

**REPORT ON EXAMINATION**  
**OF THE**  
**AMERICAN ALTERNATIVE INSURANCE CORPORATION**  
**AS OF**  
**DECEMBER 31, 2012**

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 OF EXAMINATION, made as of December 31, 2012 of the

**AMERICAN ALTERNATIVE INSURANCE CORPORATION**

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

Attest By: *Brant Biddle*

Date: April 25, 2014

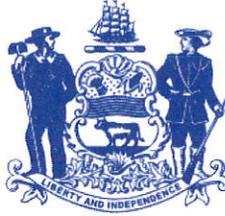


In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 25<sup>th</sup> day of April, 2014.

*[Handwritten signature]*

Karen Weldin Stewart, CIR-ML  
Insurance Commissioner

Karen Weldin Stewart, CIR-ML  
Commissioner



Delaware Department of Insurance

REPORT OF EXAMINATION  
OF THE  
AMERICAN ALTERNATIVE INSURANCE CORPORATION  
AS OF  
DECEMBER 31, 2012

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".

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Karen Weldin Stewart, CIR-ML  
Insurance Commissioner

Dated this 25<sup>th</sup> day of April, 2014

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## **SALUTATION**

February 5, 2014

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

Dear Commissioner,

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 13.006, dated March 25, 2013, an examination has been made of the affairs, financial condition and management of the

### **AMERICAN ALTERNATIVE INSURANCE CORPORATION**

hereinafter referred to as “the Company” or “AAIC” and incorporated under the laws of the State of Delaware. The Company’s registered office in the State of Delaware is located at 2711 Centerville Road, Suite 400, Wilmington, Delaware, 19808. The examination was conducted at the Company’s administrative offices located at 555 College Road East, Princeton, New Jersey, 08543. The examination of the Company was conducted concurrently with The Princeton Excess and Surplus Lines Insurance Company (PESLIC) and Munich Reinsurance America, Inc. (MRAM), both Delaware affiliated entities. Separate reports of examination were filed for each company.

The report of examination thereon is respectfully submitted.

## **SCOPE OF EXAMINATION**

The last examination was completed as of December 31, 2008, by the Delaware Insurance Department. This examination covered the period of January 1, 2009 through December 31, 2012, and encompasses a general review of transactions during the period, the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of the Company at December 31, 2012. Transactions subsequent to the examination date were reviewed where deemed necessary.

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* (Handbook) and generally accepted statutory insurance examination standards consistent with the insurance laws and regulations of the State of Delaware. The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. The examination also included 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.

All accounts and activities of the Company were considered in accordance with the risk focused examination process. The examination report addresses regulatory issues reviewed during the examination process.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, KPMG LLC. Certain auditor work papers of their 2012 audit have been incorporated into the work papers of the examiners and have been utilized in

determining the scope, areas of emphasis in conducting the examination and in the area of risk mitigation and substantive testing.

In addition to items noted in this report, the topics below were reviewed without material exception and are included in the work papers of this examination:

- Subsequent Events
- Corporate Records
- Fidelity Bonds and Other Insurance
- Pensions, Stock Ownership and Insurance Plans
- Statutory Deposits
- Compliance With Prior Examination Recommendations – none

### **SUMMARY OF SIGNIFICANT FINDINGS**

There were no material adverse findings, adjustments to the financial statements or specific recommendations as a result of this examination.

### **COMPANY HISTORY**

The Company was incorporated in New York on April 26, 1923, as American Union Insurance Company of New York. The Company's name was changed to American Union Reinsurance Company in 1987.

On January 1, 1994, American Re Corporation acquired the Company from American States Insurance Company, an Indiana domiciled insurer. American Re Corporation (name changed to the present Munich Re America Corporation (MRAC) on September 5, 2006) is a Delaware holding company and the sole owner of the Company.

On August 13, 1996, 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 (Puma), a Delaware corporation and wholly-owned subsidiary of MRG. Pursuant to the terms of the Agreement and Plan of Merger, on November 25, 1996, following approval of the merger by

MRAC's stockholders and applicable regulatory authorities, Puma was merged with MRAC with the latter being the surviving entity.

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 was merged into MRAm (an affiliate of AAIC). After the merger, MRG's ownership of MRAC stood at 91%. The remaining outstanding shares of 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.

There have been no ownership changes since September 2000.

## **MANAGEMENT AND CONTROL**

### **Board of Directors**

Pursuant to the General Corporation Law of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, all corporate powers and its business property and affairs are managed by, or under the direction of, its Board of Directors (Board). The Board shall consist of at least three members and subject to a maximum of eleven members.

