REPORT ON EXAMINATION

OF

AMERICAN STRATEGIC INSURANCE CORPORATION

ST. PETERSBURG, FLORIDA

AS OF

DECEMBER 31, 2003

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
September 3, 2004

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

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), we have conducted an examination as of December 31, 2003 of the financial condition and corporate affairs of:

AMERICAN STRATEGIC INSURANCE CORPORATION
1325 SNELL BLVD., SUITE 211,
ST. PETERSBURG, FLORIDA 33704

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2001 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced with planning at the Office on July 6, 2004. The fieldwork commenced on July 12, 2004, and was concluded as of September 3, 2004. 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 was 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 69O-137.001(4), and 69O-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination 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 work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2003. Transactions subsequent to year-end 2003 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.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for certain accounts.

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2000, along with resulting action taken by the Company in connection therewith:

Corporate Records

There was no documentation in the Board minutes that the Company's directors reviewed the previous examination report.

Resolution: The Board of Directors meeting minutes evidenced that the December 31, 2000 examination report was reviewed.

HISTORY

General

The Company was incorporated on August 18, 1997, under the laws of Florida, as a stock property and casualty insurer. The Company commenced business on December 18, 1997, with the name of American Strategic Insurance Corporation.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in the State of Florida, on December 31, 2003:

Fire	Allied Lines
Homeowners Multiple Peril	Inland Marine
Other Liability	Flood

The articles of incorporation and bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2003, the Company's capitalization was as follows:

Number of authorized common capital shares	1,000
Number of shares issued and outstanding	1,000
Total common capital stock	$1,000
Par value per share	$1

The Company was a wholly owned subsidiary of ARX Holding Corporation (ARX), which owns all of the issued and outstanding common stock of the Company. ARX was an insurance holding company domiciled in Delaware. As of December 31, 2003, ARX was owned 35% by XL

Capital Ltd, a Bermuda company, 35% by Arch Capital Group Ltd., also a Bermuda company, 21% by Marc Fasteau, individual, and the remaining nine 9% by others. On March 30, 2004, XL Capital Ltd. increased its ownership interest in ARX to 49%, ARX Executive Holdings, Inc. (a Florida corporation) acquired 25% (owned by officers and directors of the Company), Arch Capital Group Ltd., sold all of its interests, Marc Fasteau increased ownership to 22% and the remaining other interests decreased to 3.5%.

During the year 2003, an additional $1,150,000 of paid in capital was contributed to the Company.

Profitability of Company

The Company reported net income (losses) for the last three years of ($460,775), $771,263 and $2,965,434 in 2001, 2002 and 2003, respectively. Premiums earned increased from $11,997,054 in 2001 to $17,691,665 in 2002, then to $19,787,913 in 2003. Surplus as regards policyholders increased from $8,080,064 in 2001 to $11,979,159 in 2002, and then to $16,359,060 in 2003. Total net admitted assets increased 215% and total liabilities increased 400% as of the last examination date. Direct written premiums increased from $51,311,883 in 2001 to $99,880,215 in 2003, a 95% increase in two years.

Management

The annual shareholder meetings for the election of directors for the years 2001, 2002 and 2003 were not documented in minutes. The directors serving as of December 31, 2003 were:

Directors

Name and Location	Principal Occupation
John F. Auer St. Petersburg, Florida	President and Treasurer of the Company
Marc Fasteau New York, NY	Chairman & Secretary of the Company Investment Banker
Greg Hendrick Hamilton, Bermuda	XL Capital Ltd.
Robert L. Nason Hamilton, Bermuda	XL Capital Ltd.
John Clements	Arch Capital Group, Ltd.
Joseph King	Arch Capital Group, Ltd.

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

Senior Officers

Name	Title
John F. Auer	President and Treasurer
Mary Frances Bacon	Vice President, Production Management
Kevin R. Milkey	Senior Vice President
Frank C. Peck	Vice President, Marketing
Antonio Scognamiglio	Vice President, Claims
Gregory E. Stewart	Vice President, Finance

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Listed below the principal internal board committees and the members as of December 31, 2003:

Audit Committee
Marc Fasteau[1]
Joseph N. King
Robert L. Nason

[1]Chairman

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during the examination period.

