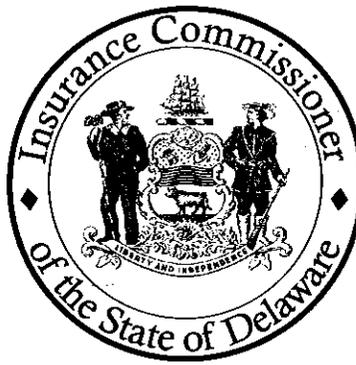


REPORT OF EXAMINATION
OF
STEADFAST INSURANCE COMPANY
AS OF
DECEMBER 31, 2006

Matthew Denn
Insurance Commissioner



Department of Insurance
841 Silver Lake Blvd.
Dover, DE 19904-2465
(302) 674-7300
(302) 739-5280 fax

REPORT ON EXAMINATION
OF THE
STEADFAST INSURANCE COMPANY
AS OF
December 31, 2006

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

Consideration has duly been 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.

A handwritten signature in black ink, appearing to read "Matt Denn", is written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 31st Day of Oct, 2008.

State of Delaware



Department of Insurance

Dover, Delaware



I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2006 of the

STEADFAST INSURANCE COMPANY

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

ATTEST BY:

Juda Sigeman

DATE: 31ST OCT. 2008



in witness whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 31ST DAY OF OCTOBER, 2008.

Matthew Denn

Insurance Commissioner

Deputy Insurance Commissioner

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SALUTATION

May 30, 2008

Honorable Alfred W. Gross
Chairman, Financial Condition (E)
Committee, NAIC
Virginia State Corporation Commission
Bureau of Insurance
1300 East Main Street
Richmond, Virginia 23219

Honorable Scott Richardson
Secretary, Southeastern Zone (II), NAIC
South Carolina Department of Insurance
1201 Main Street, Suite 1000
Columbia, South Carolina 29201

Honorable Merle D. Scheiber
Secretary, Midwestern Zone (III), NAIC
South Dakota Division of Insurance
Department of Revenue and Regulation
445 East Capitol Avenue
Pierre, SD 57501-3185

Honorable Thomas R. Sullivan
Secretary, Northeastern Zone (I), NAIC
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Secretary, Western Zone (IV), NAIC
New Mexico Public Regulation Commission
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P.E.R.A. Building, 4th Floor
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Santa Fe, New Mexico 87501

Honorable Matthew Denn
Commissioner of Insurance
State of Delaware, Insurance Department
841 Silver Lake Boulevard
Dover, DE 19904

Honorable Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 07.043, dated July 12, 2007, an examination has been made of the affairs, financial condition and management of the

STEADFAST INSURANCE COMPANY

hereinafter referred to as the "Company" incorporated under the laws of the state of Delaware as a stock Company with its statutory office located at 32 Loockerman Square, Suite 202, Dover, Delaware. The examination was conducted at the main administrative office of the Company located at 1400 American Lane, Schaumburg, Illinois. The report of the examination is respectfully submitted.

SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2003. This examination covered the three-year period from January 1, 2004 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was performed by representatives of the Delaware Department of Insurance pursuant to guidelines of the National Association of Insurance Commissioner's (NAIC) *Financial Condition Examiners Handbook* (FCEH), "Risk Surveillance" approach; and, was performed in association with a multi-state association examination of Zurich American Insurance Company (a New York domiciled company hereinafter referred to as "Zurich American" or "ZAIC") as the lead company, and ultimate parent of a group of seventeen (17) wholly owned property and casualty insurance companies (including the Company) based in the United States of America ("U.S."), hereinafter referred to as the Pool. The examination of the Company as of December 31, 2006, though separately administered by the Delaware Department of Insurance, will in addition to its own procedures, participate with and rely on significant portions of work of the multi-state association examination of the companies in the Pool.

The Risk Surveillance approach seeks to identify residual risk relating to specific operational areas that are determined in part by the evaluation of design effectiveness and operating effectiveness of internal controls. Upon the determination of medium to high residual risk, additional examination procedures are performed to determine the monetary effect upon the Company's financial statements.

