

REPORT OF EXAMINATION
OF THE
GOLDEN BEAR INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Filed May 18, 2009

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San Francisco, California
March 27, 2009

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

GOLDEN BEAR INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office, located at 709 North Center Street, Stockton, California 95202.

SCOPE OF EXAMINATION

The last examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2007. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2007, 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; business in force by states; loss experience; and sales and advertising.

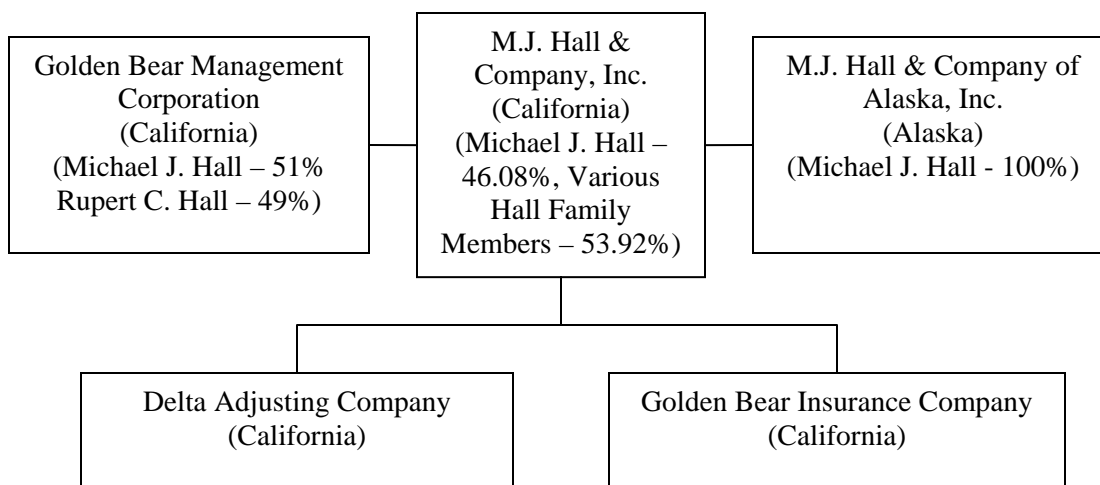
COMPANY HISTORY

The following ordinary cash dividends were declared and paid to the Company's parent M. J. Hall & Company, Inc. during the examination period:

<u>Declared Date</u>	<u>Paid Date</u>	<u>Amount</u>
November 18, 2005	December 15, 2005	\$500,000
January 3, 2007	January 26, 2007	\$500,000
February 1, 2008	February 25, 2008	\$500,000
November 10, 2008	January 26, 2009	\$500,000
March 10, 2009	March 25, 2009	\$500,000

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, of which the ultimate controlling person is Michael J. Hall. Mr. Hall has a 46.08% ownership interest in M. J. Hall & Company, Inc., the immediate parent of the Company, with the balance being held by various members of the Hall family. The following chart depicts the interrelationship of the companies within the holding company system as of December 31, 2007 (all ownership is 100% unless otherwise indicated):



Management of the Company is vested in a seven-member board of directors. Following are the directors and the principal officers of the Company as of December 31, 2007:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Peter Gerard Bernadicou Stockton, California	Businessman
Ashtok Bijay Daftary Stockton, California	Physician Sutter Gould Medical Foundation
Ronald Moffit Guntert, Jr. Stockton, California	President Guntert Steel
Michael James Hall Stockton, California	Chairman Golden Bear Insurance Company
Rupert Charles Hall Stockton, California	President Golden Bear Insurance Company
John Anthony Quattrin* Carmichael, California	Senior Vice President, Secretary and Treasurer Golden Bear Insurance Company

Directors (continued)

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Simone Luigi Toccoli Stockton, California	Principal A.F. Toccoli & Sons

**John Anthony Quattrin retired in June 2008 and was replaced by Michael William Haley.*

Principal Officers

<u>Name</u>	<u>Title</u>
Rupert Charles Hall	President
John Anthony Quattrin**	Senior Vice President, Secretary and Treasurer

