

REPORT ON EXAMINATION  
OF THE  
CAPITAL ASSURANCE COMPANY, INC.  
CORAL GABLES, FLORIDA  
AS OF  
DECEMBER 31, 2002

BY THE  
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida  
October 2, 2003

Honorable Kevin M. McCarty,  
Director  
Office of Insurance Regulation  
State of Florida  
Tallahassee, Florida 32399-0300

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), an examination has been made as of December 31, 2002, of the financial condition and corporate affairs of the:

**Capital Assurance Company, Inc.**  
**2333 Ponce De Leon Blvd, Suite 300**  
**Coral Gables, Florida 33134**

hereinafter referred to as the "Company". Such report of examination is herewith respectfully submitted.

## **SCOPE OF EXAMINATION**

This examination covered the intervening period from January 1, 2000, to the close of business on December 31, 2002. The Company was last examined by representatives of the Office of Insurance Regulation (Office) as of December 31, 1999. This examination commenced with planning at the Office on June 3, 2003. The fieldwork commenced on June 10, 2003 and was concluded as of September 19, 2003. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination represents a statutory financial examination conducted in accordance with the Financial Examiners Handbook, Accounting Practices and Procedures Manual and Annual Statement Instructions, promulgated by the NAIC as adopted by Rules 4-137.001(4) and 4-138.001, FAC, with due regard to the statutory requirements of the insurance laws, rules and regulations of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination or estimation of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain workpapers and related reports prepared by the Company's independent certified public accountants (CPA) were reviewed and utilized where applicable within the scope of this examination.

The Company's assets were valued and/or verified and the liabilities were determined or estimated as of December 31, 2002. Transactions subsequent to year-end 2002 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

**Status of Adverse Findings from Prior Examination**

There were no adverse findings from the previous examination as of December 31, 1999.

## HISTORY

### General

The Company was incorporated on August 15, 1978, under the laws of the State of Florida, as a stock multiple line insurance company and commenced business on October 1, 1978 under the name of Federal Assurance Company. The Company was acquired by Ryder Systems, Inc., approximately at the time of its incorporation. The name was subsequently changed on June 23, 1982 to Capital Assurance Company, Inc.

Skandia Direct Operations Corporation, a Delaware corporation, took ownership of the Company on January 2, 1990, after purchasing all of the shares of the Company's capital stock from Ryder Systems, Inc., pursuant to a stock purchase agreement dated October 6, 1989. The stock was transferred to Skandia America Corporation (SAC) by means of a dividend paid on May 28, 1996.

The Company has been operating in a run-off mode since April 4, 1997 pursuant to the Consent Order 17461-96-C.

On December 31, 1997, Capital Alliance Insurance Company, Inc. had merged with and into the Company in accordance with the terms of Consent Order Case No. 21545-97-C. Capital Alliance Insurance Company, Inc. was a wholly owned subsidiary and was domiciled in the State of Alabama.

The Articles of Incorporation were amended on March 28, 2001 to reflect the current principal office of the Company at The Omni Colonnade, Suite 300, 2333 Ponce de Leon Boulevard, Coral Gables, Florida 33134. The bylaws were not amended during the period covered by this examination.

### **Capital Stock**

As of December 31, 2002, the Company's capitalization was as follows:

Number of authorized common capital shares	23,500
Number of shares issued and outstanding	23,500
Total common capital stock	\$ 2,350,000
Par value per share	\$100.00

The control of the Company was maintained by its parent, SAC. SAC owned 100 percent of the stock issued by the Company, who, in turn, was 100 percent owned by Skandia U.S. Holding, LLC (SKUSH). SKUSH was 100 percent owned by Skandia, U.S. Holding, Inc. (SUSI), a Delaware corporation. The ultimate parent was Skandia Insurance Company (SICL), a Swedish corporation, as of December 31, 2002.

