

STATE OF MISSOURI



DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

RE: Examination Report of First Specialty Insurance Corporation

ORDER

After full consideration and review of the report of the financial examination of First Specialty Insurance Corporation for the period ended December 31, 2009, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, James R. McAdams, Deputy Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such examination report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo: summary of significant findings, subsequent events, company history, corporate records, management and control, fidelity bond and other insurance, pension, stock ownership and insurance plans, territory and plan of operations, growth of the company and loss experience, reinsurance, accounts and records, statutory deposits, financial statements, financial statement changes resulting from examination, and comments on financial statement items. I further specifically find and conclude that there were no material adverse findings, significant non-compliance issues, or material changes to the financial statements noted during the examination.

Based on such findings and conclusions, I hereby ORDER that the Report of the Financial Examination of First Specialty Insurance Corporation as of December 31, 2009, be and is hereby ADOPTED as filed.

So ordered, signed and official seal affixed this 6th day of June, 2011.



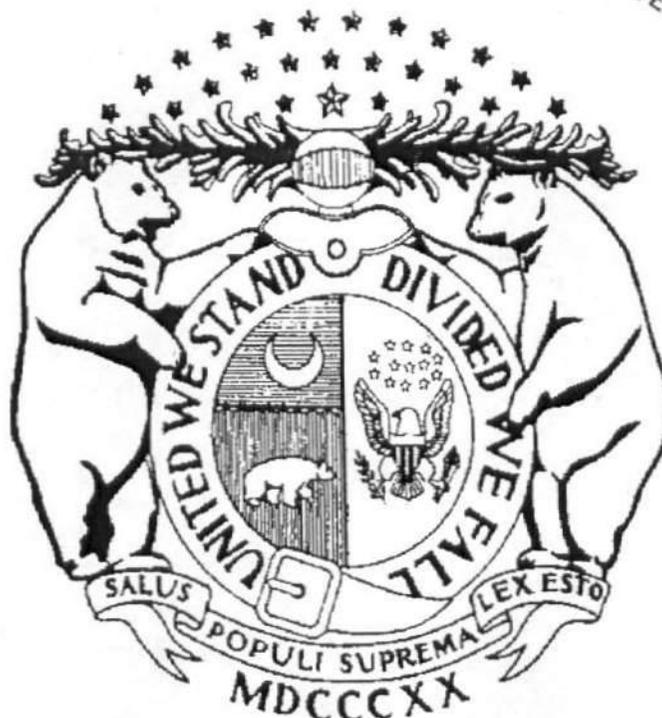
A handwritten signature in black ink, appearing to read "James R. McAdams".

James R. McAdams, Deputy Director
Department of Insurance, Financial Institutions
and Professional Registration

REPORT OF THE
FINANCIAL EXAMINATION OF
FIRST SPECIALTY INSURANCE CORPORATION

AS OF
DECEMBER 31, 2009

FILED
JUN 16 2011
DIRECTOR OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION



STATE OF MISSOURI
DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND
PROFESSIONAL REGISTRATION
JEFFERSON CITY, MISSOURI

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Overland Park, KS
March 8, 2011

Honorable Joseph Torti, III, Deputy Director and
Superintendent of Banking and Insurance
Rhode Island Department of Business Regulation
Chair, NAIC Financial Condition (E) Committee

Honorable Stephen W. Robertson, Commissioner
Indiana Department of Insurance
Midwestern Zone Secretary

Honorable John M. Huff, Director
Missouri Department of Insurance, Financial
Institutions and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65102

Gentlemen:

In accordance with your financial examination warrant, a full scope financial association examination has been made of the records, affairs and financial condition of

First Specialty Insurance Corporation

hereinafter referred to as such, as First Specialty, as FSIC, or as the Corporation. Its administrative office is located at 5200 Metcalf, Overland Park, KS 66202, telephone number 913-676-5200. The fieldwork for this examination began on January 11, 2010, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

We have performed our full scope association financial examination of First Specialty Insurance Corporation. The last examination was completed as of December 31, 2006 and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other zone participating. This examination covers the period of January 1, 2007 through December 31, 2009 and was performed concurrently with the examination of the Corporation's immediate parent, Westport Insurance Corporation (Westport). The examination also includes the material transactions and/or events occurring subsequent to the examination date which are noted in this report. The current examination was conducted by examiners from the State of Missouri representing the Midwestern Zone of the NAIC with no other zones participating.

Procedures

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook (Handbook) except where practices, procedures and applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration (the MO DIFP) and statutes of the State of Missouri prevailed. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Corporation by obtaining information about the Corporation including corporate governance, inherent risks within the Corporation, and system controls and procedures used to mitigate those risks. This examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions.

All accounts and activities of the Corporation were considered in accordance with the risk-focused examination approach. Key activities for FSIC included: Claims and Reserving, Investments, Premiums and Underwriting, Related Party Transactions, Reinsurance, and Federal Income Taxes.

Reliance Upon Others

The examination relied heavily upon information provided by the Corporation and its management. Where the examiners have deemed appropriate, this information has been tested or verified with external sources. The examiners also relied upon information supplied by the Corporation's independent auditor, PricewaterhouseCoopers, LLP of New York, New York, for its audits covering the periods from January 1, 2008 through December 31, 2008 and January 1, 2009 through December 31, 2009. Information relied upon included fraud risk analysis, attorney letters, tests of controls, and narrative descriptions of processes and controls.