The Board at December 31, 2012, was comprised of nine members, each elected or appointed in accordance with Company bylaws. Each Director shall hold office until his successor is elected and qualified, or until earlier resignation or removal.

## Directors

The Board of Directors, duly elected in accordance with the Company's bylaws and serving at December 31, 2012, was as follows:

<u>Directors Name</u>	<u>Principal Business Affiliation</u>
Giuseppina Carmela Albo	Munich Reinsurance America, Inc.
Anthony Joseph Kuczinski	Munich Reinsurance America, Inc.
Murray Steven Levy	Munich Reinsurance America, Inc.
Robin Harriet Willcox	Munich Reinsurance America, Inc.
Stephen John Morello	Munich Reinsurance America, Inc.
Craig Richard Smiddy*	American Alternative Insurance Corporation
George Terrence Van Gilder	Outside Independent Director
Charles Arthur Bryan	Outside Independent Director
James Joseph Butler	Outside Independent Director

The bylaws of the Company state the principal officers shall be a President, a Chairman, and Vice Chairman of the Board of Directors, a President, and any other Vice-Presidents, a Secretary, one or more Assistant Vice Presidents, one or more Assistant Secretaries, and such other officers, assistant officers or agents as the Board from time to time may determine.

## Officers

At December 31, 2012, the Company's principal officers and their respective titles were as follows:

<u>Officer</u>	<u>Title</u>
Craig Richard Smiddy*	President
Robin Harriet Willcox	Senior Vice President, General Counsel & Secretary
Murray Steven Levy	Senior Vice President and Chief Financial Officer
Daniel Fisher	Senior Vice President & Head of Human Resources
Melissa Ann Salton	Senior Vice President and Chief Risk Officer

\*Resigned April 2013 and replaced by Carsten Prussog in November 2013.

The minutes of the meetings of the Stockholder and Board of Directors, which were held during the period of examination, were read and noted. Attendance at meetings, election of directors and officers and approval of investment transactions were also noted.

Inspection of Company files indicated that an ethics statement/conflict of interest statement was completed by all employees for the examination period. A review of the Company's bylaws revealed that no changes were made during the examination period.

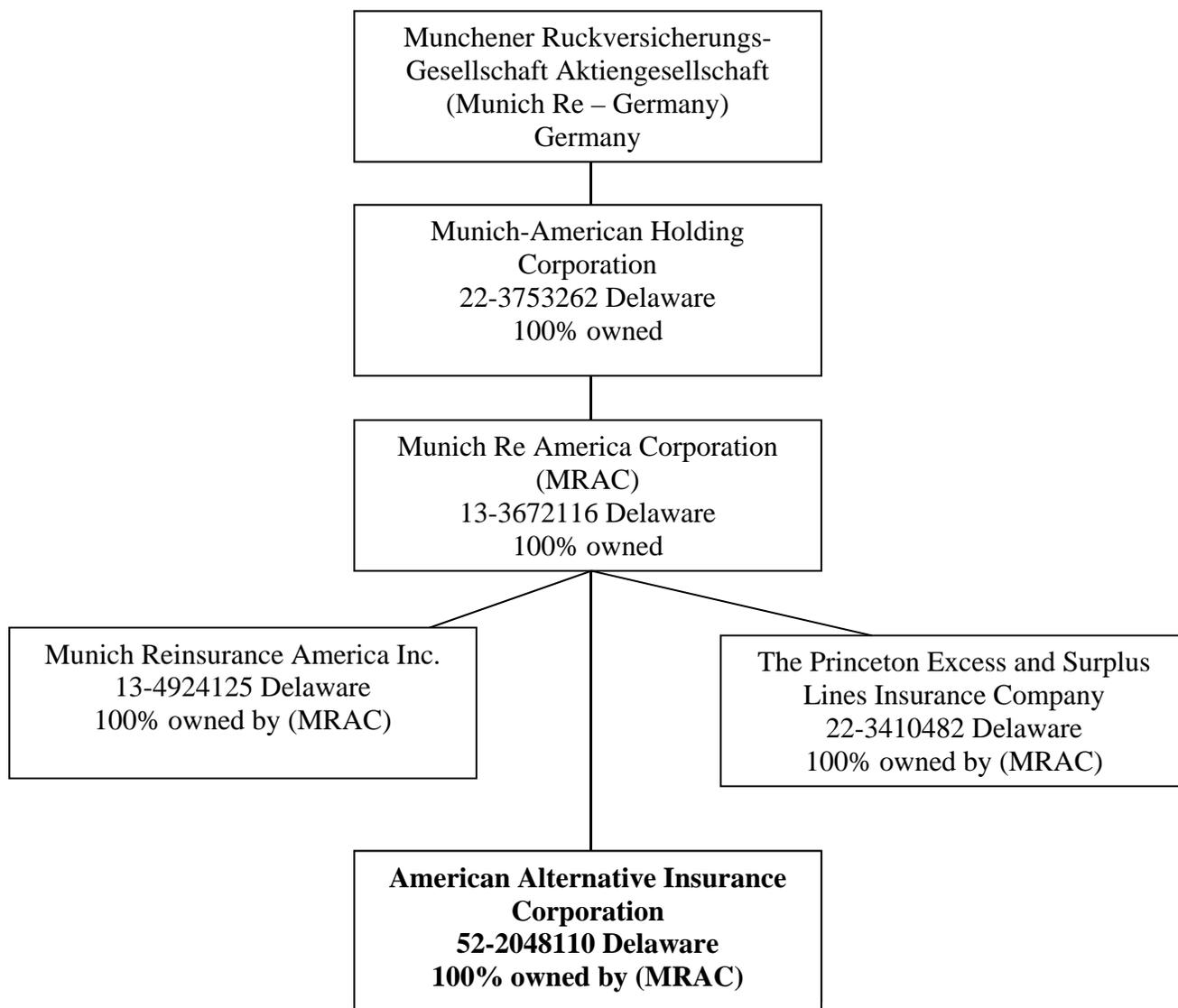
During our review for compliance with 18 Del. C. §4919, it was noted that the Company properly reported changes in directors and principal officers.