***Patrick Tunghoi Lo and Stacey Anne Jackson were appointed to the position of Treasurer and Secretary, respectively, after the retirement of John Anthony Quattrin in June 2008.*

Intercompany Agreements

A Claims Adjusting Services agreement was entered into between Delta Adjusting Company (Delta) and the Company on September 28, 1987. Under the terms of this agreement, Delta provides the Company with claim adjustment services, including reviewing claim or loss reports made by insureds, conducting investigations on each reported claim or loss, arranging independent investigations or legal services, notifying all reinsurers of potential claims or losses, participating in negotiation and settlement of all claims subject to approval by the Company, performing administrative and clerical work in connection with claims or losses, and preparing administrative reports for management. This agreement was amended, effective January 1, 2005 (Amendment No. 4), to increase the fees from \$55 per hour to \$75 per hour for adjuster services and from \$20 per hour to \$30 per hour for clerical services. On December 15, 2008, the Company submitted Amendment No. 4 to the California Department of Insurance (CDI) for review pursuant to California Insurance Code Section (CICS) 1215.5(b). Some deficiencies in the filing were noted by the CDI. It is recommended that the Company continue to work with the CDI to address the deficiencies identified on the December 15, 2008 filing.

An Allocation of Federal Income Tax agreement between the Company, MJH, Delta, and M. J. Hall of Arizona, Inc. (MJHAZ) was executed on July 21, 1987. Under the terms of this agreement, MJH will file a consolidated federal income tax return on behalf of the other companies. Federal income taxes are paid or recovered on the basis of each company's federal taxable income or loss. It is noted that MJHAZ ceased being a member of the holding company group in 2004. As such, it is recommended that this agreement be amended to remove MJHAZ from the agreement. In addition, this agreement does not contain the proper safeguards and does not meet the guidelines set by the CDI for tax sharing agreements. It is recommended that the Company amend this agreement to include the proper safeguards and file the amended agreement with the CDI in accordance with CIC Section 1215.5(b)(4). Similar comments were made in the prior examination report.

An Allocation of Operating Expenses agreement was entered into between the Company, MJH, Delta, M. J. Hall & Company of Alaska, Inc., and MJHAZ on July 22, 1987. Under the terms of this agreement, certain operating costs that are incurred by one company, but provide benefits to other companies, are allocated to the other companies based on a "formula." Expenses qualifying for allocation include payroll, advertising, insurance, travel and entertainment, accounting and legal, printing and supplies, and automobile. It is noted that MJHAZ ceased being a member of the holding company group. As such, it is recommended that this agreement be amended to remove MJHAZ from the agreement. It is also noted that this agreement does not contain the proper safeguards and do not meet the guidelines set by the CDI for intercompany agreements. In addition, the agreement is vague in regards to how expenses are allocated. It is recommended that the Company amend this agreement to include the proper safeguards and to include a proper method of allocation that complies with Statement of Statutory Accounting Principals (SSAP) No. 70. All expenses that are to be allocated should be identified in the agreement as well. Similar comments were made in the prior examination report.

The Claims Adjusting Services Agreement, Allocation of Federal Income Tax Agreement, and Allocation of Operating Expenses Agreement discussed above are not in compliance with SSAP No. 96 and No. 25, paragraph 6. The agreements do not include a settlement provision which provides for timely settlement of amounts owed, with a specific due date, as required under the

above SSAPs. It is recommended that a settlement provision in compliance with SSAP No. 96 and No. 25, paragraph 6, be added to each of these intercompany agreements.

A Brokerage Agreement was entered into between the Company and MJH on January 14, 1986. Under the terms of this agreement, the Company appoints MJH as a broker to produce business on its behalf and collect premiums. It is noted that compensation to MJH under this agreement is vague because the commission paragraph does not include a stated commission rate. In addition, this agreement does not include all the safeguards required by the CDI for service agreements. This agreement was not disclosed in the Company's Annual Holding Company Registration Statement pursuant to CICS 1215.4(b)(3)(E) either. It is recommended that this agreement be amended to reflect the actual commissions paid and to include the proper safeguards required by the CDI for intercompany service agreements. In addition, it is recommended that the Company file this agreement with the CDI pursuant to CICS 1215.5(b)(4) and disclose this agreement in accordance with CICS 1215.4(b)(3)(E).

