REPORT OF EXAMINATION
OF THE

EMPLOYERS DIRECT INSURANCE COMPANY

AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

Filed September 28, 2010

TABLE OF CONTENTS

PAGE

SCOPE OF EXAMINATION 1

SUMMARY OF SIGNIFICANT FINDINGS 2

SUBSEQUENT EVENTS 2

COMPANY HISTORY 3

MANAGEMENT AND CONTROL: 4
- Management Agreements 6
- Corporate Governance 8

TERRITORY AND PLAN OF OPERATION 9

LOSS EXPERIENCE 10

CASH FLOW FROM OPERATIONS EXPERIENCE 11

REINSURANCE: 11
- Assumed 11
- Ceded 11

FINANCIAL STATEMENTS: 13
- Statement of Financial Condition as of December 31, 2008 14
- Underwriting and Investment Exhibit for the Year Ended December 31, 2008 16
- Reconciliation of Surplus as Regards Policyholders from June 30, 2004 through December 31, 2008 17
- Reconciliation of Examination Changes as of December 31, 2008 18

COMMENTS ON FINANCIAL STATEMENT ITEMS: 19
- Workers' Compensation Deposits 19
- Current Federal and Foreign Income Tax Recoverable 19
- Net Deferred Tax Asset 19
- Losses and Loss Adjustment Expenses 19
- Funds Held by Company under Reinsurance Treaties 20
- Provision for Reinsurance 20

SUMMARY OF COMMENTS AND RECOMMENDATIONS: 20
- Current Report of Examination 20
- Previous Report of Examination 21

ACKNOWLEDGEMENT 22

Los Angeles, California
August 26, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

EMPLOYERS DIRECT INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 30301 Agoura Road, Suite 100, Agoura Hills, California 91301.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of June 30, 2004. This examination covers the period from July 1, 2004 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2008 as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; and sales and advertising.

SUMMARY OF SIGNIFICANT FINDINGS

As a result of this examination, surplus as regards policyholders as of December 31, 2008 has been reduced by $65.5 million, or 46.6 percent, to $75.2 million. The examination reduction results from an increase in the cumulative liability for losses and loss adjustment expenses of $65.3 million, an increase to funds held by company under reinsurance treaties of $10.9 million, and an increase in the provision for reinsurance of $13.6 million based on a review performed by a Casualty Actuary from the California Department of Insurance. These adjustments were offset by increases to current federal tax recoverable and the net deferred tax asset of $23.2 million and $1 million, respectively. A more detailed discussion of the examination adjustments as of year-end is reflected under the "Comments on Financial Statement Items" section of this report.

Included in the above reserve analysis was a review of the Company's reported reserves for losses and loss adjustment expenses as of December 31, 2009. Reflecting a June 30, 2009 reserve strengthening by the Company, the Company's December 31, 2009 reported reserves for losses and loss adjustment expenses were determined to be deficient by $46.4 million. The Company's parent made a capital contribution to increase surplus as a result of the indicated deficiency.

SUBSEQUENT EVENTS

On June 30, 2009, the Company's direct parent, Employers Direct Corporation (EDC), announced that the Company would cease soliciting new and renewal California business on a direct basis effective August 1, 2009.

On August 25, 2009, EDC announced the simultaneous sale of the renewal rights to the Company's directly placed workers' compensation insurance policies and the sale of the assets of its employee benefit consulting subsidiary, eDirect Insurance Services. The effective date of the transaction was September 1, 2009. It was further announced that in the future the Company will distribute its workers' compensation policies exclusively through independent agents and brokers.

Effective April 12, 2010, management announced the change of the Company's name to Pacific Compensation Insurance Company. In addition the name of the Company's direct parent was changed to Pacific Compensation Corporation (PCC).