The examination assessed and evaluated the Company's control environment through review and examination of Internal Control Framework ("ICF") documentation, proprietary to, and in place at ZAIC, and through other tests performed in the multi-state association examination, or as directed by the Delaware Department of Insurance. The Company and its affiliates, and ultimate parent are not publicly traded in the U. S. and are not required to comply with the Sarbanes-Oxley Act of 2002. The ICF in place, and utilized in the multi-state association examination, possesses similar objectives and formats as that of the Sarbanes-Oxley Act of 2002 with respect to documentation and tests of the Company's internal controls. The multi-state association examination and Delaware examination also relied on audit work performed by the Company's independent public accountants when appropriate.

The examination also consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities as of December 31, 2006. Transactions subsequent to the latter date were reviewed where deemed necessary.

In addition to items hereinafter incorporated as part of the written report, the following were checked and made part of the workpapers of this examination:

- Corporate Records
- Officers, Employees and Agents Benefit Program
- Legal Actions
- NAIC Ratios
- Statutory Deposits
- Market Conduct
- Significant Subsequent Events

The Pool companies in scope for this examination or being examined concurrently are as follows:

<u>Company</u>	<u>Reference name</u>	<u>Domicile</u>
Zurich American Insurance Company	ZAIC	NY
American Zurich Insurance Company	AZIC	IL
American Guarantee and Liability Insurance Company	AGLIC	NY
Steadfast Insurance Company	SIC	DE
Zurich American Insurance Company of Illinois	ZAICIL	IL
Maryland Casualty Company	MCC	MD
Maryland Insurance Company	MIC	TX
National Standard Insurance Company	NSIC	TX
Maine Bonding and Casualty Company	MBCC	ME
Northern Insurance Company of New York	NICNY	NY
Assurance Company of America	ACA	NY
Valiant Insurance Company	VIC	IA
Fidelity and Deposit Company of Maryland	FDCM	MD
Colonial American Casualty and Surety Company	CACSC	MD
Empire Fire and Marine Insurance Company	EFMIC	NE
Empire Indemnity Insurance Company	EIIC	OK
Universal Underwriters Insurance Company	UUIIC	KS
Universal Underwriters of Texas Insurance Company	UUTIC	TX

HISTORY

The Company was incorporated on August 31, 1973 under the laws of Delaware as a stock multiple lines insurance company having perpetual existence. Its original Delaware Certificate of Authority was issued on November 28, 1973. The Company's Registered and Home Offices are located at 32 Loockerman Square, Suite 202, Dover, DE 19901. The main administrative offices are located at 1400 American Lane, Schaumburg, IL 60196. The Company owns an affiliate, American Zurich Insurance Company (IL) which in turn owns Zurich American Insurance Company of Illinois (IL), an affiliate.

CAPITALIZATION

All of the outstanding shares (4,100 shares at \$1,000 par value per share) of the Company are owned by ZAIC, which is owned by Zurich Holding Company of America, Inc. ("ZHCA"), a business corporation domiciled in the state of Delaware, which is 99.87% owned directly by Zurich Insurance Company, Zurich, Switzerland ("ZIC"). ZIC is 100% owned by Zurich Group Holding, Switzerland, which in turn is 100% owned directly and indirectly by Zurich Financial Services, Switzerland ("ZFS").

Surplus as Regards Policyholders and totaling \$581,594,282 at December 31, 2006, increased by \$272,170,366 during the examination period. The major components of the change are as follows:

	<u>Common Capital Stock</u>	<u>Gross Paid in and Contributed Surplus</u>	<u>Unassigned Funds</u>	<u>Total</u>
December 31, 2003	<u>\$4,100,000</u>	<u>\$203,640,590</u>	<u>\$ 101,683,326</u>	<u>\$309,423,916</u>
Net income	\$ 0	\$ 0	\$ 34,884,739	\$ 34,884,739
Net change in unrealized capital gains and losses	0	0	22,279,233	22,279,233
Change in net deferred income tax	0	0	70,450	70,450
Change in non-admitted assets	0	0	(64,056)	(64,056)
Surplus paid-in	0	215,000,000		215,000,000
Change during the period	<u>\$ 0</u>	<u>\$215,000,000</u>	<u>\$ 57,170,366</u>	<u>\$272,170,366</u>
December 31, 2006	<u>\$4,100,000</u>	<u>\$418,640,590</u>	<u>\$158,853,692</u>	<u>\$581,594,282</u>

In 2004 and 2005, ZAIC contributed \$75 million and \$140 million respectively to the Company's surplus (totaling \$215 million). The Company, in turn, and respectively on November 12, 2004, and December 8, 2005, contributed \$35 million and \$20 million to the surplus of American Zurich Insurance Company, its wholly owned subsidiary.