The Company has an arrangement with MJH whereby MJH produces and underwrites the homeowners line of business on behalf of the Company. During 2007, the Company paid commissions to MJH of \$500,473 or 25% of the homeowners premiums for this service. It is noted that there is no written agreement covering the services provided under this arrangement. It is recommended that the Company develop a written agreement containing all the proper safeguards to cover the services above. In addition, it is recommended that the Company file this agreement with the CDI in accordance with CIC Section 1215.5(b)(4) and disclose this agreement in accordance with CICS 1215.4(b)(3)(E).

It is recommended that all intercompany agreements and amendments be approved by the Board of Directors and that such approvals be entered into the minutes of the Board of Directors. Once the agreements have been revised and/or amended, it is recommended that they be submitted to the CDI for approval pursuant to CICS 1215.5(b).

TERRITORY AND PLAN OF OPERATION

The Company is licensed in California and Arizona and operates as a surplus lines insurer in Hawaii and Nevada. The Company specializes in commercial risks and writes on a primary basis and on an excess and umbrella basis.

The lines of business written by the Company include other liability – occurrence, earthquake, commercial auto liability, fire, and homeowners multiple peril. The primary general liability policies are offered with coverage up to \$1 million. The excess and umbrella policies are offered on policies with underlying limits of generally \$500,000. The earthquake coverage is for commercial property only and is written on a monoline basis using a difference in conditions form with policies issued yearly. The commercial automobile liability is written on an excess/umbrella basis only.

Direct premiums written during 2007 were \$31.8 million. California accounted for the majority (98.1%) of direct premiums written.

Of the direct premiums written in 2007, earthquake accounted for \$15.1 million (47.4%), other liability – occurrence \$11.1 million (34.9%), commercial auto liability \$2.6 million (8.2%), homeowners \$2 million (6.3%), and fire \$1 million (3.2%).

Business is marketed through approximately 50 wholesale brokerage firms and its parent, M. J. Hall & Company, Inc. (MJH). MJH produced 31.2% of the direct premiums written in 2007, including 100% of the homeowners multiple peril policies in 2007.

REINSURANCE

Assumed

The Company assumes a book of business under a fronting arrangement that is produced by its affiliate, Golden Bear Management Corporation, using the Company's underwriting guidelines.

The business is written in the western states where the Company is not licensed. Policies on the assumed business are issued using North America Capacity Insurance Company policies that are reinsured by Swiss Reinsurance America Corporation, and the net retained limits are retro-ceded to the Company. Assumed premiums written during 2007 were \$6.3 million. The following table is a summary of assumed reinsurance agreements:

<u>Type of Contract</u>	<u>Ceding Company</u>	<u>Ceding Company's Retention</u>	<u>Company's Limits</u>
Casualty Excess of Loss	Swiss Reinsurance America Corporation	\$2 million excess of \$150,000 per occurrence	\$150,000 per occurrence
Umbrella Liability Quota Share	Swiss Reinsurance America Corporation	85% of first \$1 million per occurrence 100% of \$4 million excess of \$1 million	15% of first \$1 million per occurrence
Property Surplus	Swiss Reinsurance America Corporation	\$2 million excess of \$200,000 each risk	\$200,000 each risk

Ceded

The following table is a summary of the Company's ceded reinsurance program at December 31, 2007. All reinsurers are authorized unless otherwise indicated:

<u>Type of Contract</u>	<u>Lines Covered</u>	<u>Reinsurer</u>	<u>Company's Retention</u>	<u>Reinsurer's Limits</u>
Property Per Risk & Homeowners Liability Excess of Loss	All commercial property risks, homeowners, and earthquake	General Reinsurance Corporation – 60% Swiss Reinsurance America Corporation – 40%	Property: \$200,000 each risk Liability: \$200,000 each occurrence	Property: \$800,000 excess of \$200,000, each risk, with treaty occurrence limit of \$5.6 million Liability: \$300,000 excess of \$200,000 each occurrence
Property Surplus	All commercial property risks, including earthquake	Swiss Reinsurance America Corporation – 50% Munich Reinsurance America, Inc. – 37.5% QBE Reinsurance Corporation – 12.5%	Minimum gross retention of \$25,000 any one risk and maximum gross retention of \$1 million any one risk	\$6 million any one risk subject to a treaty occurrence limit of 400% of written premium to a maximum of \$50 million.
Difference in	Earthquake	General Reinsurance	Minimum and maximum	\$2.5 million any risk

