

DOCKET NO. CV 02-0814173	:	SUPERIOR COURT
	:	
SUSAN F. COGSWELL, INSURANCE	:	JUDICIAL DISTRICT OF
COMMISSIONER OF THE STATE OF	:	HARTFORD
CONNECTICUT	:	
	:	
v.	:	AT HARTFORD
	:	
THE CONNECTICUT SURETY	:	
COMPANY	:	MARCH 8, 2002

REHABILITATOR'S FIRST ACCOUNTING

Susan F. Cogswell, Insurance Commissioner, as Rehabilitator of The Connecticut Surety Company (the "Rehabilitator") submits the first accounting as to the status and affairs of The Connecticut Surety Company ("CSC") as follows:

Background to Commencement of Rehabilitation.

CSC is a Connecticut domiciled property and casualty insurance company having its principal place of business at 100 Pearl Street, 16th Floor, Hartford, Connecticut. CSC is licensed to transact the business of insurance in Connecticut, 25 other states and the District of Columbia.

Pursuant to Conn. Gen. Stat. § 38a-53, CSC filed with the Commissioner its statement of financial condition as of September 30, 2001, which reflected admitted assets of \$11.13 million, liabilities of \$6.06 million and surplus of \$5.07 million. However, among assets reported by CSC were total bonds of \$6 million. Of that amount, approximately \$2.8 million were on deposit with various states other than Connecticut and the remainder consisted of the Star Reinsurance Trust Agreement for the benefit of the book of business acquired by CSC from Star Insurance Company. In addition, a

receivable in the amount of \$1.96 million resulting from a reinsurance arrangement was and is currently overdue and may have doubtful collection value. This financial statement evidenced CSC's weak financial condition and cash flow deficiency.

Pursuant to Conn. Gen. Stat. § 38a-72, CSC was required to have \$1,000,000 in capital and surplus to be licensed. In addition, in order for an insurance company to be licensed and to remain licensed, Conn. Gen. Sec. § 38a-73(d) requires (1) its surplus must bear a reasonable relationship to its liabilities based upon the type, volume and nature of insurance business transacted and (2) its risk-based capital related to its total adjusted capital to be adequate for the types of business transacted.

On March 19, 2001, Star Insurance Company ("Star") and Alleghany Capital Corporation ("Alleghany") filed an application on Form A ("Form A") seeking approval of the Insurance Commissioner to acquire control of CSC. By letter dated June 26, 2001, Alleghany withdrew from the Form A process. Star filed an amendment to the Form A application on June 26, 2001, wherein it was the sole applicant. By letter dated August 15, 2001, Star withdrew the Form A application.

Following efforts by management to market CSC after the withdrawal of Alleghany and Star from the Form A process, Capitol Transamerica Corporation ("Capitol Transamerica"), a subsidiary of Alleghany, purchased certain assets of CSC consisting of its going forward business, certain software and tangible assets, and an option to buy the stock of CSC pursuant to that certain Asset Purchase Agreement (the "APA") dated as of January 31, 2002 by and between Capitol Transamerica. Capitol Transamerica also assumed certain lease and payroll obligations of CSC, and agreed to

assist CSC in the runoff of CSC's business at no cost to CSC. Consideration for the asset sale was (a) payment of \$260,000; (b) 1% commission on gross premium that is hereafter produced by renewals of CSC business or arises out of CSC business relationships through December 31, 2002; and (c) 10% commission payable on the profits recorded on the business produced by CSC agents or arising out of CSC business relationships. While helpful in dealing with CSC's liquidity problems, this transaction did not fully resolve such problems.

CSC's bylaws required it to have three members of the Board of Directors. On September 25, 2001, two members of the Board of Directors resigned; and on February 1, 2002, following the closing of the APA, the sole remaining director resigned, leaving CSC with no directors, in violation of its bylaws and of Conn. Gen. Stat. §§ 33-735 and 33-737(a).

Accordingly, the Insurance Department determined to place CSC in rehabilitation proceedings. On February 6, 2002, a consensual Order of Rehabilitation (the "Rehabilitation Order") was entered, which placed CSC into rehabilitation proceedings pursuant to Conn. Gen. Stat. §§ 38a-903 – 38a-961, inclusive, and appointed the Insurance Commissioner as rehabilitator. (A copy of the Rehabilitation Order is attached hereto as Exhibit A.)

Upon commencement of the rehabilitation proceeding, the Rehabilitator immediately took action to obtain custody of CSC's liquid assets and corporate books and records. The Rehabilitator's staff met with representatives of Fleet Bank and issued appropriate letters of direction to transfer control of CSC's bank accounts to the

Rehabilitator. In addition, the Rehabilitator contacted BankOne and Royal Bank of Canada regarding the transfer of control over accounts at those institutions to the Rehabilitator.

Immediately upon the commencement of the rehabilitation, the Rehabilitator retained Bingham Dana LLP of Hartford, Connecticut to represent her in the rehabilitation proceeding. Bingham Dana LLP is a nationally recognized firm that has a prominent insolvency practice and expertise in insurance insolvency matters.

Evaluation of Business Prospects for CSC.

Upon commencement of the rehabilitation, the Rehabilitator's staff immediately undertook an investigation of whether CSC could continue to pay claims under its outstanding bonds in the ordinary course. This investigation is continuing as of the date of this report. In the interim, due to the uncertainty about CSC's liquidity, the Rehabilitator has suspended the payment of claims. The Rehabilitator has requested the return of deposits by the insurance departments of other states. To date, no deposits have been returned. The Rehabilitator has also sought financing from Capitol Transamerica. If the Rehabilitator is unable to materially improve CSC's liquidity shortly, the Rehabilitator will likely seek the entry of an order of liquidation.

Employees and Office Location.

Pursuant to the APA, the Capitol Transamerica agreed to provide office space for a set period of time to CSC so that CSC could continue certain business activities. Moreover, Capitol Transamerica agreed to reimburse CSC for salary and benefits actually paid by CSC in connection with the continued employment of certain designated

employees until March 31, 2002. After the closing of the APA, CSC had only five full-time and two part-time employees. Certain of these employees will be terminated as of March 31, 2002, while others will be retained to assist the Rehabilitator's staff in the winding up of CSC's business and the continued accounting to this court.

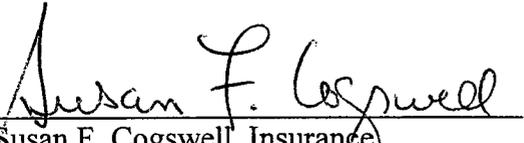
Future Actions.

The Rehabilitator is determining how best to address a range of issues which include the following: collection of deposits from other states; transfer claim handling functions on insurance issued by other insurers; management of claims against CSC on its bonds; collection of reinsurance; and termination of employees. The Rehabilitator is also attempting to determine whether these issues can be best addressed in these rehabilitation proceedings or whether liquidation proceedings are necessary.

Financial Report.

The Rehabilitator is in the process of preparing a financial report with respect to CSC's estate. This report will be filed with this court as a supplement to this First Accounting, as soon as it has been completed.

Respectfully submitted,


Susan F. Cogswell, Insurance
Commissioner of the State of Connecticut
in her capacity as Rehabilitator