Corporate Records

The Company's Organization Chart, Schedule Y, was not completed in accordance with the NAIC Annual Statement Instructions. The NAIC requires the Organization Chart to also include the Federal Employer's Identification Number, NAIC company code and the state abbreviation of the state of domicile.

The recorded minutes of the Board of Directors meetings were reviewed for the period under examination. Shareholder minutes for the years 2001, 2002 or 2003, and Audit Committee minutes for the years 2001, 2002 or 2003 were not recorded.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance during the period under examination.

Surplus Debentures

The Company entered into a subordinated surplus debenture, on December 22, 1997, with ARX in the amount of $1,000,000. Interest accrued at 8% per annum on the unpaid principal balance. The principal balance was $1,000,000 at December 31, 2003 and no interest payments have been approved by the Office or paid by the Company.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on August 12, 2004, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

The following agreements were in effect between the Company and its affiliates at December 31, 2003:

MGA Agreement

The Company entered into a Managing General Agent (MGA) Agreement with its affiliate, ASI Underwriters Corp. (ASI) on September 6, 2000. The Office approved the agreement on October 25, 2000. ASI charged an 8% commission and a $25 policy fee.

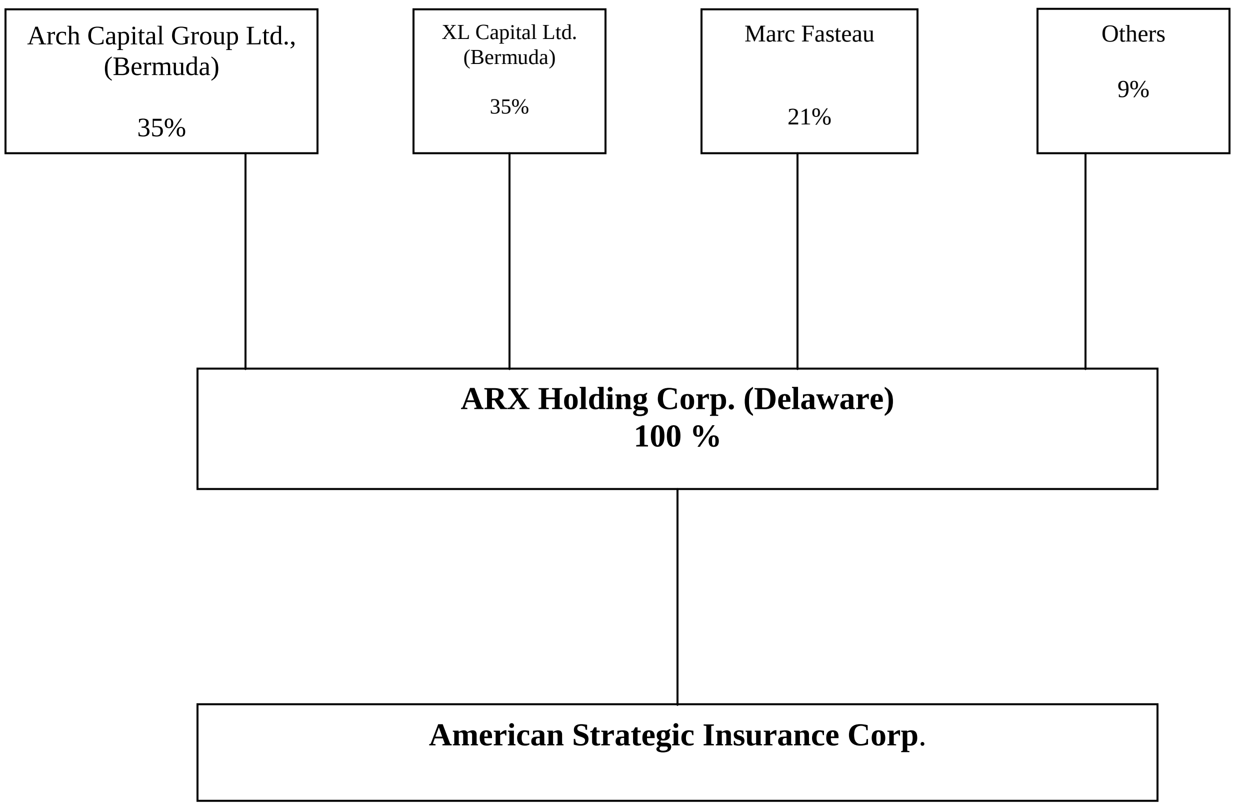
The corporate minute books for the years 2001, 2002 and 2003 contained no record of the Board of Directors approval of ASI as MGA for the Company as required by the Company's bylaws.

