REPORT ON EXAMINATION

OF THE

AMERICAN ALTERNATIVE INSURANCE CORPORATION

AS OF

DECEMBER 31, 2008

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, 2008 of the

AMERICAN ALTERNATIVE INSURANCE CORPORATION

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

Attest By: Sonia C. Harris

Date: 24 June 2010

Insurance Commissioner of the State of Delaware

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 24th day of June 2010.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

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AMERICAN ALTERNATIVE INSURANCE CORPORATION

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DECEMBER 31, 2008

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 23rd day of June, 2010

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June 24, 2010

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Honorable Karen Weldin Stewart CIR-ML
Commissioner Delaware Department of Insurance
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Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09.005, dated December 24, 2008, an Association examination has been made of the affairs, financial condition and management of the

AMERICAN ALTERNATIVE INSURANCE CORPORATION

hereinafter referred to as “Company” or “AAIC” and incorporated under the laws of the State of Delaware as a stock company with its home office located at, 2711 Centerville Road, Suite 400 Wilmington, Delaware 19808. The examination was conducted at the main administrative office of the Company, located at 555 College Road East, Princeton, New Jersey 08543.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2005. This examination covers the period since that date through December 31, 2008, and consisted of a general review of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

The format of this report is designed to explain the procedures employed on examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

The general procedures of the examination followed rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC") and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc performed an information systems review.

This examination ran concurrently with the examinations of two Delaware domestic affiliated insurers: Munich Reinsurance America, Inc. ("MRAm") and The Princeton Excess and Surplus Lines Insurance Company ("PESLIC").

In addition to items hereinafter incorporated as a part of the written report, the following items were checked without material exception and made part of the workpapers of this examination:

Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Legal Action
All Asset and Liability Items not mentioned

HISTORY

American Alternative Insurance Corporation was incorporated as an insurer in New York on April 26, 1923, under the original name of American Union Insurance Company of New York. The Company's name was changed in 1987 to American Union Reinsurance Company.

On January 1, 1994, American Re Corporation acquired American Union Reinsurance Company from American States Insurance Company, an Indiana domiciled insurer. American Re Corporation is a Delaware incorporated holding company and the sole owner of American Alternative Insurance Corporation.

On August 13, 1996, American Re Corporation (name changed on September 5, 2006 to Munich Re America Corporation "MRAC"), the Company's immediate parent, entered into an Agreement and Plan of Merger with Munchener Ruckversicherungs-Gesellschaft Aktiengesellschaft ("Munich Re Germany" or "MRG") and Puma Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of MRG. Pursuant to terms of the Merger Agreement, on November 25, 1996, following approval of the merger by MRAC's stockholders and applicable regulatory authorities, Puma Acquisition Corporation was merged with MRAC with the latter being the surviving company.

During July 1997, MRAC and MRG completed the merger of Munich American Reinsurance Company ("MARC"). At that time, the insurance assets and liabilities of the U.S. Branch of MRG were merged into MRAm (an affiliate of AAIC). After the merger, MRG's ownership of MRAC stood at 91%. The remaining outstanding shares in MRAC were acquired from Victoria Versicherung AG in 1998 and from Allianz Aktiengesellschaft in 1999, bringing MRG's ownership interest in MRAC to 100%.

Munich-American Holding Corporation ("MAHC"), a Delaware Holding Company, was organized in September 2000. After regulatory approval, MRG contributed all of the issued and outstanding stock of MRAC (and therefore its subsidiaries) to MAHC.

No changes occurred in ownership during the examination period.

CAPITALIZATION

Common Capital Stock

As of December 31, 2008, the Company had issued 3,200 shares of $1,600 par value Common Capital Stock amounting to $5,120,000. All of these shares were issued to MRAC.

Dividends

The Company paid an ordinary dividend in the amount of $12,000,000 to MRAC in 2006. In 2007 the Company paid an extraordinary dividend which was approved by the Delaware Insurance Department in the amount of $13,900,000. In 2008 the Company paid two ordinary dividends in the amounts of $13,800,000 in April and $1,750,000 in December both in the form of cash.

Surplus Note

On June 24, 2002, the Company issued a $92,500,000 Promissory Capital Note to MRAm at a 5% annual interest rate. The Note was approved by the Delaware Insurance Department. All, or any part, of the principal or interest due pursuant to this Note may be repaid at any time, or from time to time, without penalty, but subject to the prior written approval of the Delaware Insurance Commissioner. In accordance with the 5% annual interest rate, the

Company paid MRAm $4,625,000 in interest during 2008, which was approved by the Delaware Insurance Department.

MANAGEMENT AND CONTROL

Stockholders

In accordance with Article II, Section I of the Company's bylaws, the annual meeting of the stockholders shall be held each year on a date and at a time designated by the Board of Directors. At each annual meeting, directors shall be elected and any other proper business may be transacted. A majority of the stock issued outstanding and entitled to vote at any meeting of stockholders, in person or represented by proxy, shall constitute a quorum. As previously noted, the Company has only one stockholder, MRAC.

Board of Directors

In accordance with Article III, Section I of the Company's bylaws, the Board of Directors shall consist of not less than three, nor more than eleven members. The number of directors shall be fixed or changed from time to time, by vote of the stockholders or by the then appointed directors. A majority of the members shall constitute a quorum for the transaction of business at any meeting of the Board. The directors are elected at the annual meeting of the stockholder and each director serves until the next annual election and until their successors are qualified and elected.