### **Profitability of the Company**

The Company was in run-off; therefore, no longer writing or assuming premiums. The Company's net income before taxes at December 31, 2002 was \$907,569, and \$2,485,151 in the prior year. Federal and foreign income tax was \$1,038,808 in 2002 and \$94,141 in 2001. This resulted in a net loss of \$131,239 in 2002 and net income of \$2,391,010 in 2001.

### **Dividends to Stockholders**

During 2002, the Company paid ordinary and extraordinary dividends of \$1 million and \$11 million respectively, to its parent, SAC with the approval of the Office.

### **Management**

The annual shareholder meeting or the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. The members serving as of December 31, 2002, were as follows:

#### **Directors**

<b>Name and Location</b>	<b>Principal Occupation</b>
Berth Roland Maas Stockholm, Sweden	Semi Retired/Part time Consultant
John Bergentjerna Stockholm, Sweden	Semi Retired/Part time Consultant
John D. Marshall Plantation, Florida	President

Martha Rodriguez  
Miami, Florida

Chief Financial Officer  
Capital Assurance Company

Nancy P. Gordon  
Miami, Florida

Attorney

The following senior officers were appointed by the Board of Directors in accordance with the Company's bylaws:

**Senior Officers**

<b>Name</b>	<b>Title</b>
John D. Marshall	President
Berth R. Maas	Vice President
Martha Rodriguez	Vice President, Treasurer & Secretary

The Company did not establish an audit committee in accordance with Section 624.424 (8)(c), FS. The Company obtained a waiver of this requirement from the Office.

**Conflict of Interest Procedure**

At December 31, 2002, the Company had adopted a policy statement that required annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. The statement had been signed by all directors and officers listed on the Jurat page of the annual statement.

### **Corporate Records**

The recorded minutes of the meetings by the Shareholder and Board of Directors were reviewed for the period under examination. The minutes were documented and adequately approved Company transactions in accordance with Section 607.1601, FS, including the authorization of investments in accordance with Section 625.304, FS.

### **Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance**

The Company had no acquisitions, mergers, disposals, dissolutions and purchase or sales through reinsurance during the period of this examination.

### **Surplus Debentures**

The Company had no surplus debentures as of December 31, 2002.

## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 4-143.045(3), FAC. The latest holding company registration filing with the State of Florida as required by Section 628.801, FS, and Rule 4-143.046, FAC, was made on July 9, 2003.

On December 31, 2002, the following agreements were in effect between the Company and its affiliates:

### **Tax Allocation Agreement**

The Company, along with its parent, filed a consolidated federal income tax return. On December 31, 2002, the method of allocation between the Company and its parent was the lesser of the Company's separate return tax liability or its pro-rata portion of the consolidated liability.