<u>Type of Contract</u>	<u>Lines Covered</u>	<u>Reinsurer</u>	<u>Company's Retention</u>	<u>Reinsurer's Limits</u>
Conditions Property Surplus		Corporation – 11.111% Munich Reinsurance America, Inc. – 44.444% Swiss Reinsurance America Corporation – 44.444%	gross retention of \$200,000 any one risk	subject to a \$45 million occurrence limit
Property Catastrophe Excess of Loss	All commercial property risks and earthquake, including property portions of homeowners property risks and assumed reinsurance property risks	General Reinsurance Corporation – 100%	First \$1 million of ultimate net loss each occurrence plus 15% of \$2 million excess of \$1 million each occurrence	\$19 million excess of \$1 million each occurrence
Property Catastrophe Excess of Loss	All commercial property risks and earthquake, including property portions of homeowners property risks and assumed reinsurance property risks	Swiss Reinsurance Corporation – 100%	5% of reinsurer's limits	95% of \$10 million excess of \$20 million each occurrence
Property Catastrophe Excess of Loss	All commercial property risks and earthquake, including property portions of homeowners property risks and assumed reinsurance property risks	Lloyd's Underwriters – 52.5% QBE Reinsurance Corp – 25% Wuerttembergische Versicherung A.G. (unauthorized) – 10% American Agricultural Insurance Company (unauthorized) – 12.5%	None	100% of \$15 million excess of \$30 million each occurrence
Casualty Excess of Loss	All commercial primary liability business	Swiss Reinsurance America Corporation – 100%	\$150,000 any one occurrence	First Layer: \$850,000 excess of \$150,000 any one occurrence Second Layer: \$2 million excess of \$1 million any one occurrence, subject to an annual occurrence limit of \$6 million

<u>Type of Contract</u>	<u>Lines Covered</u>	<u>Reinsurer</u>	<u>Company's Retention</u>	<u>Reinsurer's Limits</u>
Umbrella Liability Quota Share	Commercial excess and umbrella business	Swiss Reinsurance America Corporation – 100%	15% of first \$1 million each occurrence	85% of first \$1 million each occurrence and 100% of \$4 million excess of \$1 million each occurrence

The Property Surplus, Difference in Conditions Property Surplus, Casualty Excess of Loss, and Umbrella Liability Quota Share reinsurance agreements do not comply with California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.13 because they do not expressly state that the agreement constitutes the entire agreement between the parties with respect to the business covered by the agreement (except for separate contracts expressly disclosed within the agreement or in an exhibit incorporated by reference). It is recommended that the ceded reinsurance agreements be amended to comply with Title 10 Section 2303.13.

The "special termination" provision in the Property Surplus and Difference in Conditions Property Surplus reinsurance agreements do not comply with CCR Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14 and Statement of Statutory Accounting Principles (SSAP) No. 62, paragraph 7 because it permits the reinsurer to cancel the agreement within 15 days of written notice upon the impairment of surplus or declaration of insolvency or placement in liquidation by a regulatory authority of the ceding company. Section 2303.14 and SSAP No. 62, paragraph 7 do not permit the entry of an order of rehabilitation, conservation or liquidation against the ceding insurer to be the basis for termination. Also, Section 2303.14 requires that early termination clauses in reinsurance agreements allow for not less than 60 days notice. It is recommended that the special termination or early termination provision in the Company's ceded reinsurance agreements be amended to comply with Title 10 Section 2303.14 and SSAP No. 62, paragraph 7.