MANAGEMENT AND CONTROL

Pursuant to the Company's bylaws, last amended on March 28, 2002, the corporate powers of the Company are to be exercised by a Board of Directors, the number of which "shall not be less than thirteen (13) (except for vacancies temporarily unfilled) nor more than twenty-one (21)." The number of Directors shall be determined from time to time by a vote of a majority of the entire Board of Directors. At December 31, 2006, the Board consisted of thirteen elected members, as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Axel P. Lehmann North Barrington, IL	Chairman, Zurich American Insurance Company
David A. Bowers Winnetka, IL	Executive Vice President and Corporate Secretary, Zurich American Insurance Company
Victoria F. Causa Carmel, NY	Executive Vice President, Zurich American Insurance Company
James D. Engel Medford, NJ	Executive Vice President, Zurich American Insurance Company
Michael T. Foley Barrington Hills, IL	Executive Vice President, Zurich American Insurance Company
Gary S. Kaplan Naperville, IL	Executive Vice President, Zurich American Insurance Company
John A. Kelm Crystal Lake, IL	Executive Vice President, Zurich American Insurance Company
Robert A. Lindermann Arlington Heights, IL	Executive Vice President, Zurich American Insurance Company
Tina G. Mallie Hamilton, OH	Executive Vice President, Zurich American Insurance Company
Louis J. Mannello, Jr. Barrington, IL	President, Zurich American Insurance Company
James W. March Forest Hill, NY	Director, Zurich American Insurance Company
Nancy D. Mueller Kildeer, IL	Executive Vice President, Zurich American Insurance Company
Juliet G. Nash Brooklyn, NY	Director, Zurich American Insurance Company

Committees of the Board of Directors

The Company's bylaws provide for an Executive Committee and an Audit Committee and one or more Committees in addition to the Executive and Audit Committees, each committee to consist of not less than one-third of the Directors of the Company for such purposes as the Board may from time to time determine.

Those serving on committees as of December 31, 2006, are as follows:

Executive Committee

Axel P. Lehmann
Nancy D. Mueller
Thomas A. Bradley
Tina G. Mallie
Frank A Patalano

Audit Committee

Axel P. Lehmann, Chairman
Nancy D. Mueller
Thomas A. Bradley
Tina G. Mallie

A review was made of the minutes of the Board of Directors' and Executive Committees' and Audit Committees' meetings.

Section §1304 of Delaware Insurance Code states:

An insurer shall not make any investment or loan (other than policy loans or annuity contract loans of a life insurer) unless the same is authorized or approved by the insurer's board of directors or by a committee thereof charged with supervision of investments and loans. The insurer shall maintain a full record of each investment.

The Executive Committees' minutes did reflect that investment transactions of the Company were ratified, but there was no detail (or full record of each investment transaction) included in the minutes.

It was recommended in the previous examination report that the Company approve all investment transactions in accordance with 18 Del. C., Section 1304.

It is again recommended that the Company include a full listing of each investment submitted to the Executive Committee for approval in the official records of the Executive Committee as required in 18 Del. C., Section 1304.

Principal Officers

As of December 31, 2006, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Axel P. Lehmann	Chairman & Chief Executive Officer
Louis J. Mannello, Jr.	President
David A. Bowers	Executive Vice President & Corporate Secretary
John C. Treacy	Senior Vice-President & Corporate Controller
Eleanor S. Barnard	Executive Vice-President
J. Peter Connors	Executive Vice-President
James D. Engel	Executive Vice-President
Michael T. Foley	Executive Vice-President
Craig J. Fundum	Executive Vice-President
Gary S. Kaplan	Executive Vice-President
John A. Kelm	Executive Vice-President
Robert A. Lindermann	Executive Vice-President
John H. Lynch	Executive Vice-President
Tina G. Mallie	Executive Vice-President
Nancy D Mueller	Executive Vice-President & Actuary
Steven P. Rand	Executive Vice-President

18 Del. C., Section 4919 requires that each domestic stock insurer shall promptly notify the Commissioner in writing of any change of personnel among its directors or principal officers. It was noted that three officers, two elected in 2005 and one in 2006 were not included in the statutory annual statements (Jurat page) for the applicable years. Also, one officer was shown in the 2006 annual statement but his election was not noted in the Board of Directors meetings. "Principal Officers" is deemed to include those officers usually included on the Jurat page of the statutory annual statements.

