

REPORT ON EXAMINATION
AS TO THE CONDITION OF
KODIAK INSURANCE COMPANY
820 BEAR TAVERN ROAD
WEST TRENTON, NEW JERSEY 08628-1021
AS OF DECEMBER 31, 2011
NAIC GROUP CODE 3703
NAIC COMPANY CODE 29750

Filed

May 17, 2013

**Commissioner
Department of Banking &
Insurance**

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State of New Jersey

DEPARTMENT OF BANKING AND INSURANCE

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March 26, 2013

Honorable Kenneth E. Kobylowski
Commissioner of Banking and Insurance
State of New Jersey
20 West State Street
Trenton, New Jersey 08625-0325

Commissioner:

Pursuant to instructions and in accordance with N.J.S.A. 17:23-22, an examination as of December 31, 2011 was made of the financial condition and affairs of

KODIAK INSURANCE COMPANY
NAIC GROUP CODE 3703 NAIC COMPANY CODE 29750

Hereinafter referred to as the "Company."

SCOPE OF THE EXAMINATION

This financial condition examination was called by the Commissioner of Banking and Insurance of the State of New Jersey pursuant to the authority granted by N.J.S.A. 17:23-22. The examination was a full scope comprehensive examination and was conducted at the Company's home office located at 120 Broadway, New York, 10271. Information regarding controls was obtained from the prior examination conducted by the New York State Insurance Department examination of the Tower Insurance Company of New York (TICNY), a New York domiciled insurer who is the lead State in the Tower Pool.

The Company was last examined as of December 31, 2008. The current examination covers the period from January 1, 2009 through December 31, 2011.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook. The Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company, including corporate governance, identification and assessment of inherent risks within the company and evaluation of system controls and procedures used to mitigate those risks. An examination also includes assessment of the principles used and significant estimates made by management, as well as evaluation of the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations. The general procedure of the examination followed the rules established by the Financial Condition, Examination and Reporting Committee of the NAIC, and included such other examination procedures as were deemed necessary.

During the course of this examination, consideration was given to work performed by both the Company's Internal Audit Department (IAD) as regards to their oversight of compliance with Sarbanes-Oxley (SOX), risk analysis, documentation, test work, remediation efforts over weaknesses identified, and by the Company's external accounting firm. Certain auditor work papers have been incorporated into the work papers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination.

In addition to the review of the Company's operations during the three-year period ending December 31, 2011, and a determination of its financial condition as of the later date, transactions occurring subsequent to the examination date were reviewed and incorporated herein when deemed appropriate. A review was made of the following matters to ascertain the Company's financial condition and its conformity with the insurance laws of the various jurisdictions in which it operates:

- History and Kind of Business
- Territory and Plan of Operation
- Management and Control
- Corporate Records
- Policy on Conflict of Interest
- Holding Company System
- Inter-company Agreements
- Fidelity Bond and Other Insurance Coverages
- Policy Forms and Underwriting
- Reinsurance
- Accounts and Records

No market conduct examination activities were undertaken. This report is confined to financial statements and comments on matters, which involve departures from law, regulations, rules, or any other matters, which are deemed to require special explanation or description.

Surplus as regards policyholders determined by the examination, at the examination date, consisted of the following:

Common Capital Stock	\$6,500,000
Aggregate write ins for other than special surplus funds	543,827
Gross Paid in and Contributed Surplus	4,050,000
Unassigned Funds	10,685,835
Total	\$21,779,662

**COMPLIANCE WITH PRIOR EXAMINATION REPORT
RECOMMENDATIONS**

Intercompany Agreements

It is hereby recommended that a new Expenses Sharing Agreement between the Company and Hermitage be entered into. It is further recommend that this new Expense Sharing Agreement include an additional provision related to the allocation of fees for EDP services.

The Company has complied with this recommendation.

It is hereby recommended that a Tax Sharing Agreement be executed by and between the Company and its parent.

The Company has complied with this recommendation.

Continuity of Operations

It is again recommended that the Company test its Disaster Recovery Plan, document the result of their test of their Disaster Recovery Plan, and make any modifications deemed necessary as the result of their test of the Disaster Recovery Plan.

The Company has complied with this recommendation.

Treatment of Policyholders

It is hereby recommended that Kodiak comply with N.J.S.A. 17:29B-4(10) requiring an insurer to maintain a complete record of all consumer complaints received since its previous examination.

