

ORDER ADOPTING REPORT OF EXAMINATION

I, Katharine L. Wade, Insurance Commissioner of the State of Connecticut, having fully considered and reviewed the Examination Report (the "Report") of HSB Specialty Insurance Company (the Company) as of December 31, 2017, do hereby adopt the findings and recommendations contained therein based on the following findings and conclusions.

TO WIT:

1. I, Katharine L. Wade, Insurance Commissioner of the State of Connecticut, and as such is charged with the duty of administering and enforcing the provisions of Title 38a of the Connecticut General Statutes ("C.G.S.").
2. The Company is a domestic insurer authorized to transact the business of insurance in the State of Connecticut.
3. On October 25, 2018, the verified Report of the Company was filed with the Connecticut Insurance Department (the "Department").
4. In accordance with C.G.S. §38a-14(e)(3), the Company was afforded a period of thirty (30) days within which to submit to the Department a written submission or rebuttal with respect to any matters contained in the Report.
5. On November 12, 2018, the Company filed a written submission indicating that they were in agreement with all of the recommendations contained in the Report. A copy of the Report is attached hereto and incorporated herein as Exhibit A.

NOW, THEREFORE, it is ordered as follows:

1. That the Report of the Company hereby is adopted as filed with the Department.
2. That the Company shall comply with the recommendations set forth in the Report, and that failure by the Company to so comply shall result in sanctions or administrative action as provided by Title 38a of the C.G.S.

3. Section 38a-14(e)(4)(A) of the CGS requires that:

"The secretary of the Board of Directors or similar governing body of the entity shall provide a copy of the report or summary to each director and shall certify to the Commissioner, in writing, that a copy of the report or summary has been provided to each director. "

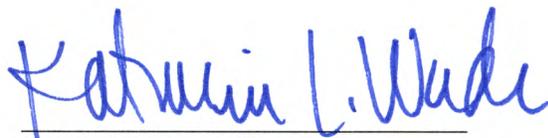
Please address the certification to the Commissioner, but send said certification to the care/attention of Mark Murphy, Supervising Examiner, of the Financial Regulation Division.

4. Section 38a-14(e)(4)(B) of the CGS requires that:

"Not later than one hundred twenty days after receiving the report or summary the chief executive officer or the chief financial officer of the entity examined shall present the report of summary to the entity's Board of Directors or similar governing body at a regular or special meeting. "

This will be verified by the Insurance Department either through analysis or examination follow-up.

Dated at Hartford, Connecticut, this 19th day of November, 2018.



Katharine L. Wade
Insurance Commissioner

EXHIBIT A

EXAMINATION REPORT

OF

**HSB SPECIALTY INSURANCE COMPANY
(NAIC # 14438)**

AS OF

DECEMBER 31, 2017

BY THE

CONNECTICUT INSURANCE DEPARTMENT



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October 5, 2018

The Honorable Katharine L. Wade
Insurance Commissioner
State of Connecticut Insurance Department
153 Market Street
Hartford, Connecticut 06103

Dear Commissioner:

In compliance with your instructions and pursuant to the requirements of Section 38a-14 of the Connecticut General Statutes (CGS), the undersigned has made a financial examination of the condition and affairs of

HSB SPECIALTY INSURANCE COMPANY

(hereinafter referred to as the Company), a corporation with capital stock, incorporated under the laws of the State of Connecticut and having its main administrative and home office located at One State Street, Hartford, Connecticut. The report on such examination is respectfully submitted.

SCOPE OF EXAMINATION

The previous examination of the Company was conducted by the Financial Regulation Division of the Connecticut Insurance Department (Department) as of December 31, 2012. The current examination, which covers the period from January 1, 2013, through December 31, 2017, was conducted at the statutory home office of the Company.

As part of the examination planning procedures, the Department reviewed certain material submitted by the Company:

- minutes of the Board of Directors (Board) meetings, reinsurance agreements, custodial agreements, and other documents related to significant transactions that require prior approval from 2013 through 2017;
- a review of the statutory audit reports completed by the Company's independent certified public accountants KPMG LLP (KPMG), during the period under examination;
- Management's Discussion and Analysis for 2017;
- documentation supporting Section 404 of the Sarbanes-Oxley Act of 2002 and the Model Audit Rule;
- 2017 Munich Re Group Annual Report, the Company's ultimate parent holding company;
- Annual Statements filed with the Department from 2013 through 2017; and
- reports of the Company's Internal Audit Department from 2016 and 2017.