At December 31, 2008, the members of the Board of Directors, together with their principal business affiliation, were as follows:

Name	Principal Business Affiliation
Pina C. Albo	Munich Reinsurance America, Inc.
John W. Hayden	American Modern Insurance Group, Inc.
Anthony J. Kuczinski	Munich Reinsurance America, Inc.
M. Steven Levy	Munich Reinsurance America, Inc.
Craig R. Smiddy	American Alternative Insurance Corporation

Officers

At December 31, 2008, the principal officers of the Company were as follows:

Name	Title
Anthony J. Kuczinski	Chairman
John W. Hayden	Vice Chairman and Chief Executive Officer
Craig R. Smiddy	President
M. Steven Levy	Senior Vice President and Chief Financial Officer
John W. Rogers	Senior Vice President and Chief Claims Officer
Robin H. Willcox	Senior Vice President, General Counsel & Secretary
Kenneth J. Jenkins	Vice President and Chief Underwriting Officer

Bylaws

A review of the Company's bylaws revealed that no changes were made during the examination period.

CORPORATE GOVERNANCE

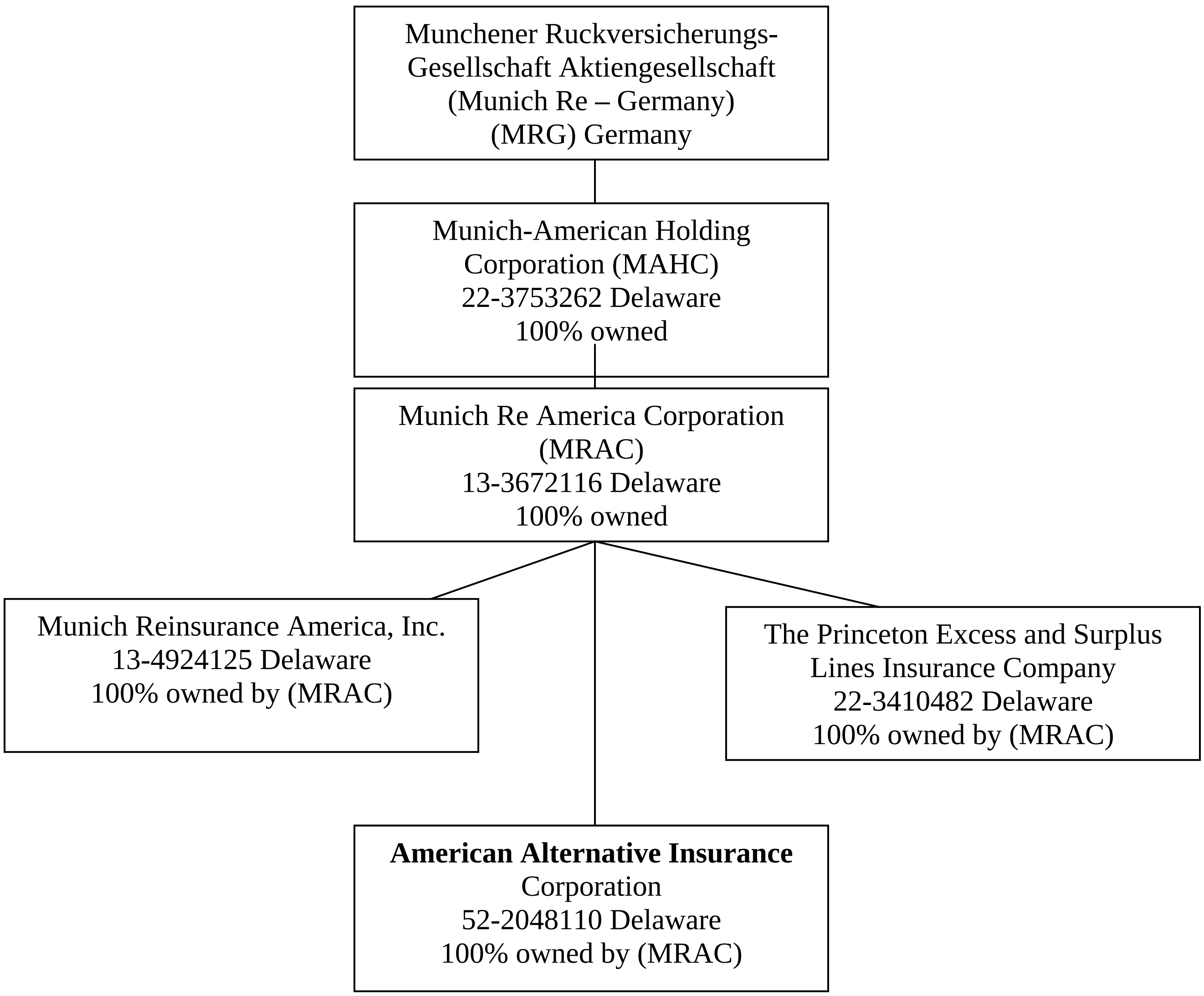
Our review of corporate governance was designed to assess the impact of the Board of Directors and management on the control environment within the organization. The control environment is heavily influenced by the decisions at the top of an organization and the control consciousness of its people is influenced in the establishment of the process. Control consciousness is developed through such intangibles as integrity, ethical values and competence of the entity's people, management's philosophy and operating style, but also through more concrete expressions such as the way management assigns authority and responsibility, and organizes and develops its people. The Company is a member of a much larger publicly traded foreign corporation, therefore external earnings pressure exists. This pressure, however, is tempered in that investment strategy is overseen by MRG. In addition, the governance process establishes the role of the Board and its' committees in the establishment of a sound risk management process that has a pervasive influence on the way business activities are structured, objectives and strategies are established, and risks identified. It also influences risk assessment, control activities, information and communication systems, monitoring activities, and anti-fraud programs. The Audit Committee and Board of Directors assist management in significantly influencing the tone at the top. In its fiduciary role, the Board is responsible for overseeing internal controls over financial reporting established by management and the process by which management satisfies itself that internal controls are working effectively. The Board is also responsible for assessing risk of financial fraud by management and ensuring that controls are in place to prevent, deter, and detect fraud by management. Oversight controls of the Board extend to understanding management's strategic initiatives, risk management processes and controls, as well as the internal and external audit plans and procedures for addressing risks within the organization. In addition, the Risk Management Committee provides oversight procedures that include a review of significant routine and non-routine transactions entered into by the Company. Examples include new business initiatives and pandemic concerns that may affect the Company. Strategic business plans, budgets, and all new products are approved by the Board prior to implementation or introduction into the market. Oversight procedures also extend to a review of accounting principles, and the policies and estimation processes used by management in determining significant estimates. In addition, significant estimates are reviewed annually with the Audit Committee.

