

**REPORT ON EXAMINATION**  
**OF**  
**REAL LEGACY ASSURANCE COMPANY, INC.**  
**GUAYNABO, PUERTO RICO**

**AS OF**  
**DECEMBER 31, 2009**

**NAIC CODE 36749**

**AMENDED**

**BY THE**  
**OFFICE OF THE COMMISSIONER OF INSURANCE**  
**OF PUERTO RICO**

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GOVERNMENT OF PUERTO RICO  
OFFICE OF THE COMMISSIONER OF INSURANCE

June 30, 2011

Mr. Ramón L. Cruz Colón, CPCU, AU, ARe  
Commissioner of Insurance  
Guaynabo, Puerto Rico

Dear Commissioner:

In compliance with your instructions and pursuant to Order Number EX-2010-230 dated September 30, 2010, and the Puerto Rico Insurance Code ("PRIC"), and in accordance with the practices and procedures issued by the National Association of Insurance Commissioners (NAIC), a comprehensive risk focus examination and financial affairs examination was made of the books, records, and financial condition of

**Real Legacy Assurance Company, Inc.**  
Metro Office Park, Calle 1, Lote 4, 2<sup>nd</sup> Floor,  
Guaynabo, Puerto Rico.

hereinafter referred to as "the Company".

**SCOPE OF EXAMINATION**

This examination covers the period from January 1, 2005 through December 31, 2009, including any relevant material transactions or events occurring subsequent to the examination date and noted during the course of the examination.

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company, including corporate governance, identifying and assessing inherent risks within the company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with the Statutory Accounting Principles and Annual Statement Instructions, when are applicable to the Puerto Rico Insurance Code, "PRIC".

All accounts and activities of the Company were examined in accordance with the risk-focused examination process.

## **SUMMARY OF SIGNIFICANT FINDINGS**

### **Reinsurance**

- We reviewed each of the finding that the New Castle Reinsurance Co. Ltd. non authorized in this office, in violation of the Ruling Letter Number. N-AF-4-63-2005 of April 11, 2005.
- The Company ceded reinsurance to not licensed to do business in Puerto Rico, contrary to the provisions of Article 4.120 (a) and (b) of the Puerto Rico Insurance Code, as amended.

**Electronic Data Processing**

- As of December 31, 2009, the balance shown in the Annual Statement for the Electronic Data Processing account was \$226,822. The SSAP 16 indicates that the equipment and software must be depreciated over a period not exceeding (3) three years, using the method chosen by the Company. We adjusted the depreciation in the amount of \$13,634, decreasing the balance of Electronic Data Processing to \$213,188.

**COMPLIANCE WITH PRIOR EXAMINATION FINDINGS**

- The Insurer did not comply with the disposition in Article 4.130 of the Puerto Rico Insurance Code, nor with the Ruling Letter Number N-E-11-62-93<sup>1</sup>, nor with the Accounting Practices and Procedure Manual, issued by the National Association of Insurance Commissioners (NAIC), by not including the insolvency clause in its reinsurance contracts.
- The Insurer ceded reinsurance to non-authorized reinsurers by doing business in Puerto Rico, contrary to the dispositions in Article 4.120(a) and (b) of the Puerto Rico Insurance Code.
- The Investment Policy of the Insurer does not express the professional qualifications of the personal that have the position to make investment decisions, contrary to the disposition in Article 6.010(1) of the Puerto Rico Insurance Code. This situation was pointed out in the previous exam report; this the Insurer corrected this finding.

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<sup>1</sup> The Ruling Letter was amended with Ruling Letter N-AF-4-63-2005 of April 11, 2005.