ACCOUNTS AND RECORDS

Information Systems Controls

A review was made of the Company's general controls over its information systems and weaknesses were noted in the areas of logical and physical security controls, operations controls, and disaster recovery/business continuity planning. The weaknesses noted were presented to the Company along with recommendations to strengthen controls. It is recommended that the Company evaluate these recommendations and make appropriate changes to strengthen its information systems controls.

Claims and Reserving Practices

A Claims Specialist from the California Department of Insurance reviewed a sample of claim files and noted violations of California Insurance Code Section (CICS) 790 and the California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 7.5, Article I, Sections 2695 et al. It is recommended the Company implement procedures to ensure compliance with CICS 790 and CCR, Title 10, Sections 2695 et al.

A review was also made of claims for reserve adequacy and it was noted that the case reserves on some claims were not increased in a timely fashion after liability has been established. Although the overall loss and loss adjustment expense reserves appear to be adequate, it is recommended that the Company implement procedures to assist in evaluating the liability of each claim and establish initial case reserves based on ultimate cost. Similar comments were made in the prior examination report.

The Company has a practice of using the policy effective date as the default date of loss when the date of loss is unknown or cannot be determined. It is recommended that the Company use the claim reported date as the date of loss when a claim is presented and the date of loss is unknown and cannot be determined. This is a repeat finding from the prior examination report.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Conditions as of December 31, 2007

Underwriting and Investment Exhibit for the Year Ended December 31, 2007

Reconciliation of Surplus as Regards Policyholders from December 31, 2003 through
December 31, 2007

Reconciliation of Examination Changes as of December 31, 2007

Statement of Financial Condition
as of December 31, 2007

	Ledger and Non-ledger Assets	Non- Admitted Assets	Net Admitted Assets	Notes
<u>Assets</u>				
Bonds	\$ 51,878,147	\$	\$ 51,878,147	(1)
Common stocks	7,114,132		7,114,132	
Cash and short-term investments	34,117,160		34,117,160	(1)
Other invested assets	339,402		339,402	
Investment income due and accrued	868,594		868,594	
Premiums and agents' balances in course of collection	2,926,839	159,696	2,767,143	(2)
Reinsurance recoverables	1,187,001		1,187,001	
Current federal and foreign income tax recoverable and interest thereon	1,247,125		1,247,125	(3)
Net deferred tax asset	2,526,606	1,703,141	823,465	
Guaranty funds receivable	447		447	
Electronic data processing equipment and software	71,854	71,854		
Furniture and equipment	68,941	68,941		
Aggregate write-ins for other than invested assets	274,339		274,339	
Total assets	\$ 102,620,587	\$ 2,003,632	\$ 100,616,955	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 40,320,645	(4)
Loss adjustment expenses			15,129,978	(4)
Other expenses			1,302,136	
Unearned premiums			6,960,966	(5)
Ceded reinsurance premiums payable			4,018,911	
Payable to parent, subsidiaries and affiliates			2,855	
Payable for securities			1,248,993	
Excess of statutory reserve over statement reserves			875,600	(6)
Total liabilities			\$ 69,860,084	
Common capital stock		\$ 1,800,000		
Gross paid in and contributed surplus		3,773,978		
Unassigned funds		25,182,893		
Surplus as regards policyholders			30,756,871	
Total liabilities, surplus and other funds			\$ 100,616,955	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2007

Statement of Income

Underwriting Income

Premiums earned		\$ 19,922,676
Deductions:		
Losses incurred	\$ 8,337,791	
Loss expenses incurred	3,907,379	
Other underwriting expenses incurred	<u>3,946,710</u>	
Total underwriting deductions		<u>16,191,880</u>
Net underwriting gain		3,730,796

Investment Income

Net investment income earned	\$ 4,101,105	
Net realized capital gains	<u>975,342</u>	
Net investment gain		5,076,447

Other Income

Net loss from agents' balances or premium balances charged off	<u>\$ (4,740)</u>	
Total other income		<u>(4,740)</u>
Net income before federal income taxes		8,802,503
Federal income taxes incurred		<u>2,004,500</u>
Net income		<u>\$ 6,798,003</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2006		\$ 26,413,900
Net income	\$ 6,798,003	
Change in net unrealized capital gains or losses	(606,903)	
Change in deferred income tax	(427,121)	
Change in nonadmitted assets	(45,408)	
Dividends to stockholders	(500,000)	
Excess of statutory reserves over statement reserves	<u>(875,600)</u>	
Change in surplus as regards policyholders for the year		<u>4,342,971</u>
Surplus as regards policyholders, December 31, 2007		<u>\$ 30,756,871</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2003 through December 31, 2007

