

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

AS OF

DECEMBER 31, 2010

NAIC CODE 36749

**BY THE
OFFICE OF THE COMMISSIONER OF INSURANCE**

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GOVERNMENT OF PUERTO RICO
OFFICE OF THE INSURANCE COMMISSIONER

February 3, 2012

Mr. Ramón L. Cruz Colón, CPCU, ARe, AU
Commissioner of Insurance
Office of the Commissioner of Insurance of Puerto Rico
B5 Tabonuco Street - Suite 216
PMB 356
Guaynabo, PR 00968-3029

Dear Commissioner:

In compliance with your instructions and pursuant to the Order Number EX-2011-09 dated September 2, 2011, and the Puerto Rico Insurance Laws and Regulations, a comprehensive risk focused examination and financial affairs examination was made of the books, records, and financial condition of

Real Legacy Assurance Company, Inc.
Metro Office Park
Lot 4, Street 1
Guaynabo, Puerto Rico 00936-8567

hereinafter referred to as RLA or the Company.

Scope of Examination

The current examination was conducted at the home office of the Company located at Metro Office Park, Lot 4, Street 1, Guaynabo, Puerto Rico. This examination covers the period of January 1, 2010 through December 31, 2010, including any material relevant transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

We conducted our examination in accordance with the *National Association of Insurance Commissioners Financial Condition Examiners Handbook* (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, 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, management's compliance with Statutory Accounting Principles and Annual Statement instructions, as applicable to the Puerto Rico Insurance Laws and Regulations.

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

Summary of Significant Findings

Current Examination Findings

The following is a summary of the adverse findings and significant non-compliance findings noted during the examination.

Intercompany Agreements

The Company is party to cost allocation arrangements with an affiliate, Overseas Insurance Agency. These arrangements are not in the form of written agreements as required by SSAP No. 96.

Negative Equity Reporting

The Company reported a negative equity position of \$4.36 million on the liability line "Other Expenses" on page 3 of the 2010 Annual Statement. This amount should have been reported as a negative Common Stock asset on page 2 in compliance with SSAP No. 97, paragraphs 7 and 13.

Unauthorized Reinsurers

Section 4.120 of the Insurance Code of Puerto Rico and Ruling Letter N-AF-4-63-2005 require that domestic insurers may only reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico (OCI).

The Company ceded business to five reinsurers which were not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Insurance of Puerto Rico.

Compliance with Prior Examination Findings

The prior examination report covered the period of January 1, 2005 through December 31, 2009, and was sent to the Company on June 29, 2011. Based upon testing performed during the current examination period, the Company was in compliance with prior examination findings. The prior examination report was issued and OCI is currently evaluating their objections to the findings.

History

Real Legacy Assurance Company, Inc. (RLA or Company) was incorporated in 1974 under the name Royal Insurance Company of Puerto Rico, Inc. and began operating on January 1, 1978. It was originally a subsidiary of Royal & SunAlliance Group, PLC which began operations in 1710. In 1998, the Company changed its name to Royal & SunAlliance Insurance (Puerto Rico) Inc., and on October 8, 2003, the Company was acquired by Cooperativa de Seguros Múltiples de Puerto Rico (CSM) at a cost of \$66.4 million. On August 2, 2004, the Company adopted its new corporate name, Real Legacy Assurance Company, Inc. RLA is also the parent company of Overseas Insurance Agency, Inc.

RLA is subject to the regulation of the Commissioner of Insurance of the Commonwealth of Puerto Rico and the applicable regulations of the Division of

Banking and Insurance of the Government of the United States and British Virgin Islands, with respect to operations in those locations.

Capital Stock

As of December 31, 2010, the Company had 500,000 common stock shares authorized, and 300,000 issued and outstanding with a par value of \$10 per share, for paid in capital of \$3,000,000. RLA is a direct subsidiary of CSM, which owns 299,995 of the 300,000 shares outstanding.

The remaining five shares were issued to the following Directors in compliance with Section 29.150(1) of the Insurance Code of Puerto Rico:

Roberto Castro Hiraldo
Edwin Quiñones Suárez
Enrique A. López Pereira
Luis A. Velázquez Vera
Víctor R. Ríos Ríos

Dividends to Stockholders

RLA did not pay any cash dividends to stockholders during 2010.

