

MARKET CONDUCT REPORT ON EXAMINATION

OF

**THE PRINCETON EXCESS & SURPLUS
LINES INSURANCE COMPANY**

AS OF

JUNE 30, 2006

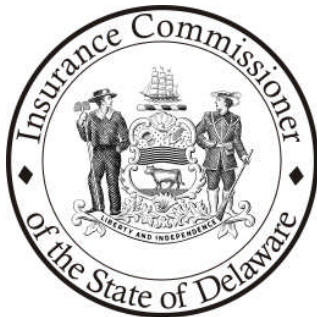
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of JUNE 30, 2006 of the

**THE PRINCETON EXCESS & SURPLUS LINES
INSURANCE COMPANY**

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

ATTEST BY: *Antoinette Handy*

DATE: 13 MARCH 2008



In Witness Whereof, I HAVE HEREUNTO SET MY HAND
AND AFFIXED THE OFFICIAL SEAL OF THIS
DEPARTMENT AT THE CITY OF DOVER, THIS
13TH DAY OF MARCH, 2008.

Matthew Denn

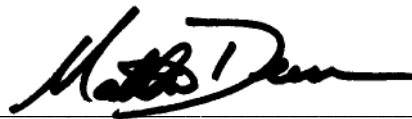
Insurance Commissioner

REPORT ON MARKET CONDUCT EXAMINATION
OF THE
THE PRINCETON EXCESS SURPLUS LINES INSURANCE COMPANY
AS OF
JUNE 30, 2006

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

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

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

A handwritten signature in black ink, appearing to read "Matt Denn", written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 13TH day of MARCH, 2008.

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SALUTATION

November 2, 2007

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

Dear Commissioner Denn:

In compliance with the instructions contained in Certificate of Examination Authority Number 06-715, and pursuant to statutory provisions including 18 Del. C. §318-322, a Market Conduct Examination has been conducted of the affairs and practices of:

The Princeton Excess & Surplus Lines Insurance Company

The examination was performed as of June 30, 2006. Princeton Excess & Surplus Lines Insurance Company, hereinafter referred to as the "Company" or as "PESLIC," is incorporated under the laws of the State of Delaware. The examination consists of two phases, an on-site phase and an off-site phase. The on-site phase of the examination was conducted at the following Company location:

- 555 College Road E., Princeton, NJ 08543

The off-site examination phase was performed at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or "DDOI," or other suitable location.

The report of examination herein is respectfully submitted.

EXECUTIVE SUMMARY

The Princeton Excess and Surplus Lines Insurance Company (“PESLIC”) a Delaware corporation, was acquired by Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München (“Munich Re”), a reinsurer domiciled in Germany. Munich Re is the “Ultimate Controlling Person” of The Princeton Excess and Surplus Lines Insurance Company pursuant to insurance holding company laws.

PESLIC operates as an admitted insurer in the State of Delaware and a non-admitted insurer in all states, and the District of Columbia, except Minnesota. No business is currently written in Delaware, so all of the premiums written nationally are produced on a surplus lines basis.

Only business that cannot be written in the admitted market is eligible for PESLIC including, for example, risks with unique or high hazard exposures or accounts that require special or manuscript coverages or have adverse claims experience.

Business produced in PESLIC can be either Single Risk (individual accounts) or Program Business (associations, pools, captive owners and homogeneous groups), but is predominately Single Risk. These clients are predominantly large commercial insureds who are qualified self-insureds in the states in which they operate, as well as public entity pools and other similar entities.

The examination was a market conduct examination of the following business areas: Company Operations/Management; Complaint Handling; Marketing/Sales; Producer Licensing, Policyholder Service; Underwriting; and, Claims Handling. This is a Delaware Baseline Examination in which the processes, procedures and controls utilized by the Company for areas of interest noted above are reviewed and evaluated.

Generally the Company has reasonable processes in place to operate in a compliant manner, however, two areas of concern were noted during the examination. These issues are more fully discussed under:

- Procedure 22 - Prevention of the Use of Persons with a Felony Conviction
- Procedure 45 - Claim File Documentation

The concern in Procedure 22 is that while the Company does appropriate background checks of producers, it does not conduct background checks of employees. The producer background check is done at point in time prior to use or appointment. There is currently no subsequent check to assure that employees or agents remain in compliance with 18 U.S.C.A. §1033.