It is recommended that the Company properly reflect officers in its statutory annual statements, and notify the Delaware Department of Insurance of any changes in principal officers as required in 18 Del. C., Section 4919.

FIDELITY BONDS AND OTHER INSURANCE

During review of the Company's Directors and Officers (D&O) policy in the multi-state association examination it was noted that the complete policy was not provided by the Company, and, this was noted as applicable for all Pool companies. The Company only provided the declarations page of the "Executive Liability and Indemnification Policy," not the full policy for review. 18 Del. C., Section 320 requires that "Every person being examined, the person's officers, attorneys, employees, agents and representatives, shall make freely available to the Commissioner, or the Commissioner's examiners, the accounts, records, documents, files, information, assets and matters of such person, in the person's possession or control, relating to the subject of the examination and shall facilitate the examination." The NAIC Financial Condition Examiners Handbook, Part 2, Section P sets forth procedures for review; which is supported by 18 Del. C., Section 318.

It is recommended that the Company provide all documentation pertaining to their D&O coverage consistent with 18 Del. C., Section 320; and, as is set forth in Part 2, Section P of the NAIC Financial Condition Examiners Handbook; and, which is consistent with 18 Del. C., Section 318.

INSURANCE HOLDING COMPANY SYSTEM

A review was made of the holding company registration statements and forms filed with the Delaware Department of Insurance. Filings appear to be in compliance with Chapter 50 of Title 18 of the Delaware Insurance Code.

As previously noted, the Company is a subsidiary of Zurich Financial Services, a Switzerland domiciled holding company. The following is an organizational chart that reflects the identities and interrelationships between the Company and parent as of December 31, 2006.

Due to the large organizational make-up of the group, the chart has been limited to show the ultimate parent, immediate parent and subsidiaries of the Company.

Company	Owned By:	Percentage Owned:
Zurich Financial Services (Zurich, Switzerland)	(Ultimate Parent)	
Zurich Holding Company of America (DE)	Zurich Insurance Company (Zurich, Switzerland)	98.87%
Zurich American Insurance Company (NY)	Zurich Holding Company of America (DE)	100%
Steadfast Insurance Company (DE)	Zurich American Insurance Company (NY)	100%
American Zurich Insurance Company (IL)	Steadfast Insurance Company (DE)	100%
Zurich American Insurance Company of Illinois (IL)	American Zurich Insurance Company (IL)	100%

INTERCOMPANY AGREEMENTS

In addition to the Intercompany Pooling Agreement discussed in “Reinsurance,” the Company was a party to the following agreements with members of its holding company system at December 31, 2006:

Amended and Restated Tax Allocation Agreement

Since 1998, the Company has been a party to a tax sharing agreement between ZHCA and its subsidiaries. This agreement was amended in January 2006. The amended change made was to clarify that the intercompany tax settlements would be paid in cash or eligible investment securities. The new effective date of the agreement was January 1, 2006. The agreement was approved by the Delaware Department of Insurance on January 9, 2007.

The participants of the agreement record their apportioned tax liabilities and estimated tax payments according to terms of the agreement. Those terms provide for allocation of the consolidated Federal income tax in an amount equal to the consolidated tax liability multiplied by a fraction, the numerator of which is the separate taxable income of the member and the denominator of which is the sum of the taxable income of all the members of the consolidated

group having taxable income. If a member has no taxable income, its share shall be zero. The allocation method is consistent with Financial Accounting Standards (“FAS”) No. 109 as modified by SSAP No. 10.

The agreement provides that when a member exits, a settlement payment shall be made to ZHCA for any benefit realized by the exiting member due to lower tax payments as a result of being part of ZHCA (less than what would have been due on a separate return basis). Conversely, a settlement payment shall be made to the exiting member for any benefit realized by ZHCA resulting from utilization of losses or credits generated by the exiting member. As this provision had the potential for creating significant contingent liabilities for all members of ZHCA, beginning with the year ending December 31, 2000, companies with losses agreed by written declaration to forego tax benefits (rights to settlement payments) related to the use of their losses by ZHCA.

