

Statutory Financial Examination of  
**SUNDERLAND MARINE MUTUAL INSURANCE COMPANY LIMITED**  
**(U.S. BRANCH)**

FE 10-01

as of December 31, 2009

Issued by  
**STATE OF ALASKA**  
**DEPARTMENT OF COMMERCE, COMMUNITY, AND**  
**ECONOMIC DEVELOPMENT**  
**DIVISION OF INSURANCE**

NAIC Company Code: 10838  
NAIC Group Code: 00000

**FINAL REPORT:**  
**June 30, 2011**

1 CERTIFIED MAIL  
2 RETURN RECEIPT REQUESTED

3 STATE OF ALASKA  
4 DEPARTMENT OF COMMERCE, COMMUNITY AND  
5 ECONOMIC DEVELOPMENT  
6 DIVISION OF INSURANCE  
7 550 WEST 7TH AVENUE, SUITE 1560  
8 ANCHORAGE, AK 99501-3567

9 Order FE 10-01 )  
10 In the Matter of Examination of )  
11 Sunderland Marine Mutual Insurance )  
12 Company Limited (U.S. Branch) )

13 FINDINGS OF FACT

14 1. A report of examination of Sunderland Marine Mutual Insurance Company Limited  
15 (U.S. Branch), domiciled in the State of Alaska, has been issued by the State of Alaska,  
16 Division of Insurance, to Sunderland Marine Mutual Insurance Company Limited (U.S.  
17 Branch).

18 2. The Report of Examination of Sunderland Marine Mutual Insurance Company  
19 Limited (U.S. Branch) (FE 10-01) has been transmitted to Sunderland Marine Mutual  
20 Insurance Company Limited (U.S. Branch) (Examinee), and Examinee has been accorded  
21 at least 30 days opportunity to review and comment on this Report of Examination. A  
22 response from the examinee was received on December 15, 2011.

23 3. The Director of the Division of Insurance has fully considered and reviewed the  
24 report, the examinee response and any relevant portions of the examiner's work papers to  
25 the extent she considered necessary.

26 CONCLUSIONS OF LAW

1. The written Report of Examination referred to in Finding of Fact No. 1 was issued in  
accordance with Alaska Statute (AS) 21.06.150(b).

2. The actions set forth in finding of Fact No. 2 were conducted in accordance with  
AS 21.06.150(b).

3. The Director of the Division of Insurance has reviewed the Report of Examination,  
the examinee response and any other relevant work papers as set forth in Finding of Fact  
No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

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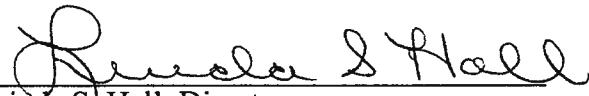
ORDER

IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the Report of Examination of Sunderland Marine Mutual Insurance Company Limited (U.S. Branch) (FE 10-01) is approved as filed.
2. Pursuant to AS 21.06.060, the Report of Examination shall be kept in the Office of the Director of the Division of Insurance and be open to public inspection.
3. The Examinee will implement all recommendations within a reasonable amount of time but no later than June 30, 2012, unless otherwise recommended in the Report of Examination. Failure to implement compliance recommendations may result in action against the Examinee for violation of this order.

This order is effective December 20, 2011.

Dated this 20<sup>th</sup> day of December 2011 at Anchorage, Alaska.

  
Linda S. Hall, Director  
State of Alaska  
Division of Insurance

STATE OF ALASKA  
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT  
DIVISION OF INSURANCE  
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STATE OF ALASKA  
DEPARTMENT OF  
**COMMERCE**  
COMMUNITY AND  
ECONOMIC DEVELOPMENT  
Alaska Division of Insurance

*Sean Parnell, Governor*  
*Susan K. Bell, Commissioner*  
*Linda S. Hall, Director*

June 30, 2011

Ms. Linda S. Hall, Director  
Division of Insurance  
Department of Commerce, Community  
and Economic Development  
State of Alaska  
550 West 7<sup>th</sup> Avenue, Suite 1560  
Anchorage, AK 99501-3567

Dear Director Hall:

In accordance with your instructions and authorizations, and in accordance with statutory requirements, an examination has been made of the financial condition and business affairs of:

Sunderland Marine Mutual Insurance Company Limited (U.S. Branch)  
Salvus House  
Ackley Heads, Durham U.K. DH1 5TS

(NAIC CoCode 10838; Group Code 0000)

**SCOPE OF EXAMINATION**

This examination covers the period of January 1, 2007 through December 31, 2009. Transactions subsequent to this period were reviewed where deemed appropriate. The most recent prior examination of the Branch covered the period from January 1, 2004 through December 31, 2006.

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 Branch including corporate governance, identifying and assessing inherent risks within the Branch 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 when applicable to domestic state regulations. All accounts and activities of the Branch were considered in accordance with the risk-focused examination process.

The examination was conducted in accordance with the guidelines and procedures recommended by the Financial Condition (E) Committee of the NAIC and the rules, regulations, and directives of the Division of Insurance, State of Alaska. The work papers of the independent certified public accountants, KPMG, LLP, were reviewed and used where it was determined to be appropriate. The appropriate KPMG, LLP work papers have been incorporated into the exam work paper file.

The Branch assets were evaluated and verified, and liabilities were analyzed to determine its financial condition as of December 31, 2009. Also, an actuarial evaluation of the reserves as of December 31, 2009, was performed by Sarah K. McNair-Grove, FCAS, MAAA, Actuary for the Division of Insurance, State of Alaska, as a part of this examination.

### **SUMMARY OF EXAMINATION FINDINGS**

The Branch was found to be out of compliance with the following items:

- The Branch is not consistent with methods used to allocate business between offices. Neither method used conforms to the method that was mutually agreed to between the division and Sunderland Marine Mutual Insurance Company Limited, the Parent Company. (Finding 1)
- The Branch reports and maintains in writing a net amount insured on any one risk that exceeds the statutory threshold of 10% of policyholder surplus. (Finding 5)
- Internal accounting of agents' balances and premium installments is combined for all states in the U.S. Segregated information applicable to the Branch only was not available. (Finding 2)
- Policies do not contain the Mutual Policyholder Rights of Membership language as required by Alaska statute. (Finding 3)
- The Parent Company manages investments for the SMMI group. It has not adopted a written investment plan as required by Alaska regulations which would cover the Alaska Branch. (Finding 9)
- The Branch does not comply with Alaska regulations that require the Board of Directors to approve a formal resolution at least annually stating that investments have been made in accordance with the investment objectives prescribed by the Board of Directors. (Finding 8)
- Branch underwriting procedures for determining if policies will be renewed are not performed early enough to allow compliance with Alaska statutes regarding advance notice of nonrenewal or of material alterations of policies. (Finding 4)
- Some reinsurance contracts do not contain provisions required by Alaska statute and regulations. Absence of these provisions prevent the Branch from taking credit for reinsurance. An adjustment to the financial statements was made increasing the Provision for Reinsurance and reducing Surplus by \$133,000. (Finding 6)
- There is no written agreement between the Branch and its Parent for management and allocation of expenses between the subsidiaries of the SMMI group and no tax allocation agreement as required by Alaska statute for affiliate agreements. (Finding 7)
- The Branch does not have written and signed commission agreements with all of its brokers. (Finding 8)

- The statutory deposit trust agreement is out of date and out of compliance with Alaska Statute and regulations. Deficiencies of the trust agreement include that: the named trustee was purchased by the current trustee more than 10 years ago, the U. S. Branch is not identified as required, and it does not include all required provisions for indemnification. (Finding 10)

## **DESCRIPTION OF BRANCH**

### **Branch History**

Sunderland Marine Mutual Insurance Company Limited, U.S. Branch is a branch of an alien insurer using Alaska as a state of entry to transact the business of insurance in the United States. Sunderland Marine Mutual Insurance Company, Ltd. (“Parent Company” or “SMMI”) is an alien insurer domiciled in the United Kingdom. It is a mutual company limited by guarantee without capital stock. The Parent Company was founded in Sunderland, England in 1882, as a marine mutual hull club. It currently operates in the United Kingdom and locations around the world, including Canada, South Africa, Australia, Europe, South America, New Zealand and the United States.

The U.S. Branch (the “Branch”) was admitted in Alaska on February 23, 1996 and authorized to write marine, wet marine, transportation and risks incidental to marine insurance including protection and indemnity. The Parent Company met the requirements of the NAIC International Insurance Department to operate in the United States on a surplus lines basis. It is currently listed in the NAIC Quarterly List of Alien Insurers and continues to meet the requirements of the NAIC.

### **Corporate Records**

The records of the Branch are maintained at the offices of the Parent Company located at Salvus House, Aykley Heads, Durham, UK DH1 1ST. Alaska Statute 21.69.390 requires that specific records be maintained within the State of Alaska. The location for these records is the office of the Branch attorneys, Farley & Graves, 807 G Street, Suite 250, Anchorage, Alaska, 99501.

### **Management and Control**

SMMI is a mutually held organization domiciled in the UK, owned by its policyholders and run for their benefit. The insurance business is written either by SMMI in the UK or by its branches in the U.S., Australia, New Zealand and Canada. SMMI also accepts risks through Sunderland Marine (Africa) in South Africa.

Until June 30, 2009, the day-to-day administration of the business, including business handled in the U.S. Branch’s Seattle office, was performed by Salvus Bain Management Ltd. (“Salvus Bain”), a wholly owned subsidiary of SMMI. On July 1, 2009, Salvus Bain was merged with SMMI with no resulting changes to personnel or day-to-day operations.

Sunderland Marine Mutual Insurance  
 Company Limited (U.S. Branch)  
 As of December 31, 2009  
 FE 10-01

**Fidelity Bond and Other Insurance**

The Branch does not have employees as all of the day-to-day operations are conducted by the Parent Company. Directors and officers' liability coverage is maintained through the Parent Company. The policy limit in 2009 was 10,000,000 GBP with a 50,000 GBP retention. Employees are covered by professional indemnity insurance with a limit per occurrence of 6,500,000 GBP. The policy is maintained through Salvus Bain Management (SBM) and has a 100,000 GBP deductible.

**Employees' and Agents' Pensions, Stock Ownership, and Other Insurance**

The Branch has no employees. The parent, Sunderland Marine Mutual Insurance Co., Ltd (UK) is responsible for personnel and pension plans.

**Territory and Plan of Operation**

The Branch specializes in marine, wet marine and transportation policies. As a U.S. Branch domiciled in Alaska, the Branch exclusively writes Alaska policies.

**Growth of Branch**

Prior to January 1, 2004, the Branch financial statements included business transacted throughout the United States. Since 2004, financial statements are limited to the business of the U.S. Branch in Alaska. Declines in assets and surplus from 2006 to 2007 are attributable to the DOI approved \$4 million withdrawal from the Trust Fund. Results of the Branch operations between 2006 and 2009 were as follows:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
2006	\$11,671,356	\$3,221,620	\$8,449,736
2007	\$7,816,038	\$4,471,712	\$3,344,326
2008	\$8,023,943	\$3,241,079	\$4,782,865
2009	\$8,362,003	\$3,679,490	\$4,683,670

**Loss Experience**

The loss experience of the Branch during the years covered by this examination follows:

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses Incurred</u>	<u>Percent of Premiums Earned</u>	<u>Loss Expenses Incurred</u>	<u>Percent of Premiums Earned</u>
2007	\$2,400,364	\$3,024,684	126.0	\$37,263	1.6
2008	\$2,273,199	\$1,620,342	71.3	\$24,691	1.1
2009	\$2,309,814	\$2,444,636	105.8	\$31,841	1.4



## Reinsurance

The Branch participates in the Parent Company's, SMMI, global reinsurance arrangements through reinsurance agreements written between the reinsurers and SMMI. The Parent Company cedes insurance to reinsurers in the ordinary course of business for the purpose of limiting exposure to large losses. Individual subsidiaries, including the US Branch, do not make claims directly against reinsurers. The Parent Company's practice is to reimburse subsidiaries for claims above 250,000 GBP and then submit for recovery once aggregation of claims of the group exceeds deductible of 5,000,000 GBP. Reimbursements received by the Parent from reinsurers are credited against the Parent's payments to the subsidiaries but are not allocated against payments to specific entities.

The principal reinsurance program of the Parent Company for policy year 2009 was as follows:

### Cross Class Cover

An all-risk agreement covers individual contracts excess of loss above 250,000 GBP up to 1,000,000 GBP. Recovery from the reinsurer is subject to an aggregate deductible by the SMMI group of 5,000,000 GBP. Thereafter, the whole account cover provides for recovery up to an aggregate 9,000,000 GBP worth of claims under the agreement. Subsidiaries' claims, including the Branch's, in excess of 250,000 GBP are paid by the parent, SMMI, which recovers from reinsurers above aggregate losses exceeding the 5,000,000 GBP deductible.

Pursuant to Annual Statement Instructions, the Branch correctly reports recoverables above 250,000 GBP in Schedule F.

### Hull

All risks are covered by the whole account ("cross class cover") in excess of 250,000 GBP up to 1,000,000 GBP. Thereafter, excess of loss hull cover provides recoveries of 18,900,000 excess of 1,000,000 GBP on any one occurrence or event, with no aggregate agreement limit.

### Protection and Indemnity (P&I)

Cross class agreement covers risks excess of 250,000 GBP up to 1,000,000 GBP. Thereafter, through June 30, 2008, excess of loss cover provides recoveries in excess of \$2 million up to \$100 million. Effective July 1, 2008, the limit was increased to \$500 million; however, excess-of-loss agreements for coverages between \$2 million and \$100 million for 2009 exclude "vessels domiciled in the United States of America."

To cover these excluded vessels in 2009, the Parent Company maintained endorsements on specific Excess P&I policies through Lloyd's of London syndicates providing a \$500,000 excess of \$500,000 layer of protection along with a second \$1 million excess of \$1 million layer for a total protection of \$2 million. Notwithstanding, the Branch was not covered for losses on U.S. vessels between \$2 million and \$100 million in 2009.

### Harlock Murray Underwriters ("HMU") Quota Share

The Parent Company also participates in a reinsurance pool with Sovereign General Insurance Company and Swiss Reinsurance USA Corporation. Policies written on the Parent Company's paper by HMU are reinsured under this marine quota share agreement. Under the agreement SMMI retains 40% of the business and cedes the remainder to Swiss Reinsurance USA Corporation (20%) and Sovereign General Insurance Company (40%). Maximum pool retention for hull coverage is \$1.5 million per vessel. Maximum pool retention for protection and indemnity coverage is \$500,000 per occurrence.

**Accounts and Records**

The Branch accounting procedures, practices, account records, and supporting data were reviewed and tested to the extent deemed necessary. The trial balance prepared for the year ended December 31, 2009, was verified to the annual statement and the Parent Company general ledger. The Branch accounting is maintained by the Parent which centralizes computer systems for Information Technology functions for all of its subsidiaries. Records are maintained electronically on separate office systems at the Vancouver and Seattle offices.

**Statutory Deposits and Minimum Basic Capital**

Pursuant to Alaska Statute (AS) 21.09.031(g), the Branch is required to maintain assets in a trust account in an amount not less than the total of the Branch reserves and other liabilities plus the greater of (1) the minimum basic capital and additional maintained surplus required under AS 21.09.070; or (2) the authorized control level risk based capital under AS 21.14. The minimum basic capital and additional maintained surplus required to be maintained in trust by the Branch is \$1,750,000, which exceeds the authorized control level risk based capital. A review of the trustee's statements on file with the state verified that the required minimum assets were maintained on deposit.

**SUMMARY OF ACTUARIAL REVIEW**

As of December 31, 2009, the Branch held \$2,652,628 in gross reserves and \$2,472,843 in net reserves. The division actuary reviewed the reserves using data provided by the Branch and held discussions with the insurer's staff as deemed necessary. She also reviewed the KPMG, LLP, actuarial report that supports the 2009 Actuarial Opinion and the London KPMG Audit PLC. actuarial report for the Parent Company's worldwide business. Based on this review, the division actuary determined that the overall reserve position of the Branch is within a reasonable range of acceptable reserve estimates and should be accepted as stated.

**FINANCIAL STATEMENTS**

The following pages contain statutory financial statements for the Branch as of December 31, 2009, as reported to the division and as adjusted by the examiners.

**FINANCIAL STATEMENTS**  
**STATEMENT OF ASSETS, LIABILITIES AND SURPLUS**  
As of December 31, 2009

	<u>As Reported</u>	<u>Adjustments</u>	<u>Finding No.</u>	<u>As Adjusted</u>
<u>Assets</u>				
Bonds	\$ 7,721,893			\$ 7,721,893
Cash & short term investments	393,489			393,489
Investment income due and accrued	80,691			80,691
Premiums and agents' balances in course of collection	123,133			123,133
Aggregate write-ins for other than invested assets	43,954			43,954
	<hr/>	<hr/>		<hr/>
Total Admitted Assets	<u>\$ 8,363,160</u>	<u>\$ 0</u>		<u>\$ 8,363,160</u>
<u>Liabilities, Surplus and Other Funds</u>				
<u>Liabilities</u>				
Losses	\$ 2,472,843			\$ 2,472,843
Loss adjustment expenses	31,841			31,841
Taxes, licenses and fees	7,953			7,953
Current federal and foreign income taxes	81,583			81,583
Unearned premiums	777,031			777,031
Amounts withheld or retained by Branch for account of others	6,264			6,264
Provision for reinsurance	277,000	133,000	(6)	410,000
Payable to parent, subsidiaries and affiliates	24,975			24,975
	<hr/>	<hr/>		<hr/>
Total Liabilities	<u>\$ 3,679,490</u>	<u>133,000</u>		<u>\$ 3,812,490</u>
<u>Surplus</u>				
Unassigned funds (surplus)	4,683,670	(133,000)	(6)	4,550,670
Surplus as regards policyholders	<u>\$ 4,683,670</u>	<u>(133,000)</u>		<u>\$ 4,550,670</u>
	<hr/>	<hr/>		<hr/>
Total Liabilities and Surplus	<u>\$ 8,363,160</u>	<u>\$ 0</u>		<u>\$ 8,363,160</u>

**FINANCIAL STATEMENTS**  
**STATEMENT OF UNDERWRITING AND INVESTMENTS**  
as of December 31, 2009

	As Amended	Examination Adjustments	Finding Number	As Adjusted
<u>Underwriting Income</u>				
<u>Revenue</u>				
Premiums earned	\$ 2,309,814			\$ 2,309,814
Total Revenue	\$ 2,309,814			\$ 2,309,814
<u>Deductions</u>				
Losses incurred	\$ 2,444,636			\$ 2,444,636
Loss adjustment expenses incurred	31,841			31,841
Other underwriting expenses	704,926			704,926
Aggregate write-ins for underwriting deductions	326,818			326,818
Total underwriting deductions	\$ 3,508,221			\$ 3,508,221
Net underwriting gain or loss	\$ (1,198,407)			\$ (1,198,407)
<u>Investment Income</u>				
Net investment income earned	\$ 276,467			276,467
Net realized capital gains or (losses)	(68,418)			(68,418)
Net investment gain or (loss)	\$ 208,049			\$ 208,049
Federal and foreign income taxes incurred	\$ 81,583			\$ 81,583
Net Income (Loss)	\$ (1,071,941)			\$ (1,071,941)
<u>Capital and Surplus Account</u>				
Surplus, December 31, prior year	\$ 4,782,865			\$ 4,782,865
<u>Gains and (Losses) in Surplus</u>				
Net income (loss)	\$ (1,071,941)			\$ (1,071,941)
Change in non-admitted assets	5,537			5,537
Change in provision for reinsurance	(64,000)	(133,000)	(6)	(197,000)
Net remittances from or (to) home office	1,031,209			1,031,209
Change in surplus as regards policyholders	\$ (99,195)	(133,000)		\$ (232,195)
Surplus for the period ended December 31, 2009	\$ 4,683,670	\$ (133,000)		\$ 4,550,670

**FINANCIAL STATEMENTS**  
**STATEMENT OF CAPITAL AND SURPLUS ACCOUNT**  
As of December 31, 2009 (as adjusted)

	Allocated to Policy Holders	SURPLUS		TOTAL
		Paid-In	Unassigned	
Balance at December 31, 2006	\$ 0	\$ 0	\$ 8,449,736	\$ 8,449,736
Net income – 2007			(1,220,769)	(1,220,769)
Change in nonadmitted assets			13,158	13,158
Change in provision for reinsurance			(282,000)	(282,000)
Net remittances from or (to) home office			(3,615,799)	(3,615,799)
Balance at December 31, 2007	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 3,344,326</u>	<u>\$ 3,344,326</u>
Net income – 2008			281,332	281,332
Change in nonadmitted assets			9,443	9,443
Change in provision for reinsurance			268,000	268,000
Net remittances from or (to) home office			879,764	879,764
Balance at December 31, 2008	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 4,782,865</u>	<u>\$ 4,782,865</u>
Net income – 2009			(1,071,941)	(1,071,941)
Change in nonadmitted assets			5,537	5,537
Change in provision for reinsurance			(64,000)	(64,000)
Change in provision for reinsurance (exam adjustment – Finding #6)			(133,000)	(133,000)
Net remittances from or (to) home office			1,031,209	1,031,209
Balance at December 31, 2009 (As adjusted)	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 4,550,670</u>	<u>\$ 4,550,670</u>

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS  
RESULTING FROM THE EXAMINATION**

This examination resulted in a finding that resulted in an adjustment to the financial statements filed as of December 31, 2009. The adjustment increased the Provision for Reinsurance on recoverables from reinsurers written under reinsurance contracts that do not contain statutorily-required provisions, and reduced Unassigned Surplus (Current Finding #6).

**COMPLIANCE WITH RECOMMENDATIONS IN  
PRIOR REPORT OF EXAMINATION**

During the examination the following recommendations in the prior report of examination were found to have been implemented or the issue was no longer present:

Prior Finding 1 – Intercompany Settlement of Cash Receipts and Disbursements  
Prior Finding 2 – Properly Classifying Agent’s Balances  
Prior Finding 4 – Retroactive Reinsurance  
Prior Finding 5 – Formal Managing General Agent Agreement  
Prior Finding 6 – Reporting of Unpaid Loss Adjustment Expenses

The following prior findings were found to not be resolved during the current examination:

**Prior Finding 3 – Reporting Premium Receivable on a Policy Basis**

While the Branch closely monitors its agents’ balances and premium installments, internal reporting is by account current from the agents for all states in the U.S. A policy-by-policy detail of the Branch agent’s balances and premium installments were not available. Receivables over 90 days past due were properly listed as nonadmitted.

**Prior Recommendation:** It is recommended the Branch be able to account for its agents’ balances of Alaska business on a policy-by-policy basis.

**Current Status:** The Branch does not maintain records to identify receivables on a policy-by-policy basis. See Current Finding 2.

**Prior Finding 7 – Reinsurance Contracts Missing Required Clauses**

The Parent Company’s contracts with Underwriters at Lloyd’s London and Swiss Re USA do not include clauses required by AS 21.12.020(g) and 3 AAC 21.635(a)(1) and (4). Regulations disallow credit to a domestic ceding insurer unless the reinsurance contract provides for payment by the assuming insurer on the basis of the liability of the ceding domestic insurer under the insurance contracts reinsured without diminution because of the insolvency of the ceding domestic insurer. The insolvency clause is absent from the Lloyd’s of London contracts. The Parent Company’s contracts with Swiss Re USA and Lloyd’s are also missing the “entire contract” clause. Regulation 2 AAC 21.634(a)(4) requires that a reinsurance contract state that the agreement constitutes “the entire contract between the parties with respect to the insurance being reinsured and that there are no understandings or agreements between the parties other than those expressed in these documents.”

Prior Recommendation: It is recommended that the Branch amend existing reinsurance agreements and include in future agreements language to comply with AS 21.12.020 and 3 AAC 21.635.

Current Status: The Branch has not amended its existing reinsurance agreements to comply with AS 21.12.020 and 3 AAC 21.635. See Current Finding 6.

#### Prior Finding 8 – Written Broker Agreements and Contingent Commissions

As noted in the prior examination report, the Branch does not have signed, written commission agreements with all of its brokers. Commissions are calculated based upon an agreed upon formula and both parties approve the commission prior to payment.

Prior Recommendation: It is recommended that all broker agreements and agreed upon compensation formulas be documented in a written agreement that is signed by both parties prior to any activity under those agreements. Furthermore, it is recommended that understanding and control of the commission payment process be consolidated into one area of the Branch.

Current Status: The Branch has not modified the broker agreement to include documentation that supports the commission payment process. See Current Finding 8.

#### Prior Finding 9 – Notice of Nonrenewal and Policy Premium Renewals

The Branch's underwriting procedures state a review of the claims/premium/loss ratio information is produced and assessed approximately 30 days prior to the renewal date. Upon conclusion of this assessment, the Branch determines if the policy is to be renewed and/or if alterations in the individual terms of the policy are required.

The procedure would not allow the Branch adequate time to provide notice of material alterations in the policy at least 45 days prior to the anniversary date of a commercial or business policy as required under AS 21.36.235(2).

As noted above, the Branch underwriting procedures do not allow sufficient time to review policy information and to comply with AS 21.36.240. This statute requires the Branch to provide notice of nonrenewal at least 45 days prior to the anniversary date of a commercial or business policy.

Prior Recommendation: It is recommended that the Branch amend its procedures for nonrenewal to ensure compliance with AS 21.36.240(2) and amend its procedures for policy renewal to ensure compliance with AS 21.36.235.

Current Status: The Branch has not amended its procedures for renewals. Current procedures continue to require policy assessment for material changes to a policy and renewal 30 days prior to the expiration date. See Current Finding 4.

Prior Finding 10 – Mutual Policyholder Rights of Membership

Sample policies reviewed did not state that “each policyholder of a domestic mutual insurer is a member of the insurer with all rights and obligations of the membership” as required by AS 21.69.280.

Prior Recommendation: It is recommended that policies be revised to state that each policyholder is a member of the insurer as stated in AS 21.69.280.

Current Status: The Branch has not revised the policy form to include the language as required by AS 21.69.280. See Current Finding 3.

**CURRENT EXAMINATION FINDINGS AND RECOMMENDATIONS**

Finding 1 – Allocation of business is not consistent between offices and not in accordance with a prior agreement with the Division of Insurance

The Branch pays premium taxes on all Alaska risks as required by AS 21.09.210. Following divestiture of non-Alaska risks in 2005, the division and the Branch came to an agreement that the home port of the vessel would be accepted and utilized to determine its resident risk location for reporting purposes. Following a review of policies written through its Seattle office and Harlock-Murray Underwriters (HMU), the Branch’s MGA located in Vancouver, BC, Canada, examiners determined that the risk location was not being consistently applied as the standard of allocation of premiums between the two offices; and, that neither one utilized the home port of the vessel as its resident location of risk. The review noted the Seattle office used the home address of the vessel’s owner as the resident risk location while the Branch’s MGA, HMU, used the location of greatest risk fished by the vessel as its risk location. It was also noted that the confusion with the appropriate allocation of premium caused the Branch to amend its audited financial statements at least once during the period under review.

Recommendation: It is recommended that the Branch complies with the method for allocating premiums that was mutually agreed to between the Division of Insurance and SMMI, and that the home port of vessel as the resident risk location be consistently applied across all of its offices for use in determining covered policies by the U.S. Branch.

Finding 2 – Reporting premium receivable on a policy basis

As noted in Prior Finding 3, while the Branch closely monitors its agents’ balances and premium installments, internal reporting is by account current from the agents for all states in the U.S. A policy-by-policy detail of the Branch agent’s balances and premium installments was not available. Receivables over 90 days past due were properly listed as nonadmitted.

Recommendation: It is recommended that the Branch be able to account for its agents’ balances of Alaska business on a policy-by-policy basis.



Finding 3 – Policies do not contain mutual policyholder rights of membership language as required by AS 21.69.280 (Membership in mutuals)

As noted in Prior Finding 10, policies reviewed did not state that “each policyholder of a domestic mutual insurer is a member of the insurer with all rights and obligations of the membership” as required by AS 21.69.280(a).

Recommendation: It is recommended that the Branch’s policies be revised to state that each policyholder is a member of a mutual insurer as required by AS 21.69.280(a).

Finding 4 – Branch’s procedures do not allow sufficient time for notice of nonrenewal and policy premium renewals pursuant to AS 21.36.235 (Notice of premium or coverage changes upon renewal) and AS 21.36.240 (Failure to renew)

As noted in Prior Finding 9, the Branch underwriting procedures state that a review of the claims/premium/loss ratio information is produced and assessed approximately 30 days prior to the renewal date. Upon conclusion of this assessment, the Branch determines if the policy is to be renewed and/or if alterations in the individual terms of the policy are required.

The procedure does not allow the Branch adequate time to provide notice of material alterations in the policy at least 45 days prior to the anniversary date of a commercial or business policy as required under AS 21.36.235(a)(2).

Similarly, the Branch’s underwriting procedures do not allow sufficient time to review policy information and to comply with AS 21.36.240, which requires the Branch to provide a notice of nonrenewal at least 45 days prior to the anniversary date of a commercial or business policy.

Recommendation: It is recommended that the Branch amend its procedures for nonrenewal to ensure compliance with AS 21.36.240(a)(2), and amend its procedures for policy renewal to ensure compliance with AS 21.36.235.

Finding 5 – Net amount insured on any one risk exceeds statutory threshold set under AS 21.12.010 (Limit of risk)

During the years under review, the Branch maintained and reported the largest net amount of risk retained on any one risk was \$2 million. This was the retention limit under the Parent Company’s written reinsurance agreements. AS 21.12.010(a) limits the largest net risk on any one subject of insurance to 10% of the Branch surplus as regards policyholders. For years 2007, 2008, and 2009, 10% of policyholder surplus equaled \$334,433; \$478,287; and \$468,367; respectively. Therefore, the Branch does not comply with this statute.

Recommendation: It is recommended that the Branch reduce the written retention on individual risks to below statutory allowance or increase surplus to accommodate greater net risks.

Finding 6 – Reinsurance contracts missing provisions required under AS 21.12.020 (Reinsurance credit allowed a domestic insurer) and 3 AAC 21.635 (General provisions for a reinsurance agreement)

AS 21.12.020(g) stipulates that an insurer may only receive credit for reinsurance transactions if the reinsurance agreement meets all applicable requirements established by the director; these requirements are enumerated within the Alaska Administrative Code (AAC), or regulations. Notably, the Parent Company's reinsurance contracts with Underwriters at Lloyd's London and Swiss Re USA do not include clauses required by 3 AAC 21.635(a)(1) and (4).

3 AAC 21.635(a)(1) disallows credit to a domestic ceding insurer unless the reinsurance contract provides for payment by the assuming insurer on the basis of the liability of the ceding domestic insurer under the insurance contracts reinsured without diminution because of the insolvency of the ceding domestic insurer [the "Insolvency Clause"]. The insolvency clause is absent from the Lloyd's of London contracts.

3 AAC 21.635(a)(4) requires that a reinsurance contract state that the agreement constitutes "the entire contract between the parties with respect to the insurance being reinsured and that there are no understandings or agreements between the parties other than those expressed in these documents" [the "Entire Contract Clause"]. The Parent Company's contracts with Swiss Re USA and Lloyd's do not include an "Entire Contract" clause.

This finding is repeated from the prior exam. (See Prior Finding 7.) An adjustment to the financial statements has been made to increase the Provision for Reinsurance by \$133,000, the amount of reinsurance recoverable reported as authorized under these agreements in the Branch annual statement, along with a like reduction in Unassigned Surplus.

Recommendation: It is recommended that the Parent Company amend existing reinsurance agreements and include in future agreements language that complies with AS 21.12.020 and 3 AAC 21.635.

Finding 7 – Agreements with affiliates not put into writing or submitted for review by the director as required by AS 21.22.080 (Transactions with affiliates) and AS 21.22.085 (Transactions requiring director review)

AS 21.22.080(4) requires that all material transactions with affiliates be maintained "so as to disclose clearly and accurately the precise nature and details of the transactions...."

Additionally, per AS 21.22.085(a)(4), a management agreement between a domestic insurer and a person in its holding company system must be submitted to the director in writing for review and non-disapproval.

Prior to 2009, the Parent Company maintained a management agreement with Salvus Bain Management (USA), or SBM (USA), to manage the Branch's business. In 2009, SBM (USA) was absorbed into SMMI, the Parent Company, by a Special Resolution of the Board during their annual meeting. Following the merger, no management agreement was put in writing between the Branch and its Parent regarding the management of the Alaska business or the method of allocating expenses between subsidiaries within the SMMI group.

Recommendation: It is recommended that a management agreement be set down in writing between SMMI and the U.S. Branch that lays out terms and allocation of

expenses between the two legal entities, and that these agreements be submitted to the Director for review.

Finding 8 – Written broker agreements and contingent commissions

As noted in Prior Finding 8, the Branch does not have signed, written commission agreements with all of its brokers. Commissions are calculated based upon an agreed upon formula with both parties approving the commission prior to payment.

Prior Recommendation: It is recommended that all broker agreements and agreed upon compensation formulas be documented in a written agreement that is signed by both parties prior to any activity under those agreements. Furthermore, it is recommended that understanding and control of the commission payment process be consolidated into one area of the Branch.

Finding 9 – The Branch does not maintain an investment policy as required by 3 AAC 21.211 (Authorization of investment by board of directors)

As a member of the SMMI group, the Branch investments are managed by the Parent Company Investment Committee authorized by the SMMI Board of Directors.

Alaska regulation 3 AAC 21.211(a) requires that an insurer adopt a written investment plan that specifies investment strategies appropriate for business conducted by the insurer. The Parent Company, and therefore, the Branch, has no written investment plan adopted by the Board of Directors as required by 3 AAC 21.211(a).

Alaska regulation 3 AAC 21.211(b) requires all investment transactions be approved at least annually “by formal resolution” that states that investments have been made in accordance with the established investment plan prescribed by the Board. While the Parent Company’s Board of Directors approves the financial package presented at the annual meeting, which includes a listing of investments from the prior year, there is no formal resolution approved in accordance with this regulation.