Management and Control

The bylaws state that the Board of Directors (Board) shall have five (5) members who shall be elected at the annual meeting of shareholders and serve a term of one (1) year.

Section 29.150 of the Insurance Code of Puerto Rico states that not less than a majority of directors of an insurer shall be residents of, and actually reside in Puerto Rico. The Company was in compliance with Section 29.150 of the Insurance Code of Puerto Rico regarding residency.

As of the examination date, the directors of the Company, who were elected at the annual meeting of stockholders on March 23, 2010, were as follows:

<u>Directors</u>	<u>Principal Occupation</u>	<u>Residence</u>
Roberto Castro Hiraldo	President, CSM	Gurabo, PR
Edwin Quiñones Suárez	Consultant	Sabana Hoyos, PR
Enrique A. López Pereira	Consultant	Guaynabo, PR
Luis A. Velázquez Vera	Professor and President, CSM Board of Directors	Quebradillas, PR
Víctor R. Ríos Ríos	President & CEO, RLA	Bayamón, PR

The officers of the Company, as appointed at the RLA Board meeting on March 23, 2010, were the following:

Víctor R. Ríos Ríos	President
Héctor L. Rivera Díaz	Secretary and Treasurer
Dennis Hanftwurz	Vice President, Underwriting/Marketing
Ramón L. Rodríguez Ortiz	Vice President, Finance
Víctor Gómez	Vice President, Claims

Subsequent to the exam period the President and Director Víctor R. Ríos Ríos was replaced in both positions by Gidel H. Méndez Martínez.

Investment Plan

Section 6.040 of the Insurance Code of Puerto Rico provides that the Board of Directors the Insurer shall adopt a written plan to acquire and maintain investments, and to outline the investment practices. The Company adopted a plan of investment, which was approved by the Board of Directors on October 1, 2008.

The Company's investment plan established the professional qualifications of the persons who will make routine decisions to ensure their investment competence and ethical conduct in compliance with the provisions of Section 6.040 of the Insurance Code of Puerto Rico.

Corporate Governance

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

Conflict of Interest

The Company requires its directors, officers, and key employees to sign the conflict of interest questionnaires concerning items that could have an impact on the way they conduct the Company's business in accordance with Section 29.230 of the Insurance Code of Puerto Rico. The review of the conflict of interest questionnaires revealed that the Company is in compliance.

Corporate Records

The Articles of Incorporation, bylaws and all amendments thereto, and the minutes of the meetings of the Board of Directors, Board committees, and shareholders were reviewed for the period under examination. No amendments to the Articles of Incorporation and bylaws were noted during the examination period.

Board of Directors and Committee Minutes

The recorded minutes of the meetings of the Board of Directors were reviewed for the period under examination. The recorded minutes of the Board of Directors adequately documented its meetings and approval of Company transactions and events in accordance with Chapter 29 of the Insurance Code of Puerto Rico.

The Board of Directors has the authority to direct investment activities. The Board of Directors regularly approved the purchases of securities. The purchases of the securities were acquired in compliance with the provisions of the Sections 6.080 and 6.090 of the Insurance Code of Puerto Rico.

The Company's overall investment procedures were in compliance with Section 6.040(2) of the Insurance Code of Puerto Rico because the Board of Directors

ratified the investment transactions, which were approved by the Investment Committee.

Fidelity Bonds and Other Insurance

The Company, through a self-managed corporate insurance program, maintained fidelity bond coverage with a single loss limit of \$1 million and an aggregate loss limit of \$2 million. These amounts are in excess of the suggested minimum amount as recommended by the NAIC of \$800,000. The Company is also a named insured on various other policies providing Inland Marine, Business Auto, Garage, Truckers, Commercial Property, General Liability, Employment Practices Liability and Commercial Umbrella coverage.

Pension and Insurance Plans

Employees' Retirement Plan

The Company has a pension plan that covers 152 employees, and has an annual salary cost of \$8.3 million with plan assets of \$13.3 million as of January 1, 2011. According to the report issued by an independent consulting group, RLA's plan is properly valued and funded as of December 31, 2010.

Intercompany Agreements

The Company has several agreements in place with their subsidiary, Overseas Insurance Agency, Inc., (OIA), including a general agency agreement and allocations to and from OIA for rental of office space, use of certain fixed assets

and general business expenses. The general agency agreement is written; however, the other agreements between RLA and OIA are not as required by SSAP No. 96.