The concern in Procedure 45 is that although there is a clear statement for responsibility for file documentation, the content of the expected documentation is not clearly stated.

In each case, a recommendation has been made to remedy the concerns.

SCOPE OF EXAMINATION

The basic business areas that are subject to a Delaware Market Conduct Examination vary depending on the type of insurer. For all insurers these areas include:

- Company Operations/Management
- Complaint Handling
- Marketing and Sales
- Producer Licensing
- Policyholder Service
- Underwriting and Rating
- Claims

This examination is a Delaware Baseline Market Conduct Examination. It is comprised of two components. The first is a review of the Company's countrywide complaint patterns. This is not a pass/fail test. Rather this review is aimed at determining if there is a detectable pattern to the complaints the Company has received from all sources.

The second component is an analysis of the management of the various business areas subject to a Market Conduct examination through a review of the written procedures and operating processes of the Company. This includes an analysis of how the Company communicates its instructions and intentions to its operational echelons, how it measures and monitors the results of those communications, and how it reacts to and modifies its communications based on the resulting findings of the measurement and monitoring activities. The examiners also determine whether or not this process is dynamic and results in enhanced compliance activities. Because of the predictive value of this form of analysis, focus is then directed on those areas where review indicators suggest that the process used by management does not appear to be achieving appropriate levels of statutory and regulatory compliance.

All business areas noted above are addressed to some extent by one or more of the procedures reviewed thus providing a comprehensive view of the Company and its component operations.

This examination report is a report by test rather than a report by exception. This means that all areas tested are described and results indicated. Substantial departure from the norm may result in a supplemental review focused on the area so noted.

HISTORY AND PROFILE

The Princeton Excess and Surplus Lines Insurance Company ("PESLIC") was incorporated as an insurer in Delaware on December 19, 1995 and has been an authorized insurer in Delaware since January 2, 1997. PESLIC started the white-listing process¹ in 1997 and is eligible to conduct Surplus Lines in all states except Minnesota and its State of Domicile, Delaware.

¹ The "white listing process" is the process through which a state determines whether a non-admitted insurer is eligible to provide coverage for risks under the states jurisdiction.

On November 25, 1996, American Re Corporation and its subsidiaries were acquired by Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München ("Munich Re"), a reinsurer domiciled in Germany. Munich Re is the "Ultimate Controlling Person" of The Princeton Excess and Surplus Lines Insurance Company pursuant to insurance holding company laws. All administrative and underwriting services for the Company are provided by Munich Reinsurance America, Inc. personnel under an Administrative Services Agreement.

PESLIC operates as an admitted insurer in the State of Delaware and a non-admitted insurer in all states, and the District of Columbia, except Minnesota. No business is currently written in Delaware, so all of the premiums written nationally are produced on a Surplus Lines basis.

Surplus Lines is considered to be the "market of last resort". Only business that cannot be written in the admitted market is eligible for PESLIC including, for example, risks with unique or high hazard exposures or accounts that require special or manuscript coverages or have adverse claims experience. Certain coverages (e.g. Workers Compensation, primary Commercial Automobile Liability) written in the admitted market are not eligible for surplus lines in most states. Business produced in PESLIC can be either Single Risk (individual accounts) or Program Business (associations, pools, captive owners and homogeneous groups), but is predominately Single Risk.

Single Risk - PESLIC provides excess coverage to "alternative market" individual accounts. These clients are predominantly large commercial insureds who are qualified self-insureds in the states in which they operate, as well as public entity pools and other similar entities. In commercial accounts, the current focus is on property and other short-tail lines but, however, historically, has included casualty as well. For Public Entity business, PESLIC provides excess General Liability, Umbrella, Excess Automobile Liability and Excess Property coverages.

Program Business - Programs are comprised of small business and middle market accounts. Most of the business written references bureau-rated rates and forms (AAIS and ISO). For Professional Liability, Umbrella and other select classes, PESLIC will use proprietary products tailored to the specific targeted market segment. Programs are typically offered on a primary, first dollar basis but PESLIC will write unsupported Umbrella facilities.

For some programs, PESLIC cedes premium and loss to certain alternative risk clients which assume risk (individual policyholders, associations or producers) under program or account specific reinsurance transactions. Such reinsurance is fully collateralized.

