

**REPORT ON EXAMINATION**  
**OF**  
**AMERICAN STRATEGIC INSURANCE**  
**CORP.**

**ST. PETERSBURG, FLORIDA**

**AS OF**  
**DECEMBER 31, 2006**

**BY THE**  
**OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida

August 31, 2007

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, 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, 2006, of the financial condition and corporate affairs of:

**AMERICAN STRATEGIC INSURANCE CORP.  
805 EXECUTIVE CENTER DRIVE WEST, SUITE 300  
ST. PETERSBURG, FLORIDA 33702**

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, 2004 through December 31, 2006. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2003. This examination commenced on June 11, 2007 and was concluded as of March 12, 2008.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition 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, 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 of assets and the determination of liabilities, as those balances affect the financial solvency of the Company as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

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 reports, 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) and other reports as considered necessary were reviewed and utilized where applicable within the scope of this examination.

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**

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2003, along with resulting action taken by the Company in connection therewith.

### **Management**

The Company's Organization Chart, Schedule Y, was not completed in accordance with the NAIC Annual Statement Instructions. **Resolution:** The Company completed the 2006 Annual Statement Schedule Y in accordance with the NAIC Annual Statement Instructions.

### **Corporate Records**

Minutes of the stockholder meetings and audit committee meetings were not available as required by the Company's bylaws. **Resolution:** The minutes of the stockholder meetings and audit committee meetings were available for the years 2004, 2005 and 2006.

### **Recording of Managing General Agent (MGA) fees**

The Company recorded MGA fees as other income, instead of premium, as required by Section 627.403, Florida Statutes. **Resolution:** The Company recorded MGA fees as premium as required by Section 627.403, Florida Statutes for the years 2004, 2005 and 2006.

### **MGA Agreement**

The Company's minutes contained no record of the appointment of ASI Underwriters Corp. as MGA. **Resolution:** The Company's Board of Directors minutes recorded the appointment of ASI Underwriters Corp. as the Company's MGA on September 2, 2004.

In addition, the following is a summary of significant adverse findings contained in the Information Technology Report as of December 31, 2003, along with resulting action taken by the Company in connection therewith.

### **Internal Audit Function**

The Company did not have an internal audit function and did not maintain a list of individuals with access to the computer facility. **Resolution:** A separate formalized internal audit function was not maintained. However as of December 31, 2006, the Company had policies and procedures in place to detect and deter fraud which were monitored by management on a consistent basis. In addition, as of December 31, 2006, the Company maintained a list of individuals with access to the computer facility.

### **Information Systems Inventory**

The Company did not have an inventory of its information systems hardware and software. **Resolution:** As of December 31, 2006, the Company had an inventory program that maintained a detailed inventory of its hardware and software.

### **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. **Resolution:** As of December 31, 2006, the Company

had backup copies of all data files in a locked, waterproof, fireproof, off-premises disaster recovery location.

### **Resolution of Information Systems Operational Failures**

The Company did not establish appropriate escalation procedures to resolve operational failures in a timely manner. **Resolution:** As of December 31, 2006, the Company had escalation procedures, along with an operational hierarchy, to resolve operation failures in a timely manner.

### **Identifying and Addressing Information Systems Operational Failures**

The Company did not have procedures and controls in place to ensure that underlying causes of operational failures were identified and addressed. **Resolution:** As of December 31, 2006, the Company had procedures and controls in place to ensure that underlying causes of operational failures were identified and addressed.

### **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. **Resolution:** As of December 31, 2006, the Company had procedures for prompt cancellation of access to the information systems when individuals cease employment with the Company.

### **Alternate Information Systems Site**

The Company did not have an agreement or contract for use by the Information Systems Department for a specific alternate site to restore data processing operations if a disaster occurred. **Resolution:** The Company had a disaster recovery site in Kissimmee, Florida that was operational since December 31, 2004.



## HISTORY

### General

The Company was incorporated in Florida on August 18, 1997 and commenced business on December 18, 1997 as American Strategic Insurance Corp.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2006:

Fire	Allied lines
Homeowners multi peril	Commercial multi peril
Inland marine	Other liability

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

**Subsequent event:** The articles of incorporation were amended on April 11, 2007 to increase the number of authorized shares of common stock to one million shares.