On September 27, 2010, the Company's ultimate parent Alleghany Corporation made a capital contribution of $40 million to PCC, which in turn made a contribution in the same amount to the Company, the proceeds of which will be added to the Company's California workers' compensation deposit to bring the deposit to a level consistent with this examination's estimate of loss and loss adjustment expense reserves. Of the amount contributed $5 million was credited to "receivable from parent, subsidiaries and affiliates" (which was reported as a non-admitted asset as of December 31, 2009) and the remaining $35 million was credited to "gross paid-in and contributed surplus."

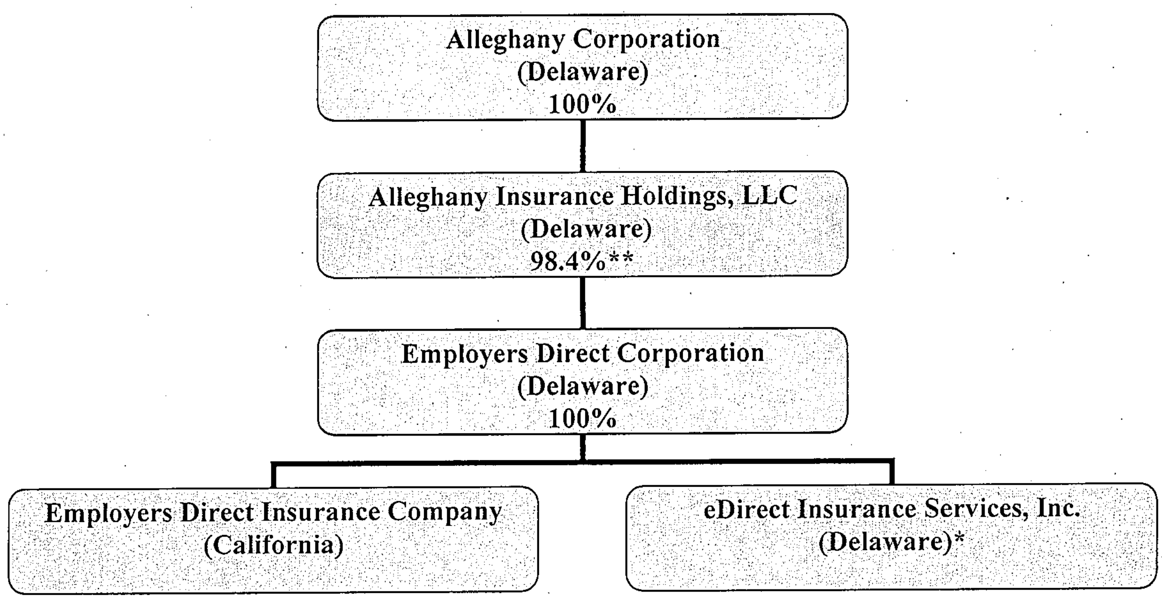
COMPANY HISTORY

The Company is a wholly-owned subsidiary of Employers Direct Corporation (EDC), a privately held corporation domiciled in Delaware. Effective July 18, 2007, Alleghany Insurance Holdings, LLC (AIHL), the insurance holding company subsidiary of the Alleghany Corporation, acquired approximately 98.4% of the common stock of EDC. The Alleghany Corporation, a Delaware domiciled publicly traded corporation, is engaged through AIHL in the property and casualty insurance business. Approval for the acquisition was granted by the California Department of Insurance on July 13, 2007. The remaining 1.6% owned by EDC senior management was acquired by AIHL during first quarter of 2009.

On August 16, 2007, AIHL transferred $50 million in cash to EDC. The proceeds were then transferred to the Company as a capital contribution. As a result of the transaction, the Company's gross paid-in and contributed surplus increased from $47.6 million to $97.6 million.

MANAGEMENT AND CONTROL

Ultimate control of the Company is maintained by the Alleghany Corporation. The following abbreviated organizational chart depicts the Company's relationship within the holding company system:



* Prior to the sale of eDirect Insurance Services, Inc.'s assets on September 1, 2009, the entity was engaged in the solicitation and sale of employee benefits and health and welfare products issued by unaffiliated insurers to the Company's current and prospective policyholders, customers and clients.