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System as defined under Chapter 50 of the Delaware Insurance Code. As previously noted, the immediate parent of the Company at December 31, 2008, was MRAC and the Ultimate Parent is MRG. The Munich Re Group, lead by MRG, maintains liaison offices in approximately 50 locations serving clients worldwide. The 2008 amounts below were reported in the most recent MRG annual report based on International Financial Reporting Standards (IFRS), converted from the Euro to US dollars at the December 31, 2008, conversion rate of 1.39 (rounded).

Assets -	$299,353,000,000
Equity -	29,339,000,000
Net premiums written -	50,406,000,000
Gain from Operations (pre-tax) -	5,329,000,000

The following organizational chart, as of December 31, 2008, reflects only identities and interrelationships between the Company and its direct parent, its intermediate parent, its ultimate parent, and affiliates concurrently examined.



A review of the Annual Form B and Form C filings made by AAIC for all years under examination revealed that the Company had complied with the requirements of Regulation 13 of the Delaware Insurance Code.

GROWTH OF THE COMPANY

The following information was extracted from copies of the Company's filed Annual Statements and covers the period from its last examination (2005) and the intervening period to this examination (2008).

Year	Net Admitted Assets	Surplus as Regards to Policyholders	Direct Premiums Written	Net Premiums Written	Net Income
2008	$461,830,983	$145,744,157	$644,400,877	$51,073,569	$20,359,962
2007	421,563,437	154,474,780	585,958,408	35,323,219	29,335,748
2006	458,302,732	139,465,484	609,119,535	28,419,220	(3,014,939)
2005	$409,029,002	$152,827,821	$562,567,831	$34,804,355	$5,519,422

The following comments describe Company growth and results of operations:

- Net Admitted Assets and Policyholder Surplus fluctuated primarily as a result of net income/loss and payment of dividends totaling $41,450,000 during the examination period.

- Direct Premiums Written increased 14.5% as a result of new lines and new producer relationship affecting; Group A&H, Commercial Property, Commercial Package, and Multi-Peril Crop.

- Net Premiums Written increased 46.7% primarily as a result of increased retention under its variable quota share arrangement with MRAm, which was decreased from 90% to 80% in 2008.

- Net Income increased 268.9% primarily as a result of underwriting gains which have off-set decreases in investment gains during examination period soft investment market conditions. The increase in underwriting gains reflects the Company's increased emphasis on profitable risk premiums and higher operational efficiencies resulting from reorganized underwriting and staff reductions.

TERRITORY AND PLAN OF OPERATION

Territory

The Company is currently licensed to write business in all fifty (50) states plus the District of Columbia and effective March 2009, Puerto Rico. In addition the Company is authorized as an acceptable Surety writer by the U.S. Treasury.

The Company's clients are traditional insurance buyers (i.e., commercial corporations) and the alternative market (i.e., risk retention groups, risk purchasing groups, captives, and risk managers of commercial companies).

AAIC primarily markets its products through the use of Managing General Agents (MGAs). During 2008, the seven largest MGAs utilized by the Company produced in excess of $ 510.6 million out of $644.4 million in total Direct Premiums Written, or 79.2%, during 2008.

