In accordance with Article V Section 1, of ASIC Bylaws, officers of the Company were elected annually by the Board and shall be a Chairman of the Board, a President, one or more Vice Presidents, a Treasurer and a Secretary.

The following ASIC Officers and respective titles served as of December 31, 2011:

<u>Name</u>	<u>Position</u>
Fredrick H. Eppinger	Chairman of the Board
Maritia Zuraitis	President
Ann K. Tripp	Vice President and Treasurer
Charles F. Cronin	Secretary

The Delaware Department of Insurance was properly notified of changes in Directors and Officers occurring during the examination period.

Committees

Hanover's Audit Committee serves as ASIC's Audit Committee. The ASIC Board has no committees as those functions were handled by the committees of Hanover's Board.

The Hanover Board has established committees including; Audit Committee, Compensation Committee, Nominating Committee and Governance Committee. Each committee consists solely of independent directors. ASIC ultimately benefits from the functions of these committees and from the governance of the Hanover Board.

Conflicts of Interest

The Company maintains a formal written Conflict of Interest Policy outlined within Hanover's Code of Ethics policy. Officers and Directors were required to sign annual Conflict of Interest Statements.

In accordance with provisions of the Delaware Examination Handbook, an inquiry was sent to the Company requesting any information on any Director, Officer or employee that had been convicted of a felony. None of the Hanover employees were convicted of a felony during the examination period. All personnel is employed through Hanover, ASIC does not have any employees.

Control

The ultimate controlling entity is Hanover, a publicly traded company domiciled in New Hampshire with its principal place of business at 440 Lincoln Street Worcester, Massachusetts 01653.

HOLDING COMPANY SYSTEM

ASIC, Hanover, and its upstream affiliates are members of THG. THG is a publicly traded holding company that is incorporated in Delaware. There were five common Directors on both the Hanover and ASIC's Board. ASIC is a wholly owned subsidiary of NOVA Casualty Insurance Company (NCC), which in turn is a wholly-owned subsidiary of NOVA American Group, Inc. (NAGI). NAGI, in turn, is a wholly-owned subsidiary of AIX Holdings, which in turn is a wholly-owned subsidiary of Hanover, domiciled in New Hampshire. Hanover, in turn, is a wholly-owned subsidiary of Opus Investment Management, Inc. (OPUS). OPUS in is a wholly-owned non-insurance subsidiary of THG, a publicly traded company incorporated in Delaware. The common stock of THG is traded on the New York Stock Exchange.



AFFILIATED AGREEMENTS

Consolidated Services Agreement

Effective on January 1, 2009, ASIC became party to an existing Consolidated Services Agreement between Hanover and United States domestic affiliates. The Consolidated Services Agreement includes any services that would be required by the operations of the affiliates. Each of the affiliate companies may provide services to any of the other companies. Under the Consolidated Service Agreement, legal entities will be charged for the cost of the service provided or expenses paid by the entity providing the service or paying the expense. In addition, the entities will be charged a portion of the costs associated with activities that were performed for the good of THG legal entities. Hanover provides the companies with management, space, and other services including accounting, electronic data processing, human resources, legal and other staff functions.

An updated version of the Consolidated Services Agreement was executed in May of 2010. The updated Consolidated Services Agreement contained changes made at the request of the California Department of Insurance to gain licensure for another company. The changes included the addition of the identification of the current members of THG, a clarification where each member shall have ultimate control and responsibility of the delegated functions and the change in language to provide that the agreement is no longer assignable. The updated Consolidated Service Agreement was retroactively effective as of January 1, 2010.

Consolidated Tax Agreement

All the United States domestic companies in THG are part of a Consolidated Tax Agreement. Under the Consolidated Tax Agreement, current taxes are allocated among all affiliated companies based on a written tax sharing agreement and are made primarily on a

separate return basis. Any current tax liability is paid to THG. Tax benefits resulting from taxable operating losses or credits of THG's subsidiaries were reimbursed to the subsidiary when such losses or credits can be utilized on a consolidated return basis.

Investment Advisory Agreement

ASIC and all THG insurance affiliates were part of an Investment Advisory Agreement with OPUS. ASIC was added to the preexisting Investment Advisory Agreement on February 1, 2009. As noted previously, OPUS is a member of THG. Expenses and fees paid by ASIC under the Investment Advisory Agreement were established on both a direct cost basis and on an allocation basis in accordance with SSAP 70 "Allocation of Expenses". Under the Investment Advisory Agreement OPUS agrees to follow the investment guidelines supplied by and approved by the ASIC Board.