A comprehensive review was made of the financial analysis files and documents submitted to the Financial Analysis Unit of the Department, reports obtained from the National Association of Insurance Commissioners (NAIC) database, as well as the

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independent audit report which indicated no material concerns with respect to financial condition or regulatory compliance issues.

The examination was conducted on a full scope, comprehensive basis in accordance with the procedures outlined in the NAIC Financial Examiners Handbook (Handbook). The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management as well as evaluating the overall financial statement presentation with respect to management compliance with the NAIC Accounting Practices & Procedures Manual and the NAIC Property and Casualty Annual Statement Instructions.

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

Concurrent examinations were made of the Company's parent, The Hartford Steam Boiler Inspection and Insurance Company (HSBIIC) and affiliate, The Hartford Steam Boiler Inspection and Insurance Company of Connecticut (HSBCT).

The Department retained the services of Milliman, Inc. (Milliman) for a review of the Company's pricing and liquidity risks. Additionally, the Department retained INS Regulatory Insurance Services, Inc. (INS) to review the adequacy and effectiveness of the information technology (IT) systems controls to determine the level of reliance to be placed on the information generated by the data processing systems.

Comments in this report are generally limited to exceptions noted or to items considered to be of a material nature.

Failure of items in this report to add to totals, or for totals to agree with captioned amounts is due to rounding.