Alaska regulation 3 AAC 21.211(c) requires that on at least a quarterly basis, the Board or Investment committee (1) must review a summary report on the insurer’s investment portfolio, investment activities, and practices to determine whether they are consistent with the written plan; and (2) review and revise, as appropriate, the written plan.

Recommendation: It is recommended that the Parent Company develop a written investment plan pursuant to guidelines established under 3 AAC 21.211(a) and that all investment transactions be reviewed on at least a quarterly basis pursuant to 3 AAC 21.211(c) along with the written plan; and that the minutes of quarterly Investment Committee meetings document the review. It is also recommended that the Board of Directors adopt a formal resolution annually according to 3 AAC 21.211(b).

Finding 10 – Statutory trust agreement is out of date and does not comply with the Custodial Agreement provisions required by AS 21.09.310 (Authorization of US Branches of alien insurers) and 3 AAC 21.865 (Requirements for custodial agreements)

The statutory trust agreement between and the Branch's Parent Company, SMMI, and the Trustee should be updated to reference the Company (US Branch) as a party to the agreement (i.e. SMMI and subsidiaries/branches). The Branch's custodian as reported in their 2010 annual statement, General Interrogatories, as well as current trust statements received by the Division, is listed as Wells Fargo Alaska Trust Company, yet there is no binding agreement between the Branch and Wells Fargo.

The Trust Agreement provided by the Branch and on file with the state covering required statutory deposits was written in 1996 and names the current trustee's precursor, National Bank of Alaska, on the trust document instead of the current trustee, Wells Fargo. National Bank of Alaska was purchased by Wells Fargo more than 10 years ago. The agreement has additional deficiencies and is non-compliant with Alaska statute and regulations as follows:

- AS 21.09.310(h) requires that "the trust be for the exclusive benefit, security, and protection of the policyholders, or policyholders and creditors, of the United States branch in the United States...."
- 3 AAC 21.865(a)(14) obligates the custodian to indemnify the insurer for any loss of custodied securities by negligence, burglary, robbery, hold-up, theft, mysterious disappearance, damage, or destruction;
- 3 AAC 21.865(a)(15) requires that if a loss of custodied securities occurs for which the custodian is obligated to indemnify the insurer, the custodian will promptly replace the securities or the value of the securities; and the value of any loss of rights or privileges resulting from the loss of securities.

Recommendation: It is recommended that the Branch enter into a Trust and Custodial Agreement with Wells Fargo, its custodian of statutory trust deposits, that properly names the Trustee and that incorporates all required provisions of AS 21.09.310(h) and 3 AAC 21.865.

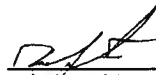
CLOSING

This examination was conducted in accordance with practices and procedures promulgated by the NAIC Financial Condition Examiners Handbook. This examination also includes a compliance review of applicable Alaska Statutes and Regulations

In addition to the undersigned, the following examiners participated in the examination: Actuary Sarah McNair-Grove, FCAS, MCAA and Insurance Financial Examiner Douglas Hartman, AFE, of the Division of Insurance and Supervisory Contractor Margaret C. Spencer, CFE, Contractor Cathie A. Stewart, CFE, Patrick White, CFE, and Melissa A. Hoke of RSM McGladrey, Inc.

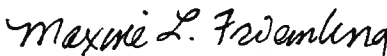
We wish to express our appreciation for the courteous cooperation and assistance extended to us by the management and staff of Sunderland Marine Mutual Insurance Company Limited during the course of this examination.

This report is respectfully submitted,



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Richard B. Foster, CFE  
Examiner-in-Charge



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Maxine L. Froemling, CFE  
Chief Financial Examiner

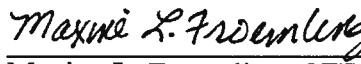
Sunderland Marine Mutual Insurance  
Company Limited (U.S. Branch)  
As of December 31, 2009  
FE 10-01

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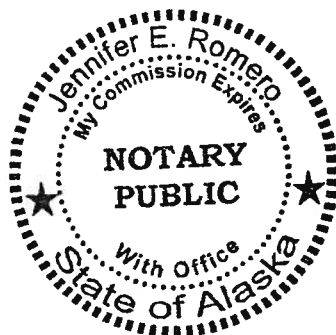
Anchorage, Alaska )  
June 30, 2011 )  
STATE OF ALASKA )  
THIRD JUDICIAL DISTRICT )

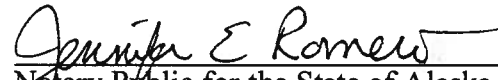
We, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2009, of Sunderland Marine Mutual Insurance Company Limited (U.S. Branch), an Alaska domiciled company holding Certificate of Authority D-8440, is true to the best of our knowledge and belief.

  
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Richard B. Foster, CFE  
Examiner-in-Charge

  
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Maxine L. Froemling, CFE  
Chief Financial Examiner

Subscribed and sworn to before me this 14<sup>th</sup> day of November, 2011.



  
\_\_\_\_\_  
Notary Public for the State of Alaska  
My commission expires: With Office