Investment Advisory Agreement

On January 1, 2003, ZAIC and its direct and indirect subsidiaries entered into an investment advisory agreement with Zurich Global Investment Advisors Limited (“ZGIA”) and Zurich Investment Services Limited (“ZIS”).

Under the terms of the agreement, Zurich Global Investment Management Inc. (“ZGIM”, formerly known as ZGIA), provides investment advice and develops investment guidelines for the Company’s investment committee. ZIS provides record keeping services for the companies. ZIS services include investment accounting and reporting such as monthly security acquisition and disposition information and investment income summaries.

Subsequent to the examination date, and effective January 1, 2007, this agreement was amended to allow subcontracting of certain services provided under the agreement, and in which

Steadfast Insurance Company

Zurich Insurance Company will provide certain administrative and other services (as subcontractor) for the benefit of ZAIC.

Information Technology Services Agreement

The Company participates in an information technology services agreement, which was signed on July 24, 2003. The agreement consolidates and transfers the entire mainframe-based computer processing functions that had been performed by the Company in Schaumburg, Illinois to the Data Center of Farmers Group, Inc. (“FGI”), an affiliate, in Los Angeles, California. This data center consolidation affects the data processing for all of the member companies of the Pool operating within North America. The primary objective of this data center consolidation is to reduce mainframe hardware and software costs for Zurich Financial Services’ North American operations.

During the examination period, this agreement was amended and restated effective October 17, 2006. The agreement states that FGI will provide information technology services, including electronic data processing and related services.

Effective January 1, 2007 the agreement was assigned by FGI to ZFUS Services, LLC (“ZFUSSL”), an affiliated Delaware limited liability company. The affected services will thereafter be provided by Farmers Services, LLC (“FSL”) employees, and/or ZNA Services, LLC, each an affiliated Delaware limited liability company and a direct subsidiary of ZFUS Services, LLC.

Claims Service Agreement

The Company and all pooled affiliates participate in a claims services agreement with Farmers Insurance Exchange (“FIE”) with an effective date of September 10, 2005. The agreement was made for the provision of claims adjusting services with respect to Zurich’s US

Steadfast Insurance Company

issued policies affected by Hurricane Katrina. The agreement was approved by the Delaware Department of Insurance on October 4, 2005.

ZAIC – ZSC Contract for Services

The Zurich Pool companies participate in a service agreement, effective November 17, 2003, with Zurich Services Corporation (“ZSC”). The Zurich Pool companies provide certain insurance benefits and services under policies issued by the Zurich Pool companies. ZSC has contracted with a network of physicians and other health care providers to provide health care services, and agrees to make available a provider network to persons insured under policies issued by the Zurich Pool companies.

The Zurich Pool companies compensate ZSC for the performance of its obligations under this agreement on an actual cost basis for the fair and reasonable value of services rendered.

Other Agreements

Intercompany Pooling Agreement

The Company also participates in a reinsurance pooling arrangement with ZAIC. Further comments may be found under the section entitled “Reinsurance.”

Services Agreement

It was noted that the Company did not have a services agreement in place during the examination period for financial reporting, regulatory services and tax services being provided to Pool participants in connection with the Intercompany Pooling Agreement. However, it was noted that an agreement executed effective January 1, 2007 was filed with the Delaware Department of Insurance on January 10, 2007 and approved on January 19, 2007.

REINSURANCE

Assumed Reinsurance

The Company assumed premiums of \$369,990,978 during 2006 (\$341,447,700 or 92% from affiliates). The remainder, totaling \$28,543,278 of the assumed premiums, is from pools and associations and non-U.S. insurers. All direct and assumed premiums (representing 100% of the \$369,990,978) are ceded to ZAIC under a Pooling Agreement, leaving \$0 net premiums written in the Company.

Ceded Reinsurance

The Company ceded premiums of \$1,782,224,268 during 2006; \$1,406,530,260, or 79% to affiliates, and \$375,694,008, or 21% to non-affiliates.

Intercompany Pooling Agreement

Effective January 1, 1999 the Company entered into an amended Pooling Agreement (the Zurich-American Insurance Companies Amended Inter-Company Pooling Agreement, or the “Pooling Agreement”) with ZAIC and 17 affiliated insurers (“Participant(s),” together with ZAIC, the “Pool”).