METHODOLOGY

This examination is based on the Standards and Tests for a Market Conduct Examination of a Property & Casualty Insurer found in Chapter VIII of the Delaware Market Conduct Examiners' Handbook. This chapter is derived from applicable Delaware Statutes, Rules and Regulations as referenced herein and the *NAIC's Market Conduct Examiners' Handbook* (2004 edition).

The types of review used in this examination fall into three general categories: generic, sample, and electronic.

A "generic" review is conducted through an analysis of general data gathered by the examiner, or provided by the examinee in response to queries by the examiner.

A "sample" review is conducted through direct review of a random sample of files using a sampling methodology described in the Delaware Market Conduct Examiners' Handbook and the NAIC's *Market Conduct Examiners' Handbook*. Samples of complaint files, underwriting files and claim files were reviewed to determine that the processes described by the Company are actually used by the Company.

An "electronic" review is conducted through the use of a computer program or routine applied to a download of computer records of the examinee. This type of review typically reviews one hundred percent (100%) of the records of a particular type.

In this examination only two Standards were directly tested. Standards and Procedures were tested through a combination of "generic" review and direct observation of the processes used.

Each Standard contains a brief description of the purpose or reason for the Standard. The Procedure review does not include this feature. The examiners' "Observations" are noted following each Standard or Procedure tested. In some cases a "Recommendation" is made. Comments, Results, Observations and Recommendations are reported with the appropriate Standard or Procedure.

A. COMPANY OPERATIONS/MANAGEMENT

This examination report is not designed to be a pass/fail report with the exception of the following two standards dealing with appropriate licensure and cooperation with the examination process.

Standard A 08

<p style="text-align: center;"><i>NAIC's Market Conduct Examiners' Handbook - Chapter VIII, §A, Standard 8</i></p> <p>The Company is licensed for the lines of business that are being written.</p> <p style="text-align: right;">18 Del. C. §318(a), §505(b), §508(b)</p>

The review methodology for this Standard is "generic." This Standard has a direct insurance statutory requirement. This Standard determines whether the Company's operations are in conformance with the Company's Certificate of Authority.

Results: **Pass**

Observations: The Company is licensed for the lines of business being written based upon a review of premium schedules and the Company's Delaware Certificate of Authority.

Recommendations: None

Standard A 09

<i>NAIC's Market Conduct Examiners' Handbook - Chapter VIII, §A, Standard 9</i>
The Company cooperates on a timely basis with the examiners performing the examination.
18 Del. C. §318(a), §320(c), §508(b), §520(b)3

The review methodology for this Standard is “generic.” This Standard has a direct insurance statutory requirement. This Standard determines whether the Company is cooperating with the state in the completion of an open and cogent review of the Company’s operations. Cooperation with the examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely manner thereby minimizing costs.

Results: **Pass**

Observations: The Company cooperated with the examiners in the conduct of the examination. Access to persons pertinent to completion of the examination was provided and persons interviewed were open and informative.

Recommendations: None

REVIEW OF PROCEDURES

The management of well-run companies generally has some processes that are similar in structure. These processes usually take the form of written procedures. While these procedures vary in effectiveness from company to company, the absence of them or the ineffective application of them is often reflected in the failure of the various Standards that follow this section of the report. The processes usually include:

- a planning function where direction, policy, objectives and goals are formulated,
- an execution or implementation of the planning function elements,
- a measurement function that considers the results of the planning and execution, and
- a reaction function that utilizes the results of measurement to take corrective action or to modify the process to develop more efficient and effective management of its operations.

The absence of written procedures that provide direction for company staff in its various operational areas tends to produce an inconsistent application of the intended process. The same is generally true of the absence of a means to measure the results of the application of procedures and a means to determine that the process is performing as intended.

The reviews in this section are not pass/fail measurements. Rather, they are intended to reflect those management strengths and weaknesses that have a bearing on regulatory compliance issues.