MGA/TPA	Direct Premiums Written
1) Volunteer Fireman’s Ins. Services (VFIS)	$177,184,625
2) Agriserve, Inc. (ASI)	$ 99,943,942
3) Glatfelter Underwriting Services (GUS)	$ 79,946,837
4) Global Aerospace, Inc. (GAI)	$ 75,943,416
5) Brit/Paulk Insurance Agency, Inc. ((B/PIA)	$ 40,294,458
6) W.F. Clayton & Associations, LLC (WFC&A)	$ 19,947,528
7) National Insurance Professionals (NIP)	$ 17,339,315
Total	$510,600,121

The examiners reviewed the applicable MGA agreements, state licenses, audit schedules, and selected audit reports. Proper licensing was noted and the selected audit reports indicated no conflicts with the Company's underwriting guidelines. All of the MGAs noted above have been granted underwriting and binding authority along with the authority to collect premiums. Further, VFIS, ASI, GUS, and GAI, all have claims adjustment and claims payment authority. None of the MGAs is permitted to bind the Company to ceded reinsurance. The premiums applicable to GAI were subsequently 100% ceded to MRG under an agreement entered into during 2003 by AAIC, MRG and GAI. Per the agreement, AAIC acts as the policy issuing company, representing MRG, as a 25% participation in a pool that is managed by GAI. The pool provides general aviation, airline, products liability, and space and satellite risk coverage to the North American aviation market. It should also be noted that a significant portion of the business underwritten by VFIS is ceded to an unaffiliated entity. These significant cessions to both affiliated and unaffiliated entities result in AAIC retaining less than 8% of its Gross Premiums Written.

During 2008, the largest lines of business written by the Company on a direct basis were as follows, and represented 76.6% of Direct Premiums Written:

Commercial Multiple Peril	$127,292,863	(19.8%)
Aircraft (all perils)	$113,234,004	(17.6%)
Allied Lines	$111,647,003	(17.3%)
Commercial Auto Liability	$ 82,307,638	(12.8%)
Other Liability- Occurrence	$ 58,544,738	(9.1%)
Total	$493,026,246	76.6%

Plan of Operation

The Company is an integral member of MRAC's plan of operation. In recent years, MRAC's business segments have been structured by distribution and product type. The property and casualty business segments were: Direct Treaty, Direct Facultative, Specialty Markets and Broker Market. In September 2007, the Munich Re Group announced a new strategy to achieve sustainable profitable growth over the course of the market cycle. As part of this strategy, beginning in 2008, the MRAC group implemented a new underwriting structure aligned by client divisions, including: National Clients, Regional Clients, Specialty Markets, and Broker Market. The new strategy employs a client-centric approach to develop client strategies and reinsurance solutions that leverage the MRAC's expertise and risk appetite, develop closer relationships to support clients' needs, and build a dominant presence in niche primary insurance segments. The business underwritten by AAIC is written primarily through the Specialty Markets segment.

MRAC has become more conservative during the examination period in terms of business being solicited and underwritten. The corporate philosophy is that risks underwritten should have adequate risk premium and MRAC appears to have applied this underwriting discipline over the past few years.

MRAC has appointed a Chief Risk Officer and heightened its awareness of risks assumed as a whole. With regards to Underwriting Risk Management, the Company has centralized the direction of underwriting guidelines. The Chief Risk Officer is closely aligned with the Integrated Risk Management Division of MRG in Germany. MRAC intends to continue to integrate itself into MRG's operations. MRAC underwriting goals and limitations are developed, reviewed and approved subsequently by MRG. MRG has an international (or group wide) Business Plan of which MRAC is a significant part.

A.M. Best Rating:

Based on A.M. Best's current opinion of the consolidated financial condition and operating performance of the Company, AAIC was assigned an A.M. Best rating of A + (Superior) for the year ending 2008. A.M. Best notes that the rating reflects the Company’s solid returns and substantial improvement in risk adjusted capitalization.

REINSURANCE

For 2008, AAIC reported the following distribution of premiums:

Direct	$644,400,877
Assumed from non-affiliates	(33,135,267)
Ceded to affiliates	(292,161,288)
Ceded to non-affiliates	(268,030,754)
Total Net Premiums Written	$51,073,569

Assumed

AAIC's assumed reinsurance is mostly comprised of participations in pools and associations. As a direct writer of workers' compensation insurance and auto insurance, the Company is required to participate in various state-operated sponsored plans or reinsurance facilities. For 2008, AAIC participated in several involuntary pools or associations with total premiums amounting to $1,469,000. AAIC also participates in three syndicates on a voluntary basis during 2008.

Ceded

AAIC writes a significant amount of business with the express purpose of ceding all or part of the loss exposure to designated reinsurers. These programs are referred to as Specific Reinsurance business and two programs dominated the Company's cessions in 2008:

- In 2003, AAIC became the designated entity within the Munich Re group that writes, on a direct basis, a portion of the business produced by Global Aerospace Underwriting Managers and Associated Aviation Underwriters relating to the Global Aerospace Underwriters Pool. The Company's direct writings are 100% ceded to the ultimate parent, MRG.

- AAIC uses primarily MGAs to produce business. The largest MGA producing business for the Company is VFIS. The Company cedes 80% of the business produced by VFIS on a quota share basis to GIG Reinsurance Company, Ltd., (GIG Reinsurance), an affiliate of VFIS. The loss cessions to GIG Reinsurance are limited to $800,000 each occurrence. In addition, AAIC cedes business produced by another MGA, GUS to GIG Reinsurance. These cessions are 20% of the business produced by GUS, with a maximum loss cession of $250,000 per occurrence. Total premiums ceded to GIG Reinsurance in 2008 were $152,433,000.