Tax Allocation Agreement

The Company, along with its parent, ARX, and other affiliated companies, filed a consolidated federal income tax return at December 31, 2003. The agreement provided that each subsidiary shall pay to the parent an amount equal to the total of the subsidiary's separate federal income tax liability as if the subsidiary filed a separate federal income tax return.

American Strategic Insurance Corp.
ORGANIZATIONAL CHART

DECEMBER 31, 2003



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to $500,000 with a deductible of $25,000. This policy covered the entire group of companies. The coverage of $500,000 was below the NAIC recommended guideline.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company's employees were eligible to participate in a 401(k) plan, whereby the Company matched up to 6% of the employees' contributions. Employees became fully vested after three years of service. The Company also participated in certain health, life and disability benefit plans for employees.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

	Description	Par Value	Market Value
FL	US Treasury Note, 5.75%, Due 11/15/05	$300,000	$309,037
	Total deposits	$300,000	$309,037

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company was authorized to transact insurance only in the State of Florida, as provided in Section 624.401(2), FS. An affiliated company, ASI Lloyds, also transacted homeowners business in Texas. This line of business was primarily underwritten out of the Company's office in St. Petersburg, Florida.

Treatment of Policyholders

At December 31, 2003, the Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

REINSURANCE

The reinsurance agreements reviewed at December 31, 2003 complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company did not assume any risks.

Ceded

The Company was a party to several reinsurance contracts with various authorized and unauthorized reinsurers. The Company, as of June 1, 2003, ceded risk on a quota share basis and kept a 35% retention. There was a 50% quota share reinsurance treaty with XL Capital Ltd (writing as XL Re). The other 15% quota share treaty was with General Re.

The Company also maintained various excess of loss reinsurance treaties for its homeowners, personal umbrella and commercial general liability coverages. XL Re was also a significant party to two of these treaties. Coverage was also in place to reinstate coverage if the first layer annual aggregate was used. Property catastrophe limits were reinsured up to $180,000,000. Reinsurance was also maintained on a per risk basis for higher valued policies. Essentially, the Company retained the first $300,000 in risk on homeowners' policies and $200,000 on umbrella policies.

The Company's strategy was to purchase enough catastrophe cover in order to protect its solvency against a once in 200 year hurricane.

As of December 31, 2003, the Company held collateral under the 50% quota share reinsurance agreement as mentioned above, in the form of a letter of credit, totaling $25,700,000, that could be drawn for amounts that remain unpaid. The letter of credit relates to the business ceded to XL Re.

The Company provided a transfer of risk calculation to support the risk transfer accounting treatment of the reinsurance contracts. There was adequate transfer of risk for all reinsurance contracts in effect as of December 31, 2003.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

The Company has been audited annually by KPMG LLP, of Tampa, Florida for the years 2001, 2002 and 2003, in accordance with Section 624.424 (8), FS. Audited statutory financial statements and supporting work papers were prepared by the CPA firm as required by Rule 69O-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Premiums receivable files maintained by the accounting department were not updated as policyholders changed their pay plans.

The Company reported Premiums booked but deferred as Premiums in course of collection.

Evaluation of Controls in Information Systems (IS)

- The Company's IS strategy was not consistent with its business strategy.
- The Company did not have an inventory of its IS hardware and software.
- The Company did not maintain backup copies of data files and programs in a locked, waterproof fireproof, off-premises location. Secured copies of data files and programs would assist in the timely recovery from a disaster.
- In the event of a business interruption the Company did not have appropriate escalation procedures in place to resolve IS operational failures in a timely manner.

- The Company did not have procedures and controls in place to ensure that underlying causes of IS operational failures are identified and addressed.
- The Company did not have a written statement that clearly defines access to the computer facility or procedures in effect to verify that only authorized individuals were permitted to enter the IS facility.
- The Company did not have a procedure for the prompt cancellation of access to the Company's IS when employees were terminated.
- The Company did not have an agreement or contract for use by IS of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs.

