



THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION

OF THE

COFACE NORTH AMERICA INSURANCE COMPANY

EAST WINDSOR, NEW JERSEY

as of DECEMBER 31, 2006

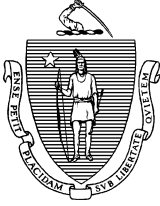
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Coface North America Insurance Company

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COMMONWEALTH OF MASSACHUSETTS

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May 28, 2008

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Pursuant to your instructions and in accordance with Massachusetts General Law ("MGL"), Chapter 175, Section 4, an examination has been made of the financial condition and affairs of

COFACE NORTH AMERICA INSURANCE COMPANY

at its principal executive offices located at 50 Millstone Road, Building 100, Suite 360, East Windsor, New Jersey 08520. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Coface North America Insurance Company (“Company” or “Coface”) was last examined as of December 31, 2005, under the association plan of the National Association of Insurance Commissioners (“NAIC”) by the Massachusetts Division of Insurance (“Division”). The current association plan examination also was conducted by the Division, and it covers the period from January 1, 2006 through December 31, 2006, including any material transactions and/or events and a review of certain Company practices, processes and controls occurring subsequent to the examination date and noted in the course of this examination.

The examination was conducted in accordance with standards and procedures established by the NAIC Financial Condition (E) Committee and prescribed by the NAIC *Financial Condition Examiners Handbook*, the examination standards of the Division, and Massachusetts General Laws. The principal focus of the examination was activity as of and for the year ended December 31, 2006; however, transactions both prior and subsequent thereto were reviewed as deemed appropriate.

In addition to a review of the financial condition of the Company, the examination included a review of the Company’s business policies and practices, corporate records, reinsurance treaties, conflict of interest disclosure statements, fidelity bonds and other insurance, employees’ pension and benefits plans, disaster recovery plan, treatment of policyholders, and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules, and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk, and examination efforts were directed accordingly.

The Division retained the independent consulting actuarial services of Milliman, Inc. (“Milliman”) to evaluate the adequacy of the Company’s loss and loss adjustment expense reserves as of December 31, 2006. An evaluation of the adequacy and effectiveness of controls over information systems was completed by the Division to determine the level of reliance to be placed on summary information generated by the data processing systems.

The Company is audited annually by KPMG LLP (“KPMG”), an independent certified public accounting firm, in accordance with 211 CMR 23.00. The firm expressed an unqualified opinion on the Company’s financial statements for the calendar year 2006. A review and use of the Certified Public Accountants’ work papers were made to the extent deemed appropriate and effective.

The examination included a review to verify the current status of the Comments and Recommendations made in the previous Report of Examination as of December 31, 2005. It was determined that the Company has addressed the Comments and Recommendations. For a summary of findings contained within this Report, refer to the Comments and Recommendations Section.

HISTORY

General

The Company is organized under the laws of the Commonwealth of Massachusetts. On December 30, 2003 Factory Mutual Insurance Company ("Factory Mutual") sold 100% of the issued and outstanding capital stock of Arkwright Insurance Company ("Arkwright") to Coface North America Holding Company ("CHC") for the purchase price of \$7,150,000 including \$5,400,000 in cash and investments. All liabilities of Arkwright were assumed by Factory Mutual. Arkwright was then renamed Coface and remains domiciled in Massachusetts.

CHC owns and operates a managing general underwriter ("MGU") that underwrites trade credit insurance business for CNA/Continental Insurance Company ("CNA"). CNA informed CHC that it wished to exit the trade credit insurance business. Consequently this book of business has incrementally been re-written by Coface as it has become licensed in more jurisdictions. As of today, approximately 10% of CHC's business is still underwritten through the MGU and reinsured from CNA to Coface S.A., a French based affiliate of the Company. The Company expects to move the remaining business to the Company over the next two years when the remaining state licenses are obtained.

During 2005, Coface S.A. was owned by Natexis Banques Populaires ("Natexis"), a French bank providing financing, investment banking, and other bank services. The parent of Natexis is Banque Federale des Banques Populaires ("BFBP") a French bank holding company. In November 2006 certain entities owned by the French bank Caisse Nationale des Caisses d'Epargne et de Prevoyance ("CNCE") merged into Natexis. Natexis was the surviving entity, and was renamed Natixis ("Natixis"). Thus, as of November 2006, the Company's ultimate parent is Natixis with BFBP and CNCE each owning 34.4% of Natixis. The remaining shares are publicly traded.

Capital Stock

The Company's Articles of Organization authorized 26,000 shares of capital stock with \$100 par value. All shares are issued and outstanding. All outstanding shares are held by CHC. During 2006 CHC contributed \$8,000,000 in additional paid-in capital to the Company. With this infusion of funds, paid-in capital totaled \$2,600,000, and the gross paid-in and contributed surplus totaled \$26,283,310 as of December 31, 2006. In addition CHC contributed \$20,000,000 of additional paid-in capital to the Company in the third quarter of 2007.

Coface North America Insurance Company

Dividends to Stockholder

In the period of examination, the Board of Directors has not issued dividends to the Company's sole stockholder.