- AAIC policies are also used by an MGA, ASI, to write insurance for the Multi-Peril Crop Insurance (MPCI) program. The MPCI program is federally subsidized and administered on behalf of the Federal Crop Insurance Commission (FCIC) by the Risk Management Agency (RMA).The current program, authorized by Congress in 1996 to provide premium subsidies and reinsurance protection on eligible crop insurance contracts, is administered through a Standard Reinsurance Agreement ("SRA") contract between individual insurers and the FCIC through the RMA. There are currently 16 SRA holders in the United States. The SRA is constant among all contract holders and is periodically revised by the RMA. AAIC cedes 100% of the premium and liability written by this program to Agrinational Insurance Company (AIC). AIC is a wholly owned captive of Archer Daniels Midland, a producer of farmer equipment, seeds and fertilizer. AIC is an SRA holder and is not licensed in all states. The Company ceded $99,944,000 of premium in 2008 to AIC. MRG is a participant on a reinsurance agreement with AIC.

Corporate Ceded Reinsurance Structure

All of AAIC's business, less Specific Reinsurance, is ceded to MRAm, under the following program:

For property casualty business:

Excess of Loss	2 layers of WC Occurrence Coverage $5 million of coverage excess of $1 million $5 million excess of $5 million per loss.
Quota Share	80% of most lines of business
Accident Year Stop Loss	100% cession in excess of an 71% loss ratio

Additionally, the Company entered into a 100% quota share with MRAm for property business produced by the Individual Commercial Risks Department.

Total premium ceded by AAIC to MRAm in 2008 was $213,862,000. Because MRAm has provided a corporate ceded reinsurance program to AAIC for many examination periods, the loss recoveries are significant. At December 31, 2008, AAIC reported reinsurance recoveries from MRAm of $782,656,000.

Effective July 1, 2009 the Company commuted all of its prior reinsurance contracts with MRAm as a first step in the establishment of a pooling agreement which covers 100% of the

Company's net liabilities (defined as gross liability net of specific cessions to other reinsurers). The previously ceded business, along with the Company's retained business at June 30, 2009, is subject to the pooling agreement.

The Company is a participant in the above stated pooling arrangement with MRAm and PESLC. The pooling agreement, effective July 1, 2009 covers all direct and assumed current and prior policies and contracts issued by PESLIC and AAIC. Under the pooling arrangement, the Company ceded 100% of net liabilities. MRAm is the lead company for the pooling arrangement and has 100% participation in the pooled business and the two affiliates have 0% participation in the pooled business.

INTERCOMPANY AGREEMENTS

The Company had the following significant intercompany agreements and arrangements in effect as of December 31, 2008:

Consolidated Income Tax Allocation Agreement

In accordance with an amended and restated agreement dated September 1, 2008, the Company participates in a consolidated Federal Income Tax Return with Munich-American Holding Corporation (MAHC) and all of its subsidiaries, including MRAm, and PESLIC. Under this agreement, income tax expenses are computed on a separate company basis as if each affiliate filed a separate tax return. Intercompany balances are settled on a quarterly basis.

General Service and Administrative Agreements

On April 1, 2004, the Company entered into an administrative services agreement with MRAm for the performance of such management services as: corporate finance, investment strategy, communications, public relations policies, actuarial, audit, executive, legal, personnel, benefits and benefit plans, accounting, tax, and other financial services. Costs and expenses are allocated and payable each quarter. The terms of this agreement were considered fair and equitable. During this examination, MRAm submitted to the Delaware Insurance Department a General Service Agreement between MAHC and numerous affiliates including the Company which was approved on July 1, 2009, with an effective date of September 1, 2009.

Investment Management Agreement

The Company is a party to an Investment Management Agreement with MEAG New York Corporation (MEAG-NY), an affiliated company. The agreement, effective August 1, 2001, and most recently amended on March 31, 2006, provides that MEAG-NY is to manage the investment and reinvestment of invested assets held by State Street Bank, the Company's most significant custodian. MEAG-NY is required to adhere to strict Investment Guidelines which are attached to the agreement and amended periodically whenever the Company amends its investment policy. The Company retains the sole authority to modify Investment Guidelines and MEAG-NY is not permitted to trade assets that are designated by the Company as regulatory or trust deposits. MEAG-NY does not act as custodian and does not physically hold any of the Company's invested assets. Regular reviews of the performance and actions of MEAG-NY are performed and the terms of the agreement were considered fair and equitable. Timely settlement occurs within 30 days after the end of each fiscal quarter.

EXTERNAL AGREEMENTS

In addition to the above intercompany agreements, the Company had the following significant external agreements in effect at December 31, 2008:

Custodial Agreements

The Company entered into a custodial agreement with State Street Bank, for the purpose of providing the safekeeping of Company's invested assets. The agreement contains the required protective language specified by the NAIC and the SAS 70 Report for State Street Bank was obtained and reviewed without exception.

