

REPORT OF EXAMINATION  
OF THE  
SAN DIEGO INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2008

Filed June 1, 2010

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Los Angeles, California  
February 19, 2010

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**SAN DIEGO INSURANCE COMPANY**

(hereinafter also referred to as the Company) at its statutory home office located at 525 B Street, San Diego, California 92101.

**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 2004. 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 concurrently with the examination of the Company's affiliate, Golden Eagle Insurance Corporation.

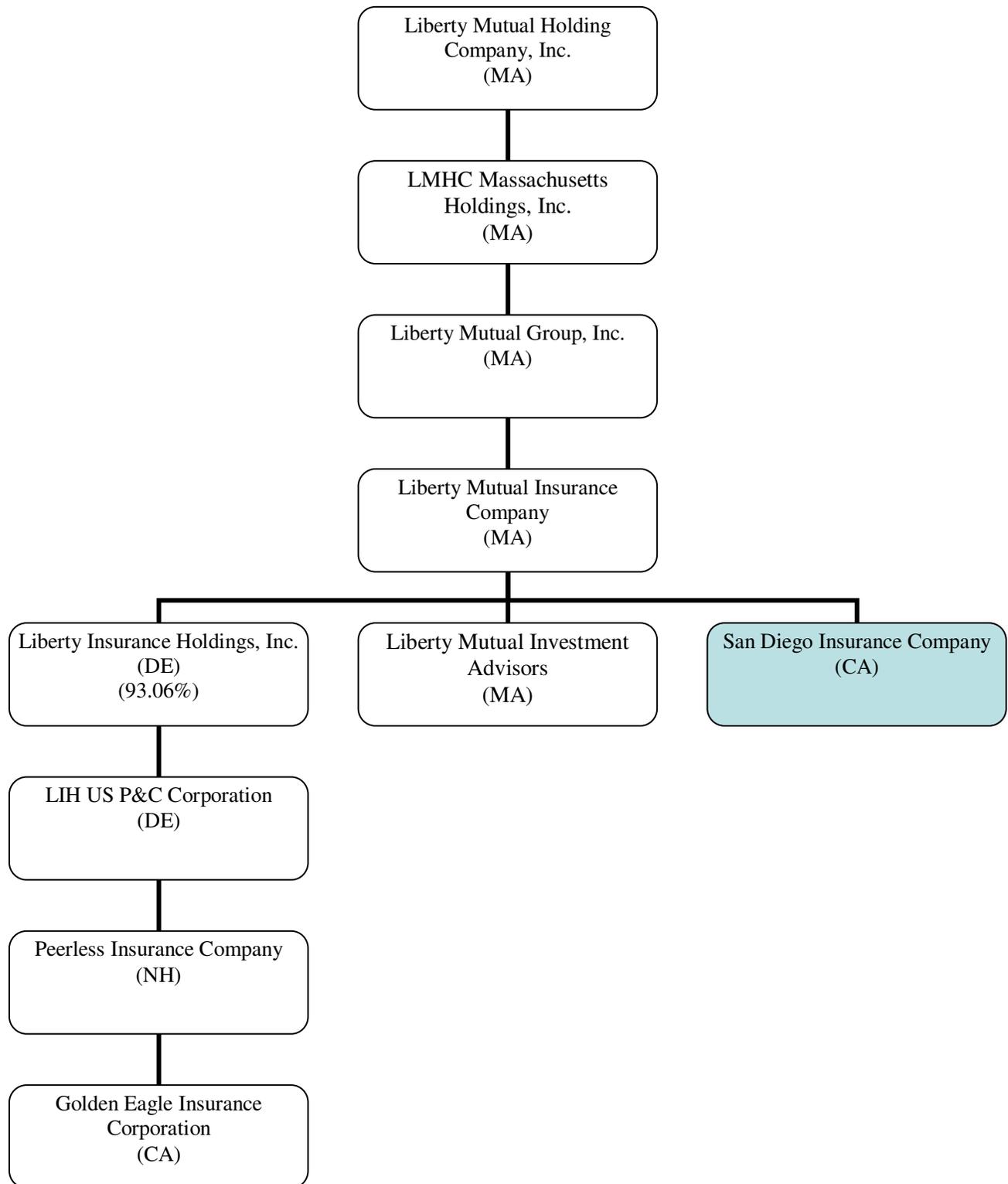
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company;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

## COMPANY HISTORY

The Company was incorporated under the laws of the State of California on July 19, 1997, and commenced business on August 22, 1997. The Company was formed as part of the rehabilitation plan of the Golden Eagle Insurance Company, which was placed under conservation on March 1, 1997 by the Insurance Commissioner of the State of California. The Company was incorporated as a wholly-owned subsidiary of Golden Eagle Insurance Corporation (GEIC). In June 2008 the Company paid a \$6,323,610 ordinary dividend to GEIC. On November 19, 2008 the California Department of Insurance approved GEIC's request to dividend the Company to Liberty Mutual Insurance Company (LMIC). On December 31, 2008, GEIC contributed 100% of the Company to LMIC valued at \$59,443,565.