#### 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, 2012, was MRAC and the Ultimate Parent is MRG. The Munich Re Group, led by MRG, maintains liaison offices in over 60 locations serving clients worldwide. The 2012 amounts below were reported in the most recent MRG annual report based on International Financial Reporting Standards (IFRS), converted from the Euro to U.S. dollars at the December 31, 2012 (conversion rate of 1.32 Euro / \$1 U.S.).

Assets	U.S. \$341.0 billion
Equity	U.S. \$ 36.2 billion
Gross Premiums Written	U.S. \$ 68.6 billion
Gain from Operations (pre-tax)	U.S. \$ 7.1 billion

The following holding company system, as of December 31, 2012, reflects only identities and interrelationships between the Company and its direct parent, its intermediate parent, and 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.

Management, Tax and Service Agreements

The Company had the following significant intercompany agreements and arrangements in effect as of December 31, 2012:

Affiliated

*Consolidated Income Tax Allocation Agreement*

Effective September 1, 2008, the Company entered into an Amended and Restated Tax Allocation Agreement with Munich-American Holding Corporation (MAHC) and all of its subsidiaries including MRAm, AAIC 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 shall be settled on a quarterly basis. This agreement was replaced by a similar Amended and Restated Tax Allocation Agreement among MAHC and its subsidiaries dated March 2, 2012, for tax years ending December 31, 2011, and later. The current tax allocation agreement was approved by the Delaware Department of Insurance on January 30, 2012. The agreement was non-materially amended on August 12, 2012 to add and remove certain affiliated companies and the amendment was filed with the Delaware Department of Insurance on an informational basis.

*General Service and Administrative Agreements*

Effective April 1, 2004, the Company entered into an Administrative Services Agreement with MRAm which states that MRAm will provide AAIC with 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. The agreement requires that charges and expenses incurred be allocated according to Delaware Insurance Laws and NAIC Accounting Practices and Procedures. Charges shall be settled within thirty days of the end of each calendar quarter. The terms of this agreement are considered fair and equitable. This agreement was terminated effective August 31, 2009, and replaced with a similar agreement described below.

Effective September 1, 2009, the Company entered into a General Services and Cost Allocation Agreement with MAHC and numerous affiliates. Parties to the agreement may provide the following services to each other: accounting, tax, auditing, underwriting, claims, actuarial, information technology, legal, payroll, human resources, corporate finance, public relations, executive, engineering, loss mitigation and inspection, executive, intellectual property and other services. The agreement requires that charges and expenses incurred be allocated according to Delaware Insurance Laws and SSAP 70. Charges shall be settled within thirty days of the end of each calendar quarter. The terms of this agreement are considered fair and equitable. This agreement was approved by the Delaware Department of Insurance on July 1, 2009. The agreement was amended as of January 14, 2013 and previously approved by the Delaware Department of Insurance on August 12, 2012.

*Investment Management Agreement*

Effective September 1, 1997, and most recently amended March 12, 2012 the Company entered into an Investment Management Agreement with affiliate MEAG New York Corporation (MEAG-NY). The agreement provides that MEAG-NY will manage the investment portfolio of invested assets held by State Street Bank, the Company's most significant custodian. MEAG-NY is required to adhere to strict Investment Guidelines 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. Charges shall be settled within thirty days of the end of each calendar quarter. All Amendments were approved by the Delaware Department of Insurance.