Growth of the Company

The growth of the Company from the years 2003 through 2006 is indicated in the following schedule which was prepared from information in the Company's Annual Statements and examination adjustments:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus and Other Funds</u>
2006	\$ 60,133,726	\$ 36,659,708	\$ 23,474,018
2005	40,862,065	24,390,788	16,471,277
2004	19,694,369	7,845,887	11,848,482
2003	5,400,027	0	5,400,027

Management

Annual Meeting

In accordance with the Company's bylaws, the annual meeting of shareholders shall be held on the second Thursday of April each year for the election of the Board of Directors. If an annual meeting shall not have been held on the date fixed in the bylaws, a special meeting in lieu of an annual meeting may be held with all the force and effect of an annual meeting. One-fifth of the shareholders shall be necessary to constitute a quorum. The corporate records document that for each year in the examination period, the requirement for an annual meeting was satisfied with an action by consent of the Company's sole shareholder.

Board of Directors

According to the bylaws, the Company's business shall be managed by a Board of Directors which may exercise all of the powers of the Company except those exclusively conferred upon or reserved solely to the shareholders. The Board of Directors may determine the number of directors on the board. The directors shall be elected at the annual meeting of shareholders or the special meeting in lieu of the annual meeting. Each director shall hold office until the next annual meeting of the stockholders and until a successor shall have been duly elected and qualified, but any director may resign. If the office of a director becomes vacant, the directors may fill any vacancy on the Board of Directors between annual meetings. Any vacancy at the time of the annual meeting may be determined by the shareholders. A director must be an officer or eligible to hold such office pursuant to any rules of eligibility and tenure adopted by the Board of Directors.

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At December 31, 2006, the Company's Board of Directors, their business or professional affiliations, and residential addresses follow:

<u>Name of Director</u>	<u>Business Affiliation</u>	<u>Residence</u>
Michael J. Ferrante	President and Chief Executive Officer, Coface	West Windsor, New Jersey
Corine J. Troncy	Executive Vice President, Sales, Coface	New York, New York
Kenneth Moyle	Senior Vice President, Underwriting and Claims, Coface	Freehold, New Jersey
Pierre Fournel	Treasurer and Chief Financial Officer, Coface	New York, New York
Friedrich von Krusenstiern	Secretary and General Counsel, Coface	Brookline, Massachusetts

The bylaws do not specify the number of meetings of the Board of Directors to be held during a year and they allow the Board of Directors to take action by consent or telephonic meetings. At any meeting of the Board of Directors, a majority of the directors in attendance at any meeting shall constitute a quorum. The Company used consent actions to complete its business during the examination period.

Committees of the Board of Directors

The bylaws allow that the directors may elect from their number an executive committee, a finance committee, an audit committee and such other committees as they may determine. In accord therewith the Board of Directors appointed an investment committee to monitor the performance of the Company's investments and authorize the purchase and/or sale of securities. The membership of the investment committee consists of Director Ferrante, Director Fournel, Director Moyle, Director von Krusenstiern and Mr. Gary Scharf, Director of Statutory/GAAP Reporting. Although the Company did not obtain timely approval by the Board of Directors of Company investments as required by MGL Chapter 175 Section 64, the Company's Board of Directors has subsequently ratified the 2006 actions of the investment committee.

Officers

According to the Company's bylaws, the Board of Directors shall elect the officers of the Company. The officers of the Company shall be the chairman of the Board of Directors, the president, the treasurer, the secretary, one or more vice chairmen of the Board of Directors, one or more executive vice presidents and one or more senior vice presidents.

Generally, the powers and duties of the Company's officers are those commonly incident to the respective office. Such powers and duties are set forth in the bylaws and are subject to action of the Board of Directors. The president shall be the chief executive officer, unless the Board of Directors determines that the chairman of the Board of Directors shall be the chief executive officer, who shall have general supervision and control of the Company's business. Subject to

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the direction of the Board of Directors, the treasurer shall have custody of Company funds and securities and the general supervision of bank accounts. The secretary shall keep the articles of organization, the bylaws, and the records of all meetings and consents of shareholders and the Board of Directors.

Key officers and management of the Company at December 31, 2006 are as follows:

<u>Name of Officer:</u>	<u>Title:</u>
Michael J. Ferrante	President and Chief Executive Officer
Corine J. Troncy	Executive Vice President, Sales
Kenneth Moyle	Senior Vice President, Underwriting and Claims
Pierre Fournel	Treasurer and Chief Financial Officer
Friedrich von Krusenstiern	General Counsel & Secretary
John Goggin	Vice President, Domestic and International Underwriting
Chris Germe	Vice President, Information Systems
Celine Hartmanshenn	Vice President Strategic Accounts
Dora M. Gonczy	Vice President
Hans Christian Friedrich Vollbehr	Vice President
Christopher J. Short	Vice President
Gary Scharf	Director of Statutory Accounting/GAAP Reporting
Anthony Logiudice	Director for Taxes and Internal Control
Evette Mikhail	Director of Accounting

Conflict of Interest Procedures

The Company has an established procedure for the reporting of any material interest or affiliation on the part of any officer or director or responsible employee, which is in, or is likely to, conflict with his/her official duties. The Company began requiring officers and directors to file conflict of interest disclosure forms in March 2006.