### **Investment Management Agreement**

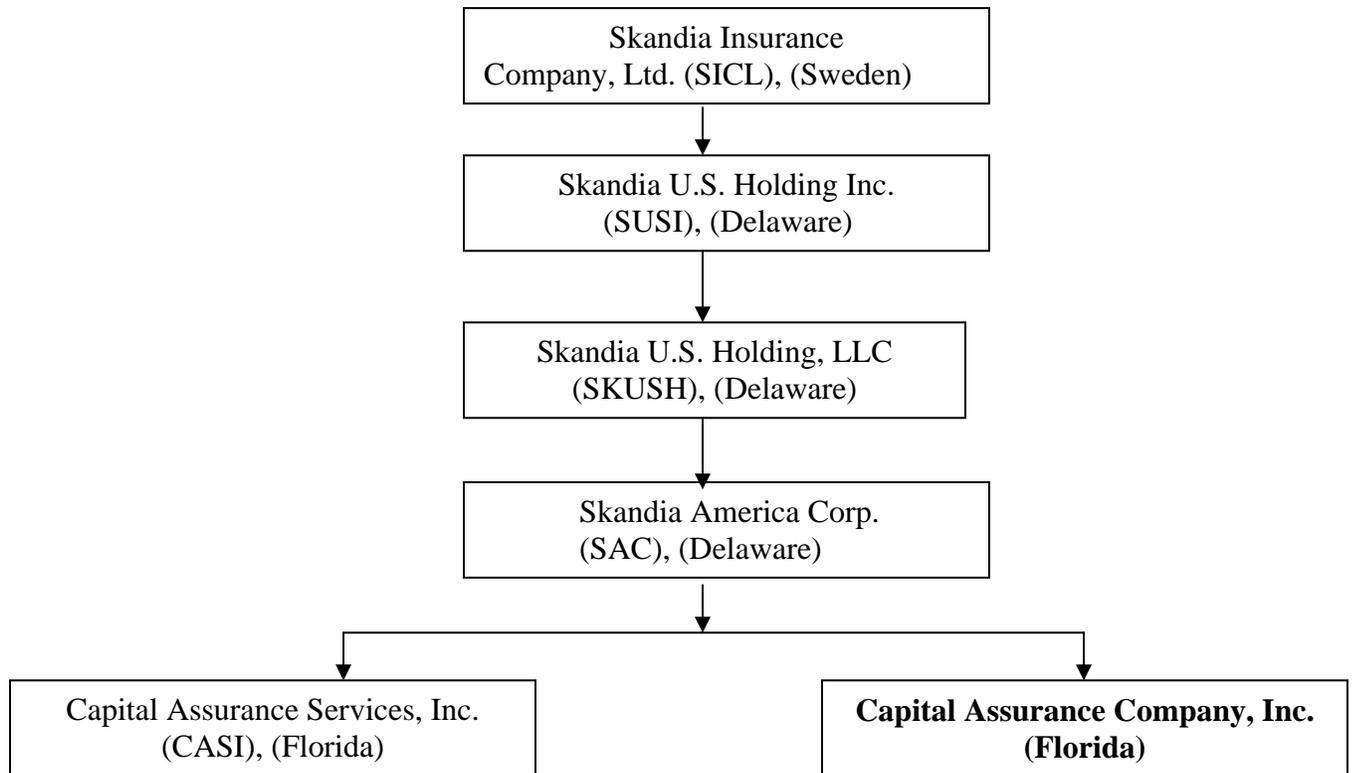
On December 30, 1991, the Company entered into an investment management agreement with Skandia Investment Management, Inc. now known as DnB Asset Management (U.S.), Inc., to provide investment advisory and investment management services with respect to an investment portfolio account held by Citicorp Trust, N.A.

## **Facilities and Services Agreement**

On January 1, 1995, the Company entered into an agreement with Capital Assurance Services, Inc. (CASI), a Florida corporation, to provide claims, accounting, financial, legal, human resources, data processing, and supervisory services as necessary, as well as office space and equipment.

A simplified organizational chart as of December 31, 2002 reflecting the holding company system, is show below. Schedule Y of the 2002 Annual Statement provided a list of all related companies of the holding company group.

**Capital Assurance Company, Inc.**  
**ORGANIZATIONAL CHART**  
**DECEMBER 31, 2002**



## FIDELITY BOND AND OTHER INSURANCE

As of December 31, 2002, the parent company, SAC, maintained fidelity bond coverage, in the amount of \$20,000,000, with a single loss limit of liability of \$10,000,000, with a single loss deductible of \$250,000. This insurance adequately covered the suggested minimum amount of coverage for the Company, as recommended by the NAIC.

## PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company had no employees.

## STATUTORY DEPOSITS

On December 31, 2002, the following amounts were deposited with the State of Florida as required by Section 624.411, FS.

State	Description	Par Value	Market Value
FL	US Treasury Note 6.125%	\$ 1,285,000	\$ 1,477,750
FL	US Treasury Note 5.750%	<u>250,000</u>	<u>253,673</u>
Total Florida Deposits		<u>\$1,535,000</u>	<u>\$1,731,423</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

The Company filed with the Office a notice of intent to withdraw on July 22, 1996. The Company ceased writing business in all states, due to a decision by SICL to terminate its non-life insurance and reinsurance operations throughout the United States. The Office granted approval of the withdrawal on November 13, 1996. CASI will continue to operate exclusively and only for the purpose of managing the Company's run-off operations.