The original agreement (including the Company as a Participant) was effective January 1, 1993. Subsequent to January 1, 1999, six amendments have been made to the Amended Agreement, each adding or deleting Participants in the Pool. During 2006, the Company ceded \$1,288,506,000 or 72% of its premiums to the Pool.

The Pooling Agreement provides that all transactions included in the net income or loss resulting from each Participant’s underwriting operations and the related asset and liability accounts after effects of third-party reinsurance associated with the Participants’ external placement of reinsurance are distributed to ZAIC 100% with no retrocession, leaving \$0 in net

premiums written to the Company. With the exception of residual balances attributable to timing differences; the remaining assets, liabilities and income on each Participants' balance sheets and income statements are related to required statutory deposits, investments and associated investment income only. ZAIC also agrees to be liable for any amounts disallowed any of the Participants on account of reinsurance with unauthorized companies and any amounts for non-admitted assets. As a result, there was no liability for "Provision for Reinsurance" reported by the Company as of December 31, 2006, since the liability is carried by ZAIC.

Reinsurance-Other Compliance Issues

As mentioned, the examination was performed in association with a multi-state association examination of ZAIC as the lead company of the Pool. Certain portions of records reviewed in the multi-state association examination, and found applicable to the Company's reinsurance records and transactions, were noted for the following exceptions:

In review of trust agreements, it was noted that the Company has some reinsurance trust accounts with multiple beneficiaries. This is in violation of Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Sections 10.1.1 and 10.2.4.5.

It is recommended that the Company amend its trust agreements to comply with Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Sections 10.1.1 and 10.2.4.5.

During review it was noted that all of the captive reinsurance treaties reviewed failed to provide language, "that in the event of insolvency of the ceding insurer, reinsurance proceeds shall be paid under a contract(s) reinsured by the assuming insurer on the basis of the amount of the claim allowed in the insolvency proceeding without diminution by reason of the inability of the ceding insurer to pay all or any part of the claim." This is contrary to 18 Del. C., Section 914(a) which states: "No credit shall be allowed as an admitted asset or deduction from liability unless the reinsurance agreement provides that in the event of insolvency of the ceding insurer,

reinsurance proceeds shall be paid under a contract(s) reinsured by the assuming insurer on the basis of the amount of the claim allowed in the insolvency proceeding without diminution by reason of the inability of the ceding insurer to pay all or any part of the claim.”

It is recommended that all reinsurance agreements with the Company named Cedent contain provisions as set forth in 18 Del. C., Section 914(a).

It was noted that seven letters of credit contained wording requiring the beneficiary to submit the original letter of credit and all original amendments as a condition to being able to draw on the letter of credit. Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Section 11.1 states that “The letter of credit shall contain an issue date and date of expiration and shall stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds and that no other document need be presented.”

It was noted further that letters of credit used by the Company contained multiple beneficiaries. Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Section 11.1 defines "beneficiary" the domestic insurer for whose benefit the letter of credit has been established (and) any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

It is recommended that the Company amend applicable letters of credit to comply with Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Section 11.1.

TERRITORY AND PLAN OF OPERATION

The Company is licensed only in the State of Delaware, but operates as a surplus lines insurer in all of the remaining states and the District of Columbia. The Company writes fire, allied lines, commercial multiple peril, inland marine, medical malpractice on an occurrence and claims made basis, earthquake, group accident and health, worker’s compensation, other liability on an occurrence and claims made basis, products liability on a claims made and occurrence basis, commercial auto liability, auto physical damage, burglary and theft, boiler and machinery, and credit insurance. The Company utilizes the resources of ZAIC to market its products.

GROWTH OF COMPANY

The following information, obtained from the Company’s filed Annual Statements, reflects the Company’s growth for the period under review:

	<u>Net Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>	<u>Direct Written Premium</u>	<u>Net Income</u>
2004	\$557,091,643	\$397,753,944	\$1,438,335,078	\$7,924,763
2005	747,193,971	555,865,090	1,559,987,112	10,461,670
2006	772,945,721	581,594,282	1,412,233,290	16,498,306

ACCOUNTS AND RECORDS

The accounts and records of the Company and its affiliates are maintained by the use of electronic data processing equipment and pre-programmed insurance related software packages.

