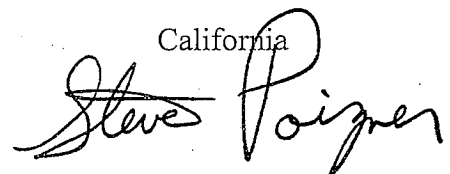


REPORT OF EXAMINATION  
OF THE  
FAIRMONT INSURANCE COMPANY

AS OF  
DECEMBER 31, 2008

Participating State  
and Zone:

California



Insurance Commissioner

**FILED** 06-17-10

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY .....	2
MANAGEMENT AND CONTROL: .....	2
Management Agreements .....	5
TERRITORY AND PLAN OF OPERATION .....	6
REINSURANCE: .....	7
Inter-Company Reinsurance Pooling Agreement .....	7
Assumed .....	7
Ceded .....	7
FINANCIAL STATEMENTS: .....	9
Statement of Financial Condition as of December 31, 2008 .....	10
Underwriting and Investment Exhibit for the Year Ended December 31, 2008 .....	11
Reconciliation of Surplus as Regards Policyholders from December 31, 2005 through December 31, 2008 .....	12
Reconciliation of Examination Changes as of December 31, 2008 .....	13
COMMENTS ON FINANCIAL STATEMENT ITEMS: .....	14
Bonds .....	14
Losses and Loss Adjustment Expenses .....	14
SUMMARY OF COMMENTS AND RECOMMENDATIONS: .....	14
Current Report of Examination .....	14
Previous Report of Examination .....	15
ACKNOWLEDGEMENT .....	16

Los Angeles, California  
May 5, 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

#### FAIRMONT INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 250 Commercial Street, Suite 5000, Manchester, New Hampshire 03101. The Company's statutory home office is located at 8880 Rio San Diego Drive, Suite 510, San Diego, California 92108.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 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.

This examination was conducted in conjunction with the examination of TIG Insurance Company, Fairmont Premier Insurance Company (immediate parent) and its affiliates, Fairmont Specialty Insurance Company, and TIG Indemnity Company.

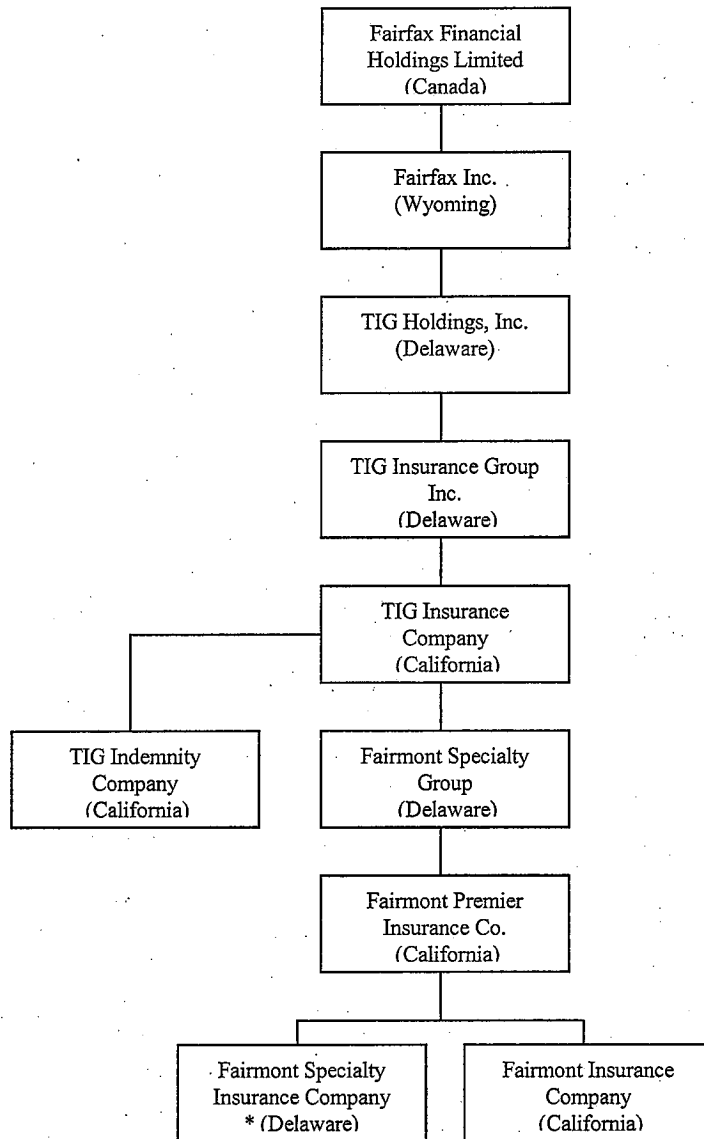
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans;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

