

REPORT OF EXAMINATION
OF THE
SAN FRANCISCO REINSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Participating State
and Zone:

California

Filed June 19, 2009

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San Francisco, California
June 15, 2009

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

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Department of Insurance
Santa Fe, New Mexico

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

SAN FRANCISCO REINSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 777 San Marin Drive, Novato, California 94998.

SCOPE OF EXAMINATION

The previous 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 examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) 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, 2007, as deemed necessary under the circumstances.

This examination was conducted concurrently with the examinations of the Company's parent, Fireman's Fund Insurance Company and the Company's affiliates, Vintage Insurance Company and Associated Indemnity 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: 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; and sales and advertising.

SUBSEQUENT EVENTS

The Fireman's Fund group of insurance companies (Group) underwent significant restructuring in August 2008. The Executive Committee of the Company's upstream parent, Allianz of America, Inc., made the decision to decentralize support services by aligning these services more closely with the operating companies. As a result, business functions that included Legal, Information Technology, Compliance and Marketing were realigned so that these functions would be managed independently by Fireman's Fund Insurance Company and Allianz Life Insurance Company of North America.

Additionally, specialty marine business was combined with Allianz Global Corporate & Specialty's (AGCS) global marine business into a new Allianz unit, AGCS Marine Insurance Company (AMIC), that will be managed by AGCS. Agribusiness, a major contributor to the Group's profitability in the last few years, is now operated as a dedicated unit. The other portions of Specialty Insurance were combined with Commercial Business to form a new commercial and specialty risks organization. As a result, the Group currently has two primary business units: Personal and Commercial.

COMPANY HISTORY

The Company began business in 1964 as National Surety Corporation of California. In 1980, the Company's name was changed to San Francisco Insurance Company and to its present name in

1981. Effective January 1, 1997, the Company ceased its underwriting operations, except for renewals, and is proceeding with the runoff of its existing business.

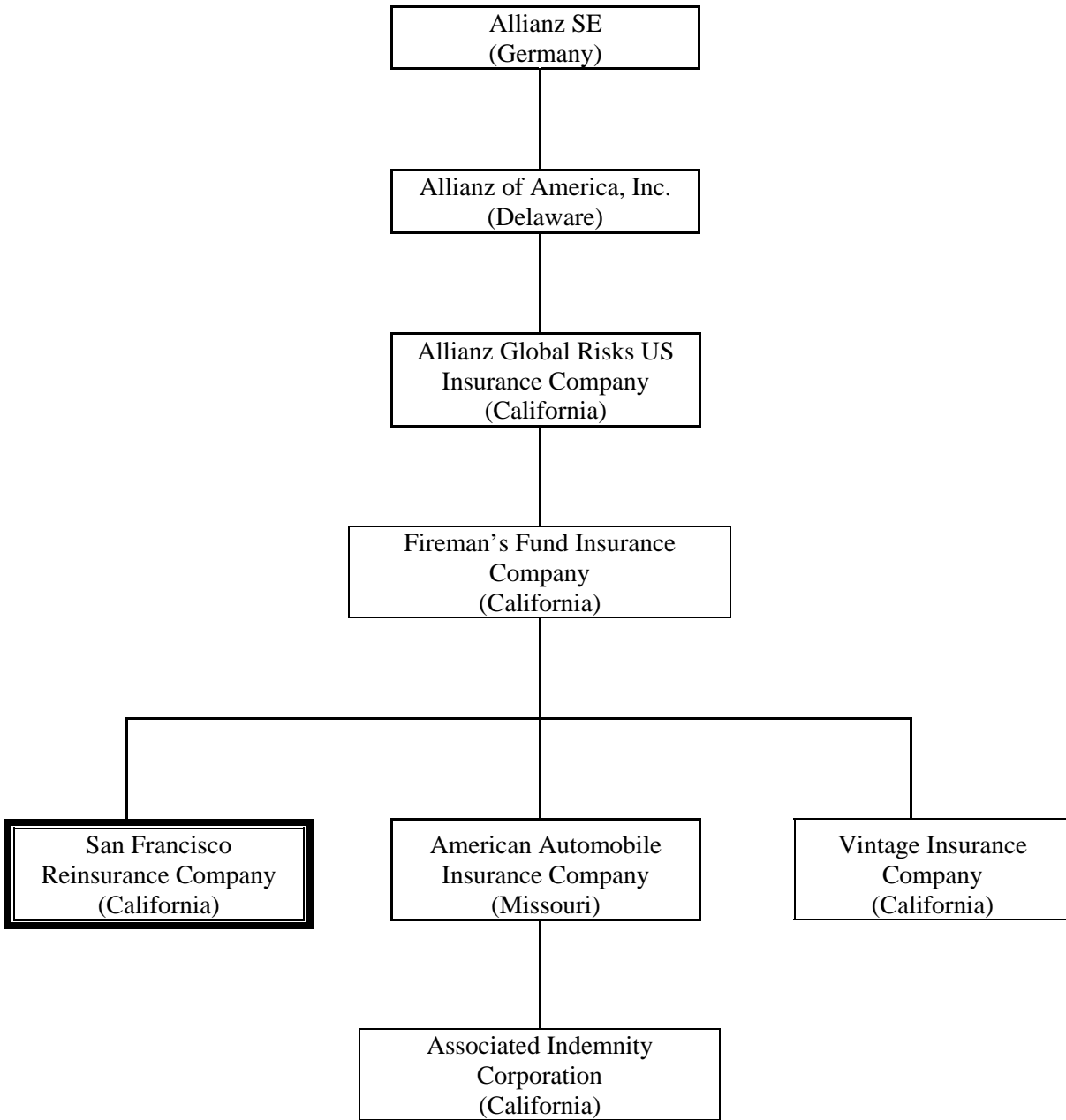
The Company is authorized to issue 60,000 shares of common stock with a par value of \$100. As of December 31, 2007, there were 39,215 shares outstanding. All outstanding shares of the Company are owned by its parent, Fireman's Fund Insurance Company (FFIC), a subsidiary of Allianz Global Risks US Insurance Company, which is wholly owned by Allianz of America, Inc. The ultimate parent of the Allianz Group is Allianz SE. In accordance with the requirements of the State of Connecticut, FFIC authorized a guarantee to the Company as follows: as long as FFIC controls the Company, the combined capital and surplus will be maintained at or above \$4,000,000.