Service and General Agency Agreement

Effective July 16, 2007, the Company was party to a Service Agreement with NAGI and a General Agency Agreement with Professional Underwriters Agency, Inc. (PUA). The agreements remain in force as of December 31, 2011. Under the terms of the Service Agreement, NAGI performs various underwriting and collection services for the Company. NAGI receives a 5% commission on annual written premium. Under terms of the General Agency Agreement, PUA receives and transmits proposals for insurance coverage and collects related premiums. The Company pays PUA a commission of 12.5% on annual written premium.

FIDELITY BONDS AND OTHER INSURANCE

The Company's fidelity insurance coverage met the minimum requirements suggested by the NAIC. In addition, the Company was afforded insurance protection of THG policies; Directors and Officers, Errors and Omissions Liability, General liability, fire and theft.

TERRITORY AND PLAN OF OPERATION

ASIC is licensed to write in the state of domicile, Delaware. The Company is eligible to do business in 49 other states and the District of Columbia as an excess surplus lines carrier. The Company writings focus on specialty commercial insurance lines of business.

The Company was formed primarily to serve as a surplus lines writer of niche specialty programs, specifically property and liability coverage risks generally not insured in the admitted market. Since 2008, management's primary focus is on the continued growth of group-wide specialty commercial insurance business.

The Company writes business pursuant to the Service Agreement with NAGI, using licensed surplus agents who have the authority to underwrite and bind the business on ASIC's behalf. Program Managers oversee classes of business with supporting agents within the programs.

The Company cedes 100% of direct written premiums and losses incurred to Hanover. The Company's five most significant states in 2011 based on direct premiums written were California, Florida, Illinois, Texas and New York. The top five states represent in total, approximately 62.3% of total direct premiums written in 2011.

GROWTH OF THE COMPANY

	Net Admitted Assets	Surplus as Regards to Policyholders	Gross Written Premium	Net Income
2008	\$55,247,156	\$20,331,545	\$26,541,037	\$(1,464,574)
2009	\$48,445,768	\$46,654,597	\$14,785,014	\$2,537,743
2010	\$49,618,093	\$48,008,287	\$35,370,008	\$1,227,924
2011	\$49,893,373	\$48,983,027	\$45,036,369	\$1,421,862

Throughout the examination period, premiums have significantly increased due to an increase in the specialty programs business. The negative written premium in 2009 was the

result of the THG acquisition and the implementation of the Intercompany 100% Quota Share Reinsurance Agreement between the Company and Hanover where-by the Company cedes 100% of the business to Hanover. Since the THG acquisition, the Company's premium growth has been aided by THG's capital strength and industry ratings.

The capital and surplus of the Company increased in 2009 due to a capital contribution of \$25 million made by Hanover.

REINSURANCE

Effective January 1, 2007, the Company entered into an Intercompany Quota Share Reinsurance Pooling Agreement with NCC. Under the 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% was retained by NCC. The reinsurance agreement was terminated between the Company and NCC, effective January 1, 2009.

Effective January 1, 2009, the Company entered into a 100% Quota Share Reinsurance Agreement with its parent Company, Hanover. All business is ceded to Hanover.

The Company does not assume any reinsurance.

LOSS EXPERIENCE

The Company did not report any net loss and loss adjustment expense reserves during the period under examination as a result of an Intercompany 100% Quota Share Reinsurance Agreement with Hanover. This agreement is discussed above in the "Reinsurance" section. The Company's 2011 Annual Statement Five-Year Historical Exhibit reported gross losses paid of \$12,001,187 in 2011 and \$11,422,955 in 2010.

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 review performed included an evaluation of the Company’s operational structure. The Company’s accounts and records were maintained at its holding company home office in Worcester, Massachusetts; in the ASIC operational offices Windsor, Connecticut, and in the ASIC systems location in Buffalo, New York. The financial reporting, investment, and related party processes were concentrated in Worcester, Massachusetts. The Company utilizes its own premium and claims processing systems located in Buffalo, New York. The processing systems service the Company’s main claims and premium processing location in Windsor, Connecticut.

In general, it has been determined that the Company has a sufficient level of controls in place for its accounting and reporting processes. These processes include information technology general controls.

The Company’s underwriting function includes the transmission of application and loss data via a secure internet interface from brokers and third party claims administrators (TPAs). On a monthly basis, detail accounting records are transmitted to the holding company headquarters for use in the preparation of various journal entries and general ledger entries. All cash receipts are routed to the holding company headquarters. The general ledger is maintained using Oracle’s PeopleSoft software.