Corporate Records

Articles of Incorporation and Bylaws

The articles of organization ("Articles") of the Company have been amended once since the acquisition of Arkwright on December 30, 2003. This amendment took effect on April 14, 2006. The bylaws of the Company were amended June 16, 2004. The Articles and the bylaws were read and reviewed.

Disaster Recovery and Business Continuity

The Company provides for the continuity of management in the event of a catastrophe or national emergency in accordance with MGL Chapter 175 Sections 180M through 180Q. An evaluation of the Company's information technology systems and control environment indicated that it has a formal plan to address disaster recovery and business continuity.

Board of Directors Minutes

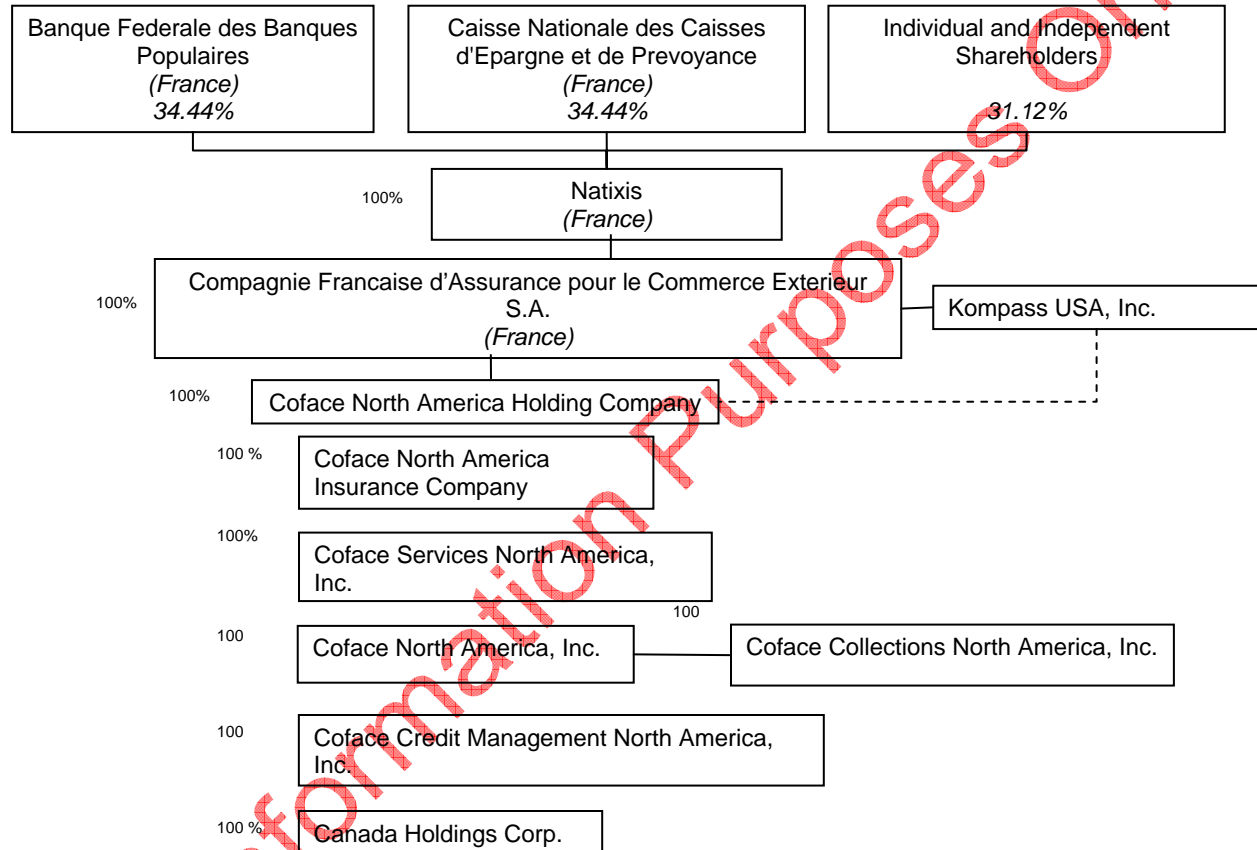
The Board of Directors meeting consents for the period under examination and subsequent to the examination date indicated that all actions were taken in accordance with the Company's bylaws. The Company has not historically obtained approval by the Board of Directors of the top five most highly compensated officers or directors and any other officer or director who has compensation exceeding \$150,000 as required by MGL Chapter 175 Section 35. The Company obtained such approval on January 1, 2007, and has agreed to prospectively obtain such approval as required.

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Coface North America Insurance Company

AFFILIATED COMPANIES

As stated in the Insurance Holding Company System Form B and Form C as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of Section 206C of MGL Chapter 175 and Regulation 211 CMR 7.00. Effective with the reorganization in November 2006, the corporate organization of which the Company is a member is as follows:



Effective July 26, 2007, Natixis reorganized by creating a wholly owned direct intermediate holding company, Coface Holding. On the same date Coface Holding acquired all of the shares of Coface S.A. from Natixis. The reorganization did not introduce a new controlling person into the CNAIC insurance holding company holding system.

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Transactions and Agreements with Subsidiaries and Affiliates

Administrative Services Agreement

The Company shares certain employee, operating and overhead expenses with affiliated companies and is reimbursed for the affiliates' share of such expenses. The Company also pays certain licensing fees to Coface Services North America, Inc. for use of its credit evaluation database and underwriting system.

The Company's administrative services agreement referenced in its April 27, 2006 Form B filing did not reflect actual intercompany administrative services between the Company and Coface North America, Inc. or other affiliates. As a result, the Company's billings and payments in 2006 to or from its affiliates for certain services rendered or incurred were not supported by a written agreement. Additionally, cash settlements for services rendered or incurred were not always made timely. The Company filed a Form D on May 24, 2007 which included an Expense Allocation Agreement for the Company and its affiliates. Such Form D was deemed approved by the Division. In addition, as of September 30, 2007, the Company has timely reconciled and settled intercompany operating accounts.

Reinsurance Agreements

See the Reinsurance Section for a discussion of intercompany reinsurance agreements.

Tax Sharing Agreement

The Company's Federal income tax return is included in the consolidated Federal income tax return of Coface North America Holding Company. Although the Company did not previously adopt a written intercompany tax sharing agreement with its parent, it filed a Form D on May 24, 2007 which included a Tax Sharing Agreement for the Company and its affiliates. Such Form D was deemed approved by the Division. Additionally, cash settlements for tax transactions were not always made timely. As of October 31, 2007, the Company has timely reconciled and settled intercompany tax balances.

See the Accounts and Records Section and the Comments and Recommendations Section for additional discussion.

FIDELITY BONDS AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with Section 60 of MGL Chapter 175. The aggregate limit of liability exceeds the NAIC suggested minimum.

The Company has further protected its interests and property by additional policies of insurance covering other insurable risks. Insurance coverage is provided by insurers licensed in the Commonwealth of Massachusetts and was in-force as of December 31, 2006.

DEFINED CONTRIBUTION PLAN

The Company participates in the Natixis/Coface US Group 401(k) Retirement Plan. This plan is available to all of the Company's employees. Each employee may contribute to the plan ("elective contributions") subject to Internal Revenue Service limits. The Company contributes equal to 70% of each employee's elective contributions up to 6% of the employee's salary. In 2006 the Company also provided a discretionary benefit of 3-5% based on each employee's age. The Company's portion of the defined contribution plan expense was \$233,207 in 2006.

STATUTORY DEPOSITS

The Company's statutory deposits as of December 31, 2006 are as follows:

<u>Jurisdiction</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Arizona	U.S Treasury Note 3.125% Due 1/31/07	\$125,000	\$124,887	\$123,253
Georgia	U.S Treasury Note 4.375% Due 1/31/08	50,000	49,582	49,406
Kansas	U.S Treasury Note 4.375% Due 1/31/08	100,000	99,163	99,340
Louisiana	U.S Treasury Note 4.375% Due 1/31/08	70,000	69,414	69,169
Massachusetts	U.S Treasury Note 4.375% Due 1/31/08	1,500,000	1,487,448	1,482,187
North Carolina	U.S Treasury Note 4.375% Due 1/31/08	300,000	297,490	296,437
Rhode Island	U.S Treasury Note 3.125% Due 1/31/07	500,000	499,549	493,010
Tennessee	U.S Treasury Note 5.5% Due 2/15/08	150,000	152,121	153,357
		<u>\$2,795,000</u>	<u>\$2,779,654</u>	<u>\$2,766,159</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting Practices

The Company primarily sells trade credit insurance and, to a lesser extent, political risk insurance policies. The Company's policyholders are typically distributors or wholesalers of goods to retail establishments and other businesses. There are no sales of insurance products to individual consumers. Trade credit coverage typically covers 30-90 day accounts receivable unpaid due to insolvency. At the time the debtor enters bankruptcy, the policyholder may choose to file a claim. The Company's trade credit underwriting includes an assessment of the policyholder's credit granting process and bad debt experience. Additionally, the Company's underwriting department reviews the policyholder's customers' credit risk. Policies are typically one year, and may include specific named customers or "named buyers" while others include all buyers meeting specific requirements. Premium is based upon a rate for the amount of coverage purchased, or a rate based on a policyholder's monthly sales activity.

Political risk coverage on trade receivables is offered using the same trade credit policy forms with a political risk rider, and also using negotiated and customized policy forms for large policyholders. In connection with the latter, political risk coverage is provided with regard to the nonpayment of trade receivables, confiscation, expropriation, nationalization and deprivation of property and non-performance of contractual obligations. The Company's underwriting focuses on country risk by considering its political, economic and legal environment.

Territory and Plan of Operation

The Company currently is licensed to write business in 31 states and the District of Columbia. It provides coverage through its network of 85 exclusive captive agents who are managed by five regional managing agents. All managing agents and captive agents are independent contractors and not employees of the Company. The agents also sell other Coface services offered by affiliated companies.