### COMPANY HISTORY

Effective January 1, 2006, the Fairmont Specialty Group of Companies (including the Company) were placed into run-off and subject business subsequently produced as the "Fairmont Specialty Division" of the affiliated Crum & Forster Holdings Corporation group of companies. Consequently the Company retained calendar years 2004 and 2005 business, which is being serviced by its affiliate, United States Fire Insurance Company.

### MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parents along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



All ownership is 100%.

(\*) During February 2009, Fairmont Specialty Insurance Company (Delaware) re-domesticated to California.

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

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John J. Bator Bedford, New Hampshire	Senior Vice President, Chief Financial Officer RiverStone Resources, LLC
Nicholas C. Bentley Exeter, New Hampshire	President and Chief Executive Officer, RiverStone Resources, LLC
Frank J. DeMaria Windham, New Hampshire	Senior Vice President RiverStone Resources, LLC
Charles G. Ehrlich Amherst, New Hampshire	Senior Vice President, Secretary RiverStone Resources, LLC
John M. Parker Manchester, New Hampshire	Senior Vice President RiverStone Resources, LLC

Principal Officers

<u>Name</u>	<u>Title</u>
Nicholas C. Bentley	President and Chief Executive Officer
John J. Bator	Senior Vice President and Chief Financial Officer
Charles G. Ehrlich*	Senior Vice President, Secretary, and General Counsel
Frank J. DeMaria	Senior Vice President
Richard J. Klimaszewski**	Executive Vice President
John M. Parker	Senior Vice President

\* On February 10, 2009, Charles Ehrlich resigned as General Counsel. However, he remained as Senior Vice President and Secretary. Richard Fabian, Senior Vice President was elected by the Board as General Counsel on February 10, 2009.

\*\* Richard Klimaszewski no longer serves as a principal officer of the Company effective December 15, 2009, and was not replaced.

## Management Agreements

Tax allocation agreement: The Company is party to an agreement with TIG Holdings, Inc., dated January 1, 2000, whereby it files its federal income taxes on a consolidated basis along with 41 other affiliated companies. Each company computes its federal income tax liability on a separate basis and settles with its parent. The California Department of Insurance (CDI) approved the agreement on January 22, 2001. The Company's portion of the net federal income taxes paid for 2006, 2007, and 2008 were \$61,243, \$(13,303), and \$35,207, respectively.

Investment Agreement: The Company is party to an affiliated agreement with Hamblin Watsa Investment Counsel Ltd. (HWIC) and Fairfax Financial Holdings Limited (Fairfax), effective January 1, 2003. Pursuant to the agreement, HWIC manages the investments of the Company in accordance with specific investment objectives. All fees are paid by the Company to Fairfax, and Fairfax reimburses HWIC for investment management services. The CDI approved the agreement on December 3, 2003. For 2006, 2007, and 2008, fees paid by the Company were \$92,891, \$103,513, and \$116,578, respectively.

Information Technology Service Agreement: A Company affiliate, Fairmont Specialty Insurance Company (FSIC), was party to a written agreement with the affiliated Fairfax Information Technology Services, Inc. (FITS) effective August 1, 2001 and expiring July 31, 2006. Pursuant to this agreement, FITS is authorized to manage and provide information technology services to FSIC. Although the Company and its parent Fairmont Premier Insurance Company (FPIC), were not named in the initial agreement, FITS is providing identical information technology services to the Company and FPIC on a fee basis. Although the initial term has expired the agreement has apparently been extended by mutual agreement of the parties. It is recommended that the agreement be amended to formalize the extension, include the Company as a named participant, and as noted in the previous examination be submitted to the CDI for approval in accordance with California Insurance Code Section 1215.4. For 2006, 2007, and 2008, fees paid by the Company were \$0, \$168,084, and \$98,439, respectively.

Claims Service and Management Agreement: The Company is party to an agreement, effective January 1, 2006, under which claims and management services are provided to the Fairmont Specialty Group companies, including the Company, on an actual cost reimbursement basis by United States Fire Insurance Company. This claims service and management agreement was approved by the CDI on December 30, 2006. For 2006, 2007, and 2008, fees paid by the Company were \$1,739,860, \$501,092, and \$306,331, respectively.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact multiple lines of property and casualty insurance in the District of Columbia and all states except Alabama, Florida, Maine, New Hampshire, New Jersey, Pennsylvania, Vermont, and Virginia.