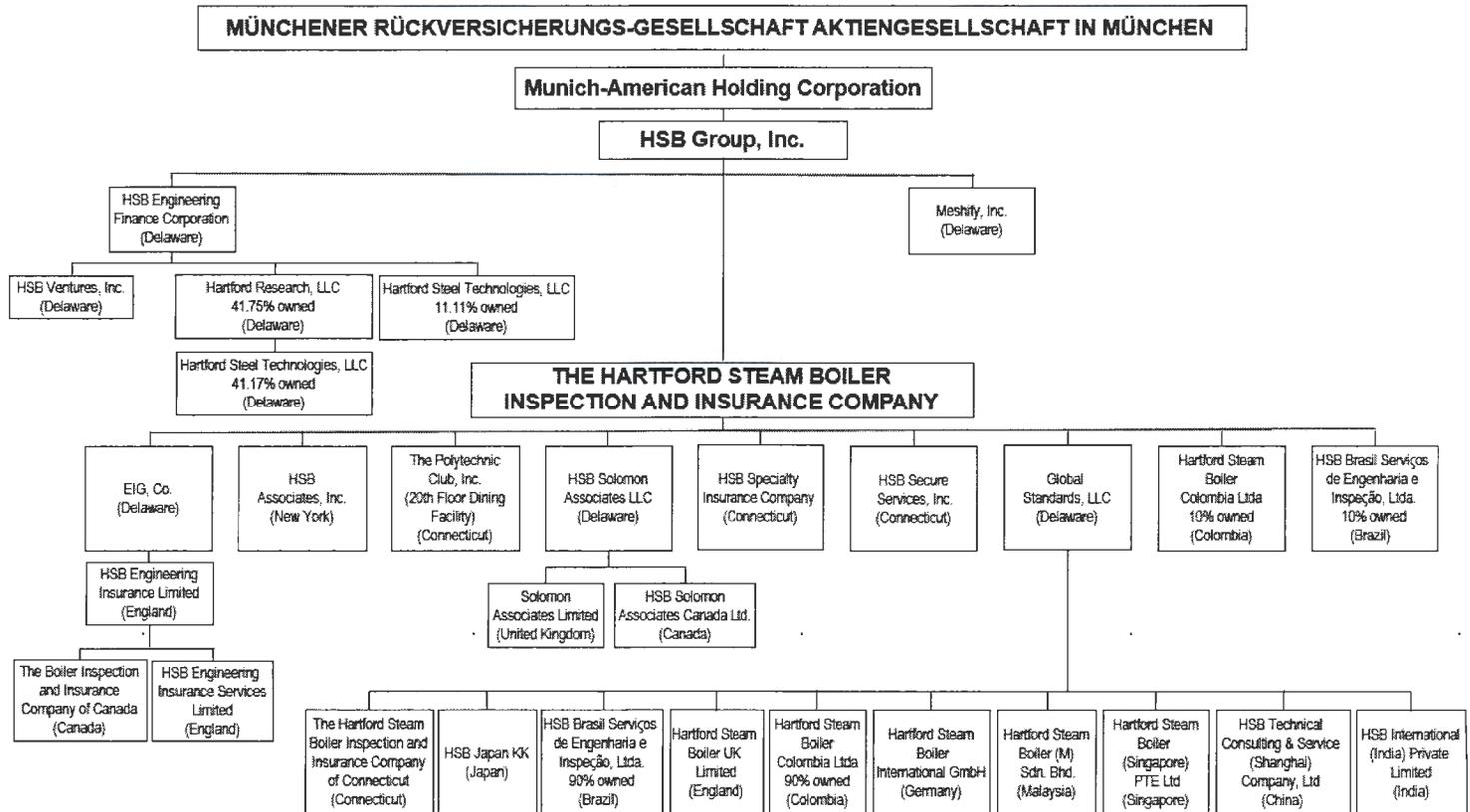
HISTORY

The Company was issued a Certificate of Incorporation by the Connecticut Secretary of State on June 11, 2012, pursuant to CGS Section 33-646. The Company is a direct and wholly owned subsidiary of HSBIIC, a Connecticut domiciled insurance company. HSBIIC is a direct and wholly owned subsidiary of HSB Group, Inc. (HSB Group). HSB Group is a direct and wholly owned subsidiary of Munich-American Holding Corporation (MAHC). MAHC is 100% owned by Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München (Munich Re), an insurance group with global operations covering reinsurance, primary insurance and international health business.

HSB SPECIALTY INSURANCE COMPANY

ORGANIZATIONAL CHART

The following is an organizational chart of the Company, its parent, main subsidiaries, and affiliates as of December 31, 2017:



Does not include EFC direct and indirect Subsidiaries less than 20% owned.

MANAGEMENT AND CONTROL

The articles of incorporation, dated June 8, 2012, state: “the Corporation shall have the power to write boiler and machinery, fire, marine, casualty, liability, indemnity, and fidelity insurance and any and all other forms of insurance against hazards of risks of every kind and description which may lawfully be the subject of insurance except life and endowment insurance and contracts for the payment of annuities; to accept and to cede reinsurance of any such risks or hazards; to make inspections and render inspection and engineering services in connection with the design, construction, maintenance or operations of boilers, machinery or any equipment regardless of whether policies of insurance are issued in connection therewith; and to engage in any lawful act or activity for which corporations may be organized under the Connecticut Business Corporation Act”.

HSB SPECIALTY INSURANCE COMPANY

Annual Stockholders Meetings

The bylaws state that the annual meeting of shareholders shall be held in the City of Hartford or such place within Connecticut as the directors may appoint. The annual meeting shall be held on the third Tuesday of April in each year or some other day within two months thereafter as fixed by the directors.

Special meetings of the shareholders may be held at such time as fixed by the Board.

Board of Directors

The articles of incorporation state that the business, property and affairs of the Corporation shall be managed by or under the direction of a Board consisting of not less than three nor more than six directors, the exact number of directorships to be determined from time to time by resolution adopted by the affirmative vote of a majority of the entire Board.

Directors are elected each year at the Company's annual shareholders meeting.

Members of the Board serving the Company at December 31, 2017, were as follows:

<u>Director</u>	<u>Principal Business Affiliation</u>
Theodore D. Kmiecik	Senior Vice President, Financial Planning, Analysis and Strategic Investments – HSBIIC
David P. Mercier	Senior Vice President, Custom Accounts Division – HSBIIC
Roberta A. O'Brien	Senior Vice President, Deputy General Counsel, and Compliance Officer – HSBIIC

Officers

According to the bylaws, there shall be a president and there may be a Chairman of the Board, each to be elected by the Board from their own number. The president shall be the chief executive officer and be responsible, under the direction of the Board, for the supervision, management and active control of the affairs and properties of the Company. There shall also be one or more vice presidents, a treasurer, a corporate secretary and such other officers as may be required for the prompt and orderly transaction of the business of the Company.

The principal officers of the Company at December 31, 2017, were as follows:

<u>Officer</u>	<u>Title</u>
David P. Mercier	President
Theodore D. Kmiecik	Treasurer
Roberta A. O'Brien	Corporate Secretary

The Company has no exclusive committees of the Board.