Surplus as regards policyholders, December 31, 2003, per Examination			\$ 10,633,976
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 21,429,936	\$	
Change in net unrealized capital gains	65,989		
Change in unrealized foreign exchange capital loss		156,941	
Change in net deferred income tax		108,402	
Change in nonadmitted assets	767,913		
Dividends to stockholders		1,000,000	
Excess of statutory reserves over statement reserves	<u> </u>	<u>875,600</u>	
Totals	<u>\$ 22,263,838</u>	<u>\$ 2,140,943</u>	
Net increase in surplus as regards policyholders			<u>20,122,895</u>
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 30,756,871</u>

Reconciliation of Examination Changes
as of December 31, 2007

<u>Account</u>	<u>Per Company</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
Excess of statutory reserves over statement reserves	\$	\$875,600	<u>\$ (875,600)</u>	(6)
Net decrease to surplus, per examination			(875,600)	
Surplus as regards policyholders, December 31, 2007, per Company			<u>31,632,471</u>	
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 30,756,871</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds, Cash and Short-term Investments

At December 31, 2007, \$15.3 million in bonds were held in a trust account in accordance with the terms of the reinsurance agreements covering the business assumed from Swiss Reinsurance America Corporation (refer to the section “REINSURANCE”). The funds in the trust account are to be used for payment of losses and loss adjustment expenses resulting from the business assumed. The trustee for the trust account is Bank of Stockton.

At December 31, 2007, the Company held a \$500,000 certificate of deposit (CD) with a bank located outside of California in violation of California Insurance Code Section (CICS) 1104.1. The Company stated that the CD matured on July 27, 2008 and was not renewed. It is recommended that the Company comply with CICS 1104.1.

The Company does not have formal procedures for identifying long outstanding unpaid cash items and escheating such items to the State in accordance with the Unclaimed Property Law (commencing with Section 1500 of the California Code of Civil Procedure). It is recommended that the Company adopt formal procedures to identify and report such items in accordance with the Unclaimed Property Law. This is a repeat finding from the prior examination.

The filing exempt designations assigned to some securities at the examination date did not match the ratings assigned to those securities by a nationally recognized securities rating organization. It is recommended that the Company improve the monitoring of its investment securities to ensure that the designation assigned to the security properly reflects its true quality at the valuation date.

(2) Agents’ Balances and Uncollected Premiums

The Company is not in compliance with Statement of Statutory Accounting Principles (SSAP) No. 53, paragraph 13, because it reports advance premiums as a credit to the premium receivable

account. SSAP No. 53, paragraph 13, requires that advance premiums be reported as a liability. No examination adjustment was made because the amount involved is immaterial. It is recommended that the Company comply with SSAP No. 53, paragraph 13.

(3) Current Federal and Foreign Income Tax Recoverable and Interest Thereon

The Company is a party to a tax allocation agreement with its parent, M. J. Hall & Company, Inc. (MJH), and its affiliates whereby MJH files a consolidated federal income tax return on behalf of the group. At December 31, 2007, the Company was owed a tax refund of \$257,941. The tax refund was received by MJH in October 2008; however, remittance of the Company's portion of the tax refund did not occur until March 2009, which was more than 90 days late. SSAP No. 25 requires that transactions between related parties be settled timely. In addition, it requires that any amounts owed to the reporting entity over 90 days due be nonadmitted. No examination adjustment was made since the amount involved is not material. It is recommended that tax refunds owed to the Company be remitted no later than 30 days following the date the refund is received. Balances not settled within 90 days should be nonadmitted in accordance with SSAP No. 25.

(4) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Statement of Actuarial Opinion and actuarial report prepared by the Company's actuary and concurred with the conclusion that the loss and loss adjustment expense reserves are reasonable.