*Letter of Credit Facility*

Effective October 13, 2009, the Company entered into an Amended and Restated Letter of Credit (LOC) Facility Fee Reimbursement Agreement with MRG, MRAM and PESLIC. MRG shall from time to time provide collateral for reinsurance in the form of letters of credit to MRAM, AAIC and PESLIC from MRG's existing LOC facilities to support unaffiliated unauthorized liabilities. MRAM, AAIC and PESLIC shall pay MRG a fee of fifty basis points for any issuances of LOCs made by the Company under any of MRG's LOC facilities. This agreement was approved by the Delaware Department of Insurance on October 23, 2009.

Unaffiliated

*Custodial Agreements*

The Company has a custodial agreement with State Street Bank and Trust which provides for the safekeeping of the Company's invested assets and contains the required protective language specified by NAIC guidelines. The most recent SSAE 16 Report for State Street Bank and Trust was obtained and reviewed without exception.

*Investment Accounting Services Agreement*

Effective June 1, 2000, the Company entered into an Investment Services Agreement (IASA) with BlackRock Financial Management, Inc. (BlackRock). As of July 1, 2009, this agreement was replaced with an IASA between Munich Re America Services, Inc., an affiliate of AAIC, which covers AAIC and various other affiliates. Per the IASA, BlackRock performs AAIC's investment accounting transaction entry along with: asset reconciliations, income and dividend projections, foreign exchange calculations and a review of all investment results.

Furthermore, 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 the detailed information necessary for the Company to complete the investment schedules for its statutory financial reports. The terms of the agreement are considered fair and equitable. BlackRock provides AAIC with a SSAE 16 Report annually and AAIC has the right to audit BlackRock operations. The most recent SSAE 16 Report for BlackRock was obtained and reviewed without exception.

#### *Agency Agreements*

The Company is a party to various managing general agency agreements and general agency agreements with the MGAs that write business on behalf of the Company. Where premiums were considered material, the underlying agreements were reviewed without exception.

### **TERRITORY AND PLAN OF OPERATION**

#### Territory

The Company is currently licensed to write business in all fifty U.S. States, the District of Columbia and Puerto Rico. In addition, the Company is authorized as an acceptable surety writer by the U.S. Treasury.

#### Plan of Operation

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 2012, the seven largest MGAs authorized by the

Company produced approximately \$556.2 million, or 72.8%, of the \$763.1 million in direct written premium as follows:

<u>MGA/TPA</u>	<u>Direct Written Premiums</u>	<u>Percent</u>
Volunteer Fireman's Insurance Services (VFIS)	\$189,363,804	24.8%
Glatfelter Underwriting Services (GUS)	90,924,585	11.9%
Global Aerospace, Inc. (GA)	80,685,404	10.6%
Cairnstone, Inc. /Munich Re Stop Loss, Inc. (CI)	56,793,146	7.4%
Personal Umbrella.com Insurance Services, Inc.	52,951,637	6.9%
Britt/Paulk Insurance Agency, Inc.	50,487,566	6.6%
Allied National (AN)	<u>35,023,980</u>	<u>4.6%</u>
Total	<u>\$556,230,122</u>	<u>72.8%</u>

The applicable MGA agreements, state licenses, audit schedules and selected audit reports were reviewed. 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.

VFIS, GUS, GA, CI and AN all have claims adjustment and claims payment authority. None of the MGAs are permitted to bind the Company to ceded reinsurance.

The premiums applicable to GA are subsequently 100% ceded to Munich Re Germany under an agreement entered into during 2003 by AAIC, Munich Re Germany and GA. Per the agreement, AAIC acts as the policy-issuing company, representing Munich Re Germany, as a 25% participant in a pool that is managed by GA. The pool provides general aviation, airline, products liability, and space & satellite risk coverage to the North American aviation market.

The largest lines of direct written premiums, which represent 67.3% of the 2012 total of \$763.1 million, were as follows:

<u>Line</u>	<u>Direct Written Premiums</u>	<u>Percent</u>
Commercial Multiple Peril	\$166,651,092	21.8%
Other Liability – Occurrence	112,725,331	14.8%
Commercial Auto Liability	92,124,663	12.1%
Aircraft (all perils)	80,685,404	10.6%
Auto Physical Damage	<u>60,947,403</u>	<u>8.0%</u>
Total	<u>\$513,133,893</u>	<u>67.3%</u>

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

AAIC 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 2012. A.M. Best notes that the rating reflects the Company's solid returns and substantial improvement in risk adjusted capitalization.