The Company maintained its principal operational offices in St. Petersburg, Florida, where this examination was conducted.

The Company and non-affiliates had the following principal agreements:

Custodial Agreement

The Company had a custody agreement with Investors Bank & Trust Company of New York, in New York, NY. This agreement did not meet all of the FAC requirements; however, this agreement was amended in 2004 to meet the FAC requirements.

Independent Auditor Agreement

The Company engaged KPMG LLP to perform an independent CPA audit.

Independent Actuary Agreement

The Company engaged Ernst & Young LLP to form an independent actuarial opinion.

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, 2003, and the results of its operations for the year then ended as determined by this examination.

AMERICAN STRATEGIC INSURANCE CORPORATION
Analysis of Assets

DECEMBER 31, 2003

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	$36,665,568		$36,665,568
Cash:			
On deposit	11,709,146		11,709,146
Agents' Balances:			
Uncollected premium	2,720,646		2,720,646
Net deferred tax asset	1,391,316		1,391,316
EDP equipment and software	52,264		52,264
Receivable from reinsurers	4,942,892		4,942,892
Receivables from PSA	779,650		779,650
Interest and dividend income due & accrued	435,790		435,790
Aggregate write-ins for other than invested assets	80,807		80,807
Totals	$58,778,079	$0	$58,778,079

AMERICAN STRATEGIC INSURANCE CORPORATION
Liabilities, Surplus and Other Funds

DECEMBER 31, 2003

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	$7,313,243		$7,313,243
Loss adjustment expenses	898,915		898,915
Commissions payable	1,086,014		1,086,014
Other expenses	980,424		980,424
Taxes, licenses and fees	695,436		695,436
Current federal taxes	585,849		585,849
Unearned premium	17,695,511		17,695,511
Advance premiums	1,921,101		1,921,101
Ceded reinsurance premiums payable	11,197,469		11,197,469
Drafts outstanding	44,570		44,570
Payable for securities	487		487
Total Liabilities	$42,419,019	$0	$42,419,019
Common capital stock	$1,000		$1,000
Surplus notes	1,000,000		1,000,000
Gross paid in and contributed surplus	10,649,001		10,649,001
Unassigned funds (surplus)	4,709,059		4,709,059
Surplus as regards policyholders	16,359,060	$0	16,359,060
Total liabilities, capital and surplus	$58,778,079	$0	$58,778,079

AMERICAN STRATEGIC INSURANCE CORPORATION
Statement of Income

DECEMBER 31, 2003

Underwriting Income	
Premiums earned	$19,787,913
DEDUCTIONS:	
Losses incurred	$9,008,344
Loss expenses incurred	1,216,285
Other underwriting expenses incurred	10,773,439
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	$20,998,068
Net underwriting gain or (loss)	($1,210,155)
Investment Income	
Net investment income earned	$1,179,213
Net realized capital gains or (losses)	(28,714)
Net investment gain or (loss)	$1,150,499
Other Income	
Net gain or (loss) from agents' or premium balances charged off	($15,579)
Finance and service charges not included in premiums	3,641,525
Aggregate write-ins for miscellaneous income	611,585
Total other income	$4,237,531
Net income before dividends to policyholders and before federal & foreign income taxes	$4,177,875
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	$4,177,875
Federal & foreign income taxes	1,212,441
Net Income	$2,965,434
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$11,979,159
Gains and (Losses) in Surplus	
Net Income	$2,965,434
Change in net deferred income tax	151,415
Change in non-admitted assets	113,052
Change in provision for reinsurance	0
Paid in surplus in year	1,150,000
Change in surplus as regards policyholders for the year	$4,379,901
Surplus as regards policyholders, December 31 current year	$16,359,060

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses $8,212,150

The Company's actuaries, Ernst & Young LLP, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2003, made 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 has reviewed work papers provided by the Company and was in concurrence with this opinion.

AMERICAN STRATEGIC INSURANCE CORPORATION
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2003

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, 2003 Annual Statement				$16,359,060
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
No adjustments necessary.				
LIABILITIES:				
No adjustments necessary.				
Net Change in Surplus:				0
Surplus as Regards Policyholders December 31, 2003, per examination				$16,359,060

SUMMARY OF FINDINGS

Compliance with previous directives

<u>General</u>

The Company has complied with previous examination directives.