The Company has complied with this recommendation.

Accounts and Records

It is hereby recommended that the Company implement a more automated General Ledger system that is less susceptible to human error.

The Company has complied with this recommendation.

Bonds

It is hereby recommended that the Company perform periodic reviews and maintain documentation of such reviews of prepaid assumptions for loan-backed securities, as required by SSAP #43.

The Company has complied with this recommendation.

Amounts withheld or retained by Company for account of others

It is hereby recommended that the Company annually prepare and submit abandoned property reports to the New Jersey State Treasurer as required by N.J.S.A. 46:30 B-16.

The Company has complied with this recommendation.

HISTORY AND KIND OF BUSINESS

The Company was incorporated under the laws of the State of New Jersey on September 2, 1986 and began business on July 7, 1986.

On April 7, 2005, the New Jersey Department of Banking and Insurance granted approval for Ontario Limited, Brascan Corporation and EdperPartners Limited to acquire control of Kodiak Insurance Company. The sale was completed on June 2, 2005.

The Company's Certificate of Authority, amended as of June 24, 2009, authorizes Kodiak to write the type of insurance specified in paragraphs "a", "b", "e", "f", "g", "j", "k", "l", "m", "n" and "o" of N.J.S.A. 17:17-1 et seq. and Health insurance defined in N.J.S.A. 17B:17-4.

At December 31, 2008, the Company had 1,650,000 shares of common stock at a par value of \$3.93 per share. All issued and outstanding shares were owned by Hermitage Insurance Company ("Hermitage"); an insurance company domiciled in the State of New York, which is a wholly owned subsidiary of Tower Group, Inc., a Delaware Corporation.

On February 27, 2009, Tower Group, Inc. completed the acquisition of HIG, Inc., a specialty property and casualty insurance holding company from Brookfield Asset Management for \$130 million. Through its insurance subsidiaries, Hermitage Insurance Company and Kodiak Insurance Company, it offered products for the commercial

customers throughout the United States. This transaction was approved by the New Jersey Department of Banking and Insurance.

The Company's main administrative office is located at 120 Broadway, 31st Floor, New York, NY 10271. The Company's statutory home office is located at 820 Bear Tavern Road, West Trenton, New Jersey 08628-1021.

The registered agent upon whom process may be served is The Corporation Trust Company, 820 Bear Tavern Road, West Trenton, New Jersey 08628.

TERRITORY AND PLAN OF OPERATION

At December 31, 2011, the Company was licensed in the State of New Jersey, Alabama, Georgia, Indiana, Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee and Virginia. All of the Company's premiums are from commercial risks. The primary lines of business written are commercial multiple peril and with lesser amounts of other liability and inland marine.

The Company's business is produced primarily by approximately forty-five independent retail brokers in the State of New Jersey. The Company uses ISO forms for all lines with the exception of Business Owners' Policy ("BOP") policies with uses MSO forms.

The Company is affiliated with Tower Group, Inc. which has provided Kodiak with improved operating efficiencies, claims management, accounting regulatory reporting and data processing capabilities.

MANAGEMENT AND CONTROL

At the Annual Board of Directors meeting for Kodiak Insurance Company the following individuals were elected to be the officers of the Company:

Michael H. Lee	President & CEO
William E. Hitselberger	Executive Vice President and Chief Financial Officer
Gary S. Maier	Executive Vice President
Elliot S. Orol	Senior Vice President and Secretary
Joel S. Weiner	Senior Vice President *
Craig A. Nyman	Treasurer *

*Officers were replaced after December 31, 2011

William F. Dove – Senior Vice President and Vito A. Nigro - Treasurer

N.J.S.A. 17:27A-4d(3) states as follows: "not less than one-third of the Directors of a domestic insurer, and not less than one-third of the members of each committee of the Board of Directors of any domestic insurer, shall be persons who are not officers or employees of that insurer or of any entity controlling, controlled by, or under common control with, that insurer and who are not beneficial owners of a controlling interest in the

voting securities of that insurer or any such entity. At least one such person shall be included in any quorum for the transaction of business at any meeting of the Board of Directors or any committee thereof.”

N.J.S.A. 17:27A-4d (4) states as follows: “The Board of Directors of a domestic insurer shall establish one or more committees comprised solely of Directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with, the insurer and who are not beneficial owners of a controlling interest in the voting securities of the insurer or any such entity. The committee shall be responsible for recommending the selection of independent certified public accountants, reviewing the insurer’s financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the Board of Directors the selection and compensation, including bonuses or other special payments of the principal officers.”