## MANAGEMENT AND CONTROL

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



(\*) all ownership is 100% unless otherwise noted.

Management of the Company is vested in a six-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 Dereck Doyle Southborough, Massachusetts	Senior Vice President and Comptroller Liberty Mutual Group
Michael Joseph Fallon Bedford, Massachusetts	Chief Financial Officer Liberty Mutual Agency Markets
Joseph Anthony Gilles Medway, Massachusetts	Manager of Strategy and Operations Liberty Mutual Agency Markets
Scott Rhodes Goodby Marblehead, Massachusetts	President of Regional Companies Group Liberty Mutual Agency Markets
Gary Richard Gregg Milton, Massachusetts	President Liberty Mutual Agency Markets
Christopher Charles Mansfield Dedham, Massachusetts	General Counsel Liberty Mutual Group

#### Principal Officers

<u>Name</u>	<u>Title</u>
Gary Richard Gregg	President and Chief Executive Officer
Dexter Robert Legg	Secretary
Michael Joseph Fallon	Treasurer and Chief Financial Officer
Anthony Alexander Fontanes	Chief Investment Officer
Scott Rhodes Goodby	Chief Operating Officer
Joseph Anthony Giles	Executive Vice President

#### Management Agreements

Management Services Agreement: The Company is a party to a Management Services Agreement with Liberty Mutual Insurance Company (LMIC), effective August 21, 1997. LMIC

provides investment management and administrative services. Under the terms of this agreement, fees are settled on a quarterly basis, but no fees were charged to the Company during the examination period. The California Department of Insurance (CDI) approved this agreement in June 2001.

**Tax Sharing Agreement:** The Company and its affiliates are part of a consolidated federal income tax agreement with its ultimate parent, Liberty Mutual Holding Company Inc. amended effective September 22, 2008. The allocation of tax is based upon separate return calculations with inter-company tax balances normally settled in the quarter subsequent to the filing of the consolidated return. The CDI approved the amendment to the agreement on September 5, 2008.

**Service Agreement:** The Company entered into a Service Agreement with Golden Eagle Insurance Corporation (GEIC), effective August 21, 1997. Under this agreement GEIC provides the Company with accounting, tax, and auditing services, as well as services related to claims administration. GEIC also provides the Company with personnel, office space, equipment, and supplies in order for the Company to conduct its operations. Under the terms of the agreement, the net amount owed shall be determined not less frequently than quarterly. Payment is made upon presentation of invoices covering the specific period to which the expenses apply. During the period under examination no services were provided by GEIC to the Company, consequently no payments were made by the Company. The agreement was approved by the CDI on December 4, 2007.

**Investment Management Agreement:** The Company entered into an Investment Management Agreement with LMIC, effective December 19, 2007. Under this agreement LMIC provides investment management services to the Company. The CDI approved this agreement on November 29, 2007, and approved the amendment to the agreement on August 28, 2008. The Company pays LMIC, monthly, based on the month ending total market value multiplied by a rate of .0000283 for the debt securities; and the beginning plus month ending total market value, divided by two, multiplied by an annual rate of .0000283 for equity securities. For 2005, 2006,

2007, and 2008 the fees paid by the Company to LMIC were \$11,397, \$21,648, \$26,554, and \$23,122, respectively.

**Investment Management Agreement:** The Company entered into an Investment Management Agreement with Liberty Mutual Investment Advisors (LMIA) effective May 1, 2000, and amended November 29, 2007. Under this agreement LMIA provides investment management services to the Company. During the period under examination no settlements or payments were made by the Company to LMIA. The agreement did not provide for timely settlement of amounts owed, with a specified due date as required by the Statements of Statutory Accounting Principles (SSAP) No. 25 as amended by SSAP No. 96. It is recommended that the Company amend its Investment Management Agreement with LMIA to include all provisions required by SSAP No. 25 as amended by SSAP No. 96, and file an amendment of this agreement with the CDI in accordance with California Insurance Code (CIC) Section 1215.5(b) (4).

**Cash Management Agreement:** The Company entered into a Cash Management Agreement with LMIA effective January 28, 2000. The management fee, along with the LMIA's expenses associated with providing cash management services for the Company is settled on a quarterly basis. The management fee is calculated by the average amount of liquid assets in the liquidity pool multiplied by a rate of .0000283. For 2005, 2006, 2007, and 2008 the fees paid by the Company to LMIC were \$5,266, \$2,078, \$8,481, and \$1,543, respectively.

### CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that, only the officially filed report was presented to the board. It is recommended that the Company implement procedures to ensure future compliance with CIC Section 735.

The Company's minutes failed to document specific references to amounts, facts and the value of securities as required under CIC Section 1201. It is recommended that the Company implement procedures to ensure future compliance with CIC Section 1201.

### TERRITORY AND PLAN OF OPERATION

The Company is licensed in the State of California as a multiple line property and casualty insurer. The Company was formed to run-off pre-March 31, 1997 insurance policies and surety bond liabilities of Golden Eagle Insurance Company, an unaffiliated insurer that was under conservation. The Company agreed that it would only transact the run-off of liabilities assumed under the reinsurance agreement approved by the Conservation Court of the State of California on February 1, 1998, and would not transact any other business without prior written approval from the California Department of Insurance.

### REINSURANCE

#### Indemnity and Reinsurance Claims Administration Agreement

The Company entered into an Indemnity and Reinsurance Claims Administration Agreement with Golden Eagle Insurance Company on August 22, 1997. Due to the nature of the agreement, it was determined that the Company was required to use deposit accounting. As of December 31, 2008 the Company had a liability deposit balance of \$10,436,222 after taking into account additional funding from the Golden Eagle Insurance Trust, the successor to Golden Eagle Insurance Company, of \$1,831,925.

#### Assumed

The Company has no reinsurance assumed.

Ceded

The Company has no reinsurance ceded.

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, 2004 through 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>Notes</u>
Bonds	\$ 36,507,241	\$	\$ 36,507,241	
Cash and short-term investments	38,112,976		38,112,976	
Investment income due and accrued	482,904		482,904	
Net deferred tax asset	<u>127,000</u>	<u>115,100</u>	<u>11,900</u>	
Total assets	<u>\$ 75,230,121</u>	<u>115,100</u>	<u>\$ 75,115,021</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Current federal and foreign income taxes			\$ 677,711	
Payable to parent, subsidiaries and affiliates			1,740,279	
Aggregate write-ins for liabilities			<u>13,482,495</u>	
Total liabilities			15,900,485	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		52,800,000		
Unassigned funds (surplus)		<u>3,814,536</u>		
Surplus as regards policyholders			<u>59,214,536</u>	
Total liabilities, surplus and other funds			<u>\$ 75,115,021</u>	

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

Statement of Income

Underwriting Income

Premiums earned	\$	0
Deductions:		
Other underwriting expenses incurred	\$	<u>10,051</u>
Total underwriting deductions		<u>10,051</u>
Net underwriting loss		(10,051)

Investment Income

Net investment income earned	\$ 3,276,463	
Net realized capital losses	<u>(2,560)</u>	
Net investment gain		3,273,903

Other Income

Aggregate write-ins for miscellaneous income	\$	<u>135,471</u>
Total other income		<u>135,471</u>
Net income before dividends to policyholders		
And before federal income taxes		3,399,323
Federal income taxes incurred		<u>1,357,178</u>
Net income		<u>\$ 2,042,145</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 63,236,101
Net income	\$ 2,042,145	
Change in net deferred income tax	375,000	
Change in nonadmitted assets	(115,100)	
Dividends to stockholders	<u>(6,323,610)</u>	
Change in surplus as regards policyholders		<u>(4,021,565)</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 59,214,536</u>

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

Surplus as regards policyholders, December 31, 2004, per Examination		\$ 55,611,847
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$ 10,057,155	\$
Net unrealized capital losses		163,755
Change in deferred income tax	148,000	
Change in nonadmitted assets		115,100
Dividends to stockholders		6,323,610
	—————	—————
Totals	<u>\$ 10,205,155</u>	<u>\$ 6,602,465</u>
Net increase in surplus as regards policyholders for the examination		<u>3,602,690</u>
Surplus as regards policyholders, December 31, 2008, per Examination		<u>\$ 59,214,537</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

None

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management Agreements – Investment Management Agreement (Page 6): It is recommended that the Company amend its Investment Management Agreement with Liberty Mutual Insurance Advisors to include all provisions required by the Statement of Statutory Accounting Principles (SSAP) No. 25 as amended by SSAP No. 96, and file an amendment of this agreement with the California Department of Insurance (CDI) in accordance with California Insurance Code (CIC) Section 1215.5(b).

Corporate Records (Page 7): It is recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Section 735. It is also recommended that the Company implement procedures to ensure future compliance with CIC Section 1201.

### Previous Report of Examination

Corporate Records (Page 4): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Section 1201. The Company has not complied.

Accounts and Records (Page 5): It was recommended that the Company maintain documentation to support all financial statement accounts. During the course of examination the examiners requested various reports, data and documentation to support the Company's financial statement balances. It was determined that documentation was adequate to support the balances in the financial statement accounts.

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/\_\_\_\_\_  
Gint Prismantas, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California