Procedure 01 – Audit (Internal and External)

Observations: The Company does not have a formal written procedure for Audit but does have processes in place that include written components and guidelines. These processes are being used to perform the needed Audit functions. Internal audits are performed in a variety of areas impacting market regulation interests including:

- MGA and PA Oversight (P-07)
- Vendor Oversight (P-08)
- Commission Review (P-10)
- Complaint Handling (P-11)
- Advertising, Sales and Marketing (P-13)
- Producer Defalcation (P-21)
- Premiums (P-24)
- Premium Accuracy (P-30) (P-33)
- Underwriting Documentation, correct contract construction, appropriate forms (P-35)
- Claim Handling (P-43)
- Claim Documentation (P-45)

The audit process is a principle means of control for a number of the management processes utilized by the Company. Audit recommendations and necessary corrective action plans are agreed upon with the management of the area that was audited and then included in a final report.

Audits of Managing General Agents (MGA's), Program Administrators (PA's) and Vendors are external but conducted by the Company's audit staff. These audits include the review of files and procedures of the MGA's and the PA's and are conducted at the location of the MGA or PA. They include discussions, review of workflow processes and review of necessary files. A wrap-up meeting is held with the MGA or PA to discuss any concerns noted during an audit.

The Company's normal frequency for internal audit is every three years. Additional audits are performed internally if necessary. Audits are performed on MGA's and PA's at least on an annual basis. Copies of audits were reviewed by the examiners and determined to be adequate.

Copies of audit reports are provided to the Insurance Company Operations Compliance Department who supervises the audit schedule and ensures that audit reports are issued to management.

Recommendations: None

Procedure 02 – Assertion of Privilege

Observations: The Company has a policy for the Assertion of Privilege that is contained within the Code of Conduct. This document is acknowledged and certified by each employee on an annual basis. The Code of Conduct defines the kinds of privilege that the Company can potentially claim and offers guidelines to avoid losing the ability to make an assertion. The guidelines are primarily limited instructions describing privilege defeating situations to be avoided. The only apparent control is that employees are required to acknowledge receipt of the

Code of Conduct and that it has been read on an annual basis. Assertion of Privilege requests are reviewed on a case-by-case basis within the Law Department under the direction and supervision of the General Counsel. The Company reported that no examination requests for privileged information have been denied by the Company.

Recommendations: None

Procedure 05 – Anti-Fraud

Observations: The Company has an Anti-Fraud Plan that was established in 2003. The plan was developed to confront the problem of insurance fraud by facilitating a program that detects insurance fraud, reduces the occurrence of fraud through efforts with law enforcement and deters the ability of consumers to fraudulently obtain insurance benefits.

The Company has contracted with a national insurance investigations firm to provide special investigative services, surveillance, fraud and claim investigating training, SIU compliance and reporting. The Company has also implemented a dedicated secure website for the reporting of all suspected fraudulent claims. From January 2004 thru June 2007, fifty-five (55) suspected fraud cases were reported to the state fraud bureaus which is an increase of reported cases from the past.

Recommendations: None

Procedure 07 – Managing General Agent (MGA) Oversight and Control

Observations: The Company does have a procedure for MGA Oversight and Control. The guidelines and expectations are contained in the Business Plan included in the Plan of Operation. Prospective MGA's and PA's are evaluated prior to entering into a contractual agreement with the Company. After a contract is signed, the Company allows them to issue policies on its behalf.

Audits are performed annually for PA's and semi-annually for MGA's. Additional reviews may be scheduled if necessary. The Company provided a variety of audits, including all that were performed during the examination period. The audits were thorough with overviews and recommendations made in each audit. An audit report documents the outcome of the audit and provides management a tool for communicating recommendations. If a weakness is found within the performance of the MGA or PA, a recommendation is made and a response is expected within fifteen (15) days from receipt of the report. All recommendations are evaluated by the audit team members to determine if they sufficiently address and resolve the concern noted.

Recommendations: None

Procedure 08 – Vendor Oversight and Control

Observations: The Company has a written procedure for Vendor Oversight and Control. Vendors are utilized in the areas of Claims, Loss Control, Premium Audit, Policy Administration, Technical Services and State Filings. Guidelines provided for each of the vendors are precise and

detailed. Audits are performed on each vendor at least on an annual basis. No issues are noted in the copies of the audits provided for review.

Recommendations: None

Procedure 09 – Customer and Consumer Privacy Protection

Observations: The Company has a process for Customer and Consumer Privacy Protection that is adequate. All employees are trained and must certify compliance with the company's Code of Conduct that contains their Privacy Policy. Private, non-public information that is obtained from producers is secured in hard-copy and electronic form. According to the Company, hard-copy information is secured under lock and key. Electronic information is maintained in a password protected database. Passwords expire every sixty (60) days and lock-out occurs after five (5) unsuccessful attempts.