N.J.S.A. 17:27A-4d(5) states as follows: The provisions of paragraph (3) and (4) of this subsection d, shall not apply to a domestic insurer if the person controlling the insurer is an entity having a Board of Directors and committees thereof that substantially meet the requirements of those paragraphs.

It was determined that the controlling entity, Tower Group Inc. which has a Board of Directors and Committees thereof that satisfied the requirements of N.J.S.A. 17:27A-4d(3) and N.J.S.A. 17:27A-4d(4).

CORPORATE RECORDS

The minutes of the meetings of the Board of Directors were reviewed and found to support adequately the Company transactions and events. The Company’s adherence to its Certificate of Incorporation and By-Laws are reviewed without exception.

POLICY ON CONFLICTS OF INTEREST

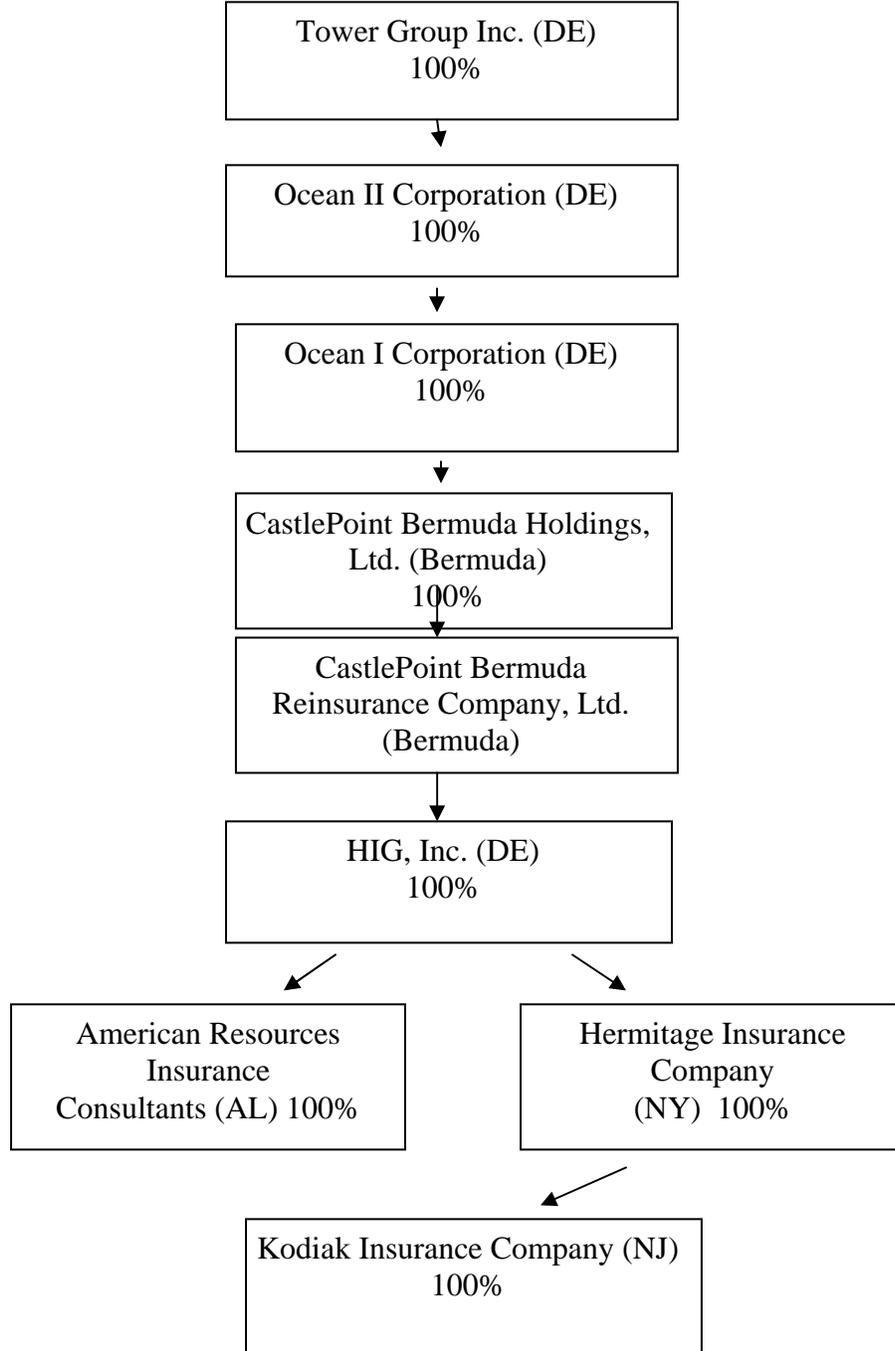
The Company has adopted a Code of Business Conduct and Ethics. This policy states that every employee, officer and director reads and understands the Code and its application to the performance of his or her business responsibilities. All employees must sign an acknowledgement that they have received and read a copy of the Code as a condition of employment and may be asked to reaffirm their receipt of the document at the discretion of the Company.

HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system as defined in N.J.S.A. 17:27A-1. As of December 31, 2011 the Company was a member of the HIG, Inc. and is a wholly owned subsidiary of Hermitage Insurance Company, a New York

domiciled insurance company. Hermitage Insurance Company is a wholly owned subsidiary of Tower Group Inc., Delaware Corporation.

Organizational Chart as of 12/31/11



The Company has a 100% quota share reinsurance agreement with an affiliate, under the terms of which Preserver Insurance Company (“PIC”) will pay, or provide services for, all of the Company's non-investment operations, both underwriting and non-underwriting, for no fee or cost as long as the reinsurance agreement is in effect. The Company also has a service and expense sharing agreement with its affiliate, PIC, for any necessary services to be performed by PIC on behalf of the Company, which are not covered under the quota share reinsurance agreement.

All outstanding shares of the Company are owned by its parent, Hermitage.

INTER-COMPANY AGREEMENTS

The Company has several inter-company agreements:

- Service and Expense Sharing Agreement – Effective December 31, 2010, the Company entered into a Service and Expense Sharing Agreement with Preserver Insurance Company whereby Preserver Insurance Company agrees to perform all the functions related to the conduct of the property and casualty business on behalf of Kodiak Insurance Company, including but not limited to the following: Underwriting and Marketing, Policy Issuance, billing and collection, state filing, loss prevention/premium audit, claims, legal and corporate services which include accounting, human resources and MIS.
- Reinsurance (Pooling) Agreement – Effective July 1, 2009, Kodiak Insurance Company and Preserver Insurance Company entered into a Quota Share Reinsurance Agreement whereby Kodiak will automatically cede to Preserver Insurance Company (the Reinsurer), and Preserver (the Reinsurer) shall be obligated to accept as assumed reinsurance, a 100% quota share portion of the Gross Liabilities with respect to such policies. Preserver Insurance Company (Reinsurer) shall be credited with all underwriting liabilities including the unearned premium reserves, loss reserves including IBNR reserves, case reserves and loss adjustment expense reserves and liabilities for commissions payable, other expenses and taxes, licenses and fees (excluding federal and foreign income taxes) at the date at which this agreement takes effect and shall then accept full liability for its proportion of all loss payments and salvages relating thereto at a subsequent date as and when the aforesaid outstanding losses are settled.
- Income Tax Allocation Agreement – Effective September 12, 2008, the tax sharing agreement among Tower Group, Inc. (“Parent”), a Delaware corporation, and each of its undersigned subsidiaries, will elect to continue to file a consolidated U.S. Federal income tax return.

FIDELITY BOND AND OTHER INSURANCE COVERAGES

As of December 31, 2011, the Group had the following insurance coverage in effect:

Coverage Description

Fidelity Bond - \$15,000,000

Management Protection Insurance Policy

Limit of Liability:

Single Aggregate Limit of Liability for all coverage parts combined - \$10,000,000

Coverage part(s) Limit of Liability

Employment Practices Liability \$10,000,000

Fiduciary Liability \$10,000,000

Insurance Company Professional Liability \$10,000,000

Insurance Agents and Brokers Professional Liability Policy

Limit of Liability:

\$2,000,000 each wrongful act or series of continuous repeated or interrelated wrongful acts

\$2,000,000 aggregate

\$500,000 deductible

The above coverage is in effect for the Company. It was determined that the coverage was adequate based on the guidelines of the National Association of Insurance Commissioners.