Investment Accounting Services Agreement

The Company entered into an Investment Accounting Services Agreement (IASA) effective June 1, 2000 with BlackRock Financial Management, Inc. (BlackRock). Per the IASA, BlackRock performs AAIC's investment accounting transaction entry along with: asset reconciliations, income and dividend projections, foreign exchange calculations and review of all investment results. Further, BlackRock performs the monthly closing process and provides AAIC with a transaction journal and transaction ledger along with a Client Holding Report showing AAIC's investment portfolio sorted by CUSIP Number and by investment classification. The PAM investment accounting application system provides detailed information necessary for the Company to complete investment schedules for its statutory financial reports.

BlackRock provides AAIC with a SAS 70 Report annually and AAIC has the right to audit BlackRock operations. The terms of the agreement were considered fair and equitable.

NAIC RATIOS

Based on 2008 financial results, five NAIC IRIS ratios were outside of the "usual" range as follows:

Change in Net Premiums Written: The 2008 ratio result of 45.0% was 12.0 points higher than the ratio benchmark of 33.0% set by the NAIC. The unusual value was due to a decrease in the cession rate of the variable quota share agreement with MRAm, resulting in greater retained premium by the Company.

Surplus Aid to Policyholders' Surplus: The 2008 ratio result of 18.0% was slightly higher than the NAIC ratio benchmark of 15.0% The unusual value was due to the ceding commission benefit under the variable quota share agreement and the significant amount of ceded reinsurance placed with MRAm.

Adjusted Liabilities to Liquid Assets: The 2008 ratio result of 111.0% was slightly higher than the NAIC ratio benchmark of 105.0%. The unusual value was due to an increase in "ceded reinsurance premiums payable". Virtually all of this increase is payable to MRAm.
Gross Agents' Balances to Policyholders' Surplus: The 2008 ratio result of 60.0% was 20 points higher than the NAIC ratio benchmark of 40.0%. Subsequent to the filing of the 2008 annual statement, the Company noticed a misclassification between uncollected premiums and agents' balances in the course of collection and deferred premiums, agents' balances and installments booked but deferred and not yet due of approximately $20.0 million causing the significant unusual result for this IRIS ratio. The misclassification was the result of a migration of information to a new policy issuance system in the fourth quarter of 2008 and has since been corrected. The Delaware Insurance Department was apprised of this misclassification. Correcting for this misclassification, the Gross Agent's Balance to Policyholder' Surplus IRIS ratio would have been 46.0%, slightly above the benchmark of 40.0%. The Company does not have any significant collection issues with any of its clients.

Estimated Current Reserve Deficiency to Policyholders' Surplus: The 2008 ratio result was 44% or 19 points higher than the NAIC ratio benchmark of 25%. The unusual value was due to the increase in the current year net earned premium, a factor in the deficiency calculation, caused by the increase in retained premium as discussed above. The 2008 accident year reserves have been established commensurate with this increase in retained premium.

Based on 2007 financial results, two NAIC IRIS ratios were outside of the "usual" range as follows:

Surplus Aid to Policyholders' Surplus: The 2007 ratio result of 18% was slightly higher than the NAIC ratio benchmark of 15%. The unusual value was due to an increase in the ceding commission benefit under the variable quota share agreement and the significant amount of ceded reinsurance placed with MRAm.

Adjusted Liabilities to Liquid Assets: The 2007 adjusted liabilities to liquid assets result of 117.0% was 12.0 points above the NAIC ratio benchmark of 105.0%. The unusual value was due to an increase in "Unearned Premiums", a decrease in "Bonds", and a decrease in the "Deposit Assets". In addition, there was no "Commission Receivable" in 2007. Due to the large loss payment in late December 2007 of $46.9 million, the liquid assets were significantly lower in 2007.

Based on 2006 financial results, three NAIC IRIS ratios were outside of the “usual” range as follows:

> Surplus Aid to Policyholders’ Surplus: The 2006 ratio result of 16% was slightly higher than the NAIC ratio benchmark of 15%. The unusual value was due to the significant amount of ceded reinsurance placed with MRAm.
>
> Liabilities to Liquid Assets: The 2006 liabilities to liquid assets result of 116.0% was 11.0 points above the NAIC ratio benchmark of 105.0%. The unusual value was due to an increase in “Funds Held by the Company under reinsurance treaties”, and increase in “Deposit funds held under non- reinsurance contracts”, and an increase in the “Provision for reinsurance write-off”. These accounts were established to enhance the timely collection of reinsurance or to proactively manage uncollectible reinsurance and are not seen as an issue to the liquidity of the Company.
>
> Gross Agent’s Balances to Policyholders’ Surplus: The 2006 ratio result of 40.0% was equal to the benchmark established by the NAIC. The Company utilized the services of many agents and MGAs to procure its insurance business. As a result, this ratio was typically high for the Company.

ACCOUNTS AND RECORDS

Accounting System

All necessary accounting records of the Company are maintained on electronic data processing equipment, which is also shared by MRAm & PESLIC. The general ledger system allows the Company to capture information necessary to produce financial statements on a Statutory Accounting Principles (SAP) basis, as well as U.S. Generally Accepted Accounting Principles (U.S. GAAP) basis and International Financial Reporting Standards (IFRS) basis. The Company’s database was tested during the examination without material exception.