During the course of examination, operational and organization controls in place in the Company's accounts and records were analyzed and tested. Based on the results of the work performed, it appears the data supporting the balances in the Company's financial statements is reasonably accurate and complete.

Actuarial work and certifications are performed by actuarial staff employees of ZAIC.

An independent CPA firm audits the Company financial statements and records annually.

FINANCIAL STATEMENTS

The financial condition of the Company as of December 31, 2006, and the results of its operations for the period under examination are reflected in the following statements:

- Analysis of Assets
- Liabilities, Surplus and Other Funds
- Statement of Income
- Capital and Surplus Account
- Schedule of Examination Changes

It should be noted that the various schedules may not add to the totals shown due to rounding.

Analysis of Assets
December 31, 2006

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 360,951,833	\$ 0	\$ 360,951,833	1
Common stocks (affiliates)	208,859,765	0	208,859,765	
Cash, cash equivalents and short-term investments	<u>51,734,721</u>	<u>0</u>	<u>51,734,721</u>	
Subtotals, cash and invested assets	\$ 621,546,319	\$ 0	\$ 621,546,319	
Investment income due and accrued	3,926,680	0	3,926,680	
Uncollected premiums and agents' balances in the course of collection	17,299,568	0	17,299,568	
Amounts recoverable from reinsurers	(14,618,612)	0	(14,618,612)	
Net deferred tax asset	234,813	187,850	46,963	
Receivable from parent, subsidiaries and affiliates	<u>144,744,803</u>	<u>0</u>	<u>144,744,803</u>	
Totals	<u>\$ 773,133,571</u>	<u>\$ 187,850</u>	<u>\$ 772,945,721</u>	

Liabilities, Surplus and Other Funds

December 31, 2006

Notes

Other Expenses	\$ 26,938
Federal and foreign income taxes	332,431
Ceded reinsurance premiums payable	147,454,149
Provision for reinsurance	0
Aggregate write-ins for liabilities	<u>43,537,921</u>
Total liabilities	\$ 191,351,439
Common capital stock	<u>\$ 4,100,000</u>
Gross paid in and contributed surplus	\$ 418,640,590
Unassigned funds (surplus)	<u>158,853,692</u>
Surplus as regards policyholders	<u>\$ 581,594,282</u>
Total Liabilities and Surplus	<u>\$ 772,945,721</u>

Statement of Income

December 31, 2006

Investment Income

Net investment income earned	\$ 17,548,770
Net realized capital gains or (losses)	<u>(927,255)</u>
Total investment gain or (loss)	\$ <u>16,621,514</u>
Net income before dividends to policyholders and federal income taxes	\$ 16,621,514
Dividends to policyholders	<u>0</u>
Net income after dividends to policyholders and before federal income taxes	\$ 16,621,514
Federal and foreign income taxes incurred (excluding tax on capital gains)	<u>123,208</u>
Net income	<u>\$ 16,498,306</u>

Capital and Surplus Account
December 31, 2006

Surplus as regards policyholders, December 31, 2003	\$ 555,865,090
Net income	16,498,306
Change in net unrealized capital gains or (losses)	9,224,492
Change in net deferred income tax	83,077
Change in nonadmitted assets	<u>(76,683)</u>
Net change in capital and surplus for the year	<u>\$ 25,729,192</u>
Surplus as regards policyholders, December 31, 2006	<u>\$ 581,594,282</u>

NOTES TO FINANCIAL STATEMENTS

Note 1 – Bonds

\$ 360,951,833

The Company keeps the majority of its investments in the care of a custodian in New York. The examiners noted that the Company’s Insurance Company Custody Agreement for these investments was approved by the Company Board of Directors on August 22, 2005. No authorization (approval by the Board of Directors) was found for an Amendment to the Insurance Company Custody Agreement dated February 14, 2006.

It is recommended that the Board of Directors approve agreements (and amendments) to the Insurance Company Custody Agreement as required by Part 1, IV. J.1 of the NAIC Financial Condition Examiners' Handbook; and, which is in accordance with 18 Del.C., Section 320(a).

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The prior examination report as of December 31, 2003, contained seven recommendations. Those recommendations and current status are as follows:

1. It was recommended that the Company immediately initiate procedures to ensure the Company's governing bodies meet periodically and on the respective dates specified in the bylaws and that the proceedings of the meetings are duly recorded in writing.

STATUS: Appropriate dates for meetings now coincide with the Company's bylaws and are appropriately documented.