Allianz SE (formerly Aktiengesellschaft Holding) is a European Company incorporated in the Federal Republic of Germany and the European Union. It was incorporated as Allianz Versicherungs Aktiengesellschaft in Berlin, Germany on February 5, 1890 and converted to a European Company on October 13, 2006. Allianz SE operates on a worldwide basis through branch offices, subsidiaries and affiliated companies.

In 2006, the Company paid an extraordinary dividend to FFIC of \$181 million. The dividend was paid as a cash distribution from gross paid-in and contributed surplus. This transaction was approved by the California Department of Insurance on November 20, 2006.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system. Allianz SE (doing business as a Societas Europaea company), formerly Allianz Aktiengesellschaft, is a European Company incorporated in the Federal Republic of Germany and the European Union. Allianz SE is the ultimate controlling entity. The chart on the following page depicts the interrelationship of the Company and its California subsidiaries within the holding company system (all ownership is 100%):



Members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2007:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Charles M. Kavitsky ^(a) Tiburon, California	Chairman, President and Chief Executive Officer Fireman's Fund Insurance Company
Janet S. Kloenhamer Larkspur, California	Senior Vice President Fireman's Fund Insurance Company
Jill E. Paterson ^(b) Tiburon, California	Executive Vice President and Chief Financial Officer Fireman's Fund Insurance Company
Cynthia L. Pevehouse ^(c) Tiburon, California	Senior Vice President and Secretary Fireman's Fund Insurance Company
Linda E. Wright ^(d) Tiburon, California	Senior Vice President and Treasurer Fireman's Fund Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Charles M. Kavitsky ^(a)	President and Chief Executive Officer
Jill E. Paterson ^(b)	Executive Vice President and Chief Financial Officer
Cynthia L. Pevehouse ^(c)	Senior Vice President and Secretary
Linda E. Wright ^(d)	Senior Vice President and Treasurer
Louise Jordan ^(e)	Senior Vice President and Controller
Janet S. Kloenhamer	Senior Vice President

The following changes in management occurred subsequent to the examination date:

- ^(a) Charles Kavitsky was elected as Chairman of the Board effective January 1, 2008. In January, 2009 the Company announced that Mr. Kavitsky will retire effective July 31, 2009. Michael LaRocco was named President and Chief Executive Officer effective March 17, 2008.
- ^(b) Jill Paterson was elected Treasurer effective October 28, 2008. Her current title is Executive Vice President, Chief Financial Officer and Treasurer.
- ^(c) Cynthia Pevehouse was elected Executive Vice President, General Counsel and Secretary at Allianz of America Corporation. Sally Narey replaced Ms. Pevehouse as Senior Vice President, General Counsel and Secretary effective September 8, 2008.
- ^(d) Linda Wright was replaced as Treasurer by Jill Paterson effective October 28, 2008.
- ^(e) Louise Jordan transferred to Allianz SE in Munich, Germany in June 2008. Jeffery Johnson, Assistant Controller, was promoted to Vice President and Controller.