**During the 1st quarter of 2009, Alleghany Insurance Holdings, LLC acquired the remaining outstanding shares of Employers Direct Corporation.

Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

Directors

Name and Residence	Principal Business Affiliation
Roger B. Gorham Hillsborough, New Jersey	Senior Vice President and Chief Financial Officer Alleghany Corporation
Ronald A. Groden Moorpark, California	Vice Chairman, Executive Vice President, and Chief Financial Officer Employers Direct Corporation
James E. Little Agoura Hills, California	Chairman, President and Chief Executive Officer Employers Direct Corporation
William M. Wilt Madison, New Jersey	Vice President Alleghany Corporation

Principal Officers

Name	Title
James E. Little	President and Chief Executive Officer
Ronald A. Groden	Executive Vice President and Chief Financial Officer
Joseph A. Cardenas	Vice President and Chief Information Officer
June E. Duxler	Vice President - Human Resources and Administration
Roger B. Gorham	Vice President - Investments
Douglas H. Helm*	Vice President – Business Development
J. Hun Kim**	Senior Vice President and Chief Actuary

* last day of employment was March 17, 2010
**last day of employment was March 31, 2010

Name	Title
Denise K. Richardson	Vice President and Controller
Joyce S. Schulman	Vice President - Claims
Jon P. Siglar	Vice President – Chief Sales and Field Services Officer
Karen A. Sterner	Vice President - Underwriting and Premium Audit
Mark E. Webb	Vice President – Governmental Relations, Assistant General Counsel, and Chief Compliance Officer

Management Agreements

Administrative/Facilities Service Agreement: Effective June 14, 2007, the California Department of Insurance (CDI) approved an administrative/facilities service agreement between the Company and eDirect Insurance Services, Inc. (eDirect)*, a wholly-owned direct subsidiary of Employers Direct Corporation (EDC), the Company's immediate parent. Under the terms of the agreement, the Company provided certain administrative support services and facilities to eDirect including, but not limited to, financial reporting, budget and cost accounting, personnel, legal, office services, policy records, information technology, computer, and communication services. Reimbursement for services provided was predicated on an actual cost basis. With respect to services rendered during 2008, eDirect paid the Company a total of $453,479.

Tax Sharing Agreement: The Company entered into a tax sharing agreement with EDC on January 1, 2003. Effective August 14, 2007, an amendment to this agreement to include eDirect, was approved by the CDI. Allocation of taxes is based on separate return calculations with current credit for net losses to the extent utilized by the consolidating entities. Intercompany tax balances are settled in the quarter subsequent to the filing of the consolidated tax return.

*With the sale of its assets on September 1, 2009, eDirect was transformed into a shell organization.

Investment Management Agreements: Authorization for the direct management of the Company's investment portfolio has been granted to two individual management firms, one an affiliate. Each firm is responsible for a designated segment of the Company's investment portfolio. Within the confines of the Company's codified guidelines, each investment management firm has the authority to execute transactions without prior consultation with the Company's management.

Effective August 1, 2007, an existing investment management agreement between General Re-New England Asset Management (GR-NEAM) and the Alleghany Corporation was amended to include the management of the Company's fixed income portfolio. Management fees for services provided under this agreement are calculated as follows: annual fee of .12% on the first $500 million of the market value of assets managed; .10% on the next $1 billion of the market value of assets managed; and .05% on the market value of the remaining assets under management. During the year 2008, Company paid GR-NEAM $300,153.

On December 19, 2007, the CDI approved an investment management agreement between the Company and Alleghany Capital Partners, Inc. (ACP), a subsidiary of Alleghany Corporation, the Company's ultimate parent. The agreement, which became effective January 1, 2008, provides for the management of the Company's equity account consisting of cash, equity securities, and other assets. Management fees for services provided are calculated as follows: annual fee of 1.0% on the first $200 million of the market value of assets managed; 0.5% on the next $200 million of the market value of assets managed; and .25% on the market value of the remaining assets under management. During 2008, the Company paid ACP $215,668.