### GROWTH OF THE COMPANY

The following information was extracted from the Company's filed Annual Statements and covers the period from the last examination (2008), and the intervening period to this examination (2012):

<u>Year</u>	<u>Net Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>	<u>Direct Written Premiums</u>	<u>Net Written Premiums</u>	<u>Net Income/ (Loss)</u>
2008	\$461,830,983	\$145,744,157	\$644,400,877	\$51,073,569	\$20,359,962
2009	413,779,082	153,371,434	630,452,090	(848,488)	27,417,103
2010	404,034,063	146,228,270	700,415,006	(3,854)	15,296,505
2011	434,550,151	156,224,860	937,073,019	0	24,979,540
2012	464,716,934	156,232,382	763,125,480	0	23,113,822

The following comments describe Company growth and results of operations:

- Net Admitted Assets and Policyholder Surplus fluctuated within a tight range due to positive net income even considering the paid dividends totaling \$83,543,701 during the examination period.
- Direct Premiums Written increased \$236.7 million, or 33.8%, from 2010 to 2011 as a result of new lines and new producer relationships affecting allied lines [crop coverage with ADM Crop Risk Services, an MGA] (increase of \$150.8 million), group A&H (increase of \$11.9 million), other A&H (increase of \$17.4 million), workers compensation (increase of \$8.0 million), other liability – occurrence (increase of \$21.9 million) and surety (increase of \$11.1 million). Direct Premiums Written then decreased \$173.9 million, or 18.6%, from 2011 to 2012 as a result of the combination of a decrease in allied lines [crop coverage with ADM Crop Risk Services] from \$267.8 million to \$24.9 million (reduction of \$242.9 million, of which \$241.7 million is a result of the reduction in the ADM Crop Risk Services business), an increase in workers compensation from \$11.8 million to \$33.1 million (increase of \$21.3 million) and an increase in surety from \$11.1 million to \$25.2 million (increase of \$14.1 million as a result of increased business from Roanoke Trade Services, an MGA).
- Net Premiums Written decreased to \$0 as a result of the termination of the variable quota share reinsurance agreement with MRAM effective June 30, 2009, and the inception of the reinsurance pooling agreement with MRAM effective July 1, 2009, in which AAIC's participation percentage is 0%.
- The Company's underwriting results are significantly influenced by the pooling arrangement. Under the pooling arrangement, net underwriting results consist solely of the ceding commission revenue in excess of the Company's acquisition and

administrative expenses. The ceding commission and net investment income are the drivers of net income since the pooling arrangement.

### **LOSS EXPERIENCE**

The Company is a participant in a pooling arrangement with two affiliates, MRAm and PESLIC. The Company has a 0% participation in the pooled business. As such, on a net basis, the Company has no incurred losses and loss adjustment expenses.

### **REINSURANCE**

AAIC reported the following distribution of written premiums in 2012:

Direct	\$763,125,480
Assumed from non-affiliates	<u>1,937,336</u>
Gross Premiums Written	\$765,062,816
Ceded to affiliates	\$566,017,061
Ceded to non-affiliates	<u>199,045,755</u>
Total Ceded Premiums	\$765,062,816
Net Premiums Written	<u><u>\$ 0</u></u>

#### Assumed

AAIC's assumed reinsurance is 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 or sponsored plans or reinsurance facilities. AAIC participated in several involuntary pools or associations in 2012 with total premiums of approximately \$590,000. AAIC also participated in three syndicates on a voluntary basis in 2012 with total premiums of \$1,347,000.

#### Ceded to affiliates

##### *Ceded to MRAm*

Through June 30, 2009, all of AAIC's business, net of the specific cessions noted below, were ceded to MRAm under the following property-casualty reinsurance program:

Quota Share	80% of most lines of business
Accident Year Stop Loss	100% cession in excess of a 71% loss ratio

Effective July 1, 2009, the Company commuted all of its prior reinsurance contracts with MRAM under a Commutation and Release Agreement as a first step in the establishment of a Reinsurance 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 agreement with MRAM and PESLIC. The Reinsurance Pooling Agreement, effective July 1, 2009, covers all direct and assumed current and prior policies and contracts issued by AAIC and PESLIC. Under the pooling agreement, each of the companies cedes 100% of its net liabilities to the pool, MRAM is the lead company for the pooling agreement and has a 100% participation in the pooled business and AAIC and PESLIC each have a 0% participation in the pooled business. A provisional ceding commission of 24.5%, adjusted quarterly for actual acquisition expenses allocable to the net business subject to the agreement, is paid to AAIC and PESLIC. In addition, an override commission of 5.5% is paid to AAIC and PESLIC under the agreement. The override commission is in excess of the acquisition costs, and therefore, in accordance with SSAP 62R – paragraph 54, a liability of \$9,543,974 equal to the difference between the reinsurance commission received and the acquisition costs was recorded at December 31, 2012. The liability for deferred ceding commissions is amortized pro-rata over the effective period of the agreement in proportion to the amount of coverage provided. The Commutation and Release Agreement and Reinsurance Pooling Agreement were approved by the Delaware Department of Insurance on September 29, 2009.