### Capital Stock

As of December 31, 2006, 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	\$1.00

Control of the Company was maintained by its parent, ARX Holding Corporation, which owned 100% of the stock issued by the Company, which in turn was owned 46% by XL Re Ltd., a Bermuda company, 25% by ARX Executive Holdings, LLLP, a Florida company, 11% by Marc

Fasteau, a New York resident, 10% by Fasteau Insurance Holdings, LLC, a Delaware company and the remaining 8% was owned by various other individuals and entities.

During the years 2006, 2005 and 2004, Paid in capital was contributed to the Company in the amounts of \$27,000,000, \$14,500,000, and \$5,650,000, respectively.

### **Profitability of Company**

The following table shows the profitability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statements.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Premiums Earned	68,532,020	51,552,415	38,605,681
Net Underwriting Gain/(Loss)	7,386,699	2,291,919	(3,779,007)
Net Income	4,860,313	3,975,580	(1,511,925)
Total Assets	236,848,147	121,294,978	80,889,696
Total Liabilities	160,588,753	80,393,621	60,497,917
Surplus As Regards Policyholders	76,259,394	40,901,357	20,391,780

### **Dividends to Stockholders**

The Company did not declare or pay dividends to its stockholder during the period covered by this examination.

### **Management**

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2006, were:

## Directors

### Name and Location

### Principal Occupation

John F. Auer  
St. Petersburg, Florida

President of the Company, ARX Holding Corp., and various affiliates

Kevin R. Milkey  
St. Petersburg, Florida

Executive Vice President of the Company & several affiliates

Marc Fasteau  
Great Barrington, MA

Chairman & Secretary of the Company & affiliate, ASI Lloyds, Inc.

Robert L. Nason  
Stamford, Connecticut

Executive Vice President, XL Global Services & Director of ARX Holding Corp.

Greg Hendrick  
Hamilton HM EX, Bermuda

Senior Vice President, XL Re Ltd. & Director of ARX Holding Corp.

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

## Senior Officers

### Name

### Title

John F. Auer

President & Treasurer

Kevin R. Milkey

Executive Vice President

Marc Fasteau

Chairman & Secretary

Mary F. Fournet

Vice President, Marketing

Antonio Scognamiglio

Vice President, Claims

Gregory E. Stewart

Vice President, Finance

Robert K. Munns

Vice President

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2006:

**Audit Committee**

Marc Fasteau<sup>1</sup>  
Robert L. Nason  
Greg Hendrick

**Investment Committee**

Marc Fasteau<sup>1</sup>  
John F. Auer  
Kevin Milkey

<sup>1</sup> Chairman

**Conflict of Interest Procedure**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook. No exceptions were noted during this examination period.

**Corporate Records**

The recorded minutes of the shareholder, Board of Directors, and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

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

There were no acquisitions, mergers, disposals, dissolutions, and purchases 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 Holding Corporation 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, 2006 and no interest payments were approved by the Office or paid by the Company.

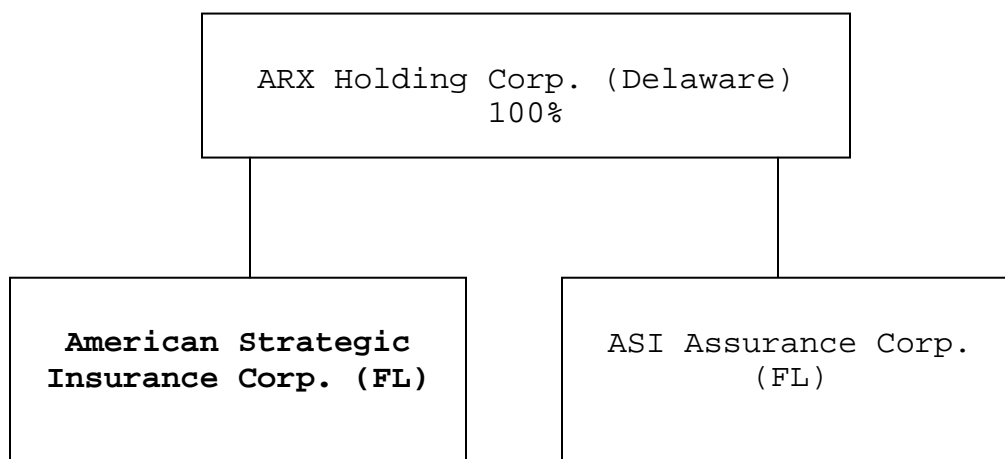
## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on December 5, 2006, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2006, reflecting the holding company system, is shown below. Schedule Y of the Company's 2006 annual statement provided a list of all related companies of the holding company group.