On March 23, 2007, the Company entered into a renewable term loan line of credit with its parent, Employers Direct Corporation, providing for loans in an aggregate amount of up to $5 million. Effective August 26, 2009, the borrowing limit was increased from $5 million to $6 million. As of year-end 2008, the outstanding principal balance owed to the Company totaled $5 million and is reflected as a non-admitted asset in the Company's annual statement. This agreement did not require CDI approval pursuant to California Insurance Code Section 1215.1 (1) (A).

Corporate Governance

The Company maintained a performance driven incentive plan ("bonus plan") for its senior executives. The bonus plan expired on payout in March 2008. In general, the bonus calculation was predicated on the differential between the budgeted (formulated at the beginning of the calendar year) and the year-end booked GAAP pre-tax underwriting income (underwriting income) for the bonus period year. Based upon the Company's audited GAAP underwriting income for the 2007 bonus period year, payments of $1.4 million were paid to senior executives covered under the bonus plan.

However, the Company's 2nd Quarter 2008 Internal Loss and Loss Adjustment Expense Reserve Analysis Report (dated May 31, 2008) reported a $12.5 million developed reserve deficiency pertaining to losses incurred during 2007, which had it been recognized as of December 31, 2007, would have eliminated the bonuses. As noted in the Company's filed 2008 Annual Statement, the one year developed deficiency for this period increased to $23.9 million.

On January 25, 2008, the Company approved the terms of a requested proposal (dated January 14, 2008) for the review of the assumptions supporting its pricing model relating to policies issued between 2003 thru 2007. Bonus payments were distributed to the plan participants prior to the consultant's initial presentation of findings to management.

For the purpose of enhancing the Company's corporate governance practices, the following recommendations are made based on the fact that the benchmark supporting the 2007 performance incentive compensation payments was not met based upon subsequently determined loss development:

- To align incentive compensation with actual performance, it is recommended that the board of directors implement revisions to any future performance driven plans to take into account the fact that it may take several years to determine ultimate losses for workers' compensation business in California. As such, it would be more prudent and reasonable to include provisions within such plans that a) require calculations of bonus payments on more developed estimates of losses and income, or b) allow the Company to recoup performance based incentive payments through some contractual mechanism (e.g., credits against future bonuses or "claw back") if it is later determined that the performance criteria were not achieved.

- To avoid an inherent conflict of interest, it is recommended that the incentive compensation calculation formula for the Company's actuary should be predicated upon the accuracy of reserves rather than underwriting results.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to write liability and workers' compensation business in Arizona, California, Colorado, Idaho, Illinois, Nevada, Oregon, and Utah.

During the period under review, writings were limited to workers' compensation coverages. The Company offered guaranteed cost, retrospectively rated and large deductible policies which were marketed through its own direct sales force. In general, the Company targeted employers whose annual premiums are at least $50,000. During 2008, the Company wrote $76.9 million of direct business. Of the direct business written, all but $136,731 was written in California.

Since its inception in 2002, the Company has maintained the practice of selling workers' compensation policies primarily on a direct basis rather than through an agency system. Effective August 1, 2009, the Company ceased soliciting new and renewal California business on a direct basis. During 2008, over 99 percent of the direct premiums written pertained to California risks. Effective September 1, 2009, the renewal rights to its directly placed workers' compensation policies were sold to an independent brokerage firm. Aside from business produced by its direct sales force, the Company is also a party to two separate administrator underwriting agreements relating to certain program business. With a minor exception, neither of the managing general underwriters has produced any new business since July 31, 2009. As such, the Company's operations are currently limited to servicing existing policies and the payment of claims incurred prior to the moratorium.