(5) Unearned Premiums

The Company misclassified two unauthorized reinsurers as "authorized" on its Schedule F - Part 3 and did not prepare a Schedule F - Part 5 Provision for Unauthorized Reinsurance in its Annual Statement. Reinsurance credit taken on account of the two unauthorized reinsurers consisted entirely of unearned premiums and the amount was immaterial and no examination adjustment was made. It is recommended that the Company properly classify unauthorized reinsurers on its

Schedule F and include these unauthorized reinsurers in the Schedule F - Part 5 Provision for Unauthorized Reinsurance. In addition, any reinsurance credit taken on account of unauthorized reinsurers should comply with CICS 922.4 and 922.5.

(6) Excess of Statutory Reserves Over Statement Reserves

The Company was not in compliance with CICS 11558 because its carried loss and loss adjustment expense reserves at December 31, 2007 for the three most recent accident years were below the statutory minimum reserves required by CICS 11558. The deficiency was determined to be \$875,600 and an examination adjustment was made. It is recommended that the Company comply with CICS 11558.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Intercompany Agreements (Page 4): It is recommended that the Allocation of Federal Income Tax agreement be amended to remove M.J. Hall of Arizona, Inc. (MJHAZ) from the agreement and to include the proper safeguards.

It is recommended that the Allocation of Operating Expenses agreement be amended to remove MJHAZ from the agreement. It is also recommended that the agreement be amended to include the proper safeguards and to comply with the CDI guidelines for intercompany agreements and to include a proper method of allocation that complies with Statement of Statutory Accounting Principals (SSAP) No. 70. All expenses that are to be allocated should be identified in the agreement as well.

It is recommended that the Brokerage Agreement be amended to reflect the actual commissions paid and to include the proper safeguards required by the CDI for intercompany service agreement. It is also recommended that this agreement be disclosed in accordance with CICS 1215.4(b)(3)(E).

It is recommended that a written agreement be developed to cover the producer and underwriting services provided by M.J. Hall & Company, Inc. to the Company for the homeowners business. The agreement should include all the proper safeguards and comply with the CDI guidelines for intercompany service agreements and disclosed in accordance with CICS 1215.4(b)(3)(E).

Furthermore, it is recommended that a settlement provision in compliance with SSAP No. 96 and No. 25, paragraph 6, be added to all intercompany agreements. It is recommended that all intercompany agreements and amendments thereto be approved by the Board of Directors and that such approvals be entered into the minutes of the Board of Directors. Once the agreements have been revised and/or amended, it is recommended that they be submitted to the CDI for approval pursuant to California Insurance Code Section (CICS) 1215.5(b).

Reinsurance – Ceded (Page 8): It is recommended that the ceded reinsurance agreements be amended to comply with California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.13.

It is recommended that the special termination or early termination provision in the Company's ceded reinsurance agreements be amended to comply with CCR, Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14 and SSAP No. 62, paragraph 7.

Accounts and Records – Information Systems Controls (Page 11): It is recommended that the Company evaluate recommendations from the general information systems controls review and make appropriate changes to strengthen its information systems controls.

Accounts and Records – Claims and Reserving Practices (Page 11): It is recommended the Company implement procedures to ensure compliance with CICS 790 and CCR, Title 10, Sections 2695 et al.

It is recommended that the Company implement procedures to assist in evaluating the liability of each claim and establish initial case reserves based on ultimate cost.

It is recommended that the Company use the claim reported date as the date of loss when a claim is presented and the date of loss is unknown and cannot be determined.

Comments on Financial Statement Items – Bonds, Cash and Short-term Investments (Page 17):

It is recommended that the Company comply with CICS 1104.1.

It is recommended that the Company adopt formal procedures to identify and report escheatable items in accordance with the Unclaimed Property Law.

It is recommended that the Company improve the monitoring of its investment securities to ensure that the designation assigned to the security properly reflects its true quality at the valuation date.

Comments on Financial Statement Items – Agents’ Balances and Uncollected Premiums (Page 17): It is recommended that the Company comply with SSAP No. 53, paragraph 13.