SUMMARY OF SIGNIFICANT FINDINGS

There were no material adverse findings, significant non-compliance issues, or material changes to the financial statements noted during the examination.

SUBSEQUENT EVENTS

There were no significant subsequent events noted from December 31, 2009 through the date of this report.

COMPANY HISTORY

General

The Corporation operates as a stock property and casualty insurer in Missouri under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life). FSIC was incorporated on November 13, 1989 and commenced business on November 21, 1989. The Corporation has been a wholly owned subsidiary of Westport since its inception.

In 2006, General Electric Company (GE) sold GE Insurance Solutions Corporation (GEIS) and its subsidiaries, including FSIC and Westport, to Swiss Reinsurance Company Ltd. (Swiss Re). Subsequently, GEIS was re-named Swiss Re Solutions Holding Corporation (SRSHC), serving as the immediate parent of Westport and all of its subsidiaries, including FSIC.

Capital Contributions

No capital contributions were received during the current examination period.

Dividends

FSIC paid dividends to its parent, Westport, of \$8.5 million in 2007, \$8.0 million in 2008, and \$8.5 million in 2009.

Mergers and Acquisitions

As a result of Swiss Re's purchase of GEIS, several transactions were entered into, which significantly changed the operational and organizational structure of Westport and its subsidiaries, including FSIC. Those affecting FSIC are summarized as follows:

- During 2007, FSIC sold its wholly owned subsidiary, FSIC Insurance Agency, LLC, to SRSHC, its upstream parent, in exchange for \$143,645 in cash.
- Effective January 1, 2008, pre-merger Westport Insurance Corporation merged with and into Employers Reinsurance Corporation (ERC). Upon execution of the merger, ERC changed its name to Westport Insurance Corporation.

CORPORATE RECORDS

A review was made of the Articles of Incorporation and Bylaws for the examination period. The Articles of Incorporation were not amended during this examination period. The Bylaws were amended and restated effective May 29, 2008; however, no significant changes were made.

The minutes of the Board of Directors' meetings, committee meetings, and stockholder's meetings were reviewed for proper approval of corporate transactions. The minutes appear to properly reflect and approve the Corporation's major transactions and events for the period under examination.

MANAGEMENT AND CONTROL

Board of Directors

The management of the Corporation is vested in a Board of Directors that are appointed by the shareholder. The Articles of Incorporation specify that the number of directors shall not be less than nine (9) and not more than twenty-five (25). (Mr. Petrilli's below-stated title is his position within FSIC and its Board. The titles noted for all other members are those positions held by the employee within Swiss Re Americas' regional operations.) The Board of Directors elected and serving as of December 31, 2009 was as follows:

<u>Name</u>	<u>Address</u>	<u>Title</u>
Robert J. Petrilli	West Simsbury, CT	Chairman, President and Chief Executive Officer, First Specialty Insurance Corporation
Craig R. Esses	Stamford, CT	Senior Vice President - Americas Tax Director
Brian E. Evans	Olathe, KS	Senior Vice President - Head Excess & Specialty Casualty
Anthony D. Hill	Shawnee, KS	Managing Director - Head Actuarial Services U.S.
Steven A. Kelner	Mullica Hill, NJ	Managing Director - Head Underwriting, Casualty
James K. Miller	Armonk, NY	Managing Director - Head North American Property
Randy L. Nordquist	Bonner Springs, KS	Managing Director - Executive Claims Manager
Robert M. Solitro	Manchester, NH	Managing Director - Americas DOO & Head North America Specialty Client Markets
William J. Steilen	Overland Park, KS	Managing Director - Chief Financial Officer Property & Casualty (P&C) Americas
Craig C. Zahnd	Overland Park, KS	Managing Director - Head Americas Legal

Although all the members of the Board of Directors are employees of Swiss Re entities, indicating a lack of independence in the Corporation's governance, this is not unusual given the ownership structure of FSIC as a subsidiary of a major corporation. To ascertain independence and prudent corporate governance standards, the examination reviewed the composition of the Board of

Directors of Swiss Re, the ultimate controlling entity of FSIC. Swiss Re's current Board of Directors is comprised of nine members, all of whom are independent based on Swiss Re's independence criteria.

Senior Officers

The Bylaws state that the Board of Directors shall elect a Chairman of the Board, a President, and a Secretary at the first regular meeting of the Board of Directors following the annual meeting of the stockholder. The Board of Directors may elect other officers as required by law or as needed as determined by the Board. The titles shown below are those stated within the FSIC Board minutes, followed by the general area of responsibility. The senior officers elected by the Board of Directors and serving as of December 31, 2009 were as follow:

<u>Name</u>	<u>Address</u>	<u>Title – Area of Responsibility</u>
Robert J. Petrilli	West Simsbury, CT	Chairman of the Board and President, First Specialty Insurance Corporation
Elissa B. Kenny	West Harrison, NY	Secretary
Kenneth J. Holferty	Lake Lotawana, MO	Treasurer
Deryck M. Malone	Shawnee, KS	Controller & Assistant Treasurer
Gregory A. Steele	Overland Park, KS	Managing Director - Executive Claims Manager
William J. Steilen	Overland Park, KS	Managing Director - Chief Financial Officer
Jon M. Albarelli	Olathe, KS	Senior Vice President - Leading Account Manager
Joyce D. Allen	Bethel, CT	Senior Vice President - Head of Shared Services
Steven W. Book	Lenexa, KS	Senior Vice President - Reserving Actuary
Brian E. Evans	Olathe, KS	Senior Vice President - Head of Excess & Specialty Casualty
Michael J. Furlong	Leawood, KS	Senior Vice President - Head Small & Midsize Accounts & Lawyers
Daniel G. Gibson	Overland Park, KS	Senior Vice President - Head Office Reporting
David G. Newkirk	Shawnee, KS	Senior Vice President - Senior Legal Counsel
Gregory A. O'Neil	Overland Park, KS	Senior Vice President - Head of Human Resources, Americas
Erika L. Ozer	Mamaroneck, NY	Senior Vice President - Senior Legal Counsel
Sabrina R. Sally	Lancaster, OH	Senior Vice President - Head Agents U.S. P&C
Arthur R. Stirnaman	Gardner, KS	Senior Vice President - Senior Legal Counsel
David L. Baughman	Bloomington, MN	Senior Vice President - Head of U.S. Casualty, Central Region
Domenic D'Arrigo	Apple Valley, MN	Senior Vice President - Head of U.S. Casualty, Eastern Region

Principal Committees

The Corporation's Bylaws state that the Board of Directors may elect an Executive Committee of not less than three members. During the intervals between the meetings of the Board of Directors, the Executive Committee shall possess and may exercise all the powers of the Board

of Directors in the management and affairs of the Corporation. The Board, at its discretion, may appoint other committees as necessary. Currently, the Board of Directors has elected an Executive Committee. The Executive Committee members as of December 31, 2009 were as follows:

Executive Committee

Robert J. Petrilli
 William J. Steilen
 Craig C. Zahnd

The various Swiss Re entities within the Americas region joined together and established the Swiss Re Americas Finance & Risk Committee (FRC) to a) approve investment policies, monitor compliance of investment managers, and verify that investments comply with regulatory and statutory restrictions and b) to monitor corporate risks based on Swiss Re’s risk selection criteria and risk management principles. The Committee is comprised of representatives from Swiss Re legal entities and product lines from the Americas region including but not limited to entities in the United States and Canada. William Steilen is the appointed committee member representing FSIC. All actions of the FRC Committee are approved by the Corporation’s Boards of Directors. The following members were serving on the FRC as of December 31, 2009:

Swiss Re Americas Finance & Risk Committee (FRC)

David H. Atkins	Robert Peduto
Walter Bell	William Steilen
David Blumer	Matthias Weber
Tracy Choka	Weldon Wilson
Jean-Jacques Henchoz	Robyn Wyatt
Paul LiCausi	Robin Zubretsky
Pierre L. Ozendo	

Swiss Re America Holding Corporation (SRAHC) has an Audit Committee; the majority of whose members as of the examination date were outside directors. As of December 31, 2009, this Committee served all legal entities within SRAHC including FSIC. The Audit Committee’s stated primary function is to assist the Board of Directors in fulfilling its oversight responsibilities relating to confirming the integrity of SRAHC’s financial statements, compliance with laws and regulations, the qualifications of external auditors, and the internal and external auditing processes with the ultimate goal of reinforcing the confidence of all interested parties. The Committee is also charged with monitoring the company’s financial reporting process and system of internal controls. The following members were serving on the Audit Committee as of December 31, 2009:

Audit Committee

David Atkins	Mathis Cabiallavetta
Walter Bell	John D’Alimonte

During 2010, FSIC designated its Board of Directors as its Audit Committee, no longer relying on the SRAHC Audit Committee to perform the necessary functions as outlined in the Model

Audit Rule. This will place the responsibility for overseeing the accounting and financial reporting processes and audits of financial statements of FSIC on its elected Board.

The Company's ultimate parent, Swiss Re, also established within its corporate Bylaws an Audit Committee comprised of Board members who are not Swiss Re's executives and who are independent and financially literate. Per the Audit Committee directives, at least one member shall have the attributes qualifying such member as an Audit Committee Financial Expert as determined by the Board. In addition, Swiss Re Audit Committee members are prohibited from accepting any consulting, advisory, or other compensatory fee from the Company and are not to serve on the audit committee of more than two other listed companies.