Treatment of Policyholders

Claim Settlement Practices

All claims are adjudicated in the Company's principal executive office. First notice of a claim typically is reported when a policyholder is aware of a customer's delinquency or insolvency. When the policyholder has knowledge of a customer's insolvency as determined by a legal proceeding, the policyholder is required to notify the Company. If the policyholder does not have knowledge of the insolvency prior to policy expiration, the claim may be filed within 20 days of the expiration. Under the terms of the policy, a policyholder also has the option of filing past due accounts as a claim where unpaid accounts receivable less than 90 days past due are assigned to the Company for collection. The Company charges fees for the assignments that are based upon amounts collected as set forth in the policy. Individual notices filed with the

Coface North America Insurance Company

Company regarding losses are accumulated against the *Primary Loss* (deductible). When the *Primary Loss* is reached the policyholder requests and completes a *Statement of Claim* (proof of loss). Claims are to be paid in 60 days after receipt of the *Statement of Claim*, once the claim is determined to be “in good order.” The Company has no unusual claim related litigation with any policyholders and has not experienced significant complaints regarding its claims practices. Procedures performed in conjunction with the claims testwork indicated that the Company investigates and settles claims timely.

Dividends to Policyholders

In the period of examination, the Board of Directors did not authorize any dividends to be paid to the Company’s policyholders.

REINSURANCE

Ceded Reinsurance

The Company entered into a quota share reinsurance agreement with Coface S.A., effective December 31, 2003. Under the quota share agreement, the Company cedes 50% of premiums written and received a ceding commission of 52.8% during 2006. The Company recognized \$14,873,863 of ceding commission income from premiums ceded during 2006. The Company recorded a deferred ceding commission liability of \$1,787,955 as of December 31, 2006, as required by the *NAIC Accounting Practices and Procedures Manual* (“APP Manual”) SSAP 62, Paragraph 51.

The Company also entered into a stop-loss reinsurance agreement with Coface S.A. The Company retains net ultimate losses up to a maximum limit of 56% of the net retained earned premium. The Company ceded \$1,100,000 of premium for the stop-loss agreement during 2006. In addition, the Company entered into an excess of loss agreement with Coface S.A. that limits the Company’s retention on any one loss per policy to a maximum of 10% of the Company’s capital and surplus. The Company’s premium for the 2006 excess of loss agreement is \$40,000.

The following table summarizes the effect of the ceded reinsurance on premiums written for 2006:

	Premium Written	Unearned Premium
Direct and assumed	\$ 59,468,169	\$ 25,284,196
Ceded – Quota share	29,399,831	12,642,098
Ceded – Stop loss	1,100,000	0
Ceded – excess of loss	60,000	0
Net	<u>\$ 28,908,338</u>	<u>\$ 12,642,098</u>

The Company’s reinsurance contracts did not originally contain all of the required terms noted in *APP Manual SSAP 62* such as an insolvency clause and arbitration clause. The Company filed a

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Form D on January 11, 2007 to amend its contracts to include such required items. Such Form D was deemed approved by the Division.

Assumed Reinsurance

The Company assumes a small amount of reinsurance from a U.S. Agency, the Overseas Private Investment Corporation ("OPIC"). OPIC was established as an agency of the U.S. Government in 1971 and helps U.S. businesses invest overseas and fosters economic development in new and emerging markets. In addition, Coface S.A. operates as a branch for business written in Canada. For the Canadian branch activity, the ultimate net loss in excess of 56% of the net retained earned premium income is assumed by the Company pursuant to a stop-loss reinsurance treaty. Assumed premiums from Coface S.A.'s Canadian branch were \$668,509 in 2006.

SUBSEQUENT EVENTS

The Company's reinsurance contracts did not originally contain all of the required terms noted in *APP Manual SSAP 62* such as an insolvency clause and arbitration clause. The Company filed a Form D on January 11, 2007 to amend its contracts to include such required items. Such Form D was deemed approved by the Division.

Addressing examination recommendations, the Company filed a Form D on May 24, 2007 which included an Expense Allocation Agreement and a Tax Sharing Agreement for the Company and its affiliates. Such Form D was deemed approved by the Division. In addition, as of September 30, 2007, the Company has timely reconciled and settled intercompany operating accounts. As of October 31, 2007, the Company has timely reconciled and settled intercompany tax balances.

The Company's parent, CHC contributed \$20,000,000 of additional paid-in capital to the Company in the third quarter of 2007 for expansion of the Company's business to additional states.

ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires and through a review of work performed by KPMG, who expressed an unqualified opinion on the Company's statutory financial statements for calendar year 2006. During the examination, review and use of KPMG's work papers were made to the extent deemed appropriate and effective. KPMG also issued a letter regarding internal controls to the Company's board of directors dated September 21, 2007. The letter identified deficiencies in internal control that KPMG considered to be significant deficiencies and other deficiencies that KPMG considered to be material weaknesses. "A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the statutory financial statements will not be detected or prevented by the entity's internal control." KPMG noted two material weaknesses as follows: the Company's information system's lack of ability to properly age receivables, and second, the aggregation of several

deficiencies regarding the adequate staffing and/or proper management oversight of the financial reporting process. See the Comments and Recommendations Section for additional discussion.

The Company's process for review of installment receivables is a time-consuming manual one. During 2007 the Company began making system changes in order to more effectively age installment receivables. For further discussion, see the Comments and Recommendations Section.

The Company added significant staff in 2006 and 2007 to address the financial reporting concerns. In addition, the Company engaged KPMG to perform agreed upon procedures ("AUP") in accordance with attestation standards established by the American Institute of Certified Public Accountants. The purpose of the AUP engagement was to assist the Company with its response to the Division regarding KPMG's internal control letter to the Board of Directors. The AUP engagement was designed by management and approved by the Company's Board of Directors. The AUP engagement was performed by KPMG and evaluated management prepared reconciliations, worksheets and analyses as of September 30, 2007. Management believes the results of the AUP engagement demonstrate significant improvements in internal controls and adequately address deficiencies noted by KPMG in its internal control letter. For further discussion, see the Comments and Recommendations Section.

The KPMG internal control letter also noted that cash reconciliations were performed timely, but that the Company is not timely clearing all reconciling items. The Company has subsequently implemented procedures to timely clear reconciling items. For further discussion, see the Comments and Recommendations Section.

The NAIC Evaluation of Controls in Information Systems Questionnaire was completed by the Company and reviewed to evaluate the adequacy of the controls in the Company's information systems.

The Company has a small internal auditing staff that has dual reporting responsibilities to the Company's President and Chief Executive Officer and the internal audit department at Coface S.A. The current internal audit plan provides assistance to the independent auditors and performs operational audits and/or specific project support. For further discussion, see the Comments and Recommendations Section.

The Company has taken subsequent actions to ensure resolution of the internal control issues noted in the KPMG letter of September 21, 2007 addressed to the Company's Board of Directors in connection with the issuance of 2006 audited statutory financial statements. Management of the Company believes the current internal control environment has been enhanced such that the issues noted previously by KPMG have been resolved with such resolutions reflected in the 2007 audited statutory financial statements. This is demonstrated by the letter on internal controls as of and for the year ended December 31, 2007, which noted no material weaknesses. This letter dated May 28, 2008 was filed with the Division of Insurance.

In accordance with 211 C.M.R. 23.00, the books and records of the Company are audited annually by a firm of independent certified public accountants. KPMG completed the audit of

the Company's 2006 statutory financial statements. KPMG issued an unqualified opinion on the financial statements of the Company noting that such statements fairly present the results of operations and financial condition of the Company as of and for the year ended December 31, 2006.

For Information Purposes Only

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and the NAIC as of December 31, 2006:

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2006

Statement of Income for the Year Ended December 31, 2006

Reconciliation of Surplus and Other Funds for the Year Ended December 31, 2006

Reconciliation of Surplus and Other Funds from Inception and for the Four Years in the Period Ended December 31, 2006

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**Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2006**

Assets	Per Company	Examination Changes	Per Examination	Notes
Bonds	\$ 3,328,224	\$ 0	\$ 3,328,224	
Cash and short-term investments	33,078,462		33,078,462	
Subtotals, cash and invested assets	36,406,686		36,406,686	
Investment income due and accrued	143,767		143,767	
Uncollected premiums and agents' balances in course of collection	14,967,402		14,967,402	
Amounts recoverable from reinsurers	1,745,476		1,745,476	
Net deferred tax asset	2,761,275		2,761,275	
Receivables from parent, subsidiaries and affiliate	4,109,120		4,109,120	
Total Assets	<u>\$ 60,133,726</u>	<u>\$ 0</u>	<u>\$ 60,133,726</u>	

Coface North America Insurance Company

**Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2006**

	Per Company	Examination Changes	Per Examination	Notes
Liabilities				
Losses	\$ 9,475,500	\$ 0	\$ 9,475,500	(1)
Loss adjustment expenses	149,186		149,186	(1)
Commissions payable, contingent commissions, and other similar charges	4,045,758		4,045,758	
Other expenses	824,481		824,481	
Taxes, licenses and fees	92,474		92,474	
Current federal income taxes	908,837		908,837	
Unearned premiums	12,642,098		12,642,098	
Deferred ceding commission	1,787,955		1,787,955	
Ceded reinsurance premiums payable	3,277,925		3,277,925	
Payable to parent, subsidiaries and affiliates	3,455,494		3,455,494	
Total Liabilities	<u>36,659,708</u>		<u>36,659,708</u>	
Common capital stock	2,600,000		2,600,000	
Gross paid-in and contributed surplus	26,283,310		26,283,310	
Unassigned funds (surplus)	(5,409,292)		(5,409,292)	
Surplus as regards policyholders	<u>23,474,018</u>		<u>23,474,018</u>	
Total Liabilities, Surplus and Other Funds	<u>\$ 60,133,726</u>	<u>\$ 0</u>	<u>\$ 60,133,726</u>	

Coface North America Insurance Company

**Statement of Income
for the Year Ended December 31, 2006**

	Per Company	Examination Changes	Per Examination	Notes
Premiums earned	\$ 25,306,339	\$ 0	\$ 25,306,339	
Deductions:				
Losses incurred	10,856,668		10,856,668	
Loss expenses incurred	143,999		143,999	
Other underwriting expenses incurred	13,538,889	(985,116)	12,553,773	(2, 3)
Total underwriting deductions	24,539,556	(985,116)	23,554,440	
Net underwriting gain	766,783	985,116	1,751,899	
Net investment income earned	1,283,631		1,283,631	
Net investment gain	1,283,631	0	1,283,631	
Miscellaneous income	816,305	(816,305)	-	(3)
Net income before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes	2,866,719	168,811	3,035,530	
Federal income taxes incurred	908,837	0	908,837	
Net income	\$ 1,957,882	\$ 168,811	\$ 2,126,693	

Coface North America Insurance Company

**Reconciliation of Surplus and Other Funds
for the Year Ended December 31, 2006**

	<u>Per Company</u>	<u>Examination Changes</u>	<u>Per Examination</u>	<u>Notes</u>
Surplus as regards policyholders as of December 31, prior year	\$ 17,419,566	\$ (948,289)	\$ 16,471,277	(2)
Net income	1,957,882	168,811	2,126,693	(2)
Change in net deferred income tax	1,418,828	(52,966)	1,365,862	(2)
Change in non-admitted assets	(5,237,441)	747,627	(4,489,814)	(2)
Paid-in surplus	8,000,000		8,000,000	
Prior period adjustment	<u>(84,817)</u>	<u>84,817</u>	<u>-</u>	(2)
Net change in surplus as regards policyholders for the year	<u>6,054,452</u>	<u>948,289</u>	<u>7,002,741</u>	(2)
Surplus as regards policyholders as of December 31, current year	<u>\$ 23,474,018</u>	<u>\$ -</u>	<u>\$ 23,474,018</u>	

Coface North America Insurance Company

**Reconciliation of Capital and Surplus from Inception and
for the Four Years in the Period ended December 31, 2006**

	<u>2006 *</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Surplus as regards policyholders as of December 31, prior year	\$ 16,471,277	\$ 11,848,482	\$ 5,400,027	\$ -
Net income (loss)	2,126,693	(1,969,704)	(2,316,529)	-
Change in net deferred income tax	1,365,862	867,213	785,400	-
Change in non-admitted assets	(4,489,814)	(1,433,521)	(344,919)	-
Paid-in surplus	<u>8,000,000</u>	<u>7,158,807</u>	<u>8,324,503</u>	<u>5,400,027</u>
Net change in surplus as regards policyholders for the year	<u>7,002,741</u>	<u>4,622,795</u>	<u>6,448,455</u>	<u>5,400,027</u>
Surplus as regards policyholders as of December 31, current year	<u><u>\$ 23,474,018</u></u>	<u><u>\$ 16,471,277</u></u>	<u><u>\$ 11,848,482</u></u>	<u><u>\$ 5,400,027</u></u>

* Per Examination

NOTES TO FINANCIAL STATEMENTS**NOTE 1:**

<u>Losses</u>	<u>\$ 9,475,500</u>
<u>Loss Adjustment Expenses</u>	<u>149,186</u>
<u>Losses and Loss Adjustment Expenses</u>	<u>\$ 9,624,686</u>

As part of the examination, the Division engaged the consulting actuarial services of Milliman to perform an actuarial review of the loss and loss adjustment expense reserves carried by the Company as of December 31, 2006. Milliman's review principally included a review of the reasonableness of the assumptions, selections, and methodologies used by KPMG in its actuarial report on the calculation of the Company's reserve estimates.

The following table summarizes KPMG's gross reserve ranges and selected point estimate reserves:

KPMG Gross Loss and Loss Adjustment Expense Reserves

Reserve Category	Low	Point	High	Company Carried
Losses + LAE	\$17,497,000	\$18,278,000	\$20,304,000	\$19,249,000

Similarly, on a net basis, the following table summarizes KPMG's reserve ranges and selected point estimate reserves, and the Company's carried loss and loss adjustment expense reserves as of December 31, 2006.

KPMG Net Loss and Loss Adjustment Expense Reserves

Reserve Category	Estimates by KPMG			Company Carried
	Low	Point	High	
Losses + LAE	\$8,749,000	\$9,139,000	\$10,152,000	\$9,624,686

In the course of analyses, Milliman reviewed KPMG's actuarial methodologies, actuarial assumptions and selections, and the Schedule P reconciliation. Milliman noted that KPMG estimated losses by underwriting year and used a variety of actuarially accepted estimation methods. In addition, Milliman reviewed the Company's allocation of underwriting year loss and loss adjustment expense reserves to an accident year basis and found the Company's approach and allocation results to be reasonable. Milliman concluded that KPMG's actuarial methodologies and actuarial assumptions and selections were reasonable. Finally, Milliman concluded that based upon its review, they believe that the gross and net loss and loss adjustment expense reserves estimated by KPMG and the Company are reasonable.

NOTE 2:

	<u>Dr (Cr)</u>
Surplus as regards policyholders as of December 31, 2005 – Examination Adjustment (Net Charge) per Financial Examination	<u>\$948,289</u>
Presented by Company in 2006 Annual Statement as follows:	
Other underwriting expenses incurred	<u>\$168,811</u>
Change in net deferred income tax	<u>(52,966)</u>
Change in non-admitted assets	<u>747,627</u>
Prior period adjustment	<u>84,817</u>
Net Charge	<u>\$948,289</u>

An examination adjustment (\$948,289 net charge – see above) was made to reflect the net effect of examination adjustments made to surplus as regards policyholders in the Division's Report of Examination as of December 31, 2005.

The Company reported such examination adjustments in its 2006 Annual Statement as other underwriting expenses incurred (2006 Statement of Income - \$168,811 charge), change in net deferred income tax (2006 Reconciliation of Surplus and Other Funds – \$52,966 credit), change in non-admitted assets (2006 Reconciliation of Surplus - \$747,627 charge), and prior period adjustment (2006 Reconciliation of Surplus and Other Funds – Beginning Adjustment - \$84,817 charge) as noted above. The Company should have aggregated these individual adjustments totaling a net charge of \$948,289 to 2006 Reconciliation of Surplus and Other Funds – Beginning Adjustment since the Company did not restate the 2005 Annual Statement and such adjustments affected the December 31, 2005 balances. The 2006 KPMG audit report presented the examination adjustments in a similar fashion as the Company.

There were no examination adjustments made to surplus as regards policyholders as of December 31, 2006. The Division of Insurance did not require the Company to restate its 2006 Annual Statement for presentation purposes as the December 31, 2006 balances required no net adjustments.

NOTE 3:

	<u>Dr (Cr)</u>
Miscellaneous income	<u>\$ 816,305</u>
Other underwriting expenses incurred	<u>(816,305)</u>

An examination adjustment (reclassification) was made to report income related to receivable adjustments, which were shown in the 2006 Annual Statement as miscellaneous income to other underwriting expenses incurred.

COMMENTS AND RECOMMENDATIONS

**Bank
Reconciliations**

The KPMG 2006 internal control letter noted that cash reconciliations were performed timely, but that the Company is not timely clearing all reconciling items. The Company has subsequently implemented procedures to timely clear reconciling items. A recommendation was made that the Company continue to ensure that all reconciling items are timely cleared through journal entries as needed. The Company has stated that reconciling items are being cleared timely.

**Premiums
Receivable**

KPMG noted that the Company's system's inability to age installment receivables, to provide the information needed for proper accounting treatment, was a material weakness. In the interim, the Company's alternative process to review and properly affect net installment receivables is a time-consuming manual one. The Company is making system changes in order to more effectively age installment receivables. A recommendation was made that the Company implement these system enhancements as soon as possible. The Company has stated that system enhancements have been implemented.

A group of annual policies known as the PBI policies have earned but unbilled ("EBUB") premium components where adjustments to the premium for changes in the level of exposure are determined based upon the customer's activity during the policy period. It may take up to six months from the expiration of the policy to calculate, bill and collect the EBUB premium. The Company conservatively estimates EBUB premiums at 65% of historical premiums and does not require collateral securing these receivables. In accordance with *SSAP No. 53, Paragraph 9, Earned but Unbilled Premium*, reporting entities shall estimate EBUB premiums, and record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The guidance states that the estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations. Further, the guidance notes that 10% of EBUB premium in excess of specifically identified collateral held shall be non-admitted. It is recommended that the Company establish a 10% reserve for its uncollateralized PBI policies in accordance with *SSAP No. 53* in its future financial statement filings. The Company has stated that it established the appropriate non-admitted asset in the 2007 Annual Statement and will continue to do so each quarter.

Internal Audit

The Company has a small, local internal auditing staff that has dual

Department

reporting responsibilities to the Company's President and Chief Executive Officer and the internal audit department at Coface S.A. There is no reporting responsibility to the Company's Chief Financial Officer. The Company has a formal internal audit plan, and the staff also provide assistance to the independent auditors and perform operational audits/or specific project support. The Company should re-assess the internal audit plan and enhance the internal audit procedures and monitoring of internal controls specific to financial controls and compliance and define the frequency and substance of such procedures. The Company has agreed to implement this recommendation.

**Settlement of
Intercompany
Balances**

The Company's intercompany expense allocation agreement, adopted and deemed approved by the Division in May 2007, requires that amounts be billed quarterly within 45 days after quarter end and paid within 60 days of receipt. The Company also has intercompany reinsurance agreements and tax sharing agreements. Settlement of amounts under the tax sharing agreement has not always been timely. As of September 30, 2007, the Company has timely reconciled and settled intercompany non-tax balances, and as of October 31, 2007, the Company has timely reconciled and settled intercompany tax balances. A recommendation was made that the Company continue to ensure that all intercompany accounts are reconciled and settled timely. The Company has stated that intercompany accounts are reconciled and settled timely.

The Company should be cognizant of SSAP No. 96 Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25-Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties, which will be effective December 31, 2007. This will require that intercompany amounts be settled within 90 days from the due date in written agreements. The Company has stated that intercompany amounts are now settled within 90 days from the due date in written agreements.

CONCLUSION

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by Rudmose & Noller Advisors, LLC who participated in this examination hereby is acknowledged.

John A. Turchi, CFE, CPCU
Supervising Examiner and Examiner-in-
Charge
Commonwealth of Massachusetts

For Information Purposes Only