Recommendations: None

Procedure 10 – Production of Business

Observations: The Company does have a procedure that is used for the Production of Business. The two divisions that supply and support the company business are "Single Risk Business" and "Program Business."

Single Risk Business provides excess coverage to alternative market individual accounts. This type of business is large commercial accounts that are qualified self-insureds in the states in which they operate. This business is produced by retail and wholesale brokerage firms. No binding or underwriting authority is granted to Single Risk Business producers, so each risk is individually underwritten and controlled by the insurer prior to binding or writing the policy.

Program Business is produced through MGA's and PA's. This business is focused on select markets and is controlled by stated guidelines. Underwriting acceptability and pricing parameters are based on group experience.

Audits are performed at least on an annual basis to assure the Company that guidelines for written business are followed and performance standards are met.

Recommendations: None

Procedure 11 – Complaint Handling

Observations: The Company has a written procedure for Complaint Handling. The guidelines for complaint handling were reviewed and no areas of concern are noted. All consumer and insurance department complaints are forwarded to the Insurance Company Operations Department (ICO) complaint coordinator who logs the complaint into a central database by date received, complainant, insured, policy number, state, insurance department complaint number,

reason, and the name of the person assigned for handling. The database automatically assigns the response due date based on regulatory requirements. The date can be changed if the requesting state requires a response earlier than the pre-established date. The process requires the complaint to be forwarded within one business day to the appropriate department for review and response. The prepared response is sent to the person or insurance department initiating the complaint.

The Company complaint log contained one (1) complaint that was reviewed by the examiners.

Recommendations: None

Procedure 13 – Advertising, Sales and Marketing

Observations: The Company does have a written procedure that outlines the policies for external communications which includes Advertising, Sales and Marketing. PESLIC does not produce newsletters, bulletins or other advertising materials since it does not market directly to producers. PA's and MGA's requesting to use the name of PESLIC for any advertising materials must acquire the approval of at least one member of the corporate marketing executive committee. Examples of the approved company advertising materials were reviewed by the examiners and no conflict with Delaware's statutes was noted.

Recommendations: None

Procedure 14 – Agent Produced Advertising

Observations: The Company is a Surplus Lines Insurer and has contractual limitations for the use of advertising that contains the Company's name and logo. MGA's and PA's are required to receive necessary internal approvals before any advertising may be completed. Audits are performed annually to verify that all advertising materials being used have received proper approval.

Recommendations: None

Procedure 15 – Producer Training

Observations: The Company does not have a formal written training procedure for Producer Training but does have a process that is used by the Program Operations Department to train its MGA's and PA's. The guidelines and training manuals are provided in hardcopy or electronic form. Continuous updates to the process are provided during the year. Audits are conducted at least annually to verify that the guidelines for training are being followed and manuals are updated as directed.

Recommendations: None

Procedure 20 – Producer Selection, Appointment and Termination

Observations: The Company does have a process in place for the Selection and Appointment of Producers and Surplus Lines Brokers. The requirements for Surplus Lines Brokers are outlined in the “Production Source Management Requirements Surplus Lines.” The procedures state the general requirements necessary to produce business for the company. Guidelines for the Surplus Lines Brokers include necessary license requirements and the responsibilities of the broker along with background investigations.

Audits are performed on an annual basis for Program Administrators and semi-annually for Managing General Agents. Violations of contract requirements found during the audits are reported to senior management and the law department. A corrective action plan may be put into place to ensure no further infractions occur. If the producer does not correct the contract violations to the Company’s satisfaction, the Company will terminate the contract of the producer and also terminate all agency and individual agent state appointments in accordance with applicable state requirements.

Recommendations: None

Procedure 21 – Producer Defalcation

Observations: The Company does have a written procedure for Producer Defalcation. Guidelines for the collection and remittance of funds are outlined and reviewed under the conditions of the MGA and PA agreements. Audits are performed semi-annually for MGA’s and annually for PA’s to verify that all funds are being handled appropriately. Results of the audits are discussed with the producers during a wrap-up meeting. Management receives final reports of the audits along with any necessary recommendations.