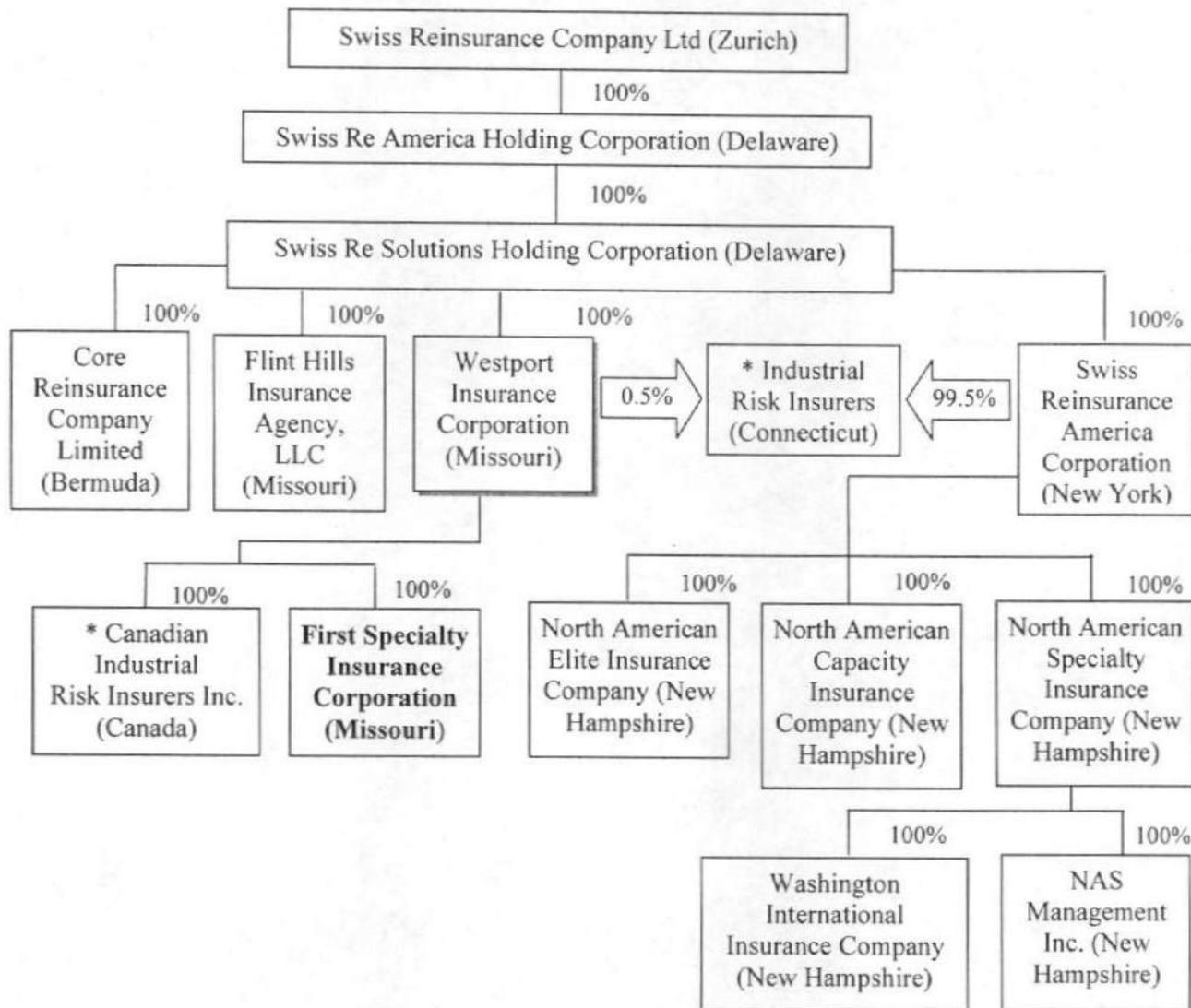
Holding Company, Subsidiaries and Affiliates

First Specialty Insurance Corporation is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by Westport, on behalf of itself and First Specialty Insurance Corporation, for each year of the examination period.

Within the holding company structure, First Specialty is wholly owned subsidiary of Westport. Westport is wholly owned by SRSHC, which in turn is wholly owned by Swiss Re America Holding Corporation. SRAHC is wholly owned by Swiss Re, the ultimate controlling entity within the holding company system. SRSHC is the holding company for Swiss Re's U.S., Canadian, and Latin American domiciled property and casualty insurance entities. SRAHC is the holding company for all Swiss Re U.S. and Latin American business, including insurance, reinsurance, and financial services. Swiss Re is a diversified reinsurer operating on a global scale who offers a wide variety of reinsurance products and financial services solutions to manage capital and risk. Swiss Re is a publicly traded company on the Swiss Exchange under the ticker RUKN and no single shareholder was determined to own 10% or more of its outstanding shares

Organizational Chart

The ultimate parent, Swiss Re, has a number of subsidiaries, both insurance and non-insurance, which are too numerous to list in this report. Therefore, only entities that have direct and indirect ownership of First Specialty and entities that have transactions with First Specialty or its direct parent are listed. The following organizational chart depicts the ownership of First Specialty as of December 31, 2009.



* Industrial Risk Insurers and Canadian Industrial Risk Insurers Inc. were dissolved effective January 1, 2011.

Intercompany Transactions

The Corporation is a party to the intercompany agreements outlined below.

1. **Type:** Service Agreement
Parties: Westport, FSIC and Flint Hills Insurance Agency LLC (FHIA)
Effective: January 28, 2009
Terms: Westport shall make available to FSIC and FHIA certain general management and administrative services, the use of assets, legal and government relations services, personnel and payroll services, information systems and technology services, tax services, corporate accounting and auditing services, financial services, actuarial services, risk management services, underwriting services, claim advisory services and related claim services, office administration, property management, vendor expenses and supply services and such other services as may be requested from time to time. FSIC and FHIA shall reimburse Westport for the cost incurred in providing the services within the agreement.

2. **Type:** Investment Advisory Agreement
Parties: Westport, First Specialty, and Swiss Re Financial Services Corporation (SRFSC)
Effective: August 22, 2006
Terms: SRFSC will provide Westport and FSIC various investment management and investment accounting services in exchange for a fee. Fees shall be computed based on the market value of the securities in each of the Company's portfolios and the annual rate. The annual rate shall range from 11 to 25 basis points based on the specific portfolio.

3. **Type:** Operating Agreement
Parties: First Specialty and Flint Hills Insurance Agency LLC
Effective: January 1, 1998
Terms: FHIA, as the underwriter for First Specialty, is given the authority to solicit and bind contracts of insurance, collect and receive premiums, cancel and non-renew policies, and various other underwriting functions as outlined in the Agreement. First Specialty will pay FHIA a monthly service fee equal to its monthly operating expenses incurred in rendering services or producing business for First Specialty to be paid within 45 days after the end of each month.