Investment management and accounting activities were provided at the holding company headquarters using Princeton Financial System’s Portfolio Accounting Management (PAM) software.

FINANCIAL STATEMENTS

The following pages contain the Company's Financial Statements for the year ending December 31, 2011, as determined by this examination, with supporting exhibits as detailed below:

Assets,
Liabilities, Surplus and Other Funds
Summary of Operation
Reconciliation of Capital and Surplus,

AIX SPECIALTY INSURANCE COMPANY**ASSETS****DECEMBER 31, 2011**

	<u>Assets</u>	<u>Non-Admitted Assets</u>	<u>Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 45,648,395	\$ 0	\$ 45,648,395	(1)
Cash	2,812,439	0	2,812,439	
Receivables for securities	<u>33,078</u>	<u>0</u>	<u>33,078</u>	
Subtotals, cash and invested assets	\$ 48,493,912	\$ 0	\$ 48,493,912	
Investment income due and accrued	520,479	0	520,479	
Net deferred tax asset	306,443	0	306,443	
Receivables from parent, subsidiaries and affiliates	572,539	0	572,539	
Aggregate write-ins for other than invested assets	<u>935,490</u>	<u>935,490</u>	<u>0</u>	
Totals	<u><u>\$ 50,828,863</u></u>	<u><u>\$ 935,490</u></u>	<u><u>\$ 49,893,373</u></u>	

AIX SPECIALTY INSURANCE COMPANY
LIABILITIES, SURPLUS AND OTHER FUNDS

DECEMBER 31, 2011

		Notes
Loss and Loss Adjustment Expenses	\$ 0	(2)
Current federal and foreign income taxes	164,515	
Ceded reinsurance premiums payable	72,272	
Payable to parent, subsidiaries and affiliates	673,559	
Total Liabilities	\$ 910,346	
Common capital stock	\$ 5,000,000	
Gross paid-in and contributed surplus	\$ 40,568,776	
Unassigned funds (surplus)	3,414,251	
Surplus	\$ 43,983,027	
Surplus as regards policyholders	\$ 48,983,027	
Total Liabilities, Capital and Surplus	\$ 49,893,373	

AIX SPECIALY INSURANCE COMPANY

SUMMARY OF OPERATION

DECEMBER 31, 2011

Investment Income

Net investment income earned	\$	1,915,543	
Net realized capital gains or (losses)		<u>167,103</u>	
Net investment gain or (loss)	\$		<u><u>2,082,646</u></u>

Other Income

Net income before federal income taxes	\$	2,082,646	
Federal income taxes incurred		<u>660,784</u>	
Net income	\$		<u><u>1,421,862</u></u>

AIX SPECIALTY INSURANCE COMPANY
RECONCILIATION OF CAPITAL AND SURPLUS

DECEMBER 31, 2011

Surplus as regards policyholders, December 31, 2010	\$ <u>48,008,287</u>
 <u>Gains and (losses) in surplus</u>	
Net income	\$ 1,421,862
Change in net deferred income tax	74,073
Change in non-admitted assets	<u>(521,195)</u>
Change in surplus as regards policyholders for the year	\$ <u>974,740</u>
Surplus as regards policyholders, December 31, 2011	\$ <u><u>48,983,027</u></u>

NOTES TO FINANCIAL STATEMENTS

Note (1): Bonds \$ 45,648,395

Investments in bonds were reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. Of the Company's investment in bonds, 70.1% were classified by the NAIC SVO as class 1 or 1FE and 29.9% were classified as 2 or 2FE.

Note (2): Loss and Loss Adjustment Expense Reserves \$ _____ 0

The Company did not report any net loss and loss adjustment expense reserves as a result of an Intercompany 100% Quota Share Reinsurance Agreement with Hanover. This agreement is discussed above in the "Reinsurance" section.

An independent analysis of the THG United States domestic reserves was performed as part of the 2011 coordinated examination conducted by Michigan, Ohio and Indiana. The analysis included the ASIC business that is ceded pursuant to the Intercompany 100% Quota Share Reinsurance Agreement. Based upon the analysis performed of the gross and ceded reserves, the independent analysis concluded that the carried reserves fall within a reasonable range of reserve estimates at December 31, 2011.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

There were no prior examination report findings noted.

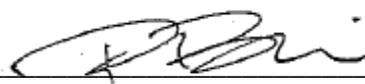
SUMMARY OF RECOMMENDATIONS

No recommendations were made as a result of this examination.

CONCLUSION

The assistance and cooperation of the Company's outside audit firm PwC and the Company's management and staff was appreciated and is acknowledged.

Respectfully submitted,



Peter Bliss, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC