REPORT ON EXAMINATION

OF THE

LEXINGTON INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2010 of the

LEXINGTON INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

Attest By: ______________________

Date: 26 Jun 2012

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 20th day of June, 2012.

____
Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

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LEXINGTON INSURANCE COMPANY

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DECEMBER 31, 2010

The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted and filed as an official record of this Department.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 26th day of June, 2012

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May 4, 2012

SALUTATION

Honorable Karen Weldin Stewart, CIR-ML
Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Boulevard
Dover, Delaware 19904

Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 11.001, an examination has been made of the affairs, financial condition and management of the

LEXINGTON INSURANCE COMPANY

hereinafter referred to as "Company" or "LIC", incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 2711 Centerville Road, Suite 400, Wilmington, Delaware. The examination was conducted at the offices of the Company located at 180 Maiden Lane, New York, New York. The examination report thereon is respectfully submitted.

SCOPE OF EXAMINATION

The last examination was as of December 31, 2008. This examination covered the period of January 1, 2009, through December 31, 2010, and encompassed a general review of transactions during the period, the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of the Company at December 31, 2010. Transactions subsequent to the examination date were reviewed where deemed necessary.

The Company was examined concurrently with the other member companies of the Chartis Surplus Lines Pool (Surplus Lines Pool); Chartis Select Insurance Company ("Chartis Select"), DE, Chartis Specialty Insurance Company ("Chartis Specialty"), IL, and Landmark Insurance Company ("Landmark"), CA. The examination of the Surplus Lines Pool was also conducted concurrently with the examination of the Chartis U.S., Inc. Admitted Pool (Admitted Pool) companies. To the extent that key processes, related risks and mitigating controls were common to all Chartis U.S., Inc. legal entities, the work performed for the Admitted Pool examination to determine residual risk and perform any necessary substantive testing was relied on as much as possible. Specifically, work performed related to investments, reinsurance, financial reporting, taxes, related parties, corporate governance, assessment of the audit function and the review of fraud was relied upon in this examination of the Surplus Lines Pool Companies.

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC*)* Financial Condition Examiners Handbook (Handbook). The NAIC 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. The examination also included 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 Company were considered in accordance with the risk focused examination process. The examination report addresses regulatory issues revealed during the examination process.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, PricewaterhouseCoopers, LLP (PwC). Certain auditor work papers have been incorporated into the work papers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination.

This report of examination was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

In addition to the items noted in this report, the following topics were reviewed without material exception and are included in the work papers of this examination:

Fidelity Bond and Other Insurance
Pension, Stock Ownership and Insurance Plans
Statutory Deposits

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings noted and no material adjustments were made to the financial statements in this report.

SUBSEQUENT EVENTS

Subsequent to December 31, 2010 and up to this examination report date, the Company took the following actions which were considered material to either operations or results of operations:

- On February 25, 2011, the Company entered into a Capital Maintenance Agreement (2011 CMA) with its ultimate parent, American International Group, Inc. (AIG). The 2011 CMA provides that in the event that the Company's Total Adjusted Capital (TAC) falls below 425% of the Company's Authorized Control Level (ACL) Risk Based Capital (RBC), as estimated by the Company at the end of the first and third fiscal quarters, subject to any adjustments or modifications required by the Company's domiciliary regulator or its independent auditors, AIG would, within a specified time period prior to close of the following fiscal quarter, contribute cash, cash equivalents, securities, or other acceptable instruments that qualify as admitted assets to the Company so that the Company's TAC is projected to be equal to 425% of its ACL RBC as of the second and fourth fiscal quarters. The 2011 CMA supersedes and replaces a CMA that related to the Company's December 31, 2009 surplus position.

- Effective February 17, 2012, the Surplus Lines Pool members, including the Company, together with the members of the Chartis Admitted Pool and the AIU Insurance Company (collectively, the Fleet), entered into a Capital Maintenance Agreement with AIG and Chartis Inc. (AIG CMA). The AIG CMA provides that in the event that the Fleet's Total Adjusted Capital (TAC) falls below the specified minimum percentage (SMP) of 350% of the Fleet's Authorized Control Level (ACL) Risk Based Capital (RBC), as estimated by Chartis Inc. on a semi-annual basis, subject to any adjustments or modifications required by the Company's domiciliary regulator or its independent auditors, AIG will, within a specified time period prior to the close of the following fiscal quarter, contribute cash, cash equivalents, securities or other acceptable instruments that qualify as admitted assets to the Fleet so that the Fleet's TAC is projected to be equal to or greater than the SMP as of the upcoming year-end. Additionally, each Chartis and each Fleet member agreed, subject to approval by their board of directors and, if necessary, their domestic regulator, as applicable, to pay dividends that will be paid to AIG up to an amount equal to the lesser of (i) the amount necessary to reduce the Fleet's ACL RBC to an amount not materially greater than the SMP or (ii) the maximum ordinary dividends permitted by any applicable domiciliary regulator.

- Effective February 17, 2012, the Fleet entered into a Capital Maintenance Agreement **(**Chartis CMA) with Chartis Inc., Chartis U.S., Inc. and Chartis International, LLC (the Chartis entities). The Chartis CMA provides that in the event that the Fleet's TAC exceeds the SMP (as determined pursuant to the terms of the AIG CMA) while at the same time any Fleet member, as an individual legal entity, has a TAC below 300% of such Company's ACL RBC (the Individual Entity Minimum Percentage) (as determined by Chartis pursuant to the methodology set forth in the AIG CMA that is used to determine the SMP), the Chartis Entities and each Fleet member agree to make contributions, pay dividends or cause other transactions to occur that would result in each Fleet member's TAC being above the Individual Entity Minimum Percentage. No Fleet member is required to pay any dividend which would trigger the extraordinary dividend provisions of its domiciliary state or that is otherwise prohibited by such state.

- On March 18, 2011, AIG issued a preliminary pre-tax insurance loss estimate for Chartis Inc., its world-wide casualty insurance holding Company, related to the recent earthquake in Japan, consequent tsunami, and related exposures. The preliminary estimates excluded losses arising from AIG's general insurance operations in Japan that participate in the Japanese Earthquake Reinsurance Company (JERC), including Fuji Fire and Marine. The Company continues to assess its exposure to these events.

- Effective January 1, 2012, Landmark was merged with and into National Union Fire Insurance Company of Pittsburgh, Pa. (NUFIC) and Chartis Select was merged with and into the Company. In conjunction with these mergers, Chartis Select and Landmark were deleted as members of the Surplus Lines Pool. The fixed percentage pooling participations for the Company and Chartis Specialty were revised retroactively to 90 percent and 10 percent, respectively. The Amended and Restated Inter-Company Pooling Agreement was amended on December 30, 2011 to effect, as of January 1, 2012, the removal of Landmark and Chartis Select as parties to the agreement. As of December 31, 2011, the members of the Surplus Lines Pool were Lexington (70%), Chartis Select (18%), Chartis Specialty (10%) and Landmark (2%). On January 1, 2012, NUFIC's ownership of the Company increased from 70% to 77.7%, while The Insurance Company of the State of Pennsylvania (ISOP) and Chartis Property Casualty Company (CPCC) ownership in the Company decreased from 20% and 10% to 14.9% and 4.4%, respectively, upon the merger of Chartis Select into the Company.

- Effective March 31, 2012, Lexington and Chartis Specialty shares owned by CPCC and ISOP were distributed to Chartis U.S., Inc. and subsequently contributed to NUFIC. As a result of this transaction, NUFIC now owns 100% of Lexington and Chartis Specialty.

- During 2011 and 2010, the Company identified additional corrections related to its remediation efforts that resulted in after-tax statutory income adjustments of $(78,356,891) and $(33,783,295), respectively. In accordance with SSAP No. 3, entitled *Accounting Changes and Corrections of Errors*, the corrections of errors have been reported in the 2011 and 2010 Annual Statements as adjustments to unassigned funds.

- During 2011 and 2010, the Company recorded $25,939,900 and $6,193,565 in write-downs on its investments in joint ventures and partnerships due to other than temporary impairments in fair value.

COMPANY HISTORY

The Company was incorporated on March 31, 1965 under the laws of the State of Delaware and began business on April 1, 1965. The Company commenced business by assuming substantially all the in-force business of the First State Insurance Company, a Delaware Corporation. At the time of incorporation, the Company was 100% owned by AIG, a Delaware Holding Company.

On December 31, 1985, AIG transferred its ownership of the Company as follows; 70% to NUFIC, 20% to ISOP, and 10% to CPCC, all of which are subsidiaries of AIG.

Common Capital Stock

The Certificate of Incorporation, as amended, provides that the authorized capital stock of the Company shall be 5,000,000 shares of $5 par value common stock. At December 31, 2010, 1,000,000 shares were issued and outstanding, resulting in total capital stock of $5,000,000.

During the examination period, the Company's gross paid in and contributed surplus increased by $398,277,899, from $497,562,341 in 2008, to $895,840,240 in 2010. All contributions made during the period were reconciled without exception.

Dividends

The Company paid $366,993,000 and $0 in ordinary stockholder dividends in 2010 and 2009, respectively based on the stockholders' percentage ownership.

CORPORATE RECORDS

The recorded minutes of the shareholders, Board of Directors (Board), and certain internal committees of the Company were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events. No exceptions were noted during the review of the Company minutes.

MANAGEMENT AND CONTROL

The Company's amended Certificate of Incorporation provides that all corporate powers of the Company be managed by a Board of Directors (Board). The Company's bylaws stipulate that the Board shall consist of not less than seven (7) members or as may be determined from time to time by action of the Stockholders or the Board. The term of office for all Directors shall be one (1) year and each Director shall hold office until his term has expired, his successor has been elected and qualified, or until his death, removal, or resignation.

In accordance with Company bylaws, the annual meeting of the stockholders shall be held at such time and place as the Board shall designate. The Board may, in its sole discretion, determine that the meeting may be held solely by means of remote communication. The Stockholders or Board may call special meetings for any purpose or purposes when required by the General Corporate Law to do so. Minutes of meetings held by Stockholders during the examination period were reviewed and no exceptions were noted.

At December 31, 2010, the eight (8) members of the Board together with their principal business affiliation were as follows:

Name	Principal Occupation
John Quinlan Doyle	Executive Vice President, Chartis and President and Chief Executive Officer, Chartis U.S., Inc.
Peter James Eastwood	President and Chief Executive Officer, Lexington Insurance Company
David Neil Fields	Senior Vice President, Chief Reinsurance Officer and Chief Underwriting Officer, Chartis U.S., Inc.
David Lawrence Herzog	Executive Vice President and Chief Financial Officer, American International Group

Monika Maria Machon	Senior Vice President and Chief Investment Officer, American International Group
Kristian Philip Moor	President and Chief Executive Officer, Chartis Inc.
Robert Scott Higgins Schimek	Executive Vice President and Chief Financial Officer, Chartis Inc.
Mark Timothy Willis	Executive Vice President, Chartis U.S., Inc.

In accordance with the Company's bylaws, the Board may designate committees by resolution that set forth the powers and authority of the committee. The bylaws, Article III, Section 1, state that, "The Board of Directors shall have the power at any time to fill vacancies in, to change the membership of, to change the number of members of, or to dissolve the Executive Committee." There were no operating committees appointed by the Board of Directors during the period under review.

In accordance with the Company's bylaws, the Board may elect a Chairman of the Board, a President, one or more Vice Presidents, one or more Assistant Vice Presidents, a Secretary, one or more Assistant Secretaries, a Treasurer, one or more Assistant Treasurers, and any other such officers as the Board deems necessary. Only the Chairman is required to be a Director. At December 31, 2010, the Company's principal officers and their respective titles were as follows:

Name	Office
Kristian Philip Moor	Chairman
Peter James Eastwood	President and Chief Executive Officer
Sean Thomas Leonard	Senior Vice President and Chief Financial Officer
Denis Martin Butkovic	Secretary

Russell Mark Johnston	Executive Vice President and chief Operating Officer
Nicholas Edward Anselmo	Executive Vice President
David Joseph Bresnahan	Executive Vice President, Division Executive, Casualty, Programs and Healthcare
Frank Hienmen Douglas, Jr.	Executive Vice President, Chief Actuary
David Neil Fields	Executive Vice President

HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system as defined in 18 Del. C. §5001(4) “Insurance Holding Company System”.

As of December 31, 2010, the Company was owned by NUFIC (70%); ISOP (20%); and CPCC (10%). These companies, along with approximately fifty-seven (57) additional insurance and non-insurance entities were directly or indirectly owned by Chartis U.S., Inc. and comprised the Chartis US domestic property and casualty insurance group. The Chartis U.S. and Chartis International group of companies, along with the Chartis Global Services, Inc. and Chartis Global Claims Services, Inc. were in turn owned by Chartis Inc., a Delaware holding company.

The ultimate controlling entity of the system is AIG. AIG, a Delaware corporation, is a holding company which, through its subsidiaries, is

engaged in a broad range of insurance, insurance-related, financial, and other non-insurance activities in the United States and abroad. AIG’s primary activities include both general insurance and life insurance and retirement services. Other significant activities include financial services and asset management. As of December 31, 2010, AIG possessed assets totaling $683 billion, shareholder equity of $85 billion, and earned net income of $10 billion on total reported revenues of $77 billion.

The following depicts a partial organizational structure of AIG as of December 31, 2010 (specifically focused on U.S. insurance affiliates and all ownership is 100% unless otherwise noted):

- American International Group, Inc.
  - AIG Life Holdings (International) LLC
    - Various Entities
  - SunAmerica Financial Group, Inc.
    - Various Entities
  - AIG Capital Corporation
    - Various Entities
  - AIG Global Services, Inc.
    - Various Entities
  - AIG Financial Products Corp.
    - Various Entities
  - United Guaranty Corporation
    - Various Entities
  - AIUH, LLC
    - Chartis Inc.
      - Chartis International, LLC
        - Various Entities
      - Chartis Global Services, Inc.
      - Chartis Global Claims Services, Inc.
      - Chartis Claims, Inc.
      - Chartis U.S., Inc.
        - National Union Fire Insurance Company of Pittsburgh, PA
          - Chartis Specialty Insurance Company (70%)
          - **Lexington Insurance Company (70%)**
          - Spruce Peak Realty, LLC (1%)
          - Chartis Select Insurance Company
            - Chartis Excess Limited
          - National Union Fire Insurance Company of Vermont
          - MtMansfield Company, Inc.
            - Spruce Peak Realty, LLC (99%)
        - American Home Assurance Company
          - Chartis Non-Life Holding Company (Japan), Inc.
            - The Fuji Fire & Marine Insurance Company, Limited (38.62%)
              - American Fuji Fire & Marine Insurance Company
              - Fuji Life Insurance Company Ltd.
              - Fuji International Insurance Company Limited

New Hampshire Insurance Company
Chartis Casualty Company
Granite State Insurance Company
Illinois National Insurance Co.
Morefar Marketing, Inc.
Commerce and Industry Insurance Company
AIG Polska Towarzystwo Ubezipiecen S.A.
The Insurance Company of the State of Pennsylvania
Chartis Specialty Insurance Company (20%)
Lexington Insurance Company (20%)
Landmark Insurance Company (100%)
Chartis Property Casualty Company
Chartis Specialty Insurance Company (10%)
Lexington Insurance Company (10%)
Chartis Insurance Company of Canada
Quartz Holdings LLC
Fieldstone Securitization I LLC
Graphite Management LLC
Lavastone Capital LLC
Slate Capital LLC
Alabaster Capital LLC
Chartis Aerospace Insurance Services, Inc.
Chartis Warranty Guard, Inc.
Chartis Warranty Services, Inc.
Risk Specialists Companies, Inc.
Risk Specialists Companies, Inc.
Risk Specialists Companies Insurance Agency, Inc.
Design Professionals Association Risk Purchasing Group, Inc.
Medical Excess Insurance Services, Inc.
Medical Excess LLC (70%)

AFFILIATED AGREEMENTS

The following agreements were in effect between the Company and its affiliates at December 31, 2010:

Amended AIG Service and Expense Agreement

Effective February 1, 1974, amended December 30, 1998 to include Lexington and Landmark, and subsequently amended January 1, 2002 to include Chartis Select, and further amended at subsequent times, the companies entered into a Service and Expense Agreement

(Agreement) with AIG. AIG and its subsidiaries have agreed to provide at cost, services and facilities as required to the named parties to the Agreement. Services include: Law, Investment, EDP, Internal Audit, Actuarial, Claims, Underwriting, Accounting, Tax, and Employee Benefits.

Administrative Services Agreement

As amended and effective December 1, 2009, the Company and other affiliates (Participating Companies) entered into an agreement with Chartis Technology and Operating Management Corp. (CTOM), a Philippines company and an affiliate within the AIG group. Under the terms of this agreement CTOM will perform such services as requested by the Participating Companies, including but not limited to administrative services or activities (including data entry from imaged documents, call center operations, indexing, and a number of other basic policy and claim related activities), and certain accounting services such as accounts payable processing, invoice matching, bank account reconciliations and suspense account reconciliations. The performance of all such services shall at all times be subject to the direction and control of the Participating Companies. The Participating Companies are to provide such performance standards, guidelines and procedures as necessary for CTOM to comply with the standards in the agreement. Within 30 days after the end of each month CTOM is to provide a written statement of charges due from the preceding month, and all amounts due are to be paid in US dollars within 45 days following receipt of the statement of charges. Charges are defined as the cost for delivery of the services plus any taxes and other governmental mandated charges or fees or requirements. The term of the agreement shall be for a 3 year period, with subsequent automatic 1 year renewals each year. The agreement may be terminated by either party with 90 days written notice prior to the renewal date once the initial 3 year period is completed, but may also be terminated immediately for cause.

Investment Management Agreement

Effective January 1, 1991, the Company entered into an Investment Management Contract with an affiliate, PineBridge Investments LLC (f/k/a AIG Global Investment Corp.) The agreement provides for PineBridge Investments LLC to act as the investment manager for the Company, subject to the direction of the Company's Board. As compensation, the Company pays a set fee per amount under management, which fees are billed quarterly in advance, plus a prorated share of the AIG Services related fees. The agreement may be terminated by either party without notice.

In conjunction with a sale of AIG's third party asset management business, effective March 26, 2010, PineBridge Investments LLC entered into an agreement with AIG Asset Management (U.S.), LLC (AMG) to assign to AMG all of its right, title and interest in and obligations under the above agreement, excluding any obligations and liabilities relating to the management of investments/portfolios to be retained by PineBridge Investments companies which will be managed under newly executed agreements. Attendant with this assignment, an Investment Management Contract was entered into, also effective March 26, 2010, between the Company and AMG. This agreement was executed to reflect the change in management over the Company's portfolio while not changing any of the terms of the original agreement.

Tax Sharing Agreement

As amended effective January 1, 2010, the Company is a party to a Tax Sharing agreement with Chartis Inc., its upstream parent, and is considered to be a part of a tax Subgroup that was formed with Chartis Inc. as the Subgroup Parent. Chartis Inc. in turn, has entered into a separate tax sharing agreement with AIG, the upstream parent company. These agreements provide that AIG will not charge Chartis Inc. a greater portion of the consolidated tax liability than would have been paid by the tax Subgroup if it had filed a separate federal income tax return, and Chartis Inc. in turn, will not charge the Company, a greater portion of the consolidated tax liability than would have been paid by the Company if it had filed a separate federal income tax return. Additionally, the Company's tax sharing agreement contains the following significant requirements:

- The Company is to settle inter-company income taxes with Chartis Inc. as if the Company was filing its own separate tax return, and any net liability will be settled with Chartis Inc. in accordance with estimated tax payment requirements, with final payments/refunds to be paid within 30 days after Chartis Inc. settles with AIG.
- Any tax realized by the Company from triggering a deferred inter-company gain of a qualifying transaction will be paid by Chartis Inc.
- Chartis Inc. assumes the Company's tax reserves through a deemed capital contribution transaction, where the tax reserves mean any liability recorded in accordance with FASB Interpretation No. 48 (aka FIN 48).

<u>Intercompany Pooling Agreement</u>

During 2009, an Amended Pooling Agreement between Lexington, Chartis Select, Chartis Specialty and Landmark was submitted to the Delaware, Illinois, and California Departments for approval.

Under the Amended Pooling Agreement, Chartis Specialty was added to the existing Surplus Lines Pool Agreement and cedes 100% of its existing policyholder assets and liabilities to Lexington. In turn, Chartis Specialty assumes a 10% share of the Pool and Lexington's participation was reduced from 80% to 70%. Landmark's and Chartis Select's participation percentages were not affected.

The Amended Pooling Agreement changed the Pool participants' percentages as follows:

70% - Lexington
18% - Chartis Select
10% - Chartis Specialty
2% - Landmark

The amended agreement, with an effective date of January 1, 2010, was approved by the Delaware Department of Insurance.

Capital Maintenance Agreement

On February 23, 2010, the Company entered into a Capital Maintenance Agreement (2010 CMA) with its Ultimate Parent, AIG. The 2010 CMA provides that in the event that the Company's Total Adjusted Capital falls below 200% of the Company's Authorized Control Level Risk Based Capital (RBC), as shown in the Company's 2009 Annual Statement, together with any adjustments or modifications required by the Company's domiciliary regulator, AIG would, within thirty days of written notice thereof, provide a capital contribution to the Company in an amount that equals the difference between the Company's Total Adjusted Capital and 200% of the Company's Authorized Control Level RBC. In lieu of making any such capital contribution, with the approval of the Company's domiciliary regulator, the 2010 CMA provides that AIG may provide a letter of credit naming the Company as beneficiary. The 2010 CMA superseded and replaced a similar agreement that related to the Company's December 31, 2008 surplus position.

EXTERNAL AGREEMENTS

In addition to the above inter-company agreements, the Company had the following external agreements in effect as of the previous examination and remained in effect at December 31, 2010:

- Custodial agreement with Mellon Bank N. A. amended July 27, 2007
- Various Program Administrator (PA) Agreements
- Various Broker Agreements
- Various Third Party Administrator (TPA) Agreements
- Other Vendor Contracts

TERRITORY AND PLAN OF OPERATION

At December 31, 2010, the Company was only licensed in one state, Delaware. The Company is an eligible excess and surplus lines insurer in all remaining states as well as the District of Columbia, territory of Puerto Rico and U.S. Virgin Islands with its largest volumes in California, Florida, New York, and Texas, respectively.

Lexington Insurance Company, together with its pool members, is the largest excess and surplus lines carrier in the U.S. As a surplus lines insurer, Lexington provides flexibility in capacity, rate, and form that allow it to meet customer needs with insurance products for unique risks. The majority of the Company’s business written is Other Liability-Claims Made, Other Liability-Occurrence, fire products, allied lines and Medical Malpractice-Claims Made. However, the Company writes substantially all classes of business insurance including large commercial or industrial property insurance, excess liability, medical malpractice, inland marine, environmental, and excess and umbrella coverages. The Company offers many specialized forms of insurance such as equipment breakdown, directors and officer’s liability, difference in conditions, and various types of errors and omissions coverages.

The Company accepts business mainly from insurance brokers, enabling selection of specialized markets and retention of underwriting control. Any licensed insurance broker is able to submit business to the Company, but such broker usually has no authority to commit the Company to accept the risk. The Company utilizes the services of certain program administrators and third party administrators for policy issuance and administration, underwriting, and claims adjustment services.

As noted previously, effective January 1, 2010, the Company, as lead Company in the Surplus Lines Pool, entered into an amended intercompany pooling agreement with three AIG affiliates, Chartis Specialty, Chartis Select and Landmark; collectively known as the Lexington Pool; the pooling percentages of which are as follows: Lexington - 70%, Chartis Select - 18%, Chartis Specialty - 10% and Landmark - 2%. The Company also assumes reinsurance from other carriers and AIG affiliates. The approach to reinsurance structure varies by line of business and size of portfolio.

GROWTH OF THE COMPANY

The following information was extracted from the Company's filed Annual Statements and covers the two (2) year period from its last examination as of December 31, 2008, through this examination, December31, 2010:

Year	Net Premium Written	Admitted Assets	Surplus as Regards Policyholders	Net Income (Loss)
2010	$3,684,484,931	$18,658,006,058	$5,541,383,657	$384,816,973
2009	$3,082,902,296	$15,920,307,903	$5,187,335,535	$629,642,038
2008	$3,999,270,777	$15,293,478,834	$4,262,782,631	$208,534,746

The changes over the examination period are as follows:

- A 7.87% decrease in Net Written Premiums
- A 22.00% increase in Net Admitted Assets
- A 29.99% increase in Surplus as Regards Policyholders

Continuing soft market conditions and additional property quota share reinsurance purchases from Chartis' Admitted Pool contributed to a 22.9% decline in net written premiums in 2009.

LOSS EXPERIENCE

Net loss and expenses unpaid reserves as of December 31, 2009, restated for impact of the January 1, 2010 Amended Pooling Agreement, were $7.638 billion. During 2010, $246.1 million was paid for incurred loss and loss adjustment expense attributable to insured events of prior years. Reserves remaining for prior years are $7.41 billion as of December 31, 2010, as a result of the re-examination of unpaid losses and loss adjustment expenses principally by increases on Asbestos and certain Excess Casualty classes, which were offset by favorable emergence on other classes of business such as Property, Healthcare and Miscellaneous Errors & Omissions. Therefore, there has been a $16.4 million unfavorable development for 2010. The decrease is generally the result of ongoing analysis of recent loss development trends.

REINSURANCE

General

The Company reported the following distribution of net premiums written for 2010:

Direct	$4,605,906,824
Reinsurance assumed from affiliates	2,630,895,873
Reinsurance assumed from non-affiliates	349,160,028
Total gross (direct and assumed)	$7,585,962,725
Reinsurance ceded to affiliates	$3,213,280,989
Reinsurance ceded to non-affiliates	688,196,805
Total ceded	$3,901,477,794
Net premiums written	$3,684,484,931

The Company retained 48.6% of its gross business in 2010.

Assumed

For calendar year 2010, assumed premiums by cedent (top 5) are as follows:

	Premiums	Percent of Total
Chartis Specialty Insurance Company (IL)*	$2,215,630,000	74.3%
Chartis Select Insurance Company (DE)*	223,769,000	7.5%
National Union Fire Insurance Co. of Pittsburgh, Pa. (PA)*	41,139,000	1.4%
American Home Assurance Company (NY)*	39,793,000	1.3%
The Insurance Company of the State of Pennsylvania (PA)*	24,821,000	.8%
All Others	434,903,901	14.6%
Total	$2,980,055,901	100.00%

*Denotes Affiliate

Ceded

The Company's Reinsurance is coordinated and controlled by Chartis Inc. The Company's Management located in Boston is responsible for selection of the working and excess treaty reinsurance coverages for the Surplus Lines Pool. When purchased, facultative reinsurance is placed on an individual basis by the applicable underwriter. The Global Reinsurance Division in New York, is responsible for placing Catastrophe reinsurance.

All reinsurance treaty contracts are setup in the eTreaty reference system for coding parameters and treaty documentation, including contract wording, reinsurer signings, risk transfer, and other information is stored centrally in the iReContract Treaty document management system.

Significant Reinsurance Program Details:

The Company had one significant program change, effective January 1, 2010. As described in the "Affiliated Agreements" section of this Report, the Surplus Lines Pooling Agreement was amended effective January 1, 2010 to add Chartis Specialty as a 10% participant. The Company's participation was reduced from 80% to 70%. The participation percentages of Chartis Select and Landmark did not change.

The following reinsurance programs are presented on a 100% pooling basis. The Company's share is based on its 70% participation percentage. The Surplus Lines Pool places a major treaty program across all lines of business, which is placed through domestic and foreign reinsurers. The program consists of working and excess layers that cover all property business. Pro rata treaties are placed on Commercial and Personal Lines Property, Primary Casualty, Excess Casualty, Program, Marine and Healthcare business. Property Catastrophe Excess of Loss (XOL) Treaties protect the Surplus Lines Pool's net retention. Per Risk XOL treaties are placed on Commercial Property, Program Property and Recreational Marine business. Facultative reinsurance is also purchased in varying amounts on the above mentioned classes.

The major Excess of Loss, Catastrophe and Quota Share Treaties are summarized below:

Excess of Loss Reinsurance

1st Property per Risk XOL $25 million in excess $25 million (80% Ceded)
2nd Property per Risk XOL $50 million in excess $50 million (95% Ceded)
3rd Property per Risk XOL $150 million in excess $100 million (100% Ceded)
Health/Higher Ed. Property XOL $250 million in excess $250 million (91% Ceded)
1st Max Loss Property XOL $500 million in excess $500 million (95% Ceded)
2nd Max Loss Property XOL $500 million in excess $1.00 billion (100% Ceded)
1st – 3rd Program Property per Risk XOL $35 million in excess $5 million (100% Ceded)
CAT Excess Liab. Casualty XOL $78.055 million in excess $50 million (100% Ceded)

Property Catastrophe XOL Reinsurance

The Company has a 12 layered property catastrophe coverage, beginning with the 1st layer's coverage being 60% of $250 million in excess of $1.00 billion and ends with the 12th layer coverage being 60% of $250 million in excess of $3.500 billion.

Property Catastrophe XOL (2nd Event) Reinsurance

The Company also has a 13 layered property catastrophe coverage, beginning with the 1st layer's coverage being 40% of $250 million in excess of $1.00 billion to the 12th layer coverage being 40% of $250 million in excess of $3.500 billion and ends with the 13th layer being 100% of $750 million in excess of $3.750 billion.

Quota Share Reinsurance (QS)

Property QS, Company participation 81% reinsurer participation 19%
Personal Lines Property QS, Company participation 87% reinsurer participation 13%
Program Primary Casualty QS, Co. participation 85.5% reinsurer participation 14.5%
Program Professional Liability QS, Co. participation 85.5% reinsurer participation 14.5%
CAT Excess Liab. Casualty QS, Co. participation 85.37% reinsurer participation 14.63%

In addition, the Company is a named participant (with all other Chartis domestic insurance subsidiaries) under Chartis' "external" property catastrophe program. This excess protection covers all Chartis property exposures.

The Schedule F data contained in the Company's annual statements filed for the years within the examination period were found to accurately reflect its reinsurance transactions. The above material reinsurance agreements were reviewed and evaluated for compliance with SSAP 62 of the NAIC Accounting Practices and Procedures Manual and appeared to include the required contractual clauses.

The Company uses reinsurance intermediaries responsible for handling treaties and monitoring the reinsured. The reinsurance intermediary agreements were found to be in compliance with 18 Del. C. §1603 and §1604.

ACCOUNTS AND RECORDS

The Company maintains its records on a combination of client server, host, and network applications which utilize various reporting systems to record and report financial information. A significant change in systems was noted relative to the implementation of a new general ledger system (SAP) in 2010.

The accounts and records reviewed included an evaluation of the Company's operational and organizational controls. The areas evaluated included computer systems, accounting systems, organizational structures, and the processing structure.

The independent certified public accounting firm, PricewaterhouseCoppers, LLP (PwC), audited the Company's records for the years ended 2009 and 2010. Audit reports and applicable work papers were made available for the examiners' use.

The accounts and records review included an assessment of the Company's risk management process in identifying and controlling risks in the key operational areas of the Company. In making the assessment in each key area, processes were reviewed, risks were identified, operational and organizational controls were identified and tested, and the Company's methodology for assessing the effectiveness of the established mitigation factors was evaluated.

The primary systems used in the operations of the Company were also evaluated. The consulting firm of INS Services, Inc. performed an Exhibit C review of the Company's IT operations.

During the course of the examination, the Company's books and records were reviewed and compared to reported items and values in the annual statements. No material discrepancies were noted during this review.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2010:

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Capital and Surplus Account
Analysis of Financial Statement Changes

ASSETS
DECEMBER 31, 2010

	Assets	Non-Admitted Assets	Net-Admitted Assets	NOTES
Bonds	$ 14,699,637,652	$ 0	$ 14,699,637,652	1
Preferred stocks	132,687,082	0	132,687,082	
Common stocks	460,616,890	0	460,616,890	
Cash and short-term investments	498,663,209	0	498,663,209	
Derivatives	(29,279)		(29,279)	
Other invested assets	1,164,312,132	10,552,272	1,153,759,860	
Receivables for securities	131,867	0	131,867	
Investment income due and accrued	188,115,807	0	188,115,807	
Premiums and considerations:				
Uncollected premiums and agents balances	315,124,544	39,989,813	275,134,731	
Deferred premium	108,350,536	573	108,349,963	
Accrued retrospective premiums	22,688,429	544,212	22,144,217	
Reinsurance:				
Amounts recoverable from reinsurers	203,818,697	0	203,818,697	
Funds held by or deposited with reinsured companies	710,447		710,447	
Current federal and foreign income tax recoverable and interest thereon	144,930,785	370,717	144,560,068	
Net deferred tax asset	593,953,226	165,829,993	428,123,233	
Electronic data processing equipment and software	93,835	93,835	-	
Receivable from parent, subsidiaries and affiliates	118,587,492	4,308,749	114,278,743	
Aggregate write-ins for other than invested assets	238,489,421	11,186,550	227,302,871	
Total Assets	**$ 18,890,882,772**	**$ 232,876,714**	**$ 18,658,006,058**	

LIABILITES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2010

			NOTES
Losses	$	8,225,774,039	2
Reinsurance payable on paid losses and LAE		10,072,233	
Loss adjustment expenses		1,617,584,536	2
Commissions payable, contingent commissions and similar charges		1,384,523	
Other expenses		942,083	
Taxes, licenses and fees due and accrued		68,323,951	
Unearned premiums		2,482,144,458	
Ceded reinsurance premiums payable		143,594,507	
Funds held by company under reinsurance treaties		36,539,289	
Amounts withheld or retained by company for account of others		165,222	
Remittances and items not allocated		16,516,717	
Provision for reinsurance		29,700,833	
Net adjustments in assets and liabilities due to foreign exchange rates		0	
Payable to parent, subsidiaries and affiliates		333,213,023	
Derivatives		4,249,935	
Payable for securities		887,721	
Aggregate write-ins for liabilities		145,529,331	
Total Liabilities	$	13,116,622,401	
Special surplus funds	$	143,862,405	
Common capital stock		5,000,000	
Gross paid in and contributed surplus		895,840,240	
Unassigned funds (surplus)		4,496,681,012	
Surplus as regards policyholders	$	5,541,383,657	
Total liabilities, surplus and other funds	**$**	**18,658,006,058**	