Total premium ceded by AAIC to MRAM in 2012 was \$453,204,000. Because MRAM has provided the corporate ceded reinsurance program to AAIC for many years, the loss recoveries have been significant through the examination period. At December 31, 2012, AAIC reported net reinsurance recoverable from MRAM of \$865,272,000.

*Ceded to other affiliates*

The remaining business ceded to affiliates totaled \$112,813,000 in 2012:

- \$80,685,000 was ceded to parent MRG pursuant to a 100% Quota Share Reinsurance Agreement effective April 2003. In 2003, AAIC became the “nominated insurance company” within the Munich Re group that writes, on a direct basis, a portion of the business produced by Global Aerospace Underwriting Managers (GAUM) and Associated Aviation Underwriters (AAU) relating to the Global Aerospace Underwriters Pool.
- \$25,200,000 ceded to Watkins Syndicate at Lloyd’s Syndicate 457 (domiciled in Great Britain) pursuant to a Surety Quota Share Reinsurance Agreement effective March 1, 2011, and approved by the Delaware Department of Insurance on March 9, 2011.
- \$6,928,000 ceded to Hartford Steam Boiler Inspection and Insurance Company (domiciled in Connecticut) under miscellaneous reinsurance agreements which were below the materiality thresholds and not required to be filed with the Delaware Department of Insurance.

Ceded to non-affiliates

AAIC, which ceded \$199,046,000 in premiums to non-affiliates in 2012, 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 2012, accounting for 92.7% of total premiums ceded to non-affiliates as follows:

- 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), a captive reinsurer affiliate of VFIS. The loss cessions to GIG Reinsurance are limited to \$800,000 each occurrence. In addition, AAIC cedes 20% of the business produced by GUS,

another MGA, on a quota share basis to GIG Reinsurance. The loss cessions to GIG Reinsurance for this program are limited to \$250,000 each occurrence. Total premiums ceded to GIG Reinsurance under these two programs in 2012 were \$159,681,000, or 80.2% of total premiums ceded to non-affiliates.

- AAIC policies are also used by an MGA, ADM Crop Risk Services, Inc., to write insurance for the Multiple Peril Crop Insurance (MPCI) and Crop Hail Programs, which are federally-subsidized by the U.S. Government 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 18 SRA holders in the United States. The SRA is consistent 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), an authorized reinsurer domiciled in Vermont. AIC is a wholly owned captive of Archer Daniels Midland (ADM), an international producer of farmer equipment, seeds and fertilizer. AIC is an SRA holder and is not licensed in all states. The Company ceded \$24,860,000 of premium in 2012 to AIC, or 12.5% of total premiums ceded to non-affiliates. MRG is a participant on a reinsurance agreement with AIC.

The Company is a party to several contracts which do not meet the risk transfer requirements established in SSAP 62R and are accounted for as \$2,496,516 in deposit assets (for ceded business) and \$4,975,199 in deposit liabilities (for assumed business).

### **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 and 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 analysis concluded that:

- 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 policies and procedures were complied with, and
- such policies and procedures have been placed in operation as of December 31, 2012.

**FINANCIAL STATEMENTS**

The following pages contain the Company's Financial Statements for the year ending December 31, 2012, as determined by this examination, with supporting exhibits as detailed below:

Analysis of Assets,  
Statement of Liabilities, Surplus and Other Funds  
Underwriting and Investment Exhibit - Statement of Income  
Capital and Surplus Account  
Reconciliation of Surplus since last Examination  
Schedule of Examination Adjustments

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding. Narratives on certain individual accounts were included to provide the reader with additional supporting information.