As of January 1, 1997, the Company ceased providing all insurance products except the commercial products line, which was terminated April 7, 1997.

### **Treatment of Policyholders**

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS. The Company maintained a claims procedure manual that included detailed procedures for each type of claim.

## **REINSURANCE**

The reinsurance agreements reviewed as of December 31, 2002 were found to meet NAIC regulations with respect to the standard insolvency clause, arbitration clause, and transfer of risk, reporting and settlement information deadlines.

### **Assumed**

The Company did not assume any reinsurance during the period of examination. Prior to June 30, 1997, the Company assumed risk on an excess of loss and quota share basis from several non-affiliated insurers. The amount of assumed business varied depending upon the treaty and the year business was written. All treaties have been in run-off since June 30, 1997.

### **Ceded**

The Company has not entered into any reinsurance contracts during the period of examination. Prior to June 30, 1997, the Company was a party to numerous reinsurance contracts with various retention limits based on the treaty and year written. The Company ceded risk on the basis of quota share, excess of loss, and excess catastrophe, with various authorized and unauthorized reinsurers. All treaties have been in run-off since June 30, 1997.

### **Commutation of aggregate excess of loss reinsurance agreement**

The aggregate excess of loss reinsurance agreement with Cumulus Reinsurance Company S.A. (Cumulus) was commuted in 2002. The reinsurance agreement limited the Company's exposure on business written or assumed prior to January 1, 1990. The agreement limited exposure to the amount of loss reserves recorded as of December 31, 1989. In the agreement, a commutation was called for when 90% of losses as of December 31, 1989 has been paid.

### **ACCOUNTS AND RECORDS**

The Company was exempt from a CPA audit pursuant to Section 624.424 (8)(c), FS.

The Company's accounting records were maintained according to Section 607.1601(2), FS with the exception of the account that is mentioned later in this report.

The Company maintained its principal operational office in Coral Gables, Florida, where this examination was conducted.

On December 31, 2002, the following agreements were in effect between the Company and non-affiliates:

#### **Custodian Agreement**

The Company executed a custodian account services agreement with Citicorp Trust, N.A. on February 1, 1995. The agreement was amended on May 1, 2003. The amended agreement met the requirements of Rule 4-143.042, FAC.

#### **Risk-Based Capital**

The Company reported its risk-based capital at an adequate level.

### **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2002 as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

**CAPITAL ASSURANCE COMPANY, INC.**  
**Analysis of Assets**

**DECEMBER 31, 2002**

Classification	Assets	Nonadmitted Assets	Admitted Assets
Bonds	\$32,747,069		\$32,747,069
Cash:			
On deposit	633,980		633,980
Short-term investments	15,193,931		15,193,931
Reinsurance recoverable	27,433	27,433	0
Funds held by or deposited with reinsured companies	127,401		127,401
Federal & foreign income tax recoverable	2,575,316	1,258,143	1,317,173
Interest and dividend income due & accrued	98,131		98,131
Aggregate write-ins for other than invested assets	1,568,777		1,568,777
<b>Totals</b>	<b>\$52,972,038</b>	<b>\$1,285,576</b>	<b>\$51,686,462</b>

**CAPITAL ASSURANCE COMPANY, INC.**  
**Liabilities, Surplus and Other Funds**

DECEMBER 31, 2002

**Liabilities**

Losses		\$23,250,947
Reinsurance payable		140,988
Loss adjustment expenses		6,347,878
Other expenses		17,726
Taxes, licenses and fees		424,047
Provision for reinsurance		56,000
Payable to parent, subsidiaries & affiliates		2,470,625
Aggregate write-ins for liabilities		67,186
Total Liabilities		<hr/> \$32,775,397
Common capital stock	\$2,350,000	
Gross paid in and contributed surplus	15,563,835	
Unassigned funds (surplus)	997,230	
Surplus as regards policyholders		\$18,911,065
Total liabilities, capital and surplus		<hr/> <hr/> \$51,686,462