The gross premiums written by the Company during the last five years were as follows:

<u>Year</u>	<u>Premiums</u>
2004	\$ 45,904,324
2005	52,447,361
2006	24,259,025
2007	( 70,321)
2008	( 164,847)

The Company began discontinuing its operations in 2006. While transitioning that year the Company ceded business to an affiliate, United States Fire Insurance Company (U.S. Fire), pursuant to a quota share reinsurance agreement. During 2006 the Fairmont Specialty Division business could not immediately be written by Crum & Forster (C&F) insurers in some jurisdictions due to rate and form filing requirements and the need for certain C&F insurers to be licensed for additional lines of insurance in some states. For these reasons the business continued to be written by the Fairmont Specialty Group of companies, including the Company, and was then 100% reinsured with U.S. Fire.

Prior to discontinuing its operations the Company wrote private passenger auto liability, commercial auto liability, auto physical damage, homeowners, and various other lines of business.

## REINSURANCE

### Inter-Company Reinsurance Pooling Agreement

The Company, its parent Fairmont Premier Insurance Company (FPIC) and affiliate, Fairmont Specialty Insurance Company (FSIC) entered into an inter-company reinsurance pooling agreement effective January 1, 2004. Under the terms of the agreement, the Company and FSIC cede 100% of their net business to FPIC. FPIC, after retaining 20% of the pooled business, retrocedes the remaining amount back to the participants in the following percentages: 67% to FSIC and 13% to the Company.

This agreement was approved by the California Department of Insurance (CDI) on December 23, 2003.

### Assumed

The Company assumes business from FPIC pursuant to the aforementioned pooling agreement.

### Ceded

The Company is in runoff and there are no active treaties currently in place as of the date of this examination. The following schedule depicts the most recent active reinsurance ceded:

Lines Reinsured or Type	Name of Reinsurer	Company Retention	Treaty Limits
<b>Casualty Lines:</b>			
First Casualty Excess Liability Workers' Compensation	Swiss Reinsurance America Corp - 80%, nSpire Re Ltd - 20%	\$1.5 million	\$4.5 million excess \$1.5 million
Second Casualty Clash Liability Workers'	Arch Reinsurance - 25%, Endurance Specialty Ins. Ltd. -	\$6 million	\$5 million excess \$6 million

Lines Reinsured or Type	Name of Reinsurer	Company Retention	Treaty Limits
Compensation	20%, Lloyds Syndicates - 25%, nSpire Re. Ltd. - 10%, Platinum Underwrites Reinsurance - 20%		
Third Casualty Clash Liability Workers' Compensation	Arch Reinsurance - 25%, Endurance Specialty Ins. Ltd. - 20%, Lloyds Syndicates - 25%, Hannover Life Reinsurance - 10%, Platinum Underwrites Reinsurance - 20%	\$11 million	\$9 million excess \$11 million
Specialty Umbrella Quota Share Casualty Loss Occurrence	Swiss Reinsurance America Corp - 80%	\$1 million primary plus 20% of \$5 million Umbrella	80% of \$5 million after the primary
Hawaii Umbrella Quota Share Casualty Risk attach	General Reinsurance Co. 80%	\$1 million primary plus 20% of \$5 million Umbrella	80% of \$5 million after the primary
<b>Property Lines:</b>			
Boiler and Machinery property Quota Share, Risks attached	Hartford Steam Boiler	Zero	100% of \$25 million
Property per risk excess of loss occurrence	General Reinsurance Co. 100%	\$1 million	\$1 million excess \$1 million
Property per risk excess of loss occurrence	General Reinsurance Co. 100%	\$2 million	\$3 million excess \$2 million
Property per risk excess of loss occurrence	General Reinsurance Co. 100%	\$5 million	\$5 million excess \$5 million
Hawaii property per risk excess of loss occurrence	General Reinsurance Co. 100%	\$1 million	\$1 million excess \$1 million
Hawaii property per risk excess of loss occurrence	General Reinsurance Co. 100%	\$2 million	\$3 million excess \$2 million
Property Catastrophe per risk excess of loss	General Reinsurance Co. 100%	\$2 million and 5% of \$18 million excess	95% of \$18 million excess \$2 million

Effective January 1, 2006, FPIC (the lead company in the reinsurance pool) entered into a Transition Period Reinsurance and Services Agreement in which a 100% quota-share of the Fairmont Specialty Group of Companies' (including the Company) pooled business was ceded to an affiliate, United States Fire Insurance Company (U.S. Fire). The subject business was defined as Fairmont Specialty Group policies with effective dates of January 1, 2006 or later. Unearned premiums in-force at December 31, 2005 were not subject to this quota share cession. As part of this agreement, U.S. Fire

agreed to perform underwriting, administration, financial, and claims services with respect to the subject business. This agreement was approved by the CDI on December 23, 2005.