Analysis of Assets  
As of December 31, 2012

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Note</u>
Bonds	\$ 213,779,176		\$ 213,779,176	1
Cash and short-term investments	10,314,552		10,314,552	
Investment income due and accrued	1,553,970		1,553,970	
Uncollected premiums and agents' balances in the course of collection	26,114,817		26,114,817	
Deferred premiums, agents' balances & Installments booked but deferred and not yet due	46,635,904		46,635,904	
Amounts recoverable from reinsurers	106,870,722		106,870,722	
Funds held by or deposited with reinsured companies (reinsurance)	576,214		576,214	
Current federal and foreign income tax recoverable and interest thereon	1,571,810		1,571,810	
Net deferred tax asset	4,266,419	544,363	3,722,056	
Guaranty funds receivable or on deposit	568,822		568,822	
Receivable from parent; subsidiaries and affiliates	1,018,266		1,018,266	
Aggregate write-ins for other than invested assets	52,181,773	191,147	51,990,626	
Total Assets	<u>\$ 465,452,445</u>	<u>\$ 735,510</u>	<u>\$ 464,716,935</u>	

Statement of Liabilities, Surplus and Other Funds  
As of December 31, 2012

		<u>Note</u>
Losses	\$ -	2
Loss adjustment expenses	-	2
Reinsurance payable on paid losses and loss adjustment expenses	97,316	
Commissions payable, contingent commissions & other similar charges	1,801,416	
Other expenses	1,026,247	
Taxes, licenses and fees (excluding federal and foreign income taxes)	4,631,093	
Ceded reinsurance premiums payable	218,501,915	3
Funds held by company under reinsurance treaties	54,764,170	
Payable to parent, subsidiaries and affiliates	7,571,405	
Aggregate write-ins for liabilities	20,090,991	
Total Liabilities	<u>\$ 308,484,553</u>	
Common capital stock	\$ 5,120,000	
Surplus notes	\$ 92,500,000	
Gross paid in and contributed surplus	8,611,387	
Unassigned funds (surplus)	50,000,995	
Surplus as regards policyholders	<u>\$ 156,232,382</u>	
Total Liabilities, Capital and Surplus	<u><u>\$ 464,716,935</u></u>	

Underwriting and Investment Exhibit - Statement of Income  
As of December 31, 2012

<b>UNDERWRITING INCOME</b>	
Premiums earned	\$ <u>          -</u>
<b>DEDUCTIONS</b>	
Losses incurred	\$ -
Loss adjustment expenses incurred	-
Other underwriting expenses (income) incurred	<u>(26,351,716)</u>
Total underwriting deductions (income)	<u>(26,351,716)</u>
Net underwriting gain or (loss)	<u>\$ 26,351,716</u>
<b>INVESTMENT INCOME</b>	
Net investment income earned	\$ 6,069,092
Net realized capital gains or (losses)	<u>516,402</u>
Net investment gain or (loss)	<u>\$ 6,585,494</u>
<b>OTHER INCOME</b>	
Net gain (loss) from agents' balances charged off	68,543
Aggregate write-ins for miscellaneous income	2,680,990
Total other income	2,749,533
Net income before dividends to policyholders and before federal income taxes	<u>\$ 35,686,743</u>
Federal and foreign income taxes incurred	<u>12,572,921</u>
Net income	<u><u>\$ 23,113,822</u></u>

Capital and Surplus Account  
As of December 31, 2012

**CAPITAL AND SURPLUS ACCOUNT**

Surplus as regards policyholders, December 31, 2011 \$ 156,224,860

**GAINS AND (LOSSES) IN SURPLUS**

Net income \$ 23,113,822

Change in net unrealized capital gains or (losses) less capital gains tax 0

Change in net deferred income tax 175,889

Change in non-admitted assets 408,908

Dividends to stockholder (23,532,938)

Aggregate write-in for gains and losses (158,159)

Change in surplus as regards policyholders for the year \$ 7,522

Surplus as regards policyholder, December 31, 2012 \$ 156,232,382

Reconciliation of Surplus since last Examination

	<b>Aggregate Write-ins for Special Surplus Funds (3)</b>	<b>Common Capital Stock</b>	<b>Surplus Notes</b>	<b>Gross Paid - in &amp; Contributed Surplus</b>	<b>Unassigned Funds (Surplus)</b>
December 31, 2008	\$ -	\$ 5,120,000	\$92,500,000	\$ 8,611,387	\$ 39,512,770
Operations 2009 (1)					27,952,307
Dividends 2009 (2)					(20,359,962)
2009 Special Surplus	34,933				
Operations 2010 (1)					17,087,352
Dividends 2010 (2)					(24,354,287)
2010 Special Surplus	123,771				
Operations 2011 (1)					25,293,639
Dividends 2011 (2)					(15,296,504)
2011 Special Surplus	(545)				
Operations 2012 (1)					23,698,618
Dividends 2012 (2)					(23,532,938)
2012 Special Surplus	(158,159)				
December 31, 2012	<u>\$ -</u>	<u>\$ 5,120,000</u>	<u>\$ 92,500,000</u>	<u>\$ 8,611,387</u>	<u>\$ 50,000,995</u>