4. **Type:** Excess and Surplus Insurance Business Service Agreement
Parties: FSIC, North American Capacity Insurance Company (NAC) and North American Specialty Insurance Company (NAS)
Effective: April 8, 2008

- Terms:** NAC and NAS will provide various insurance related services to FSIC to facilitate FSIC's expansion of excess and surplus lines insurance business. FSIC agrees to reimburse NAC and NAS for actual, reasonable, and necessary expenses. The actual, reasonable, and necessary expenses due from FSIC shall be calculated within a range of 3% and 10% of gross written premium less return premium on policies written on FSIC paper.
5. **Type:** Securities Lending Agreement
- Parties:** FSIC and Swiss Re Financial Services Corporation
- Effective:** September 26, 2006
- Terms:** Westport shall appoint SRFSC as its agent to lend securities from its custodial safekeeping account from time to time to borrowers in accordance with the terms of the Master Security Loan Agreement. For the services provided, SRFSC receives an agent's fee of 20% of the sum of all interest, dividends and other distributions earned from cash collateral investments and securities loan fees paid or payable by the relevant borrowers, net of rebates paid to relevant borrowers, and brokerage commissions incurred in making cash collateral investments.
6. **Type:** Excess and Surplus Insurance Business Service Agreement
- Parties:** FSIC, Westport, and North American Capacity Insurance Company
- Effective:** August 13, 2007
- Terms:** Under the terms of the agreement, Westport and FSIC will provide various insurance related services to NAC to facilitate NAC's expansion of excess and surplus lines insurance business. NAC agrees to reimburse Westport and FSIC for actual reasonable and necessary expenses. The actual reasonable and necessary expenses due from NAC shall be calculated as 7% of gross written premium less return premium on policies written on NAC paper. No fees were due or accrued for 2008 or 2009 under this agreement.
7. **Type:** Federal Tax Allocation Agreement
- Parties:** Swiss Re America Holding Corporation, Westport, and FSIC
- Effective:** For tax years ending after January 1, 2005
- Terms:** Under the terms of the agreement, each member of the group shall compute its federal income tax liability on a separate return basis in any manner and subject to such computations as may be permitted under the Code and all Treasury Regulations relevant thereto. The tax charge payable by, or the tax refund payable to, each member of the group under this agreement shall be the amount that each member of the group would have paid or received if it had filed on a separate return basis.

8. **Type:** Parental Guarantee
Parties: Westport and First Specialty
Effective: June 30, 2003
Terms: Westport acts as guarantor and agrees to reimburse First Specialty for 100% of the liabilities that an external reinsurer is unable to pay due to insolvency. FSIC shall pay the guarantor a premium of \$10,000 in consideration of the obligation assumed. Other than the premium paid no other amounts were due or accrued for 2008 or 2009 under this agreement.

In addition to the above listed agreements, FSIC has reinsurance agreements with Westport and other affiliates, which are described in the Reinsurance section of this report.

The following table summarizes the fees incurred and revenues and/or recoveries (earned) during the exam period, between FSIC and its affiliates, pursuant to the intercompany agreements noted above.

Net Amounts Incurred or (Earned) by FSIC

Agreement	2008	2009
Service Agreement between FSIC, Westport, & FHIA	\$ 12,783,383	\$ 11,116,767
Investment Advisory Agreement between FSIC & SRFSC	162,199	171,606
Operations Agreement between FSIC & FHIA	800,000	600,000
Excess & Surplus Insurance Business Service Agreement between FSIC, NAS, & NAS	(48,300)	(32,260)
Securities Lending Agreement between FSIC & SRFSC	42,774	9,097
Totals	\$ 13,740,056	\$11,865,210

Note: 2007 was excluded from the above schedule due to the changes in FSIC’s organizational structure during 2008.

FIDELITY BOND AND OTHER INSURANCE

As of December 31, 2009, First Specialty Insurance Corporation is covered by two financial institution bonds providing fidelity and crime coverage, purchased by its parent, SRAHC. SRAHC is the named insured together with its subsidiaries. The bonds have an aggregate liability limit of \$75 million, a single loss liability limit of \$50 million, and a deductible of \$2 million. This level of coverage exceeds the suggested minimum amount of fidelity insurance coverage of approximately \$33 million according to the NAIC guidelines.

SRAHC is also a named insured on several other insurance policies. Although FSIC is not specifically named as an insured on most of these policies, the terms define coverage as being

applicable to all subsidiaries of SRAHC, which would include FSIC. These additional insurance policies are as follows: property, commercial general liability, travel accident, workers compensation, fiduciary liability, directors' and officers' liability, kidnap and ransom, and business auto.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

FSIC does not have any direct employees. All employees are employed by Westport, Swiss Re America Corporation (SRAC), or SRAHC with cost reimbursed by FSIC under intercompany agreements. Employees are offered a defined contribution 401(k) Plan through FSIC's ultimate parent, Swiss Re. Swiss Re matches employee bi-weekly contributions up to 6% of an employee's bi-weekly salary and may also make an additional annual contribution to the employees' 401(k) Plan of 6% base annual salary earned in a plan year provided the employee is actively employed during the last pay period of the plan year. FSIC is allocated a portion of contributions to the 401(k) Plan. Plan years are on a calendar year basis.