Comments on Financial Statement Items – Current Federal and Foreign Income Tax Recoverable and Interest Thereon (Page 18): It is recommended that tax refunds owed to the Company be remitted no later than 30 days following the date the refund is received. Balances not settled within 90 days should be nonadmitted in accordance with SSAP No. 25.

Comments on Financial Statement Items – Unearned Premiums (Page 18): It is recommended that the Company properly classify unauthorized reinsurers on its Schedule F and include these unauthorized reinsurers in the Schedule F - Part 5 Provision for Unauthorized Reinsurance. In addition, any reinsurance credit taken on account of unauthorized reinsurers should comply with CICS 922.4 and 922.5.

Comments on Financial Statement Items - Excess of Statutory Reserves Over Statement Reserves (Page 19): It is recommended that the Company comply with CICS 11558.

Prior Report of Examination

Company History (Page 2): It was recommended that any future surplus notes be submitted to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code (CIC) Section 1215.5(b), and be disclosed in the Insurance Holding Company System Registration Statement in accordance with CIC Section 1215.4(b). No surplus notes were issued during the current examination period.

Management and Control – Intercompany Agreements (Page 4): It was recommended that the Company amend the agreements to reflect all of the services provided and a reasonable allocated cost basis for those services and include substantive safeguard provisions, and be submitted to the CDI for approval in accordance with CIC Section 1215.5(b)(4). The intercompany agreements have not been amended.

Corporate Records (Page 5): It was recommended that the Company take measures to ensure that all officers and directors properly and timely complete a conflict of interest statement each year. The Company has complied with the recommendation.

Reinsurance – Ceded (Page 8): It was recommended that the reinsurance agreements be amended to meet the requirements of CIC Section 922.2(a) (2) and remove any reference to New York laws from the insolvency clause. The Company has complied with the recommendation.

It was recommended that the reinsurance agreements be amended to remove any reference to “insolvency” or New York laws from the offset clause. The Company has complied with the recommendation.

It was recommended that the reinsurance agreements be amended to comply with SSAP No. 62, paragraph 7, of the NAIC Accounting Practices and Procedures Manual. Some ceded reinsurance contracts still are not in compliance with SSAP No. 62, paragraph 7.

Accounts and Records – Information Systems Control Environment (Page 10): It was recommended that the Company prepare a written disaster recovery and business continuity plan. The Company still does not have a disaster recovery and business continuity plan.

Accounts and Records – Claims and Reserving Practices (Page 10): It was recommended that the Company develop a formal claims-handling procedures manual. The Company has complied with the recommendation.

It was recommended that the Company put more effort in determining an appropriate date of loss instead of using the policy effective date. Also, it was recommended that the Company use the date of discovery or date reported as the date of loss when an exact date of loss cannot be determined. The Company has not complied with the recommendation.

It was recommended that the Company put in a good faith effort in evaluating the liability of each claim and establish sufficient reserves on a case basis. The Company has not complied with the recommendation.

Comments on Financial Statement Items – Bonds, Stocks, and Cash and Short-term Investments (Page 16): It was recommended that the securities and funds on deposit with Union Safe Deposit Bank and UBS Financial Services, Inc. be moved to a qualified custodian, and that the Company submit a new application for approval to the CDI as soon as possible in accordance with CICS 1104.9. The Company is now in compliance.

It was recommended that the Company file its securities with the NAIC Securities Valuation Office (SVO) to be rated and valued or, designate the securities as “provisionally exempted (PE)” if they meet the conditions for provisional exemption under the NAIC SVO Manual. The Company has complied with the recommendation.

It was recommended that the Company adopt formal procedures to identify and report such items in accordance with the unclaimed property laws of applicable states. The Company has not complied with the recommendation.

The Company has two investments in foreign countries which do not qualify as admitted assets under CIC Section 1241(c). The Company did not hold any foreign investments as of the current examination date.

Comments on Financial Statement Items – Agents’ Balance and Uncollected Premiums (Page 17): It was recommended that the Company not offset credit balances over 90 days due of one policyholder with debit balances over 90 days due of another policyholder in accordance with SSAP No. 6, paragraph 9. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/S/

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