Management has represented that (1) the Company intends to re-enter the market at such time as it determines that rates have returned to an adequate level, and (2) that in the future it will distribute workers' compensation policies exclusively through independent agents and brokers.

LOSS EXPERIENCE

The following is a summary of the Company's reported net underwriting and operational results for the years under review:

Year	Net Underwriting Gain or (Loss)	Net Income or (Loss)
2004	$ 17.1 million	$ 9.1 million
2005	$ 28.1 million	$ 17.3 million
2006	$ 62.4 million	$ 47.1 million
2007	$ 11.8 million	$ 16.3 million
2008	$(56.4) million	$(39.0) million
2009	$(70.0) million	$(33.5) million

The reported 2009 $70.0 million underwriting loss reflects the substantial decrease in net premiums resulting from the Company's decision to cease soliciting new and renewal business on a direct basis in June 2009 and a $34.5 million current and prior accident year reserve increase recorded during the second quarter of 2009.

CASH FLOW FROM OPERATIONS EXPERIENCE

The following is a summary of the Company's reported cash flow from operations experience for the years under review and the subsequent three quarters of 2009:

Year	Net Cash from Operations
2004	$ 72.5 million
2005	$ 85.0 million
2006	$ 62.4 million
2007	$ 28.7 million
2008	$(10.5) million
2009	$(31.1) million*

*The reported 2009 net cash from operations includes a $17.0 million federal income tax recovery. Excluding this event, net cash from operations for the period would have totaled a negative $48.1 million.

REINSURANCE

Assumed

With the exception of the Company's minor participation in the National Council on Compensation Insurance Pool, the Company did not assume reinsurance during the period under review.

Ceded

The Company's ceded reinsurance program provides protection for all business classified by the Company as workers' compensation and employers' liability. At year-end 2008, the Company maintained excess of loss reinsurance coverage for losses in excess of $1 million up to an aggregate amount of $75 million. The Company is solely responsible for any loss above $75 million. As of December 31, 2008, the Company maintained the following reinsurance agreements:

Type of Contract	Reinsurer's Name*	Company's Retention	Reinsurers' Limits
First Excess of Loss	100.00% Allianz Risk Transfer (U)	$1 million	$9 million each and every occurrence
Second Excess of Loss	10.00% Endurance Specialty Ins (U) 7.50% Flagstone Reassurance (U) 10.00% Partner Re (A) 25.00% Tokio Millenium Re (U) 15.00% Aspen Insurance UK Ltd (A) 32.50% Lloyd's Syndicates (A)	$10 million	$10 million each and every occurrence
Third Excess of Loss	10.00% Axis Specialty Ltd (U) 15.00% Endurance Specialty Ins (U) 13.75% Flagstone Reassurance (U) 7.50% Munich Re America (A) 7.50% Partner Re (A) 15.00% Aspen Insurance UK Ltd (A) 31.25% Lloyd's Syndicates (A)	$20 million	$20 million each and every occurrence
Fourth Excess of Loss	14.29% Allied World Assurance (U) 10.00% Axis Specialty Ltd (U) 15.00% Endurance Specialty Ins (U) 10.00% Everest Reinsurance Co (A) 5.46% Flagstone Reassurance (U) 15.00% Aspen Insurance UK Ltd (A) 30.25% Lloyd's Syndicates (A)	$40 million	$35 million each and every occurrence
NCBR**	100.00% Catlin Insurance Co (U)	$5 million	$10 million each and every occurrence

* (A) - authorized reinsurer
(U) - unauthorized reinsurer
** nuclear, chemical, biological, and radiological coverage

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders
from June 30, 2004 through December 31, 2008