The Company began formal tracking of its account current payments in January 2006. Most payments are due on the 15th of each month. The examiners found that only one account revealed a consistent late payment. Discussion with the Company indicated a reasonable handling of the situation. Specifics of the case did not indicate defalcation.

Recommendations: None

Procedure 22 – Prevention of the Use of Persons with a Felony Conviction

Observations: The Company does have a process to address the requirements of 18 U.S.C.A. §1033. This Federal Law is intended to prevent the use of producers or the hiring of employees with prescribed felony convictions. The ICO Source Management staff administers the review process for producers. A criminal background check is performed to determine that there are no felony convictions on a producer before appointment is provided or business is accepted. After initial review, the Company does not periodically confirm compliance with 18 U.S.C.A. §1033.

The Human Resources Department performs application screening on new employees but does not perform criminal background checks to confirm compliance with the requirements of 18

U.S.C.A. §1033. Following the hiring process, employees provide an annual certification per the Code of Conduct to attest that the employee has not been convicted of an offense that would violate 18 U.S.C.A. §1033.

Recommendations: It is recommended that the Company implement a criminal background check on new employees and an annual review process to verify and maintain assurance that all employees and all producers writing business for the Company are not in conflict with 18 U.S.C.A. §1033.

Procedure 24 – Premium Billing

Observations: The Company has a process for Premium Billing that utilizes guidelines for billing and timely collection of premiums. The process details the billing process for the single risk policy that is broker billed. It also details the billing process for program business generated by the MGA and the PA.

Management reviews unpaid premium balances that are ninety (90) days from the entry date. Collection issues are addressed to the agent and monitored by senior management.

Recommendations: None

Procedure 26 – Policy Issuance

Observations: The Company has a formal written procedure for Policy Issuance. The process is outlined in several documents located in the Program Administrator’s Manual. Necessary policy requirements are provided in order for a policy to be issued by a Managing General Agent or a Program Administrator.

Surplus Lines business or non-admitted business policies are issued directly by the Company and are reviewed by the Single Risk Manager for approval.

Audits are performed at least annually to verify that manuals are current. The audits also confirm adherence to policy language terms and conditions and current procedures. Reports are provided to management to identify any deviations from the guidelines provided.

Recommendations: None

Procedure 27 – Reinstatements

Observations: The Company has a written procedure for Reinstatements. The Program Administrators Manual contains the guidelines for reinstating a policy. The guidelines and related training are provided by the Program Operations Department to MGA’s and PA’s. The Company’s reinstatement notice was reviewed and determined to be adequate.

The Program Operations Department conducts a minimum of one on-site audit per year to verify that the procedure for Reinstatement is working as expected.

Recommendations: None

Procedure 28 – Requesting Claim History

Observations: The Company does have a written procedure for an Insured Requested Claim History. The procedure entitled Loss History Requests, was provided in the Program Administrators Manual. The guidelines for making such a request are outlined and a response with a completed loss history document is mailed or faxed to the requestor within thirty (30) days of receipt of the request.

Recommendations: None

Procedure 30 – Premium Determination and Quotation

Observations: The Company has a written procedure for Premium Determination and Quotation. The Program Administrators Manual and the Line of Business Manual provide guidelines to an agent to make a rate quotation. Depending on the type of policy, reference manuals are available manually or electronically. Required information is entered into the application to determine a rate quote for a potential policy.

Audits are performed annually to assure management that guidelines are being followed and that manuals being used are current and updated as needed. Guidelines for the premium determination are also addressed in the Underwriting Guidelines.

The examiners reviewed corrective action plans that have been implemented as the result of Market Conduct Examinations conducted by the State of North Carolina in 2004 and the State of California in 2005. The corrective plans were the result of non-compliant practices in the State of California and specific deficiencies being addressed for the State of North Carolina. Deficiencies in those examinations have been resolved.

Recommendations: None

Procedure 31 – Policyholder Disclosures

Observations: The Company has a formal written procedure for Policyholder Disclosures. These are contained in several manuals depending on the line of business affected and the producing entity. The guidelines for use of appropriate policyholder notices are required to be used by the MGA's and PA's. Policyholder notices with Company and state specific guidelines were reviewed by the examiners.