Growth of the Company

The following data was obtained from the Annual Statements filed with the Office of the Commissioner of Insurance (OCI):

Year	Admitted Assets	Liabilities	Company Capital Stock	Unassigned Surplus
2010	\$ 152,646,853	\$ 85,612,624	\$ 3,000,000	\$ 25,220,719
2009	153,757,935	94,518,437	3,000,000	22,202,366
2008	153,199,485	93,698,837	3,000,000	22,190,746

Insurance Products and Related Practices

The Company is authorized to write all kinds of property and casualty insurance in conformity with the Chapter 4 of the Insurance Code of Puerto Rico. For the period covered by this examination, the major kinds of insurance and gross premiums written were as follows:

	2008	2009	2010
Liability Lines	\$ 11,370,045	\$ 10,812,085	\$ 10,972,409
Property Lines	51,930,079	61,240,201	62,059,459
Property and Liability Combined Lines	56,407,239	49,313,472	46,061,532
All other Lines	267,866	347,909	184,061
TOTAL	\$119,975,229	\$121,713,667	\$ 119,277,461

Territory and Plan of Operations

For the period covered under this examination, the Company was licensed to transact insurance business in the following territories with the corresponding written gross premiums:

	2008	2009	2010
Puerto Rico	\$ 105,359,295	\$ 106,750,629	\$ 102,727,336
US Virgin Islands	14,615,934	14,963,038	15,164,801
British Virgin Islands	0	0	1,385,324
TOTAL	\$ 119,975,229	\$ 121,713,667	\$ 119,277,461

Statutory Deposits

As of December 31, 2010, the Company maintained the following statutory deposits with the OCI in compliance with Section 3.151 of the Insurance Code of Puerto Rico:

Description	Maturity Date	Par Value	Book/ Adjusted Carrying Value
Federal Home Loan Bank	2/11/15	\$1,500,000	\$ 1,500,000
TOTAL		\$1,500,000	\$1,500,000

Section 3.151 of the Insurance Code of Puerto Rico requires that a domestic insurer shall not be authorized to transact insurance in Puerto Rico, unless it deposits and maintains on deposit assets with a value not less than fifty percent (50%) of the amount of the paid-in capital. The deposit is held to protect the Puerto Rico insurance policyholders and creditors. The Company was in compliance with Section 3.151 of the Insurance Code of Puerto Rico.

Section 3.090 of the Insurance Code of Puerto Rico requires the Company to maintain minimum paid-in capital of \$3,000,000 and a statutory deposit of not less than \$1,500,000 of amortized value. The Company was in compliance with Section 3.090 of the Insurance Code of Puerto Rico as of December 31, 2010.

Section 3.160 of the Insurance Code of Puerto Rico requires that fifty percent (50%) of the minimum paid in capital be in Puerto Rico securities. The Company maintained investments in Puerto Rico securities by the amount of \$1,500,000 at amortized cost. The Company was in compliance with Section 3.160 of the Insurance Code of Puerto Rico as of December 31, 2010.

Unclaimed Funds

The Company complied with Section 26.040 of the Insurance Code of Puerto Rico by reporting unclaimed funds to the OCI on or before May 1 for the years under examination.

The Company submitted to the OCI the notice of unclaimed funds owed and made payment for the unclaimed funds. The Company was in compliance with Sections 26.050 and 26.060 of the Insurance Code of Puerto Rico.

Reinsurance

Reinsurance Assumed

The Company did not assume any risks during the examination period.

Reinsurance Ceded

During 2010, RLA ceded \$85,004,835 in premium to various reinsurers. As of December 31, 2010, amounts recoverable from reinsurers amounted to \$4,077,610 and ceded reinsurance premiums payable were \$512,960.

RLA cedes premiums under quota share, excess of loss and facultative treaty agreements. The quota share agreements provide reinsurance on commercial, personal, and motor business. The reinsured share ranges from 15% to 40% based on the individual policy coverage written. The excess of property agreements are placed on a property per risk basis. The coverage provides reinsurance of \$1 million on each policy up to a maximum of \$50 million. The motor liability agreements are written on an excess of loss basis with coverage of \$20 million subject to retention of \$250,000 by RLA.

RLA also maintains catastrophe reinsurance agreements that provide coverage for losses in excess of \$5 million per catastrophe, subject to a maximum coverage of \$500 million.