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INSURANCE COVERAGE

The Company and its parent and affiliates are insured by a financial institution blanket bond/computer crime policy with Zurich - Fidelity and Deposit Company of Maryland. Primary and excess combined single limit coverages are in place. The aggregate limit of liability is greater than the prescribed minimum set forth by the Handbook's schedule of suggested minimum amounts of fidelity insurance.

The Company and its parent and affiliates also have a directors and officers' liability policy to protect against wrongful acts on a claims made basis and in the aggregate. In addition, the Company is a named insured on a series of additional master policies with its parent and affiliates.

TERRITORY AND PLAN OF OPERATION

The Company is a Domestic Surplus Lines Insurer and is eligible to write boiler and machinery (equipment breakdown), commercial multiple peril, marine, liability, reinsurance and several other lines of insurance in the State of Connecticut on a non-admitted basis. As of December 31, 2017, the Company was eligible to write excess and surplus lines insurance business in 49 additional states, the District of Columbia and Puerto Rico.

REINSURANCE

The Company writes business through brokerage firms. During 2017 and 2016, the Company ceded 100% of all premiums, losses and allocated loss adjustment expenses to HSBIIC. For business written prior to December 31, 2014, that was to insure U.S. locations of insureds of its foreign affiliates, HSB Engineering Insurance Limited (HSB-EIL) and The Boiler Inspection and Insurance Company of Canada (BI&I), the Company ceded direct premiums, losses and allocated loss adjustment expenses to HSB-EIL and BI&I. On June 26, 2013, HSBIIC issued General Guarantee Agreements on the Company's behalf. Under the agreements, HSBIIC unconditionally and irrevocably guaranteed to the Company, the payment due of all present and future obligations and liabilities of any kind whatsoever of HSB-EIL and BI&I to the Company arising under the Company's respective reinsurance agreements with HSB-EIL and BI&I including but not limited to payments for claims, losses and return premiums prior to the portfolio transfer from the Company to HSBIIC (effective December 31, 2014) whether due or to become due, which remain unpaid by HSB-EIL or BI&I more than 90 days after the due date specified in the above reinsurance agreements.

INFORMATION TECHNOLOGY CONTROLS

A risk-focused assessment and review of the Company's Information Technology General Controls (ITGC) was performed in accordance with the Handbook. The guidance and direction used to perform the review of the Company's ITGCs was derived from Exhibit C Part 1 – Information Technology Planning Questionnaire (ITPQ) and Exhibit C Part 2 – Information Technology Work Program (collectively, Exhibit C). The Company's responses to the ITPQ were evaluated, and certain controls within the IT

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control environment were tested to assess whether the selected controls were designed effectively and were functioning properly.

The objectives were to obtain reasonable assurance about whether:

- the Company has a process in place to effectively identify, mitigate and manage its IT risks;
- the Company's control structure policies and procedures were suitably designed and complied with in order to achieve the control objectives specified in Exhibit C; and
- the Company's policies and procedures were in place during the examination period.

The objectives above were achieved through a combination of reviewing the Company's policies and procedures, testing in key areas related to Exhibit C, interviewing the Company's IT senior management, reviewing IT risk assessment processes, and leveraging relevant risk assessment procedures performed by KPMG.

No control deficiencies were noted which would impair the overall effectiveness of the IT control environment. It was, however, noted that the 2016 KPMG work identified several IT deficiencies, comprising a significant deficiency, which were remediated during 2017. While work was performed by INS to verify that the significant deficiency was remediated during 2017 and the IT general controls were operating effectively, reliance was not placed on the IT general controls environment for the purposes of other areas of this examination.

ACCOUNTS AND RECORDS

The Company uses a PeopleSoft general ledger accounting system within a local area network. Security controls within PeopleSoft limit access to general ledger data based on user function. The accounting system produces an automated trial balance, general journal report and a general ledger activity detail report on a monthly basis. The Company uses WINGS software from Eagle Technology Management, Inc. to produce its statutory annual statement.

Detailed analyses were performed on individual general ledger accounts throughout the examination.

The 2017 year-end trial balance was reconciled to the annual statement without exception.

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FINANCIAL STATEMENTS

The following statements represent the Company's financial position, as filed by the Company as of December 31, 2017. No adjustments were made to surplus as a result of the examination.