EMPLOYEE WELFARE AND PENSION PLAN

At December 31, 2011, the Company had no employees or facilities. However, management, operations, and claim services are provided under a management agreement with Preserver Insurance Company, as discussed in this report under the heading "Intercompany Agreements." All employee related expenses, including welfare and pension benefits, are allocated to the Company in accordance with the terms of the Service and Expense Sharing Agreement.

REINSURANCE

The Company cedes 100% of its gross liabilities to its affiliate Preserver Insurance Company. "Gross Liabilities" for the purposes of this agreement means direct and assumed liabilities net of excess and facultative reinsurance that inures to the benefit of the Company. Preserver Insurance Company is part of the Tower Group Pooling Agreement. The Tower Pool cedes business to various external reinsurers under reinsurance agreement designed to protect the surplus of members of the Group.

The Company assumes business under one agreement with American Resources Insurance Corporation. ARIC (which is domiciled in Alabama). Per conversation with company personnel, the Company wished to purchase the block of business from ARIC, but was not licensed in all states where ARIC sold business. The Company assumed the business from ARIC, as the Company obtained licenses in each of the applicable states, the renewal policies were written on the Company's paper. This transaction received the approvals of both the Alabama, ARIC's state of domicile, and New Jersey Department of Banking and Insurance. For the examination period as of December 31, 2011, this business is ceded gross to Preserver Insurance Company.

ACCOUNTS AND RECORDS

The General Books of account are maintained at the Company's ultimate parent. "Tower Group Inc.'s" office which is located at 120 Broadway, New York, NY 10271. The Company's software for Premium is SunGard, the policy administration software is (CSC) Point In and for claims the software is Claims Plus.

The General Ledger system utilized by the Company is SunGard General Ledger software. The accounts payable system utilized by the Company is SunGard Accounts Payable software.

Since January 2010, the Company's investment accounting service provider is SS&C Technology Inc. and the assets were held at The Northern Trust Corporation beginning in November 2011.

FINANCIAL STATEMENTS AND OTHER EXHIBITS

Financial statements and other exhibits are presented as listed below:

Exhibit A - Comparative Statement of Assets, Liabilities, Surplus and Other Funds at December 31, 2011

Exhibit B – Underwriting and Investment Exhibit for the three year examination period ended December 31, 2011

Exhibit C – Capital and Surplus Account for the period ended December 31, 2011

<u>Comparative Statement of Assets</u>				
<u>Liabilities, Surplus and Other Funds at December 31, 2011</u>				
				<u>Exhibit A</u>
	Balance	Balance per		
	per	Company as		
	<u>Examination</u>	<u>of 12/31/11</u>	<u>Note</u>	<u>Examination</u>
				<u>Change</u>
Assets:				
Bonds	\$18,327,482	\$18,327,482		
Preferred and Common Stocks	745,750	745,750		
Cash, Cash Equivalents & Short term investments	1,403,813	1,403,813		
Receivable for Securities	0	0		
Investment income due and accrued	319,450	319,450		
Uncollected premium and agents' balances in the course of collection	0	0		
Deferred premiums, agents' balances and installments booked but deferred and not yet due	0	0		
Amounts recoverable from reinsurers	0	0		
Other amounts receivable under reinsurance contracts	0	0		
Current Federal and Foreign income tax recoverable and interest thereon	0	0		
Net deferred tax asset	818,125	818,125		
Receivable from parent, subsidiaries and affiliates	209,850	209,850		
Aggregate write-ins for other than invested assets	0	0		
Guaranty funds receivable or on deposit	0	0		
Total Assets	\$21,824,470	\$21,824,470		
Liabilities:				
Losses	\$0	\$0	1	
Reinsurance payable on paid loss and LAE	0	0		
Loss adjustment expenses	0	0	1	
Commission payable, contingent commissions and other similar charges	0	0		
Other expenses	0	0		
Taxes, licenses and fees	0	0		
Current federal and foreign income taxes	44,808	44,808		
Unearned premiums	0	0		
Advance premiums	0	0		
cede reinsurance premium payable	0	0		
Amounts withheld or retained by Company				
Drafts Outstanding	0	0		
Payable to parent, subsidiaries and affiliates	0	0		
Aggregate write ins for liabilities	0	0		
Total Liabilities	\$44,808	\$44,808		
Capital and Surplus:				
Aggregate write-ins for special surplus funds	\$543,827	\$543,827		
Common capital stock	6,500,000	6,500,000		
Surplus notes	0	0		
Gross paid in and contributed surplus	4,050,000	4,050,000		
Unassigned Funds (surplus)	10,685,835	10,685,835		
Surplus as regards policyholders	<u>\$21,779,662</u>	<u>\$21,779,662</u>		
Total Liabilities and Surplus and Other Funds	\$21,824,470	\$21,824,470		