As of December 31, 2008, reinsurance recoverable, for all ceded reinsurance totaled \$6.3 million or 25% of surplus as regards policyholders. The affiliated companies' ceded reinsurance recoverables from FPIC and U.S. Fire were \$3.9 million and \$2.5 million, respectively.

### 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 December 31, 2005 through December 31, 2008

Reconciliation of Examination Changes as of December 31, 2008

Statement of Financial Condition  
as of December 31, 2008

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Note</u>
Bonds	\$ 18,785,851	\$ 4,007,670	\$ 14,778,181	(1)
Stocks:				
Common stocks	679,551		679,551	
Cash and short-term investments	19,092,710		19,092,710	
Premiums and considerations:				
Premiums and agents' balances in course of collection	120,796	120,796		
Amounts recoverable from reinsurers	628,786		628,786	
Funds held by or deposited with reinsured companies	171,642		171,642	
Current federal income tax recoverable	100,047		100,047	
Net deferred tax asset	11,884,238	11,694,371	189,867	
Investment income due and accrued	397,447		397,447	
Aggregate write-ins for other than invested assets	<u>993,890</u>	<u>884,473</u>	<u>109,417</u>	
Total assets	<u>\$ 52,854,958</u>	<u>\$ 16,707,310</u>	<u>\$ 36,147,648</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 8,450,522	(2)
Loss adjustment expenses			4,041,092	(2)
Commissions payable, contingent commissions			26,638	
Other expenses			458,657	
Ceded reinsurance premiums payable			(72,357)	
Funds held by company under reinsurance treaties			140,905	
Amounts withheld or retained by company for others			91,735	
Provision for reinsurance			3,000	
Payable to parent, subsidiaries and affiliates			<u>1,386,450</u>	
Total liabilities			14,526,642	
Common capital stock		\$ 8,340,000		
Gross paid-in and contributed surplus		3,290,740		
Unassigned funds (surplus)		<u>9,990,266</u>		
Surplus as regards policyholders			<u>21,621,006</u>	
Total liabilities, surplus and other funds			<u>\$ 36,147,648</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ (132,528)
Deductions:		
Losses incurred	\$ (779,965)	
Loss adjustment expense incurred	847,132	
Other underwriting expenses incurred	<u>770,010</u>	
Total underwriting deductions		<u>837,177</u>
Net underwriting loss		(969,705)

Investment Income

Net investment income earned	\$ 1,362,056	
Net realized capital gains	<u>1,122,871</u>	
Net investment gain		2,484,927

Other Income

Net loss from agents' balances charged off	\$ (9,454)	
Aggregate write-ins for miscellaneous income	<u>(2,838)</u>	
Total other income		<u>(12,292)</u>
Net income before federal income taxes		1,502,930
Federal income taxes incurred		<u>(74,323)</u>
Net income		<u>\$ 1,577,253</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 24,304,477
Net income	\$ 1,577,253	
Change in net unrealized capital losses	(3,820,493)	
Change in net unrealized foreign exchange capital losses	(255,513)	
Change in net deferred income tax	1,037,329	
Change in nonadmitted assets	(1,237,047)	
Change in provision for reinsurance	<u>15,000</u>	
Change in surplus as regards policyholders		<u>(2,683,471)</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 21,621,006</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2005 through December 31, 2008