SUMMARY OF OPERATIONS
DECEMBER 31, 2010

Underwriting Income

Premiums earned	$ 3,316,356,568
Deductions	
Losses incurred	2,383,321,044
Loss adjustment expenses incurred	470,032,039
Other underwriting expenses incurred	706,418,911
Total underwriting deductions	$ 3,559,771,994
Net underwriting gain or (loss)	$ (243,415,426)

Investment Income

Net investment income earned	$ 652,204,073
Net realized capital gains or (losses)	34,216
Net investment gain or (loss)	$ 652,238,289

Other Income

Net gain or (loss) from agents' or premium balances charged off	3,321,410
Aggregate write-ins for miscellaneous income	44,028,537
Total other income (loss)	47,349,947
Net income after dividends to policyholders, but before federal income taxes	$ 456,172,810
Federal income taxes incurred	71,355,837
Net income	**$ 384,816,973**

RECONCILIATION OF CAPITAL AND SURPLUS
FROM DECEMBER 31, 2008 to DECEMBER 31, 2010

Capital and Surplus Account

Capital and Surplus, December 31, 2008	$ 4,262,782,631
Net Income	$ 1,014,459,011
Change in net unrealized capital gains	132,986,505
Change in net unrealized foreign exchange capital gain	2,962,715
Change in net deferred income tax	76,172,323
Change in non-admitted assets and related items	33,671,218
Change in provision for reinsurance	15,825,660
Cumulative effect of changes in accounting principles	(32,956,383)
Surplus Paid In	338,019,901
Dividends to stockholder	(366,993,000)
Aggregate Write-Ins for Changes in Surplus	64,453,076
Change in surplus as regards policyholders for the year	$ 1,278,601,026
Capital and Surplus, December 31, 2010	**$5,541,383,657**

ANALYSIS OF CHANGES IN THE FINANCIAL STATEMENTS
DECEMBER 31, 2010

There were no financial adjustments to the Company's financial statements as a result of this examination.

NOTES TO THE FINANCIAL STATEMENTS

(Note 1) Bonds **$14,699,637,652**

Over 99% of the Company's bonds are rated as Class 1 or Class 2 by the NAIC. Of the total bonds owned, 69% mature within 5 years and 89% within 10 years. The Company has minimal exposure to investments in residential and commercial mortgage backed securities. The Company's strategy has been to invest in high quality fixed-income investments while maintaining sufficient diversification to avoid inappropriate exposure to any one issuer and/or industry.

(Note 2)	**Losses**	**$8,225,774,039**
	Loss Adjustment Expenses	**$1,617,584,536**

The above captioned amounts are the same as that reported by the Company in its 2010 Annual Statement.

The Department's consulting actuary, INS Consultants Inc., (INS), was retained and performed an independent analysis of the Company's gross and net loss and loss adjustment expense (LAE) reserves as of December 31, 2010.

The INS reserve review involved projecting reported paid losses, incurred losses, legal expenses, and adjuster fees to an ultimate basis. These were done individually or in combination within reserve segments. (The largest reserve segments are as follows: Programs, Catastrophic Excess Liability, Casualty, Healthcare and Asbestos, Pollution and Mass Tort).

INS was provided with Lexington's reserve review reports for each division along with additional work papers when requested. INS utilized the Lexington reports as a model for the analysis and generally applied the methodologies used by the Lexington actuarial staff.

The INS review of Lexington's year-end 2010 loss and LAE reserves was performed for selected reserve segments. Generally, the reserve lines within these segments, where the Lexington indicated IBNR reserve was over $140 million, were reviewed, and INS either accepted the Lexington results or INS developed an independent estimate of IBNR. The reserve lines within these segments where the Lexington indicated IBNR reserve was below $140 million were not reviewed, but were accepted by INS as stated.

The INS analysis employed standard reserving methodologies and techniques. Loss and LAE reserves are subject to errors of estimation arising from the fact that the ultimate liability for claims evaluated as of the evaluation date is dependent on future contingent events which cannot always be anticipated. The possible occurrence of such events, as well as the inherent uncertainty associated with statistical estimates, allows no guarantee that the actual ultimate liability will be the same as the reserve levels at the evaluation date.

INS found that the gross and net loss and loss adjustment expense reserves for the Company were reasonably stated.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

There were no recommendations in the prior exam report issued by the Department.

SUMMARY OF RECOMMENDATIONS

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

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

Description	December 31, 2010	December 31, 2008	Increase
Assets	$18,658,006,058	$15,293,478,834	$3,364,527,224
Liabilities	$13,116,622,401	$11,030,696,203	$2,085,926,198
Capital and Surplus	$ 5,541,383,657	$ 4,262,782,631	$1,278,601,026

The assistance of Delaware’s consulting actuarial firm, INS Consultants, Inc. and INS Services, Inc. is acknowledged.

Respectfully submitted,

Douglas E. Bey

Douglas E. Bey
Examiner In-Charge
State of Delaware