The Company ceded business to five reinsurers which were not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Puerto Rico. Section 4.120 of the Insurance Code of Puerto Rico and Ruling Letter N-AF-4-63-2005 require that domestic insurers may only

reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico.

The reinsurance contracts reviewed complied with NAIC guidelines with respect to the insolvency clause, arbitration clause, transfer of risk, reporting, and settlement information deadlines as stated in SSAP No. 62 of the *NAIC Accounting Practices and Procedures Manual*.

Accounts and Records

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

An independent CPA audited the Company's statutory basis financial statements for the year 2010 in compliance with Rule XIVa of the Regulations of the Insurance Code of Puerto Rico. Supporting work papers were prepared by the CPA as required by Rule XIVa of the Regulations of the Insurance Code of Puerto Rico.

The Company's actuarial study and opinion for the period under examination was prepared by Martha A. Winslow, FCAS, MAAA, of Towers Watson, Minneapolis, Minnesota.

Financial Statements

Below are the financial statements of the Company:

- Assets
- Liabilities, Surplus, and Other Funds
- Summary of Operations
- Capital and Surplus Account

Real Legacy Assurance Company, Inc.
Assets

As of December 31, 2010

	Annual Statement	Examination Adjustments	Examination Balance
Bonds	\$ 119,240,374		\$ 119,240,374
Common Stock (Note 2)		\$ (4,366,524)	(4,366,524)
Cash and short-term investments	12,406,965		12,406,965
Investment income due and accrued	750,979		750,979
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	15,535,541		15,535,541
Amounts recoverable from reinsurers	4,077,610		4,077,610
Electronic data processing equipment and software	324,379		324,379
Receivables from parents, subsidiaries and affiliates	65,012		65,012
Aggregate write-ins for other than invested assets	245,993		245,993
Total Assets	\$ 152,646,853	(\$4,366,524)	\$ 148,280,329

Real Legacy Assurance Company, Inc.
Liabilities, Surplus and Other Funds

As of December 31, 2010

	Annual Statement	Examination Adjustments	Examination Balance
Losses (Note 1)	\$ 21,697,912		\$ 21,697,912
Loss adjustment expenses (Note 1)	4,891,835		4,891,835
Commissions payable	209,645		209,645
Other expenses (Note 2)	4,443,752	(\$ 4,366,524)	77,228
Taxes, licenses and fees	112,744		112,744
Current federal & foreign income taxes	39,321		39,321
Net deferred tax liability	207,884		207,884
Unearned premiums	41,997,751		41,997,751
Advance premium	220,389		220,389
Ceded reinsurance premiums payable	512,960		512,960
Amounts withheld or retained by company	588,955		588,955
Provision for reinsurance	212,200		212,200
Payable for securities	8,120,000		8,120,000
Aggregate write-ins for other liabilities	2,357,276		2,357,276
Total Liabilities	\$ 85,612,624	(\$4,366,524)	\$ 81,246,100
Aggregate write-ins for special surplus funds	\$ 38,813,510		\$ 38,813,510
Common capital stock	3,000,000		3,000,000
Unassigned funds (surplus)	25,220,719		25,220,719
Total Surplus	\$ 67,034,229		\$ 67,034,229
Total Liabilities and Surplus	\$ 152,646,853	(\$4,366,524)	\$ 148,280,329

Real Legacy Assurance Company, Inc.
Summary of Operations

As of December 31, 2010

Premiums earned	\$ 34,422,996
Total revenues	<u>\$ 34,422,996</u>
Losses	\$ 8,326,171
Loss adjustment expenses	4,702,253
Other underwriting expenses	19,823,925
Total underwriting deductions	<u>\$ 32,852,349</u>
Net underwriting gain	1,570,647
Net investment income earned	3,914,279
Net realized capital gains	40,442
Net income after capital gains tax and before all other federal income taxes	<u>\$ 5,525,368</u>
Federal and foreign income taxes incurred	0
Net (Loss)/Income	<u><u>\$ 5,525,368</u></u>

Real Legacy Assurance Company, Inc.
Capital and Surplus Account

As of December 31, 2010

Surplus as regards to policyholders, December 31, prior year	<u>\$ 59,239,498</u>
Net income (loss)	\$ 5,525,368
Change in net deferred income tax	893,531
Change in non-admitted assets	(752,248)
Change in provision for reinsurance	(34,000)
Aggregate write-ins for gains and losses in surplus	2,162,080
Change in surplus as regards to policyholders for the year	<u>\$ 7,794,731</u>
Surplus as regards to policyholders, December 31, current year	<u>\$ 67,034,229</u>

**Real Legacy Assurance Company, Inc.
Reconciliation of Capital and Surplus Account**

As of December 31, 2010

The following is a reconciliation of the Surplus reported by the Company and as determined by the examination.