- The Insurer does not maintain a contract with Scotiabank of Toronto, who is the custodial of part of the Insurer's investments. By not establishing written terms and conditions by which the custodial must comply for the good management of the investments, the Insurer manifests a lack of internal control that guarantees the strict compliance of the responsibility delegated to others. Require the Insurer, to formalize a contract with Scotiabank of Toronto. During this exam the Company submitted the requested contract.
- The amount \$19,847 in the cash item was reclassified to the accumulated costs item, because it was considered unclaimed funds.
- The accumulated costs item was increased by \$136,827, to recognize some accumulated costs, or recognize the difference between the accumulated and the truly paid by the Insurer, in conformity with the disposition in Article 5.030(2) of the Puerto Rico Insurance Code.
- The amount \$19,847 was reclassified to the accumulated costs item, coming from the cash account of unclaimed funds.
- As of December 31, 2005, the Insurer did not comply with the established in Subsection (A) of Section 8 of Ruling LXXII of the Regulations of the Insurance Code of Puerto Rico, and continued subscribing catastrophic business, in this topic, the Insurer was required to make a contribution to its surplus.
- The unassigned surplus of the Insurer was affected by \$116,980, by the adjustments performed in the previous exam.

## HISTORY

The Company commenced operations on January 1, 1978, when it was approved by the Office of the Commissioner of Insurance of Puerto Rico as "The Royal Insurance Company of Puerto Rico".

On July 1, 1998, the Company changed its name to Royal & SunAlliance Insurance (Puerto Rico), Inc. On June 1, 2003, each of total shareholders sold their shares to Royal International Insurance Holdings, Ltd., who owned 94.32% of the shares of the Company, so all shares were transferred to the new shareholder, "Cooperativa de Seguros Múltiples de Puerto Rico".

On September 23, 2003, the change in ownership was approved by the Office. With this change approved, the "Cooperativa de Seguros Múltiples de Puerto Rico", became the owner of the shares of the Company.

On August 2, 2004, the Company changed its name from Royal & SunAlliance Insurance (Puerto Rico), Inc., to Real Legacy Assurance Company, Inc.

## CAPITAL STOCK

At December 31, 2009, the outstanding common stocks amounted to \$3,000,000 and consisted of 300,000 having a par value of \$10 per share.

Cooperativa de Seguros Múltiples de Puerto Rico owns 299,995 shares. Pursuant to Article 3.090 of the PRIC, is required to maintain minimum paid-in capital of \$3,000,000. The Company complies with the provision of paid in capital as of December 31, 2009.

In compliance with Article 29.150(1) of the PRIC, the remaining five (5) shares were issued to the following directors: Roberto Castro Hiraldo, Luis A. Velázquez Vera, Enrique A. López Pereira, Edwin Quiñones Suárez, and Víctor R. Ríos Ríos.

### **DIVIDENDS OF STOCKHOLDERS**

As of December 31, 2009, the Company did not pay dividends to the stockholders.

### **MANAGEMENT AND CONTROL**

#### **BOARD OF DIRECTORS**

Under the provisions of the Articles of Incorporation of the Company, it establishes that the Board of Directors shall consist of not less than five (5) or more than seven (7) Directors. Therefore, Article 1, Section 1 of the By-Laws provides that the shareholders at its annual meeting elect the Board of Directors. The Board of Directors shall exercise the powers granted to the Company under the By-Laws and its Articles of Incorporation.

A Corporate Resolution as of February 15, 2008, resolved to amend Article III, Section 1 of the By-Laws of the Company; in which the business of the Company is administered by a Board of five (5) Directors elected specifically in, Article II, Section 3 of the By-Laws.

At December 31, 2009, the Board of Directors of the Company consisted of the following:

<b>Name</b>	<b>Position</b>
Roberto Castro Hiraldo	Chairman of the Board of Directors
Víctor R. Ríos Ríos	Director

<b>Name</b>	<b>Position</b>
Edwin Quiñones Suarez	Director
Luis A. Velazquez Vera	Director
Enrique A. López Pereira	Director
Héctor L Rivera Díaz	Secretary & Treasurer

For the period covered by the examination, the Board of Directors of the Company was elected in accordance with Article 29.160(2) of the Puerto Rico Insurance Code, and Article II, Section 3 of the By-Laws.