Management Agreements

Tax Reimbursement Agreement: Effective December 17, 1999, the Company entered into a Tax Reimbursement Agreement for the purpose of clarifying an agreement that was in effect since 1991. The Tax Reimbursement Agreement was between Allianz of America, Inc. (AZOA), the Company and its affiliates. Under the terms of this agreement, the tax liability of the Company and its affiliates will be computed as if each member filed a separate stand-alone return. AZOA is the party primarily responsible for filing and making all tax payments on behalf of the Company and its affiliates.

TERRITORY AND PLAN OF OPERATION

The Company is a professional reinsurance company, which wrote pro-rata and excess reinsurance in both the domestic and foreign markets. With the exception of Alaska, it was licensed in all states and the District of Columbia, but had no direct premium. In October 2006 the Company's parent, Fireman's Fund Insurance Company, announced that the Company would cease underwriting new and renewal risks effective January 1, 1997. Following the parent's decision to place the Company into run-off, the renewal rights to the Company's book of business were sold to Hartford Fire Insurance Company.

REINSURANCE

The Company had no assumed or ceded premium written during the period covered by this examination. The reported liability for losses and loss adjustment expenses were for years prior to the examination period.

Retroactive Reinsurance

On September 30, 2002, the Company entered into a retroactive reinsurance contract whereby it ceded all net carried reserves totaling \$4.3 million related to asbestos and environmental (A&E) claims to its ultimate parent, Allianz SE, formerly known as Allianz Aktiengesellschaft Holding.

The Company received approval from the California Department of Insurance to account for the transaction as a prospective arrangement. Under prospective accounting, the Company recorded ceded premium of \$4.3 million and ceded losses of \$4.3 million, with no impact on net income. The ceded losses are reflected on the statement of admitted assets, liabilities and surplus as a decrease in net loss reserves.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, several low risk findings were noted in controls over logical security. These findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

Federal Income Taxes

Currently the methodology being used for measuring temporary book/tax differences is not in compliance with Statement of Statutory Accounting Principles (SSAP) No. 10, paragraph 6.a., which states "Temporary differences are identified and measured using a balance sheet approach whereby statutory and tax basis balance sheets are compared." The Company currently uses an income statement approach where the current year non-taxable amounts are added/subtracted from last year's cumulative timing difference. The updated cumulative timing difference is used to support the deferred tax asset or liability. The balance sheet approach is preferred in order to assure completeness and accuracy of the deferred tax inventories, particularly where the tax basis calculations are complicated and are developed over several years. It is recommended that the Company identify and measure temporary differences using a balance sheet approach in compliance with SSAP No. 10, paragraph 6.a.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition 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

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 96,686,008	\$	\$ 96,686,008	
Preferred stocks	3,496,291		3,496,291	
Cash	9,082		9,082	
Other invested assets	1,966,433		1,966,433	
Receivable for securities	2,006		2,006	
Investment income due and accrued	1,127,648		1,127,648	
Amount recoverable from reinsurers	1,501,804		1,501,804	
Funds held by or deposited with reinsured companies	94,599		94,599	
Net deferred tax asset	1,203,751	1,203,751		
Receivables from parents, subsidiaries and affiliates	<u>469,099</u>	<u> </u>	<u>469,099</u>	
Total assets	<u>\$ 106,556,721</u>	<u>\$ 1,203,751</u>	<u>\$ 105,352,970</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 32,810,000	(1)
Reinsurance payable on paid loss and loss adjustment expenses			52,246	
Other expenses			(197,404)	
Taxes, licenses and fees			40,711	
Current federal and foreign income taxes			1,647,370	
Ceded reinsurance premiums payable			(4)	
Funds held by company under reinsurance treaties			89,421	
Provision for reinsurance			<u>734,118</u>	
Total liabilities			35,176,458	
Common capital stocks	\$ 3,921,500			
Gross paid in and contributed surplus	10,633,647			
Unassigned funds (surplus)	<u>55,621,365</u>			
Surplus as regards policyholders			<u>70,176,512</u>	
Total liabilities, surplus and other funds			<u>\$ 105,352,970</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$	0
Deductions:			
Losses incurred	\$ 8,275,075		
Other underwriting expenses incurred	<u>(340,953)</u>		
Total underwriting deductions			<u>7,934,122</u>
Net underwriting loss			(7,934,122)