Information Systems

INS Services, Inc. reviewed the Company’s responses to the Evaluation of Controls in Information Systems Questionnaire (Exhibit C) and performed tests of the systems. INS Services, Inc. concluded the following from their review:

- the Company's responses to Exhibit C present fairly, in all material respects, the aspects of the Company's policies and procedures that may be relevant to their internal control structure,

- the control structure policies and procedures were suitably designed to achieve the control objectives implicit in the questionnaire, if those polices and procedures were complied with, and

- such policies and procedures have been placed in operation as of December 31, 2008.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2008, a statement of income for the period 2008, and the account of capital and surplus, from 2007 to 2008, as determined by this examination:

Analysis of Assets, December 31, 2008

Statement of Liabilities, Surplus and Other Funds, December 31, 2008

Statement of Income, December 31, 2008

Capital and Surplus Account, December 31, 2008

Analysis of Assets

	Assets	Non-admitted Assets	Net Admitted Assets	Note
Bonds	$168,773,391		$168,773,391	1
Preferred Stocks	5,000,000		5,000,000	
Cash, Cash Equivalents and Short-term Investments	98,186,843		98,186,843	
Receivable for Securities	88,208		88,208	
Investment Income Due and Accrued	1,845,832		1,845,832	
Uncollected Premiums and Agents' Balances in Course of Collection	88,344,410	$790,746	87,553,664	
Deferred Premiums, Agents' Balances And Installments Booked But Deferred and Not Yet Due	13,180,828		13,180,828	
Amounts Recoverable from Reinsurers	51,247,925		51,247,925	
Funds Held by Reinsured Companies	3,022,730		3,022,730	
Federal Income Taxes Recoverable	17,511		17,511	
Net Deferred Tax Asset	8,351,799	6,026,552	2,325,247	
Guaranty Funds Receivable or On Deposit	868,333		868,333	
EDP Equipment and Software	3,234	3,234		
Furniture and Equipment	1,564	1,564		
Receivable from Parent, Subsidiaries and Affiliates	593,670		593,670	
Aggregate Write-ins for Other Than Invested Assets	30,295,539	1,168,739	29,126,801	
Total Assets	$469,821,819	$7,990,836	$461,830,983	

Liabilities, Surplus and Other Funds

		Note
Losses	$69,897,423	2
Reinsurance Payable on Paid Losses and Loss Adjustment Expenses	1,688,013	
Loss Adjustment Expenses	13,001,946	2
Other Expenses	913,023	
Taxes, Licenses and Fees	6,737,758	
Unearned Premiums	23,560,735	
Ceded Reinsurance Premiums Payable	117,423,689	
Funds Held By Company Under Reinsurance Treaties	10,494,556	
Amounts Withheld or Retained by Company for the Account of Others	1,053,910	
Payable to Parent, Subsidiaries and Affiliates	6,198,637	
Aggregate Write-ins for Liabilities	65,117,135	
Total Liabilities	$316,086,826	
Common Capital Stock	$5,120,000	
Surplus Notes	92,500,000	
Gross Paid In and Contributed Surplus	8,611,387	
Unassigned Funds (Surplus)	39,512,770	
Surplus as Regards Policyholders	$145,744,157	
Total Liabilities, Surplus and Other Funds	$461,830,983	

Statement of Income

UNDERWRITING INCOME	
Premiums Earned	$51,567,759
DEDUCTIONS:	
Losses Incurred	$26,454,252
Loss Adjustment Expenses Incurred	10,251,943
Other Underwriting Expenses Incurred	(20,652,348)
Total Underwriting Deductions	$16,053,847
Net Underwriting Gain (Loss)	$35,513,911
INVESTMENT INCOME	
Net Investment Income Earned	$7,853,592
Net Realized Capital Gains (Losses)	(4,886,296)
Net Investment Gain (Loss)	$2,967,296
OTHER INCOME	
Aggregate Write-ins for Miscellaneous Income	$(4,482,988)
Total Other Income	$(4,482,988)
Net Income After Dividends to Policyholders, After Capital Gains Tax and Before All Other Federal and Foreign Income Taxes	$33,998,219
Federal and Foreign Income Taxes Incurred	13,638,257
Net Income	$20,359,962

Capital and Surplus Account

Surplus as Regards Policyholders, December 31, 2007	$154,474,780
Net Income	$20,359,962
Change in Net Unrealized Capital Gains or (Losses)	(35,750)
Change in Net Deferred Income Tax	2,635,209
Change in Non-admitted Assets	(3,968,287)
Dividends to Stockholders	(15,550,000)
Aggregate write-ins for Gains and Losses in Surplus	(12,171,757)
Change in Surplus as Regards Policyholders for the Exam Period	$ (8,730,623)
Surplus as Regards Policyholders, December 31, 2008	$ 145,744,157

SUMMARY OF EXAMINATION ADJUSTMENTS

No financial adjustments were made as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

(1) Bonds: $168,773,391

The above-captioned amount, which is the same as that reported by the Company in its Annual Statement, has been accepted for purposes of this report. An evaluation of the Company's bond portfolio noted that 98.8% of the portfolio is U.S. Government bonds with an NAIC rating of 1 or 2. With the exception of bonds held for statutory purposes, investments are primarily held by State Street Bank under a custodial agreement. A review of corporate records indicated that the Board of Directors has approved the Company's investment transactions made during the examination period in accordance with 18 Del.C. §1304.