#### **OFFICERS**

Company's Officers were elected by the Board of Directors, as formulated in Article 29.210 of the Puerto Rico Insurance Code. At December 31, 2009, the Officers were the following:

<b>Officials</b>	<b>Position</b>
Víctor R. Ríos Ríos	President
Dennis Hanftwurz	Vicepresident of Underwriting
Ramón L. Ortíz Rodríguez	Finance Director
Héctor L. Rivera Díaz	Vicepresident of Operation
Víctor M. Gómez	Vicepresident of Claims

#### **AUDIT AND INVESTMENT COMMITTEE**

The Article V of the Company's Investment Policy states that the Director of Finance shall be a member of the Committee and serve as intermediary and coordinate between the Board and the investment consultants in that committee.

The Company maintains By-Laws of the Investment Committee which reported their responsibilities to the Board of Directors.

The Audit Committee consisted of the following:

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**Member**

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Edwin Quiñones Suarez  
Ramón L. Ortiz Rodríguez  
Rosa E. Vélez

**CORPORATE GOVERNANCE**

The Board of Directors is responsible for providing general oversight over corporate governance matters, including the development and implementation of the appropriate governance policies and procedures.

The Company is not a publicly traded corporation and, therefore, is not subject to the Sarbanes-Oxley Act of 2002.

**CONFLICT OF INTEREST**

The Company for the period under review prepared a conflict of interest questionnaire which aims to ensure that every director and officer of the Company discharge their responsibilities in a way that the interest of the Company will not be affected or compromised by personal interests.

**CORPORATE RECORDS****MINUTES**

We reviewed the minutes of the meetings of Shareholders, Board of Directors and Audit Committee, covering the reporting period. In the case of the Executive and Investment Committee, the Company does not maintain minutes of its meetings. The issues and decisions taken at meetings such as the election of the Directors and Officers, and Board of Directors and Shareholders, were made as established by its Articles of Incorporation and By-laws.

## INTERCOMPANY AGREEMENT

Overseas Insurance Agency, Inc. is an affiliate and general agent of Real Legacy Assurance Company, Inc. Overseas Insurance Agency, Inc. was authorized by the Office on July 1, 2002, to act as general agent and insurance broker in Puerto Rico.

The Company entered into an agreement with Overseas Insurance Agency, Inc. (OIA) under which the Company provides OIA rental and maintenance, employees pension plan and other general administrative expenses. The annual fee to be paid to the Company is \$177,500 of overhead and expenses. The operational costs are not included in the general agent contract.

## TERRITORY AND PLAN OF OPERATIONS

The Company is licensed to underwrite business within Puerto Rico and U.S. Virgin Islands. The operations of the Company is to write principally commercial multiple risk and auto liability/physical insurance.

## STATUTORY DEPOSIT

As of December 31, 2009, the Company maintained the following statutory deposits in compliance with the Article 3.151 of the PRIC.

Description	Cusip	Maturity Date	Value
Federal Home Loan Bank	3133XPHM9	2/11/15	\$1,500,000
Bonds	3133XM3P4	8/28/12	1,500,000
Total			\$3,000,000

### UNCLAIMED FUNDS

The Company was in compliance with Article 26.040 of the Insurance Code of Puerto Rico by reporting unclaimed funds to this Office on or before May 1 for the year under examination.

The Company submitted to this Office the negative certification of unclaimed funds for all years examined, in compliance with the Circular Letter Number C-A-3-1684-2003 of March 24, 2003 of this Office.

### REINSURANCE

The Company had several outstanding reinsurance contracts at December 31, 2009, these contracts are handled through Gill & Roeser, Inc. and Guy Carpenter & Company, Inc. The contracts were verified in order to comply with Article 4.130 of the Insurance Code of Puerto Rico and SSAP 62 of the Manual of Accounting Practices and Procedures issued by the National Association of Insurance Commissioners (NAIC).