Reconciliation of Examination Changes as of December 31, 2008

Statement of Financial Condition
as of December 31, 2008

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$303,525,340	$	$303,525,340	(1)
Common stocks	10,645,570		10,645,570	
Cash and short-term investments	16,518,139		16,518,139	
Other invested assets	615,900		615,900	
Receivables for securities	12,195		12,195	
Investment income due or accrued	3,551,412		3,551,412	
Uncollected premiums and agents' balances in course of collection	871,593	146,372	725,221	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,208,556	111,415	1,097,141	
Accrued retrospective premiums	2,045,959	626,378	1,419,581	
Current federal and foreign income tax recoverable	16,725,626	(23,187,669)	39,913,295	(2)
Net deferred tax asset	21,227,596	12,746,995	8,480,601	(2)
Guaranty funds receivable or on deposit	4,819,251		4,819,251	
Electronic data processing equipment and software	2,071,093	2,071,093		
Furniture and equipment	1,568,339	1,568,339		
Receivables from parent, subsidiaries and affiliates	5,452,778	5,452,778		
Other amounts receivable	68,251		68,251	
Aggregate write-ins for other than invested assets	4,264,072	1,733,970	2,530,102	
Total assets	$395,191,670	$1,269,671	$393,921,999	

Statement of Financial Condition
as of December 31, 2008
(Continued)

Liabilities, Surplus and Other Funds

Losses		$232,633,708	(3)
Loss adjustment expenses		40,865,523	(3)
Commissions payable, contingent commissions and other similar charges		142,874	
Other expenses		3,890,561	
Taxes, licenses and fees		662,880	
Unearned premiums		4,406,095	
Advance premium		327,323	
Ceded reinsurance premiums payable		69,600	
Funds held by company under reinsurance treaties		18,170,551	(4)
Amounts withheld or retained by company for account of others		924,735	
Remittances and items not allocated		95,738	
Provision for reinsurance		13,598,516	(5)
Aggregate write-ins for liabilities		2,936,509	
Total liabilities		318,724,613	
Common capital stock	$ 2,600,000		
Gross paid-in and contributed surplus	97,587,500		
Unassigned funds (surplus)	(24,990,114)		
Surplus as regards policyholders		75,197,386	
Total liabilities, surplus and other funds		$393,921,999	

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Statement of Income

Underwriting Income		
Premiums earned		$ 63,361,140
Deductions:		
Losses incurred	$162,393,056	
Loss expenses incurred	4,194,872	
Other underwriting expenses incurred	28,033,129	
Aggregate write-ins for underwriting deductions	1,316,594	
Total underwriting deductions		195,937,651
Net underwriting loss		(132,576,511)
Investment Income		
Net investment income earned	$ 12,715,826	
Net realized capital losses	(11,660,730)	
Net investment gain		1,055,096
Other Income		
Net loss from agents' or premium balances charged off	$ (258,883)	
Aggregate write-ins for miscellaneous income	365,758	
Total other income		106,875
Net income before federal income taxes		(131,414,540)
Federal and foreign income taxes incurred		(39,482,146)
Net loss		$ (91,932,394)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		$ 182,843,232
Net loss	$ (91,929,394)	
Change in net unrealized capital losses	(1,478,472)	
Change in net deferred income tax	8,982,868	
Change in nonadmitted assets	(11,094,636)	
Change in provision for reinsurance	(12,126,212)	
Change in surplus as regards policyholders		(107,645,846)
Surplus as regards policyholders, December 31, 2008		$ 75,197,386

Reconciliation of Surplus as Regards Policyholders
from June 30, 2004 through December 31, 2008

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, June 30, 2004, per Examination			$ 50,018,862
Net income	$	$ 3,929,332	
Change in net unrealized capital losses		1,278,760	
Change in net deferred income tax	16,386,808		
Change in nonadmitted assets and related items		22,401,675	
Change in provision for reinsurance		13,598,516	
Surplus adjustment – paid in	50,000,000		
Aggregate write-ins for losses in surplus		1	
Totals	$ 66,386,808	$ 41,208,284	
Net increase in surplus as regards policyholders			25,178,524
Surplus as regards policyholders, December 31, 2008, per Examination			$ 75,197,386