(2) Losses $ 69,897,423
Loss Adjustment Expenses $ 13,001,946

The above-captioned amounts, which are the same as those reported by the Company in its Annual Statement, have been accepted for purposes of this report. The balance reported by the Company was comprised of the following:

Losses	
Reported Losses (Case)	
Direct	$ 489,351,880
Reinsurance Assumed	10,549,235
Reinsurance Ceded	(477,577,731)
Net Reported Losses	$ 22,323,383
Incurred but not reported (IBNR)	
Direct	$ 572,273,144
Reinsurance Assumed	(10,699,836)
Reinsurance Ceded	(513,999,268)
Net IBNR	$ 47,574,040
Net Losses Unpaid	$ 69,897,423
Loss Adjustment Expenses (LAE)	$ 13,001,946

The examination retained the firm of INS Consultants, Inc. (INS or consulting actuary) to review the Company's stated reserves. The consulting actuary was provided with the Company's statement of actuarial opinion and an actuarial report as supporting documentation of the actuarial opinion with loss and loss adjustment expense reserves evaluated as of December 31, 2008. In addition, INS was provided with other reports, schedules, exhibits and relevant information as requested.

The Consulting actuary's review of loss and allocated loss adjustment expenses (ALAE) reserves consisted of separately analyzing the Company's property and casualty books of business on a gross and net basis. In addition, for unallocated loss adjustment expenses (ULAE), the consulting actuary reviewed the methodology employed by the Company's actuaries. INS accepted the methodology and factor selections utilized by the Company's actuaries and ultimately found the Company's reserves to be reasonable.

In conjunction with the actuarial review, the examination team validated loss data used by the Company without material exception.

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

A review was performed of appropriate balance sheet and forepart files to verify corrective action had been taken with regards to prior examination report comments and recommendations. Based on that review, it has been determined that the Company has complied with these comments and recommendations.

SUMMARY OF RECOMMENDATIONS

There are no examination recommendations.

SUMMARY COMMENTS

1) In recent years, MRAC's business segments have been structured by distribution and product type. The MRAC’s property and casualty business segments have been; Direct Treaty, Direct Facultative, Specialty Markets and Broker Market. In September 2007, the Munich Re Group announced a new strategy to achieve profitable growth over the course of the market cycle. As part of this strategy, beginning in 2008, MRAC implemented a new operating underwriting structure aligned by client type, including: National Clients, Regional Clients, Specialty Markets, and Broker Market.

2) During the examination period the Company paid both ordinary and extraordinary dividends in the amount of $41,450,000.

3) Effective December 31, 2007, the variable quota share reinsurance agreement mentioned in the Ceded Reinsurance section of the report with MRAm was reduced to 80% from 90%.

4) In 2008, the Company reported five NAIC IRIS ratios were outside of the “usual” ranges which are explained under the section “NAIC Ratios”.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

Description	December 31, 2005	December 31, 2008	Increase
Assets	$414,411,652	$461,830,983	$47,419,331
Liabilities	$271,580,181	$316,086,826	$44,506,645
Surplus as regards policyholders	$142,831,471	$145,744,157	$2,912,686

In addition to the undersigned, Anthony Cardone, CPA, CFE, Andy Chiodini, CFE, Kelly Willison, CPA, CFE, Greg Bealuk, CFE, and Ann Pruett, CFE participated in the examination. James J. Blair, Jr., CPA, CFE participated in the examination and served as the examination supervisor. The assistance of Gene Thompson, ACAS, MAAA of the actuarial consulting firm, INS Consultants, Inc. is acknowledged along with the information systems consulting firm of INS Services, Inc.

Respectfully submitted,

Joseph Murano Jr.

Joseph Murano, Jr. CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC

SUBSEQUENT EVENTS

1) In April 2009 management commenced a long-term, active cost management program designed to significantly reduce annual administrative expenses and enhance market competitiveness. This program included realignment of the MRAC's property and casualty business segments aimed at realizing greater operational efficiencies, a voluntary and involuntary staff reduction (about 200 employees out of 1200 employees), a freeze on the MRAC's two defined pension plans and changes to the retiree health care benefits plan. Estimated severance and related costs of approximately $16,000,000 were recognized in the second quarter of 2009.

2) During this current examination MRAm submitted to the Delaware Insurance Department a General Service Agreement between MAHC and numerous affiliates including the Company which was approved on July 1, 2009, with an effective date of September 1, 2009.

3) Effective July 1, 2009 the Company commuted all of its prior reinsurance contracts with MRAm as a first step in the establishment of a pooling agreement which covers 100% of the Company's net liabilities (defined as gross liability net of specific cessions to other reinsurers). The previously ceded business, along with the Company's retained business at June 30, 2009, is subject to the pooling agreement. The Company is a participant in the pooling arrangement with MRAm and PESLIC. The pooling agreement covers all direct and assumed current and prior policies and contracts issued by PESLIC and AAIC. Under the pooling arrangement, the Company ceded 100% of net liabilities. MRAm is the lead company for the pooling arrangement and retains 100% of the business. The two affiliates have 0% participation in the pooled business.

4) In March, 2009, the Company became licensed in the Commonwealth of Puerto Rico.