By letter dated December 17, 2008, the Company requested the OCI, the approval for the use of unauthorized reinsurance in 2009.

We reviewed each of the finding that the New Castle Reinsurance Co. Ltd. -non authorized in this office, in violation of the Ruling Letter No. N-AF-4-63-2005 of April 11, 2005.

The Company ceded reinsurance to not licensed to do business in Puerto Rico, contrary to the provisions of Article 4.120 (a) and (b) of the Puerto Rico Insurance Code,

**ACCOUNTS AND RECORDS**  
as amended.

The Company maintained its principal operational offices in Guaynabo, Puerto Rico where this examination was conducted.

An independent CPA KPMG, LLP, audited the Company's statutory basis financial statements for the year 2009 in compliance with Rule IX of the Regulations of Puerto Rico Insurance Code. Supporting work papers were prepared by the KPMG, LLP as required by Rule IX of the Regulations of the Puerto Rico Insurance Code.

The actuarial opinion was prepared by the Actuary Martha A. Watson of Winslow Towers, FCAS, MAAA.

#### **RETIREMENT PLAN**

The company's employees participate in the Retirement Benefits Plan, hereinafter "the Plan" for both, salaried employees of the Company and its affiliated Overseas Insurance Agency, Inc. This Plan is a non-contributory qualified defined benefit plan based on the years of service of the employees. The Company makes annual contributions to the Plan, as determined by an actuarial calculation, which should be at least the minimum required by ERISA fund. The Plan assets consist primarily of government securities in the United States.

The Company established a qualified Savings Plan under Section 1165(e) of the 1994 Internal Revenue Code of Puerto Rico, as amended. This plan covers employees who work full time.

#### **INFORMATION SYSTEMS**

The Company Information Systems were tested in accordance with the Manual of Accounting Practices and Procedures, using the approach outlined in Exhibit C, entitled "Evaluation of Information Technology Controls." The review of controls included the implementation and operation of security controls and contingency planning among others.

We verified the operation of the Company's information systems and recommended the following:

- The implementation and review of security mechanism and procedures that can build up a strong system architecture for e-commerce. This mechanism should include firewall mechanism and data encryption among others.
- The policy Anti-virus/Anti-malware Policy or Procedure was not provided. An anti-virus policy has to be created, reviewed and monitor at all times. Without an effective antivirus, production environments and data can be at risk of viruses or worms.
- Intrusion Prevention/detection policy was requested but not provided. Also unauthorized access can be permitted due to the lack of this security control. This policy has to be created and monitored periodically.
- The backup policy was requested but not provided. Even though a backup schedule was received, there was no policy associated with backups. Backups are critical to the business continuity plan and are also a vital element of an anti-virus strategy. A backup policy or detailed procedure is highly recommended.

- Updated policies regarding the use of the computer, user's access to the system, use of the internet and e-mails were received. Although a user access policy was in place, we noticed that the removal of the employee's access was not within 24 hours as stated in the policy. The potential risk associated with this action is an unauthorized internal intrusion attack, using an authorized user access. Data confidentiality and integrity could be at risk.
- An Incident Report policy or procedure was requested, but not received. Incident handling is crucial in the IT security management. Incident policies must be revised periodically and continuously monitored. Incident procedures in place help ensure the IT business continuity.

#### **CATASTROPHIC RESERVE**

At December 31, 2009, the Company filed its Annual Statement with a balance of \$34,037,132 as a reserve. The balance includes deposits to the Trust and the interest earned since it was established.

In the previous examination report E-2006-392 of September 18, 2006, this account was subject to reclassification, under Article 25.030(6) of the Puerto Rico Insurance Code. The reserve for catastrophic insurance losses shall be part of the liabilities of the domestic insurer up to a total amount of at least two percent (2%) of its catastrophic risk for hurricanes. This situation was corrected by the Company.

During the years 2007, 2008 and 2009, the Company complied with the reserve to policyholder ratio.