Current examination comments and required corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2003.

Management

The Company's Organization Chart, Schedule Y, was not completed in accordance with the NAIC Annual Statement Instructions. **It is recommended that the Company complete its' Schedule Y, Organization Chart in accordance with the Annual Statement Instructions in all future filings of the Annual Statement. Subsequent event: The Company stated in correspondence dated December 29, 2004, that the appropriate changes to Schedule Y were filed in the June 30, 2004 quarterly statutory filings.**

Corporate Records

Minutes of the stockholders meeting were not available for the years 2001, 2002 and 2003 as required by the Company's bylaws. There were also no available minutes for the Audit Committee for the years 2001, 2002 and 2003. **It is recommended that the Company record the minutes of the shareholders meetings, as required by the Company's bylaws; and to document in**

minutes, the Audit Committee meetings; for all future meeting of the shareholders and audit committee.

Recording of MGA fees

The Company changed its methodology as of December 31, 2003 for recording MGA fees. The Company was recording the fees as Other income, rather than as Premiums. **It is recommended that the Company record its MGA fees as premiums, in accordance with Section 627.403, FS in all future filings of quarterly and annual statements with the Office**.

Internal Audit Function

The Company did not have an internal audit function. Additionally, the Company should document and maintain a list of individuals with access to the computer facility. **It is recommended that the Company establish an internal audit function and have an Information Systems Specialist position as part of that function.**

Information Systems Inventory

The Company did not have an inventory of its Information Systems hardware and software. **It is recommended that the Company maintain an inventory of hardware and software, and to provide a copy to the Office within 90 days of the issuance of this report.**

Information Systems Data Files

The Company did not have backup copies of data files and current software programs, in a locked, waterproof, fireproof, off-premises location. **It is recommended that the Company establish and secure a location to maintain and update data and programs.**

Resolution of Information Systems Operational Failures

The Company did not establish appropriate escalation procedures to resolve IS operation failures in a timely manner. **It is recommended that the Company establish escalation procedures to resolve operational failures timely.**

Identifying and Addressing Operational Failures

The Company did not have procedures and controls in place to ensure that underlying causes of operational failures are identified and addressed. **It is recommended that the Company establish procedures and controls to ensure that causes of operational failures are recorded.**

Termination of Employee Access to Information Systems

The Company did not have a procedure for the prompt cancellation of access to the information systems when individuals with access cease employment with the Company. **It is recommended that the Company establish a procedure to cancel access to information systems when individuals with access are terminated.**

Alternate Information Systems Site

The Company did not have an agreement or contract for use by IS of a specific alternate site to restore data processing operations after a disaster occurs. **It is recommended that the Company establish an agreement or contract for use of an alternate site and computer operations to restore data processing operations after a disaster occurs.**

MGA Agreement

The Company's minutes contained no record for any of the three years under review approving the appointment of ASI as MGA. The Company's bylaws require that the Board approve all major agreements. On September 2, 2004, the Board of Directors approved the existing contract with ASI.

SUBSEQUENT EVENTS

During August 2004, the Company increased its fidelity bond coverage to $1,200,000.

The Company's IS strategy has evolved since early in 2004 and was currently consistent with its business strategy. The Company stated in correspondence dated December 29, 2004, that appropriate measures to address the IS findings in this report have been taken in 2004.

The Company's ultimate ownership structure changed on March 30, 2004. The new shareholders of the parent company, ARX, were noted in this report.

During 2004, four major hurricanes have impacted the insurance industry in the State of Florida. These hurricanes occurred subsequent to the period of this examination and may have affected the Company's financial position. This examination does not include any assessment of the potential impact on the Company of the hurricanes; however, based upon preliminary information, expected losses are not expected to result in regulatory violations.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **American Strategic Insurance Corporation,** as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was $16,359,060, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Michael Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, Joe Boor, FCAS, Actuary and David Schleit, CPA, CA, FLIP, CFA, Financial Examiner/Analyst II, participated in the examination.

Respectfully submitted,

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Roger Kelley
Financial Examiner/Analyst II
Florida Office of Insurance Regulation