Reconciliation of Examination Changes
as of December 31, 2008

	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Assets				
Current federal income tax recoverable	$ 16,725,626	$ 39,913,295	$ 23,187,669	(2)
Net deferred tax asset	7,470,973	8,480,601	1,009,628	(2)
Liabilities				
Losses and loss adjustment expenses	208,210,089	273,499,231	$ (65,289,142)	(3)
Funds held by company under reinsurance treaties	7,318,041	18,170,551	(10,852,510)	(4)
Provision for reinsurance	45,083	13,598,516	(13,553,433)	(5)
Net decrease to surplus as regards policyholders			(65,497,788)	
Surplus as Regards Policyholders, December 31, 2008 per Company			140,695,174	
Surplus as Regards Policyholders, December 31, 2008 per Examination			$ 75,197,386	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Workers' Compensation Deposits

California Insurance Code (CIC) Section 11691 states, in part, that an insurer writing workers' compensation business in the State of California must maintain a deposit with the state to provide protection to the workers of the state in the event that it is unable to pay compensable workers' compensation claims when due. With consideration given to $65.3 million reserve deficiency, it is recommended that Company recalculate its current workers' compensation deposit requirements and fund any deficiencies. As noted under the "Subsequent Events" section, the Company's parent made a surplus contribution to the Company, the proceeds of which the Company used to fund an additional deposit.

(2) Current Federal and Foreign Income Tax Recoverable
(2) Net Deferred Tax Asset

The tax effect of the examination adjustments for losses and loss adjustment expenses resulted in an increase in the current federal and foreign income tax recoverable under the terms of the Company's Tax Sharing Agreement of $23.2 million to $39.9 million. In addition, the net deferred tax asset increased by $1 million to approximately $8.5 million as a result of the examination adjustment previously mentioned.

(3) Losses and Loss Adjustment Expenses

Based on a review of the Company's loss and loss adjustment expense reserves by a Casualty Actuary from the California Department of Insurance, the Company's reserves for losses and loss adjustment expenses were determined to be deficient by $65.3 million as of year-end 2008.

The year-end 2008 reserve deficiency consists of an estimated net loss reserve deficiency of $65.5 million and an estimated savings in net loss adjustment expense reserves of $194,938.

A subsequent review of the December 31, 2008 loss and loss adjustment expense reserves as of December 31, 2009 indicated the reserve deficiency had been reduced by $27.1 million to $38.2 million primarily as a result of reserve strengthening implemented by the Company in June 2009.

(4) Funds Held by Company under Reinsurance Treaties

The above referenced year-end 2008 loss and loss adjustment expense reserve deficiencies resulted in the understatement of the Company's funds held balance by $10.9 million.

(5) Provision for Reinsurance

The above referenced year-end 2008 loss and loss adjustment expense reserve deficiencies resulted in the understatement of the Company's provision for reinsurance liability account by $13.6 million.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Corporate Governance (Page 8): It is recommended that the board of directors implement revisions to any future performance driven plans to take into account the fact that it may take several years to determine ultimate losses for workers' compensation business in California. As such, it would be more prudent and reasonable to include provisions within such plans that a) require calculations of bonus payments on more developed estimates of losses and income, or b) allow the Company to recoup performance based incentive payments through some contractual mechanism (e.g., credits against future bonuses or "claw back") if it is later determined that the performance criteria were not achieved. It is also recommended that the incentive compensation calculation formula for the Company's actuary should be predicated upon the accuracy of reserves rather than underwriting results.

Comments on Financial Statement Items – Workers' Compensation Deposits (Page 19): It is recommended that the Company recalculate its workers' compensation deposit requirements and fund any deficiencies. As noted under the "Subsequent Events" section, the Company's parent made a surplus contribution to the Company, the proceeds of which the Company used to fund an additional deposit.

Previous Report of Examination

The previous report did not reflect any comments or recommendations.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

________/S/_________________
David A. Fischman, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California