### **SUBSEQUENT EVENTS**

The operational plan aims to establish a Legal Division within the Company by 2011.

For the year 2011, the Company will implement an IT project to establish new techniques and stay current in its reporting system.

### **FINANCIAL SITUATION**

Below are the following financial statements of the Company:

1. Comparative Balance Sheets as of December 31, 2009 and 2008, as was presented in the Annual Statement.
2. Comparative Statements of Revenues and Expenses for the years ended December 31, 2009 and 2008, as was presented in the Annual Statement.
3. Statements of Cash Flows as of December 31, 2009 and 2008.
4. Conciliation of Unassigned Surplus as of December 31, 2009.

The financial statements are presented in accordance with statutory accounting principles.

Real Legacy Assurance Company, Inc.  
**COMPARATIVE BALANCE SHEET**  
As of December 31 2009 and 2008

	Years	
	2009	2008
<b>ASSETS</b>		
Bonds	\$119,006,572	\$113,069,376
Cash	13,973,558	16,571,839
Investment Income Due and Accrued	861,382	1,076,105
Premium Receivable	15,209,329	18,441,504
Reinsurance Recoverable	4,086,362	3,599,821
Electronic Data Processing	226,822	140,182
Receivables from Affiliates	120,585	-0-
Aggregate write-ins for invested assets	273,325	300,658
Total Assets	<u>\$153,757,935</u>	<u>300,65885</u>
<b>LIABILITIES</b>		
Losses	\$28,021,388	\$25,377,723
Loss adjustment Expenses	5,904,293	5,601,789
Commissions Payable, Contingent	167,445	100,000
Other expenses	3,526,266	2,246,735
Taxes, Licenses and Fees	98,860	99,009
Current Federal and Foreign	39,321	690,664
Net Deferred Tax Liability	286,694	-0-
Unearned Premiums	42,148,125	47,662,415
Advance Premium	240,850	239,635
Ceded Reinsurance Premiums	(982,465)	2,368,930
Amounts Withheld	550,410	843,522
Provision for Reinsurance	178,200	178,200
Payable to Affilates	-0-	38,660
Payable for Securities	9,270,406	5,015,000
Aggregate write-ins for liabilities	5,068,644	3,411,582
Total Liabilities	<u>\$94,518,437</u>	<u>\$93,873,864</u>
<b>CAPITAL</b>		
Common Capital Stocks	\$3,000,000	\$3,000,000
Catastrophe Reserve	34,037,132	34,134,875
Unassigned Funds	22,202,366	22,190,746
Total Capital and Surplus	<u>\$59,239,498</u>	<u>\$59,325,621</u>
Total Liabilities, Capital and Surplus	<u>\$153,757,935</u>	<u>\$153,199,485</u>

Real Legacy Assurance Company, Inc.  
**COMPARATIVE STATEMENTS OF REVENUES AND EXPENSES**  
As of December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Premiums Earned	\$38,812,138	\$43,555,332
Losses Incurred	15,262,754	13,362,904
Loss Adjustment Expenses Incurred	5,586,230	5,553,523
Other Underwriting Expenses Incurred	20,524,715	21,764,233
Total Underwriting Deductions	<u>\$41,373,699</u>	<u>\$40,680,660</u>
Net Underwriting Gain (Loss)	\$(2,561,561)	\$2,874,672
Net Investment Income Earned	\$4,564,650	\$4,638,256
Net Realized Capital Gains (Losses)	37,740	33,355
Net Investments Gain (Loss)	<u>\$4,602,390</u>	<u>\$4,671,611</u>
Net Income before Dividends to Policyholders	2,040,829	7,546,283
Net Income, after Dividends to Policyholders	<u>2,040,829</u>	<u>7,546,283</u>
Federal and Foreign Income Taxes Incurred	571,343	(712,638)
Net Income	<u><u>\$2,612,172</u></u>	<u><u>\$6,833,645</u></u>