Swiss Re also offers a savings plan (the Employee Participation Plan (EPP)) whereby employees may allocate up to 10% of their salary to a two-year savings plan that tracks Swiss Re share price gains. Swiss Re sets a share purchase price annually and discounts that price by 23% for plan participants. Certain employees are also offered participation in stock appreciation rights, at the discretion of the CEO.

Prior to the acquisition in June 2006 by Swiss Re, FSIC employees were covered under the General Electric Pension Plan. Employees' covered under this plan had the option to freeze their pension benefits with GE or rollover the benefits to a similar plan with Swiss Re. The GE pension plan remains the liability of GE, pursuant to the terms of an Employee Matters Agreement which was executed between Swiss Re and GE as part of the purchase of ERC and its subsidiaries.

Other benefits offered FSIC employees include healthcare insurance, vision coverage, flexible spending accounts, short-term and long-term disability, life insurance, accidental death and dismemberment coverage, commutation benefit, paid vacation, holiday, sick and personal time and a discretionary bonus plan based upon performance.

TERRITORY AND PLAN OF OPERATIONS

First Specialty Insurance Corporation is licensed as a property and casualty insurer by the MO DIFP under Chapter 379 RSMo (Insurance Other Than Life). The Corporation is not licensed in any other states; however, the Corporation is admitted and writes business in the other forty-nine states and the District of Columbia on an excess and surplus lines basis.

First Specialty is a direct insurer only, with no assumed business. The Corporation had direct written premiums of \$66.2 million as of December 31, 2009.

First Specialty, along with its parent Westport Insurance Corporation, are now organized in accordance with Swiss Re's organizational structure and are included as part of SRAHC's Property and Casualty Division, specifically the Insurance & Specialty Division (renamed Corporate Solutions effective October 1, 2010). The Insurance & Specialty Division includes the Client Markets Department, which is responsible for marketing, sales, and account management; and the Products Department, which is responsible for the management of underwriting, contracts, and claims. The organizational structure revolves around business units rather than legal entities.

Underwriting guidelines are issued by the Americas Single Risk Hub and complement the Swiss Re's group guidelines. In addition, each Business Unit has its own underwriting guidelines, which further specify underwriting rules for its respective markets and lines of business.

FSIC is utilized to write certain risks not eligible for admitted treatment in addition to writing risks eligible for excess and surplus treatment. As of December 31, 2009, First Specialty was primarily a direct underwriter for coverage involving "Professional Liability & Property and Casualty" and "Excess and Surplus Individual Risk Casualty (E&S Casualty)". Coverages offered under "Professional Liability & Property and Casualty" are: U.S. P&C Agents Errors and Omissions, Life Agents Errors and Omissions, and Lawyers Errors and Omissions. Coverages offered as part of "E&S Casualty" includes General Liability, Umbrella, and Excess Liability.

GROWTH OF THE COMPANY AND LOSS EXPERIENCE

The trends indicated below were the result of various and significant events happening during the examination period. Soft market conditions plus the exiting of the program business in 2008 and the General Binding Authority business in 2006 resulted in decreases in the Corporation's net premium writings of 66% and earned premiums of 64% during the examination period. Various commutations have transpired during the examination period, along with an adverse loss development cover with Westport, which have influenced FSIC's outstanding loss and LAE reserves, earned premiums and net income. In addition, the Corporation, along with Westport entered into a 20% Quota Share retrocession agreement with National Indemnity Company (National Indemnity) effective January 1, 2008 for a five year period for all direct and assumed business after other external reinsurance. This agreement is prior to a non-obligatory 80% quota share reinsurance agreement with SRAC, whereby FSIC shall cede 80% of all business retained after cessions to other parties. Ultimately, FSIC's net retention was reduced to approximately 16%.

	2007	2008	2009
Direct Written Premiums	\$ 97,860,907	\$ 78,268,429	\$ 66,194,792
Net Written Premiums	19,411,823	12,773,717	10,642,852
Premiums Earned	24,765,276	14,928,262	11,796,572
Net Income (Loss)	9,813,776	5,745,923	(3,778,932)
Net Loss & LAE Reserves	81,505,529	67,968,263	70,859,467
Net Loss & LAE Incurred	22,793,370	9,113,622	15,579,531

Total Capital & Surplus	86,373,818	85,162,725	75,872,844
Total Admitted Assets	204,756,169	171,258,622	161,201,274
Direct Written Premium to Surplus	113.3%	91.9%	87.2%
Net Written Premium to Surplus	22.5%	15.0%	14.0%
Net Loss & LAE Reserves to Surplus	94.4%	79.8%	93.4%
Net Loss and LAE Incurred to Premiums Earned	92.0%	61.0%	132.1%

REINSURANCE

General

The Corporation's premium activity on a written direct, assumed and ceded basis, for the period under examination, is detailed below:

<u>Premiums:</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Direct Business	\$ 97,860,907	\$ 78,268,429	\$ 66,194,792
Reinsurance Assumed	N/A	N/A	N/A
Reinsurance Ceded:			
Affiliates	(78,658,563)	(52,407,140)	(42,340,308)
Non-affiliates	209,479	(13,087,572)	(13,211,632)
Net Written Premiums	<u>\$ 19,411,823</u>	<u>\$ 12,773,717</u>	<u>\$ 10,642,852</u>

Assumed

The Corporation did not assume any reinsurance during the examination period.

Ceded

Since the purchase by Swiss Re, the Corporation's ceded reinsurance has changed. Previously, FSIC ceded a significant portion of its written business to Westport, with small amounts to various unaffiliated reinsurers. These reinsurance agreements were non-renewed during 2006 and are currently in runoff representing approximately 65% of FSIC's ceded loss reserves.