- (1) Operations is defined as: net income, change in net unrealized capital gains or (losses), change in net deferred income tax, change in non-admitted assets, change in provision for reinsurance, and aggregate write-ins for gains and losses to surplus.
- (2) See dividend section
- (3) The Aggregate Write-ins for Special Surplus Funds at year-end 2011 was \$158,159. The Company elected to apply the expanded admissibility provisions of SSAP 10R, which replaced SSAP 10. SSAP 10R provides an election to expand the deferred tax asset admissibility limitation from 10% to 15% of surplus and an increase in the reversal/realization periods from one to three years. The surplus benefit from the application of the expanded admissibility provisions of the deferred tax assets under SSAP 10R at December 31, 2012, was \$158,159, shown as a reduction to the Aggregate Write-ins for Special Surplus Funds down to \$0. SSAP 101 replaced SSAP 10R effective January 1, 2012.

Dividends

According to Company records for the years indicated, as reflected in the Board of Director meeting minutes, cash dividends were paid to the sole stockholder and approved by the Delaware Insurance Department as follows:

<u>Date Declared</u>	<u>Date Paid</u>	<u>Dividend Type</u>	<u>Dividend Paid</u>
November 30, 2012	December 18, 2012	Ordinary	\$23,532,938
November 10, 2011	November 28, 2011	Ordinary	\$15,296,504
November 4, 2010	November 16, 2010	Ordinary	\$18,609,962
May 6, 2010	June 15, 2010	Ordinary	\$5,744,335
December 18, 2009	January 15, 2010	Ordinary	\$1,750,000
October 1, 2009	October 13, 2009	Ordinary	<u>\$18,609,962</u>
Total Dividends			<u>\$83,543,701</u>

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 and with approval from the Delaware Insurance Department, the Company paid MRAM \$2,312,500 in interest during 2012.

Capitalization

The Company is authorized to issue 3,200 common shares with a par value of \$1,600 per share. As of December 31, 2012, the Company has 3,200 common shares issued and outstanding, for a common capital stock balance of \$5,120,000. All of the issued and outstanding shares are owned by Munich Re America Corporation.

Schedule of Examination Adjustments

No examination changes were made as a result of this examination.

**NOTES TO FINANCIAL STATEMENTS**

(1) Bonds \$213,779,176

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. 100.0% of the Company's bonds have a NAIC SVO rating of either 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 indicates 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 \$0  
Loss Adjustment Expenses \$0

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.

Losses

<u>Reported Losses (Case)</u>	
Direct	\$448,131,581
Reinsurance Assumed	6,366,344
Reinsurance Ceded	<u>(454,497,925)</u>
Net Reported Losses	\$ 0
 <u>Incurred but not reported (IBNR)</u>	
Direct	\$586,868,139
Reinsurance Assumed	5,782,615
Reinsurance Ceded	<u>(592,650,774)</u>
Net IBNR	<u>\$ 0</u>
 Net Losses Unpaid	 <u>\$ 0</u>
 <u>Loss Adjustment Expenses (LAE)</u>	 <u>\$ 0</u>

The Delaware Insurance Department 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, 2012. 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.

(3) Ceded Reinsurance Premiums Payable \$218,501,915

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. Approximately \$184,966,000, or 84.7%, of the total is due to MRAM under the Reinsurance Pooling Agreement effective July 1, 2009. Approximately \$(699,000), or (0.3)%, of the total is due to affiliates Hartford Steam Boiler Inspection & Insurance Company, Watkins Syndicate and MRG under miscellaneous reinsurance agreements. Approximately \$28,696,000, or 13.1%, of the total is due to non-affiliate GIG Reinsurance Company Ltd. The remaining \$5,539,000, or 2.5%, of the total is due to approximately 40 non-affiliates.

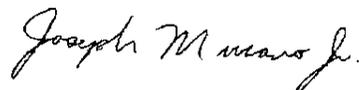
**CONCLUSION**

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

<u>Description</u>	<u>December 31, 2008</u>	<u>December 31, 2012</u>	<u>Increase (Decrease)</u>
Assets	\$ 461,830,983	\$ 464,716,935	\$ 2,885,952
Liabilities	\$ 316,086,826	\$ 308,484,553	\$ (7,602,273)
Common Capital Stock	5,120,000	5,120,000	-
Surplus notes	92,500,000	92,500,000	-
Gross Paid In and Contributed Surplus	8,611,387	8,611,387	-
Unassigned Funds (Surplus)	39,512,770	50,000,995	10,488,225
Total Surplus as Regards Policyholders	\$ 145,744,157	\$ 156,232,382	\$ 10,488,225
Totals	\$ 461,830,983	\$ 464,716,935	\$ 2,885,952

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. and INS Services, Inc. is acknowledged.

Respectfully submitted,



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