**CAPITAL ASSURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2002**

<b>Underwriting Income</b>	
Premiums earned	(\$20)
<b>DEDUCTIONS:</b>	
Losses incurred	(1,610,641)
Loss expenses incurred	748,407
Other underwriting expenses incurred	1,301,225
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$438,991</u>
Net underwriting gain or (loss)	(\$439,011)
<b>Investment Income</b>	
Net investment income earned	\$1,237,809
Net realized capital gains or (losses)	102,034
Net investment gain or (loss)	<u>\$1,339,843</u>
<b>Other Income</b>	
Aggregate write-ins for miscellaneous income	\$6,737
Total other income	<u>\$6,737</u>
Net income before dividends to policyholders and before federal & foreign income taxes	<u>\$907,569</u>
Dividends to policyholders	<u>\$0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$907,569
Federal & foreign income taxes	<u>1,038,808</u>
Net Income	(\$131,239)
<b>Capital and Surplus Account</b>	
Surplus as regards policyholders, December 31 prior year	\$25,264,033
<b>Gains and (Losses) in Surplus</b>	
Net Income	(\$131,239)
Net unrealized capital gains or (losses)	0
Change in net deferred income tax	368,693
Change in non-admitted assets	5,414,578
Cumulative effect of change in accounting principles	(5,000)
Dividends to stockholders	(12,000,000)
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>(\$6,352,968)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$18,911,065</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Assets

#### Federal & Foreign income tax recoverable

The Company erroneously reported the net admitted portion of the deferred tax asset totalling \$1,317,173, in the 2002 annual statement. This deferred tax asset was overstated by \$677,407. The Company used the incorrect percentage to calculate the portion of accrued severance and termination balance that will reverse within one year. Since the amount was considered immaterial, no exam adjustment was made.

#### Subsequent Event

The Company corrected this error and subsequently reported the correct net admitted deferred asset amount of \$600,870 in the June 30, 2003 quarterly statement filing.

## Liabilities

### Losses and Loss Adjustment Expenses

\$29,598,825

An outside actuarial firm appointed by the Board of Directors rendered an opinion that the amounts carried in the balance sheet as of December 31, 2002 make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office Actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

**CAPITAL ASSURANCE COMPANY, INC.**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2002**

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders per December 31, 2002, Annual Statement	\$18,911,065
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustments			
LIABILITIES:			
No adjustments			
Net Change in Surplus:			\$0
Surplus as Regards Policyholders December 31, 2002, Per Examination			\$18,911,065

## **FINDINGS, COMMENTS AND CORRECTIVE ACTION**

### **Compliance with previous directives**

There were no adverse findings from the previous examination as of December 31, 1999.

### **Current examination comments and corrective action**

There are no corrective actions to be taken by the Company regarding findings in the examination as of December 31, 2002.

### **Subsequent Events**

The following changes have been made to the management of the Company subsequent to the examination date:

On April 30, 2003, pursuant to the Consent Order Case No. 67545-03-CO, SICL purchased 100% of the membership interest of SKUSH from SUSI. The ultimate controlling entity, SICL, now directly owns SKUSH, which in turn directly owns SAC, the Company's direct corporate parent. On May 1, 2003, SICL sold 3,060 shares (90%) of the common stock of SUSI to Prudential Financial, Inc. SICL expects to sell its remaining ownership interest to Prudential Financial, Inc. later this year pursuant to a put/call arrangement.

## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of the **Capital Assurance Company, Inc.**, as of December 31, 2002, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$18,911,065, which was in compliance with Section 624.408, FS.

In addition to the undersigned, John Berry, Financial Examiner/Analyst Supervisor, and Doug Haseltine, Actuary, participated in the examination.

Respectfully submitted,

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Samita Lamsal  
Financial Examiner/Analyst II  
Office of Insurance Regulation