Investment Income

Net investment income earned	\$ 4,951,910		
Net realized capital gain	<u>240,857</u>		
Net investment gain			<u>5,192,767</u>
Net income before federal and foreign income taxes			(2,741,355)
Federal and foreign income taxes incurred			<u>167,940</u>
Net income		\$	<u>(2,909,295)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2006		\$	74,101,620
Net income	\$ (2,909,295)		
Change in net unrealized capital gains	(477,568)		
Change in net unrealized foreign exchange capital gain	43,519		
Change in net deferred income tax	(1,341,622)		
Change in nonadmitted assets	991,684		
Change in provision for reinsurance	<u>(231,826)</u>		
Change in surplus as regards policyholders for the year			<u>(3,925,108)</u>
Surplus as regards policyholders, December 31, 2007		\$	<u>70,176,512</u>

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

Surplus as regards policyholders, December 31, 2003 per Examination			\$ 237,586,182
	Gain in <u>Surplus</u>	Loss in <u>Surplus</u>	
Net income	\$ 13,885,290	\$	
Net unrealized capital gains	262,355		
Change in net foreign exchange capital losses		12,738	
Change in net deferred income tax		732,741	
Change in nonadmitted assets		68,516	
Change in provision for reinsurance	256,680		
Surplus adjustments: Paid-in	<u> </u>	<u>181,000,000</u>	
Total gains and losses	<u>\$ 14,404,325</u>	<u>\$ 181,813,995</u>	
Net increase in surplus as regards policyholders			<u>(167,409,670)</u>
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 70,176,512</u>

Reconciliation of Examination Changes
as of December 31, 2007

<u>Liabilities</u>	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Surplus</u> <u>Increase</u> <u>(Decrease)</u>	<u>Notes</u>
Losses and loss adjustment expenses	\$ 25,466,781	\$ 32,810,000	<u>\$ (7,343,219)</u>	(1)
Net decrease to surplus			(7,343,219)	
Surplus as regards policyholders, December 31, 2007, per Company			<u>77,519,731</u>	
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 70,176,512</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI) retained an independent Consulting Actuary to evaluate the loss and loss adjustment expense reserves (loss reserves) as of December 31, 2007. In addition, a Senior Casualty Actuary with the CDI reviewed the work of our Consulting Actuary, and performed additional analysis as deemed appropriate. Based on the analyses performed by the CDI's Consulting Actuary and in-house Senior Casualty Actuary, the CDI has determined its best estimate of loss reserves to be \$32,810,000, as compared to the Company's carried reserves of \$25,466,781. The reserve deficiency primarily relates to adverse development on asbestos and environmental reserves (A&E), which triggered amounts due from Allianz SE under a Keep Well Commitment. The Keep Well Commitment is held by the Company's parent, Fireman's Fund Insurance Company.

The CDI understands that the Company has retained an actuarial firm to perform a full ground up analysis of its A&E reserves. The CDI will closely monitor the development of the Company's A&E reserves and will be reviewing the results of the A&E reserve study.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 7): As the result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Accounts and Records – Federal Income Taxes (Page 7): It is recommended that the Company identify and measure temporary differences using a balance sheet approach in compliance with Statement of Statutory Accounting Principles No. 10, paragraph 6.a.

Previous Report of Examination

Accounts and Records - Information Systems Controls (Page 7): It was recommended that the Company evaluate the recommendations from the Information Systems review and make appropriate changes to strengthen its information system controls. The Company has implemented changes to strengthen its controls over information systems.

Comments on Financial Statement Items – Bonds (Page 12): It was recommended the Company revise its Custodial Agreement with Mellon Trust of California to include provisions recommended by the NAIC Financial Examiners Handbook. It was also recommended the Company submit the revised agreement to the California Department of Insurance (CDI) for approval. The Company included the provisions and submitted the agreement to the CDI for approval as recommended. The revised agreement was approved by the CDI on February 28, 2006.

Comments on Financial Statement Items – Common Stocks and Other Invested Assets (Page 13): It was recommended that the Company classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA. The Company has complied with this recommendation.

ACKNOWLEDGMENT

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/_____
Gordon M. Curtis, CFE, CISA
Examiner-In-Charge
Department of Insurance
State of California