<u>Underwriting and Investment Exhibit</u> for the THREE year period ending December 31, 2011			<u>Exhibit B</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>
<u>Underwriting Income</u>			
Premiums earned	\$9,775,145	\$0	\$0
Deductions:			
Losses incurred	4,708,222	(1,704)	0
Loss adjustment expenses incurred	1,530,075	(71)	0
Other underwriting expenses incurred	661,150	0	0
Aggregate write-ins for underwriting deductions	0	0	0
Total underwriting deductions	\$6,899,447	(\$1,775)	\$0
Net underwriting gain	\$2,875,698	\$1,775	\$0
<u>Investment Income</u>			
Net investment income earned	1,115,213	670,358	736,884
Net realized capital gains	609,420	125,554	175,951
Net investment gain	1,724,633	795,912	912,835
<u>Other income</u>			
Net gain or (loss) from agents' or premium balances charged off	(5,890)	0	0
Finance and service charges not included in premiums	72,583	0	0
Aggregate write-ins for miscellaneous income	0	0	0
Total other income	66,693	0	0
Net income, before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	4,667,024	797,687	912,835
Federal and foreign income taxes incurred	(228,387)	216,650	(88,074)
Net income	\$4,895,411	\$581,037	\$1,000,909
<u>CAPITAL AND SURPLUS</u> for the THREE year period ending December 31, 2011			<u>Exhibit C</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>
Net Income	4,895,411	581,037	1,000,909
Change in net unrealized capital gains or (losses)	61,152	21,574	(14,607)
Change in net deferred income tax	3,192,911	(631,012)	(276,750)
Change in non-admitted assets	(3,012,610)	794,290	252,801
Change in provision for reinsurance	(75,200)	75,200	0
Capital changes - Paid in	0	0	0
Transferred from surplus (stock dividend)		4,099,250	
Transferred to Capital (Stock Dividend)		(4,099,250)	
Aggregate write-ins for gains and losses in surplus	(286,380)	220,788	(57,588)
Change in Surplus as regards to policyholders for the year	4,775,284	1,061,877	904,765
Surplus December 31 previous year	15,037,736	19,813,020	20,874,897
Surplus December 31 current year	19,813,020	20,874,897	21,779,662

NOTES TO FINANCIAL STATEMENTS

Note 1: LOSSES AND LOSS ADJUSTMENT EXPENSES

Loss and Loss Adjustment Expense Reserves as reported at December 31, 2011 were \$0 and \$0, respectively. The New Jersey Department of Banking and Insurance, Office of Solvency Regulation, Actuarial Unit reviewed the December 31, 2011 Actuarial Report for the Tower Group. On the basis of this review, the Gross and Net Loss and Loss Adjustment Expense Reserves were found to be reasonably stated.

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES-STATEMENT BY NEW JERSEY DEPARTMENT OF BANKING AND INSURANCE ACTUARY

I, Boris Privman, FCAS, MAAA, Managing Actuary, New Jersey Department of Banking and Insurance, Office of Solvency Regulation, Actuarial Unit have reviewed the December 31, 2011 Actuarial Report for the Tower Group. On the basis of this review, the Gross and Net Loss and Loss Adjustment Expense Reserves were found to be reasonably stated.

Actuarial findings as stated above and in this examination report are the sole responsibility of the New Jersey Department of Banking and Insurance, Office of Solvency Regulation, Actuarial Unit

/S/

Boris Privman, FCAS, MAAA

SUMMARY OF RECOMMENDATIONS

There were no specific recommendations as a result of this examination.

CONCLUSION

I, Nancy Lee Chice, do solemnly swear that the foregoing report of examination is hereby presented to be a full and true statement of the condition and affairs of the Kodiak Insurance Company as of December 31, 2011, to the best of my knowledge and belief.

Respectfully submitted,

/S/

Nancy Lee Chice, CFE
Examiner-In-Charge

State of New Jersey
County of Mercer

Subscribed and sworn to before me.
On this 12th day of April, 2013.

/S/

Linda L. Boone
Notary Public of New Jersey
My Commission Expires March 26, 2014