To verify that policyholder disclosures are being delivered properly, audits are performed on-site annually at the office of the MGA or PA. Manuals are reviewed to verify that all disclosure material is current and to ensure compliance.

Recommendations: None

Procedure 32 – Underwriting and Selection

Observations: The Company underwrites through Managing General Agents (MGA's) or Program Administrators (PA's) under a Program Administration Agreement. The Company's written procedure for underwriting and selection is contained in guidelines in the Program Administration Agreement. Underwriting oversight of MGA's and PA's operating under this Agreement is provided by the Program Operations Department. Guidelines for underwriting vary depending on the type business that is being written. Samples of program underwriting guidelines for the Company's major programs were reviewed by the examiners and no issues were noted.

The Program Operations Department completes on-site operational audits at the MGA's and PA's offices at least annually to verify compliance with the procedures as stated in the Program Administration Agreement. In addition, on-site underwriting audits are completed by Munich Reinsurance America Underwriting Management Services Department or by the Referral Underwriter assigned to the program for adherence to the program underwriting guidelines. Needed amendments or changes to the Program Administration Agreement are included in the recommendations from these audits.

Recommendations: None

Procedure 33 – Rate and Form Filing

Observations: Surplus Lines writers do not have or need rate and form filing functions or processes.

Recommendations: N/A

Procedure 34 – Terminations

Observations: The Company has a written procedure for Terminations. The examiners reviewed the required details in the Program Administrator's Manual. The Company utilizes ODEN Policy Terminator, a product of ODEN Insurance Services, that provides reference materials needed to provide state specific notices at the time of cancellation or termination. State specific requirements for terminations were provided and reviewed by the examiners. Copies of the notices are required to be maintained in the policy file. A reason for the termination of a policy must be clear and also documented in the policy file.

Audits of the Managing General Agent and Program Administrator are performed by the Program Operations Department on-site at least annually to verify that policy terminations are being processed according to the procedure guidelines. Audit results were reviewed and no exceptions were noted. Any deviation or non-compliance found in an audit is reported to management for appropriate disposition.

Recommendations: None

Procedure 35 – Underwriting File Documentation

Observations: The Company has a written procedure for Underwriting File Documentation. The required guidelines for file documentation are contained in the Program Administrators Manual and also the Line of Business Manuals. Specific file documentation is necessary to meet the requirements to issue a policy.

Annual audits are performed by the Program Operations Department and the Underwriting Department to assure the Company that required documents are maintained and specific requirements are met to enable issuance of a new policy. Any negative audit reports are provided to management for review and to determine if additional remedial action is needed.

Recommendations: None

Procedure 40 – Staff Training

Observations: The Company's staff training process impacts several areas with training needs including claims, policyholder services and complaint handling. Company staff is trained and tracked through the individual employee Performance and Management and Development (PMD) process. Company employees receive mid-term and annual reviews to identify training needs and recommend appropriate course work. The PMD process monitors employee development and communicates training goals. Training opportunities are communicated through Human Resources.

Staff training requirements for MGA's, PA's and third party administrators are communicated through service agreements and verified by the audit process. Annual audits are conducted with the MGA's and PA's that verify areas for recommended training needs. The examiners reviewed copies of the annual audits to verify the process. No issues of merit were identified in these reports.

Recommendations: None

Procedure 43 – Claim Handling

Observations: The Company does not have a direct written Claim Handling procedure but instead contracts with MGA's and TPA's to perform claim handling functions. The Company provides a series of guidelines that outline the expected claim handling criteria. For MGA's,

these guidelines are contained within the MGA Agreement. For TPA's, these guidelines are conveyed within a "Claims Services Agreement" that is provided during the initial setup of the program. The guidelines are clear and include the standards established to settle claims on behalf of the Company with a settlement authority amount for each of the MGA's or TPA's. Checks for payment of claims, losses, and loss adjustment expenses are issued by the MGA's or TPA's on behalf of the Company.

On-site audits of the MGA's are conducted twice a year and TPA's audits are conducted at least annually. More frequent audits may be utilized if conditions or circumstances warrant. Audit reports measure the work product, identify trends, report claim handling and office performance, evaluate authority levels, assess training needs and address any needed corrective action.

Oversight of MGA's and TPA's is through Claim Consultants employed by the Company's affiliate, Munich RE America. All Company business is monitored by Claim Consultants located in the Princeton Office.