Subsequent to the purchase, all new business is ceded under the reinsurance contracts detailed below. A smaller portion continues to be ceded to various unaffiliated reinsurers, pending the transfer/novation/termination of the individual contracts.

FSIC new business is generally ceded pursuant to the following two reinsurance agreements:

Swiss Re entered into a 20% quota share agreement with National Indemnity which includes all Swiss Re group entities. Under the agreement, FSIC cedes 20% of gross written premiums.

FSIC also entered into a quota share agreement with SRAC. Under this agreement, FSIC cedes 80% of net written premiums after all other cessions.

FSIC also has a few remaining reinsurance contracts with unaffiliated reinsurers. These contracts are a holdover from the GE era and are not material.

The Corporation is contingently liable for all reinsurance losses ceded or retroceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under its reinsurance agreement with the Corporation.

ACCOUNTS AND RECORDS

First Specialty's financially significant business applications are accessed through local Intranet and Wide Area Network connections linked to servers located in Overland Park, Kansas and Zurich, Switzerland. A combination of Microsoft Windows Servers and IBM z Series mainframe servers are utilized by the Corporation. Swiss Re is in the process of relocating all application servers to Zurich, which is expected to be completed by year-end 2011. As of the end of fieldwork, the CRAS System for reinsurance management and the AMS System utilized for account and policy management for commercial industrial risks were the only two applications administered by the Overland Park IT staff. Additional financially significant applications used by the Corporation include CDS for general ledger and accounting functions, ABC for additional general ledger functions, WPCe for policy and claim management, Pyramid for claims processing, WINS for billing and collections, Commercial Intelysis and Studio (Jupiter) the underwriting system which populates WINS, and iBank for reporting.

Financial statements of the Corporation were audited as of December 31, 2009, by the CPA firm, PricewaterhouseCoopers LLP, of New York, New York. PricewaterhouseCoopers LLP also issued audited statutory financial statements of the Corporation for the years 2007 and 2008.

The 2009 Statement of Actuarial Opinion was issued by Steven Book, FCAS, MAAA, Managing Actuary, an officer of First Specialty Insurance Corporation. The 2007 and 2008, Statements of Actuarial Opinion were also issued by Steven Book. The actuary was appointed by the Board of Directors to render an opinion.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the MO DIFP as of December 31, 2009, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with RSMo Section 379.098 (Securities to be Deposited by All Companies, Kind and Amount). The funds on deposit as of December 31, 2009, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. Treasury Note	\$2,600,000	\$2,801,500	\$2,853,475

Deposits with Other States, Territories, and Countries

The Corporation also has funds on deposit with various other states. The funds on deposit as of December 31, 2009, were as follows:

<u>State</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Arkansas	U.S. Treasury Note	\$ 450,000	\$ 457,938	\$ 466,433
Louisiana	U.S. Treasury Note	100,000	106,313	99,177
Massachusetts	U.S. Treasury Note	750,000	754,250	768,243
New Hampshire	U.S. Treasury Note	1,500,000	1,643,059	1,570,012
New Jersey	U.S. Treasury Note	200,000	215,500	219,498
New Mexico	U.S. Treasury Note	130,000	134,688	137,186
New York	U.S. Treasury Note	3,000,000	3,174,461	3,217,428
South Carolina	U.S. Treasury Note	150,000	158,502	149,497
Totals		<u>\$ 6,280,000</u>	<u>\$ 6,644,711</u>	<u>\$ 6,627,474</u>

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of First Specialty for the period ending December 31, 2009. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Comments on Financial Statement Items." The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the "Comments on Financial Statement Items." These differences were determined to be immaterial concerning their effect on the financial statements and therefore were only communicated to the Corporation and noted in the workpapers for each individual activity.

	<u>Assets</u>		
	<u>Assets</u>	<u>Non-Admitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$ 69,495,707	\$ -	\$ 69,495,707
Cash and Short-term Investments	75,354,686	-	75,354,686
Investment Income Due and Accrued	180,122	-	180,122
Uncollected Premium and Agents' Balances In the Course of Collection	2,112,609	1,712,446	400,163
Deferred Premiums, Agent Balances, and Installments Booked and Not Yet Due	853,827	-	853,827
Amounts Recoverable from Reinsurers	1,078,699	-	1,078,699
Net Deferred Tax Asset	5,681,247	1,789,988	3,891,259
Receivable from Parent, Subsidiaries and Affiliates	10	-	10
Aggregate Write-Ins for Other Than Invested Assets:			
Deductible Recoverable	372,723	372,723	-
Other Assets	75,000	75,000	-
Paid Loss Advance	9,946,801	-	9,946,801
Total Assets	\$ 165,151,431	\$ 3,950,157	\$ 161,201,274

Liabilities, Surplus and Other Funds

Losses	\$ 43,444,788
Loss Adjustment Expenses	27,414,679
Commissions Payable, Contingent Commissions and Other Similar Charges	1,338,823
Other Expenses (Excluding Taxes, Licenses and Fees)	163,700
Unearned Premiums	3,613,001
Ceded Reinsurance Premiums Payable (Net of Ceding Commissions)	2,730,396
Funds Held by Company Under Reinsurance Treaties	70,889
Remittances and Items Not Allocated	2,406,380
Provision for Reinsurance	294,909
Payable to Parent, Subsidiaries and Affiliates	1,396,865
Aggregate Write-Ins for Liabilities:	
Excess Ceding Commissions	2,454,000
Total Liabilities	\$ 85,328,430
Increased Surplus from use of paragraph 10.e of SSAP 10R	725,819
Common Capital Stock	5,000,000
Gross Paid In and Contributed Surplus	41,000,000
Unassigned Funds (Surplus)	29,147,025
Surplus as Regards Policyholders	<u>\$ 75,872,844</u>
Total Liabilities and Surplus	<u>\$ 161,201,274</u>