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$48,463,713		\$48,463,713
Cash, cash equivalents and short-term investments	1,494,511		1,494,511
Investment income due and accrued	131,105		131,105
Premiums and Considerations:			
Uncollected premiums and agents' balances in the course of collection	512,236	\$154,566	357,670
Deferred premiums and agents' balances and installments booked but deferred and not yet due	5,375,449		5,375,449
Net deferred tax asset	28,875		28,875
Receivables from parent, subsidiaries and affiliates	353,359		353,359
Aggregate write-ins for other than invested assets	3,588		3,588
TOTALS	<u>\$56,362,836</u>	<u>\$154,566</u>	<u>\$56,208,270</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Other expenses (excluding taxes, licenses and fees)	\$7,917
Taxes, licenses and fees (excluding federal and foreign income taxes)	6,587
Current federal and foreign income taxes	165,422
Ceded reinsurance premiums payable (net of ceding commissions)	5,267,906
Payable to parent, subsidiaries and affiliates	82,504
Total liabilities	5,530,336
Common capital stock	2,000,000
Gross paid in and contributed surplus	48,000,000
Unassigned funds (surplus)	677,934
Surplus as regards policyholders	50,677,934
TOTALS	<u>\$56,208,270</u>

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STATEMENT OF INCOME

UNDERWRITING INCOME	
Premiums earned	\$0
DEDUCTIONS	
Other underwriting expenses incurred	(31,039)
Total underwriting deductions	(31,039)
Net underwriting gain or (loss)	31,039
INVESTMENT INCOME	
Net investment income earned	308,701
Net realized capital gains or (losses) less capital gains tax	326,054
Net investment gain	634,755
OTHER INCOME	
Finance and service charges not included in premiums	19,968
Total other income	19,968
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	685,762
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	685,762
Federal and foreign income taxes incurred	253,161
Net income	432,601
CAPITAL AND SURPLUS ACCOUNT	
Surplus as regards policyholders, December 31 previous year	50,220,848
GAINS AND (LOSSES) IN SURPLUS	
Net income	432,601
Change in net unrealized capital gains or (losses) less capital gains tax	(21,694)
Change in net deferred income tax	(42,468)
Change in nonadmitted assets	88,647
Change in surplus as regards policyholders for the year	457,086
Surplus as regards policyholders, December 31 current year	<u>\$50,677,934</u>

COMMON CAPITAL STOCK \$2,000,000

As of December 31, 2017, the Company had authorized 20,000 shares of common stock. There were 100 shares of common stock issued and outstanding with a stated value of \$2,000,000. All outstanding shares are owned by HSBIIIC.

GROSS PAID IN AND CONTRIBUTED SURPLUS \$48,000,000

The balance of this account remained unchanged during the period under review.

UNASSIGNED FUNDS (SURPLUS) \$677,934

During the period under examination the balance in this account increased primarily due to net income.

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SUBSEQUENT EVENT

Effective January 1, 2018 the company converted from an authorized licensed domestic insurer to a domestic surplus lines insurer.

CONCLUSION

The results of this examination disclosed that as of December 31, 2017, the Company reported admitted assets of \$56,208,270, liabilities of \$5,530,336, and surplus as regards policyholders of \$50,677,934. During the period under examination, admitted assets increased \$6,178,674, liabilities increased \$5,488,129 and surplus as regards policyholders increased \$690,545.

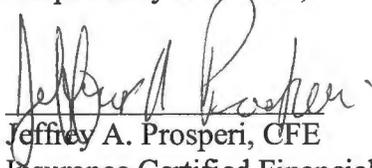
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SIGNATURE

In addition to the undersigned, Mark Murphy, CFE, Keith Kleindienst, CFE, Daniel Levine, AFE, CPA, Ellen McCarthy, AFE, and Lisa Pagliaro, AFE, of the Department and the professional services firms of Milliman and INS participated in this examination.

I, Jeffrey A. Prosperi, CFE, CPA, do solemnly swear that the foregoing report of examination is hereby represented to be a full and true statement of the condition and affairs of the subject insurer as of December 31, 2017, to the best of my information, knowledge and belief.

Respectfully submitted,



Jeffrey A. Prosperi, CFE
Insurance Certified Financial Examiner
State of Connecticut
Insurance Department

State of Connecticut

ss Hartford

County of Hartford

Subscribed and sworn to before me, Nancy M. Mercier, Notary Public/Commissioner of the Superior Court, on this 25th, day of October, 2018.

Nancy M. Mercier
Notary Public/Commissioner of the Superior Court

My commission expires 6/30/2020