Surplus as regards policyholders, December 31, 2005, per Examination		\$ 17,476,083																								
	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%;"></th> <th style="width: 25%; text-align: center; border-bottom: 1px solid black;">Gain in Surplus</th> <th style="width: 25%; text-align: center; border-bottom: 1px solid black;">Loss in Surplus</th> </tr> </thead> <tbody> <tr> <td>Net income</td> <td style="text-align: right;">\$ 6,813,039</td> <td style="text-align: right;">\$</td> </tr> <tr> <td>Net unrealized capital losses</td> <td></td> <td style="text-align: right;">3,896,440</td> </tr> <tr> <td>Change in net unrealized foreign exchange capital loss</td> <td></td> <td style="text-align: right;">204,185</td> </tr> <tr> <td>Change in net deferred income tax</td> <td></td> <td style="text-align: right;">392,545</td> </tr> <tr> <td>Change in non-admitted assets</td> <td style="text-align: right;">1,828,054</td> <td></td> </tr> <tr> <td>Change in provision for reinsurance</td> <td></td> <td style="text-align: right; border-top: 1px solid black;">3,000</td> </tr> <tr> <td> Totals</td> <td style="text-align: right; border-top: 1px solid black;"> <u>\$ 8,641,093</u></td> <td style="text-align: right; border-top: 1px solid black;"> <u>\$ 4,496,170</u></td> </tr> </tbody> </table>		Gain in Surplus	Loss in Surplus	Net income	\$ 6,813,039	\$	Net unrealized capital losses		3,896,440	Change in net unrealized foreign exchange capital loss		204,185	Change in net deferred income tax		392,545	Change in non-admitted assets	1,828,054		Change in provision for reinsurance		3,000	 Totals	 <u>\$ 8,641,093</u>	 <u>\$ 4,496,170</u>	
	Gain in Surplus	Loss in Surplus																								
Net income	\$ 6,813,039	\$																								
Net unrealized capital losses		3,896,440																								
Change in net unrealized foreign exchange capital loss		204,185																								
Change in net deferred income tax		392,545																								
Change in non-admitted assets	1,828,054																									
Change in provision for reinsurance		3,000																								
 Totals	 <u>\$ 8,641,093</u>	 <u>\$ 4,496,170</u>																								
Net increase in surplus as regards policyholders		4,144,923																								
Surplus as regards policyholders, December 31, 2008, per Examination		<u>\$21,621,006</u>																								

Reconciliation of Examination Changes  
as of December 31, 2008

<u>Assets</u>	<u>Per Company</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
Bonds	\$ 18,785,851	\$ 14,778,181	<u>\$ (4,007,670)</u>	(1)
Net decrease to surplus as regards policyholders			\$ (4,007,670)	
Surplus as regards policyholders, December 31, 2008 per Company			<u>25,628,676</u>	
Surplus as regards policyholders, December 31, 2008 per Examination			<u>\$ 21,621,006</u>	

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds

The captioned item was overstated by \$4,007,670 at December 31, 2008. The Company erroneously listed as owned certain United States Treasury Bonds (book value \$4,007,670). The bonds were actually owned by the Company's parent, Fairmont Premier Insurance Company and were held by the State of California as a special deposit. During 2009, these bonds were removed from the Company accounts. It is recommended that the Company review its methodology of reconciling the securities transactions.

### (2) Losses and Loss Adjustment Expenses

The Company was directed by the California Department of Insurance (CDI) to retain the actuarial firm of AMI Risk Consultants, Inc. (AMI) for the purpose of assisting this examination in determining the reasonableness of the Company's loss and loss adjustment expense reserves. Based on the analysis by AMI and the review of their work by a Casualty Actuary from the CDI, the Company's December 31, 2008 reserves for losses and loss adjustment expenses were deemed to be reasonably stated.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control - Information Technology Services Agreement (Page 5): An affiliate, Fairfax Information Technology Services, Inc., provided information technology services although the Company is not named on the written agreement. It is recommended that the agreement be amended to formalize the extension, include the Company as a named participant, and as noted in the previous

examination be submitted to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code (CIC) Section 1215.4.

Previous Report of Examination

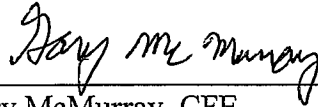
Management and Control – Information Technology Services Agreement (Page 7): An affiliate, Fairfax Information Technology Services, Inc., provided information technology services although the Company is not named on a supporting written agreement. It was recommended that the Company submit an amended information technology services agreement, to include the Company and parent Fairmont Premier Insurance Company as parties to the agreement, to the CDI for approval. At the date the current examination was concluded the Company had not submitted the agreement for approval.

Corporate Records (page 8): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Sections 1200 and 1201. The Company is in compliance with CIC Sections 1200 and 1201.

ACKNOWLEDGEMENT

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

Respectfully submitted,

A handwritten signature in cursive script that reads "Gary McMurray". The signature is written in black ink and is positioned above a horizontal line.

---

Gary McMurray, CFE  
Examiner-In-Charge  
Department of Insurance  
State of California