Statement of Income

Underwriting Income	
Premiums Earned	\$ 11,796,572
Deductions:	
Losses Incurred	1,032,855
Loss Adjustment Expenses Incurred	14,546,676
Other Underwriting Expenses Incurred	4,164,578
Excess Ceding Commissions	(611,000)
Net Underwriting Gain or (Loss)	\$ (7,336,537)
Investment Income:	
Net Investment Income Earned	\$ 1,404,434
Net Realized Capital Gains or (Losses)	2,938,357
Net Investment Gain or (Loss)	\$ 4,342,791
Other Income	
Net Gain or (Loss) from Agents' or Premium Balances Charged Off Finance and Service Charges Not Included in Premiums	\$ (1,122,691)
Aggregate Write-Ins for Miscellaneous Income:	
Miscellaneous Income	(38)
Total Other Income	\$ (1,112,729)
Net Income Before Dividends to Policyholders and Income Taxes	(4,116,475)
Dividends to Policyholders	-
Net Income Before Federal and Foreign Income Taxes	\$ (4,116,475)
Federal and Foreign Income Taxes Incurred	(337,543)
Net Income	\$ (3,778,932)

Capital and Surplus Account

Surplus as Regards Policyholders, December 31, 2008	\$ 85,162,722
Net Income	(3,778,932)
Change in Net Deferred Income Tax	616,368
Change in Nonadmitted Assets	1,870,523
Change in Provision for Reinsurance	(223,653)
Dividends to Stockholders	(8,500,000)
Increased Surplus from paragraph 10.e of SSAP 10R	725,819
Examination Change	-
Net Change in Surplus as Regards Policyholders for 2009	\$ (9,289,875)
Surplus as Regards Policyholders, December 31, 2009	\$ 75,872,847

FINANCIAL STATEMENT CHANGES RESULTING FROM EXAMINATION

None

COMMENTS ON FINANCIAL STATEMENT ITEMS

None

SUMMARY OF RECOMMENDATIONS

None

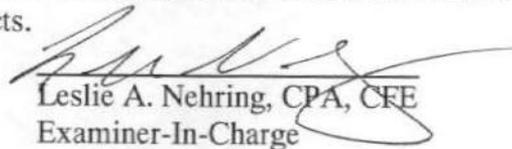
ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of First Specialty Insurance Corporation during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Karen Baldree, CPA, CFE; Timothy Carroll; Vicki Denton, CFE; Al Garon, CFE; Larry Kleffner, CFE; Steven Koonse, CFE; Bernie Troop, CFE; and Valerie Hastings examiners for the MO DIFP, participated in this examination. The firm, Expert Actuarial Services, LLC also participated as consulting actuaries.

VERIFICATION

State of Missouri)
County of)

I, Leslie A. Nehring, CPA, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of First Specialty Insurance Corporation, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

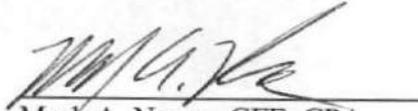

Leslie A. Nehring, CPA, CFE
Examiner-In-Charge
MO DIFP

Sworn to and subscribed before me this 28th day of February, 2011.
My commission expires: 04/14/2012 Beverly M. Webb
Notary Public

BEVERLY M. WEBB
Notary Public - Notary Seal
STATE OF MISSOURI
County of Clay
My Commission Expires 4/14/2012
Commission # 08464070

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed, except where practices, procedures and applicable regulations of the MO DIFP and statutes of the State of Missouri prevailed.



Mark A. Nance, CFE, CPA

Audit Manager

Missouri Department of Insurance, Financial
Institutions and Professional Registration

Swiss Re



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DEPT OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION

First Specialty Insurance Corporation
5200 Metcalf
Overland Park, KS 66201
913-676-3162
913-676-6226
www.swissre.com

April 26, 2011

VIA EXPRESS MAIL SERVICE

Mr. Fred Heese
Chief Financial Examiner
Missouri Department of Insurance, Financial
Institutions & Professional Registration
301 West High, Room 630
Jefferson City, MO 65101

Re: Draft Report of Association Financial Examination (as of December 31, 2009)
First Specialty Insurance Corporation

Dear Mr. Heese,

First Specialty Insurance Corporation ("FSIC") is in receipt of the above-captioned report dated March 8, 2011, and provided to us for review on March 30, 2011. FSIC appreciates the opportunity to review the report and provide comments. Accordingly, FSIC respectfully requests that this letter be incorporated into or attached to the final financial examination report of the Missouri Department of Insurance, Financial Institutions and Professional Registration ("DIFP").

The General Comments and/or Recommendations section of the draft examination report included no matters requiring correction or comment. As such, we do not believe it is necessary to address this part of the report.

FSIC would like to thank DIFP and its onsite examination team for the professionalism and candor that characterized this examination. If you have any comments or questions regarding this letter, please let us know.

Sincerely,

William Steilen
Managing Director and Chief Financial Officer