2. It was recommended that the Company immediately initiate procedures to ensure the Company complies with §1304 of the Delaware Insurance Code, that requires the Board of Directors periodically review and approve investment transactions of the Company. It was noted during the course of the examination the Company's Board of Directors did not approve the Company's investment transactions in 2001.

STATUS: The Executive Committees' minutes did reflect that investment transactions of the Company were ratified, but there was no detail (or full record of investment transactions) included in the minutes. The Company has not complied with this recommendation.

3. It was recommended that the Company immediately initiate the procedures necessary to comply with the requirements of NAIC Handbook Part I General, IV.J.1 pertaining to the approval of the investment custodial agreement.

STATUS: The Insurance Company Custody Agreement was approved by the Board of Directors on August 22, 2005.

4. It was recommended that the Company immediately initiate the procedures necessary to comply with the requirements of NAIC Handbook Part I General, IV.J.2 pertaining to the inclusion of the required termination language in the custodial agreement.

STATUS: The Insurance Company Custody Agreement dated December 1, 2002 was amended February 14, 2006 to include recommended termination language of the NAIC Handbook, Part 1, IV.J.2.

5. It was recommended that the Company immediately initiate the procedures necessary to obtain its own separate and distinct securities lending agreement.

STATUS: A Securities Lending Agreement dated July 6, 2005 was executed naming the Company as a “Lender” (along with the other participating affiliates). The Agreement was approved by the Company’s Board of Directors August 22, 2005.

6. It was recommended that the Company immediately initiate measures to ensure future compliance with SSAP #43 pertaining to the proper disclosure of the book value adjustment methodology used for loan-backed securities in the annual statement.

ACTION: The Company now states how loan backed securities are calculated in Footnote C.4 of the Notes to Financial Statements in the statutory annual statements.

7. It was recommended the Company immediately initiate procedures to ensure that the agents utilized to market its products are properly licensed and appointed.

ACTION: The Company is a non-admitted carrier (surplus lines insurance) and therefore agents are not appointed. Business is written through surplus lines brokers. No exceptions were noted.

SUMMARY OF CURRENT RECOMMENDATIONS

1. It is again recommended that the Company include a full listing of each investment submitted to the Executive Committee for approval in the official records of the Executive Committee as required in 18 Del. C., Section 1304 (p.7).
2. It is recommended that the Company properly reflect officers in its statutory annual statements, and notify the Commissioner in writing of any change of personnel among its directors or principal officers as required in 18 Del.C., Section 4919 (p. 8).
3. It is recommended that the Company provide all documentation pertaining to their D&O coverage consistent with 18 Del. C., Section 320; and, as is set forth in Part 2, Section P of the NAIC Financial Condition Examiners Handbook; and, which is consistent with 18 Del. C., Section 318 (p. 9).
4. It is recommended that the Company amend its trust agreements to comply with Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Sections 10.1.1 and 10.2.4.5 (p. 15).
5. It is recommended that all reinsurance agreements with the Company named Cedent contain provisions as set forth in 18 Del. C. Section 914(a) (p. 16).
6. It is recommended that the Company amend applicable letters of credit to comply with Delaware Insurance Department Regulation 1003, Credit for Reinsurance, Section 11.1 (p. 16).

7. It is recommended that the Board of Directors approve agreements (and amendments) to the Insurance Company Custody Agreement as required by Part 1, IV. J.1 of the NAIC Financial Condition Examiners' Handbook; and, which is in accordance with 18 Del.C., Section 320(a) (p. 21).

CONCLUSION

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

<u>Description</u>	<u>December 31, 2006</u>	<u>December 31, 2003</u>	<u>Increase (Decrease)</u>
Assets	\$ <u>772,945,721</u>	\$ <u>309,615,255</u>	\$ <u>463,330,466</u>
Liabilities	\$ 191,351,439	\$ 191,339	\$ 191,160,100
Surplus as regards policyholders	\$ <u>581,594,282</u>	\$ <u>309,423,916</u>	\$ <u>272,170,366</u>
Totals	\$ <u>772,945,721</u>	\$ <u>309,615,255</u>	\$ <u>463,330,466</u>

Respectfully submitted,



Donald M. Sanders, CFE
 Examiner-In-Charge
 Department of Insurance
 State of Delaware