Capital and Surplus Account			
December 31, 2010, per Annual Statement			\$ 67,034,229
	<u>Per</u>	<u>Per</u>	<u>Increase</u>
	<u>Company</u>	<u>Examination</u>	<u>(Decrease)</u>
			<u>in surplus</u>
Assets:			
Common Stock	\$ 152,646,853	\$ 148,280,329	(\$4,366,524)
Liabilities:			
Other Expenses	\$ 85,612,624	\$ 81,246,100	\$4,366,524
Surplus per examination			<u>\$ 67,034,229</u>

Comments on the Financial Statements

(Note 1)

Loss reserves	\$ 21,697,912
Loss adjustment expense reserves	4,891,835

An independent review of aggregate reserves was performed by INS Consultants, Inc. (INS), Philadelphia, Pennsylvania.

Reserves were reviewed by INS for compliance with standard valuation laws, applicable National Association of Insurance Commissioners Actuarial Guidelines, and Model Regulations. The balance sheet items enumerated above appear to be calculated using valuation parameters, which appear to be free of any material error and valuation files that appear to be complete. Based on the above discussion and analysis, INS concluded that the December 31, 2010, balance sheet items covered in the examination scope appear fairly stated subject to the previously mentioned recommendations. They have been accepted for the purpose of this report.

Note 2

Common Stock	(\$ 4,366,524)
Other Expenses	4,366,524

The Company reported a negative equity position of \$4,366,524 on the liability line "Other Expenses" on page 3 of the 2010 Annual Statement. This amount should have been reported as a negative invested asset on page 2 in compliance with SSAP No. 97, paragraphs 7 and 13. The reclassification of this amount did not result in a surplus adjustment

Subsequent Events

On May, 17 2011 the President and Director Víctor R. Ríos Ríos was replaced in both positions by Gidel H. Méndez Martínez in a extraordinary meeting of the Board of Directors.

Summary of Examination Recommendations

Intercompany Agreements

The Company is party to cost allocation arrangements with affiliate, Overseas Insurance Agency, Inc. These arrangements are not in the form of written agreements as required by SSAP No. 96.

We recommend that all intercompany transactions be in the form of a written agreement as required by SSAP No. 96.

Negative Equity Reporting

The Company reported a negative equity position of \$4.36 million on the liability line "Other Expenses" on page 3 of the 2010 Annual Statement. This amount

should have been reported as a negative invested asset on page 2 in compliance with SSAP No. 97, paragraphs 7 and 13.

We recommend that the Company report any negative equity position in an invested asset in compliance with SSAP 97, paragraphs 7 and 13.

Unauthorized Reinsurers

Section 4.120 of the Insurance Code of Puerto Rico and Ruling Letter N-AF-463-2005 require that domestic insurers may only reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico.

The Company ceded business to five reinsurers which were not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Puerto Rico.

We recommend the Company obtain permission from the OCI before placing reinsurance with an unauthorized reinsurer in accordance with Section 4.120 of the Insurance Code of Puerto Rico and Ruling Letter N-AF-4-63-2005.

Conclusion

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Real Legacy Assurance Company, Inc.** as of December 31, 2010, consistent with the insurance laws of Puerto Rico.

In addition to the undersigned, Peter Bliss, CFE, Examiner-in-Charge; Kelly Willison, CFE, Staff Examiner; Kristina Sampson, CPA, Staff Examiner; John Normile, CFE, Staff Examiner, and Patricia Casey Davis, CPA, CFE, Manager, all of INSRIS-PR, LLC; Robert Ficken, CPA, CISA, CFE, AES, IT Specialist, INS Services, Inc.; and Michael Morro, ACAS, MAAA, Actuary, INS Consultants, Inc. participated in the examination.



Peter Bliss, CFE
Examiner-in-Charge