**AMERICAN STRATEGIC INSURANCE CORP.  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2006**



The following agreements were in effect between the Company and its affiliates:

**Tax Allocation Agreement**

The Company, along with its parent and affiliates, filed a consolidated federal income tax return. On December 31, 2006, the method of tax allocation between the companies was based upon calculations on a separate return basis.

**Managing General Agency Agreement**

The Company had a MGA agreement with its affiliate, ASI Underwriters, Inc., to provide claims and underwriting services for all lines of business except commercial. ASI Underwriters, Inc. received

8% of premiums written plus a \$25 policy fee for new policies for underwriting services performed on behalf of the Company. For claims processing services, ASI Underwriters, Inc. received 5% of direct losses incurred for non catastrophe claims and 1% for catastrophe claims.

The Company also had a MGA agreement with its affiliate, Safe Harbour Underwriters, Inc., to provide underwriting services for its commercial business. Safe Harbour Underwriters, Inc. issued the policies and collected the premiums for the Company on the insurance written pursuant to the agreement and received 8% of premiums written plus a \$25 policy fee for underwriting services performed.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$1,200,000 with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability insurance coverage with limits of \$2,000,000 and a deductible of \$150,000 as well as workers' compensation for the employees of the Company.

### **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company had a 401(k) plan for its employees along with several health, life and disability plans for its employees.

## STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes:

<u>State</u>	<u>Description</u>	<u>Par Value</u>	<u>Market Value</u>
FL	Bond, 5.0%, 06/01/21	<u>\$ 325,000</u>	<u>\$ 347,315</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 325,000</u>	<u>\$ 347,315</u>

## INSURANCE PRODUCTS

### Territory

The Company was authorized to transact insurance in the State of Florida.

### Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(j), Florida Statutes.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1)(i)3a, Florida Statutes.

## REINSURANCE

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



## **Assumed**

The Company assumed risk on a 20% quota share basis from its affiliate, ASI Assurance Corp. ASI Assurance Corp. paid a 24% ceding commission to the Company.

## **Ceded**

The Company ceded risk on a quota share and excess of loss basis to authorized and unauthorized reinsurers. The unauthorized reinsurers included XL Re Ltd, a Bermuda company, who was a 46% shareholder of the Company's parent. Letters of credit were properly established for all unauthorized reinsurers.

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

An independent CPA audited the Company's statutory basis financial statements annually for the years 2004, 2005 and 2006, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

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 Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company had a custodial agreement with Investors Bank & Trust Company dated September 29, 2004. The agreement was in accordance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

The Company had an agreement with Gregory, Sharer & Stuart, P.A. to audit the Company's statutory basis financial statements annually for the years 2004, 2005 and 2006.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2006, and the results of its operations for the year then ended 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."

**AMERICAN STRATEGIC INSURANCE CORP.  
Assets**

**DECEMBER 31, 2006**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$136,978,752		\$136,978,752
Cash	65,193,799		65,193,799
Investment income due or accrued	1,189,247		1,189,247
Agents' Balances:			
Uncollected premium	6,253,357		6,253,357
Deferred premium	9,101,350		9,101,350
Reinsurance recoverable	3,718,911		3,718,911
Net deferred tax asset	6,823,448		6,823,448
Guaranty funds receivable	5,832,689		5,832,689
Electronic data processing equipment	51,837		51,837
Receivables from parent, subsidiaries and affiliates	657,548		657,548
Aggregate write-in for other than invested assets	1,047,209		1,047,209
Totals	\$236,848,147	\$0	\$236,848,147