Munich Re America also handles Umbrella and Excess claims directly through its Claim Consultants.

Recommendations: None

Procedure 44 – Internal Claim Audit

Observations: The Company utilizes guidelines found in "Claim Division Audit Process" and "Quarterly File Management Reviews" for Internal Claim Audit. These documents provide outlines for the Internal Claim Audit. Audits are conducted on a quarterly basis. An employee of Munich Re America Internal Audit department collects and reviews audit data from the managers involved in the audit. The audit department is responsible for monitoring compliance.

Recommendations: None

Procedure 45 – Claim File Documentation

Observations: The Company has a process for file documentation that is outlined in the Service Agreement with the MGA and TPA at the time the program is implemented. The agreement poses a responsibility for file documentation but does not describe a process or guideline for defining it or for accomplishing it. The Company's "Claim Consultant File Handling Guidelines" do address File documentation and establish a Standard for review by Company personnel. The Standard states:

"Supplement reports containing meaningful information should be concisely documented 15 working days of receipt. Reports received which would have no material impact on handling or direction of the case need not be documented."

The Standard does not address in any detail, the materials expected to be seen in the claim file at audit.

Audits of the MGA's and TPA's are conducted at least annually to verify that file documentation guidelines are adhered to and to confirm that files are actually being maintained in a professional manner. Quarterly file reviews are conducted to verify the effectiveness of the Company's claim consultants.

Recommendations: It is recommended that the Company develop specific guidelines to describe all documentation expected to be seen in a claim file.

Procedure 46 – Subrogation and Deductible Reimbursement

Observations: The Company claims processes are handled by MGA's or TPA's including the management of Subrogation or Deductible Reimbursement. MGA's and TPA's are subject to performance standards in these areas which are monitored by the Company and confirmed through an audit at least annually for MGA's and semi-annually for TPA's. The contract for MGA's and the Claim Service Agreements for TPA's each contain performance language that reads: "Pursue subrogation, deductible reimbursements and loss and Loss Adjustment Expense recovery opportunities related to the payment of claims."

The Company employee Claims Consultants are responsible for oversight of the claims functions of its MGA's and TPA's. They utilize several tools to develop statistics to manage the claim function as well as subrogation and deductible recovery. These tools are also used to determine if adjustments to the audit cycle are needed. These adjustments include

- Review of Monthly Loss Runs provided by the MGA or TPA
- Maintaining hard copy files on claims
- Quarterly File Management Reviews

If the Company detects through its statistical reports that an MGA's or TPA's performance is not in compliance with its standards related to claims, the Company will take appropriate steps to address the issue. These steps include a variety of options intended to correct adverse trends or patterns. The Company noted that its "Claim Consultants can also assume direct handling of a claim if deemed necessary and appropriate. Oversight may be altered with regard to a specific MGA or TPA due to conditions identified by the Consultant or results of an audit."

Recommendations: None

Procedure 48 – Catastrophic Claim Handling

Observations: The Company has filed catastrophe plans with the states of Florida, Texas and New York. The Company uses the same plan in all other states to address claims arising from a catastrophic event. The Company does not utilize staff adjusters for its handling of claims. The Company business is primarily General Liability, with a limited property exposure and limited Workers Compensation exposure thus reducing its potential for the usual stress on operations from a catastrophic event.

Recommendations: None

SUMMARY OF RECOMMENDATIONS

Procedure 22 – Prevention of the Use of Persons with a Felony Conviction

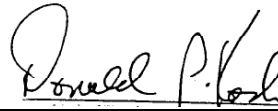
Recommendations: It is recommended that the Company continue to perform criminal background checks for producers, and that they expand that practice to include company personnel in upper management positions. These checks should be conducted prior to hiring said management. In addition, the Company should receive an annual attestation from those same individuals, documenting continued compliance with 18 U.S.C.A. §1033.

Procedure 45 – Claim File Documentation

Recommendations: It is recommended that the Company develop specific guidelines to describe all documentation expected to be included in a claim file.

CONCLUSION

The examination was conducted by Donald P. Koch, Cynthia M Amann and Steve E. Misenheimer and is respectfully submitted,



Donald P. Koch, CIE
Market Conduct Examiner-in-Charge
Insurance Department
State of Delaware