Real Legacy Assurance Company, Inc.  
**STATEMENTS OF CASH FLOWS**  
As of December 31, 2009 and 2008

	2009	2008
<b>CASH FROM OPERATIONS</b>		
Premiums Collected Net of Reinsurance	\$34,100,788	\$43,212,427
Net Investment Income	4,759,999	4,332,956
Total	<u>\$38,860,787</u>	<u>\$47,545,383</u>
Benefit and Loss Related Payments	\$13,105,630	\$15,633,447
Commissions, Expenses Paid	26,347,803	26,411,778
Federal and Foreign Income Taxes Paid	79,994	128,725
Total	<u>\$39,533,427</u>	<u>\$42,173,950</u>
Net Cash from Operations	(672,640)	5,371,433
<b>CASH FROM INVESTMENTS</b>		
Proceeds from Investment:		
Bonds	\$73,685,000	\$77,554,800
Miscellaneous	4,255,406	5,015,000
Total Investments Proceeds	<u>\$77,940,406</u>	<u>\$82,569,800</u>
Cost of Investments Acquired		
Bonds	<u>79,565,083</u>	<u>87,680,281</u>
Total Investments Acquired	79,565,083	87,680,281
Net Cash from Investment	\$(1,624,677)	(5,110,481)
<b>CASH FROM FINANCING</b>		
Capital and Paid in Surplus	97,743	-0-
Other Cash Provided (Applied)	(398,707)	513,543
Net Cash from Financing	<u>\$(300,964)</u>	<u>\$513,543</u>
<b>RECONCILIATION OF CASH</b>		
Net Change in Cash	<u>(2,598,281)</u>	<u>774,495</u>
Beginning of Period	16,571,839	15,797,344
End of Year	<u>\$13,973,558</u>	<u>\$16,571,839</u>

Real Legacy Assurance Company, Inc.  
**CONCILIATION OF THE UNASSIGNED SURPLUS**  
 As of December 31, 2009

	<b>EXAMINATION ADJUSTMENT</b>		<b>BALANCE</b>
	<b>Increase</b>	<b>Decrease</b>	
Unassigned Surplus as Annual Statement			\$22,202,366
<b>ASSETS</b>			
Electronic Data Processing		<u>\$13,634</u>	
Unassigned Surplus as Examination			<u><u>22,188,732</u></u>

**COMMENTS ON NON COMPLIANCE ITEM AND SIGNIFICANT CHANGES IN  
THE FINANCIAL STATEMENTS**

**Reinsurance**

- The Company ceded reinsurance to not licensed to do business in Puerto Rico, contrary to the provisions of Article 4.120 (a) and (b) of the Puerto Rico Insurance Code, as amended.

**Electronic Data Processing**

- As of December 31, 2009, the balance shown in the Annual Statement for the Electronic Data Processing account was \$226,822. The SSAP 16 indicates that the equipment and software must be depreciated over a period not exceeding (3) three years, using the method chosen by the Company. We adjusted the depreciation in the amount of \$13,634, decreasing the balance of Electronic Data Processing to \$213,188.

**Material Changes**

	December 2009	December 2008	Variation
Net Premiums Written	33,297,847	38,817,227	(14%)
Net Income	2,612,172	6,833,645	(62%)
Net Losses Paid	12,619,091	14,409,826	(12%)

**CONCLUSION**

The Company financial position as of December 31, 2009, after adjusting for consideration is:

<b>Assets</b>	<u>\$153,744,301</u>
Liabilities*	128,555,569
Capital	3,000,000
Unassigned Surplus	<u>22,188,732</u>
<b>Total Liabilities, Capital y Surplus</b>	<u>\$153,744,301</u>

\*Includes Catastrophic Reserve

The Unassigned Surplus was reduced by the amount of \$22,188,732 as a result of adjustments made in the review.

Respectfully,



Vanessa Pellot Tirado  
Examiner in Charge