**AMERICAN STRATEGIC INSURANCE CORP.  
Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2006**

	Per Company	Examination Adjustments	Per Examination
Losses	\$21,795,322		\$21,795,322
Reinsurance payable on paid losses and loss adjustment expense	309,509		309,509
Loss adjustment expenses	2,841,230		2,841,230
Commissions payable	2,489,534		2,489,534
Other expenses	5,300,548		5,300,548
Taxes, licenses and fees	2,140,539		2,140,539
Current federal income taxes	1,955,549		1,955,549
Unearned premiums	99,346,971		99,346,971
Advanced premium	5,903,468		5,903,468
Ceded reinsurance premiums payables	14,087,357		14,087,357
Funds held under reinsurancce agreements	32,054		32,054
Payable to parent, subsidiaries and affiliates	1,780,578		1,780,578
Aggregate write-ins for liabilities	2,606,094		2,606,094
Total Liabilities	\$160,588,753	\$0	\$160,588,753
Common capital stock	\$1,000		\$1,000
Surplus notes	1,000,000		1,000,000
Gross paid in and contributed surplus	57,799,001		57,799,001
Unassigned funds (surplus)	17,459,393		17,459,393
Surplus as regards policyholders	\$76,259,394		\$76,259,394
Total liabilities, surplus and other funds	\$236,848,147	\$0	\$236,848,147

**AMERICAN STRATEGIC INSURANCE CORP.**  
**Statement of Income**

**DECEMBER 31, 2006**

<b>Underwriting Income</b>	
Premiums earned	\$68,532,020
<b>Deductions:</b>	
Losses incurred	20,527,163
Loss expenses incurred	2,156,857
Other underwriting expenses incurred	38,461,301
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$61,145,321</u>
Net underwriting gain or (loss)	\$7,386,699
<b>Investment Income</b>	
Net investment income earned	\$5,381,771
Net realized capital gains or (losses)	168,239
Net investment gain or (loss)	<u>\$5,550,010</u>
<b>Other Income</b>	
Net gain or (loss) from agents' or premium balances charged off	\$0
Finance and service charges not included in premiums	561,671
Aggregate write-ins for miscellaneous income	751,342
Total other income	<u>\$1,313,013</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$14,249,722
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>\$14,249,722</u>
Federal & foreign income taxes	<u>9,389,409</u>
Net Income	\$4,860,313
<b>Capital and Surplus Account</b>	
Surplus as regards policyholders, December 31 prior year	\$40,901,357
Net Income	\$4,860,313
Change in net deferred taxes	4,515,833
Change in non-admitted assets	(1,018,109)
Surplus adjustments: Paid in Examination Adjustment	27,000,000
Change in surplus as regards policyholders for the year	<u>0</u>
Change in surplus as regards policyholders for the year	<u>\$35,358,037</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$76,259,394</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

#### Losses and Loss Adjustment Expenses \$24,636,552

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, 2006, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

Walter J. Haner, FCAS, contracted by the Office, reviewed the Company's reserves. Mr. Haner determined the reserves of unpaid loss and loss adjustment expense obligations reported by the Company as of December 31, 2006, were reasonable.

### Capital and Surplus

The amount reported by the Company of \$76,259,394 exceeds the minimum of \$14,692,201 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**AMERICAN STRATEGIC INSURANCE CORP.  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2006**

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 December 31, 2006, per annual statement	\$76,259,394
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
<b>ASSETS:</b>			
No adjustment needed.			
<b>LIABILITIES:</b>			
No adjustment needed.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2006, per examination			\$76,259,394

## **SUMMARY OF FINDINGS**

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 2003 examination report issued by the Office.

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

There were no examination comments or corrective action in the examination as of December 31, 2006.



## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **American Strategic Insurance Corp.** as of December 31, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$76,259,394, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Kethessa Carpenter, CPA, Financial Examiner/Analyst Supervisor, and Walter Haner, FCAS, of Walter Haner and Associates, participated in the examination.

Respectfully submitted,

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Donna Letterio, CFE, CPA, MS  
Financial Specialist  
Florida Office of Insurance Regulation