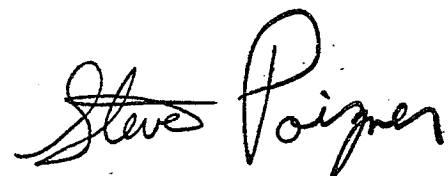


REPORT OF EXAMINATION
OF THE
ZNAT INSURANCE COMPANY
AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California



Insurance Commissioner

FILED 06-09-10

TABLE OF CONTENTS

PAGE

SCOPE OF EXAMINATION	1
SUBSEQUENT EVENTS	2
MANAGEMENT AND CONTROL:.....	2
Management Agreements	3
TERRITORY AND PLAN OF OPERATION	4
GROWTH OF COMPANY.....	5
REINSURANCE:	5
Intercompany Pooling Agreement	5
Assumed	6
Ceded	6
FINANCIAL STATEMENTS:.....	8
Statement of Financial Condition as of December 31, 2008	9
Underwriting and Investment Exhibit for the Year Ended December 31, 2008.....	10
Reconciliation of Surplus as Regards Policyholders from December 31, 2005 through December 31, 2008.....	11
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	12
Losses and Loss Adjustment Expenses	12
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	12
Current Report of Examination	12
Previous Report of Examination.....	12
ACKNOWLEDGEMENT	13

Los Angeles, California
May 21, 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

ZNAT INSURANCE COMPANY

(hereinafter also referred to as the Company) at the statutory home office and primary location of its books and records, 21255 Califa Street, Woodland Hills, California 91367.

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 was conducted concurrently with the examination of the Company's parent, Zenith Insurance Company. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances.

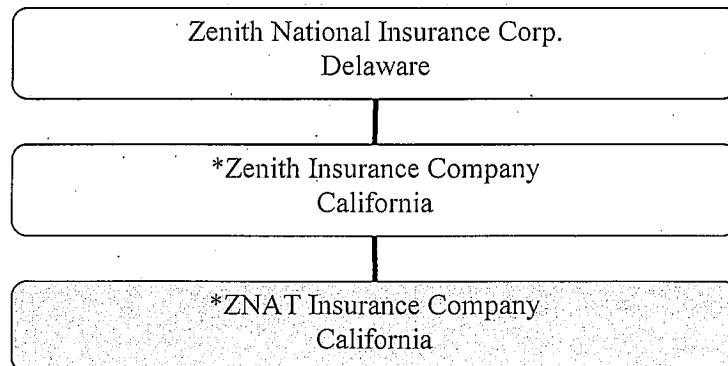
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare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

SUBSEQUENT EVENTS

On May 20, 2010, the Company's ultimate parent Zenith National Insurance Corp. (ZNIC) merged with Fairfax Financial Holdings Limited (Fairfax). Under the merger agreement, Fairfax acquired all of the outstanding shares of ZNIC common stock which it did not currently own for \$38.00 per share in cash.

MANAGEMENT AND CONTROL

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



(*) all ownership is 100%

Management of the Company is vested in a three-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>
Jack D. Miller Moraga, California	President Zenith Insurance Company
Kari L. Van Gundy Chatsworth, California	Executive Vice President, Chief Financial Officer, and Treasurer Zenith Insurance Company
Stanley R. Zax Beverly Hills, California	Chairman of the Board and Chief Executive Officer Zenith Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Stanley R. Zax	Chairman of the Board
Jack D. Miller	President
Michael E. Jansen	Executive Vice President and General Counsel
Keith E. Trotman	Executive Vice President
Kari L. Van Gundy	Executive Vice President and Treasurer
Robert E. Meyer	Executive Vice President and Chief Actuary
Hyman J. Lee Jr.	Vice President and Secretary

Management Agreements

Administrative Services and Cost Sharing Agreement (Agreement): Zenith National Insurance Corp. (ZNIC) and its insurance subsidiaries are parties to the Agreement dated January 1, 2008. The Agreement terminates, supersedes and replaces the Cost Allocation Agreement which had been in effect since 1991. On October 9, 2008, Amendment No. 1 was entered into and added Zenith

Insurance Management Services, Inc., a Florida corporation and a non insurance affiliate of the Company, as a party to the Agreement. Under the terms of the Agreement, costs of shared facilities, services, and expenses are allocated to each party on a cost allocation basis using actual and reasonable costs. During the years 2006, 2007, and 2008, the Company paid fees of \$19.7 million, \$37.4 million, and \$37.4 million, respectively. On February 21, 2008 and October 2, 2008 the California Department of Insurance (CDI) approved the Agreement and Amendment No.1, respectively.

Tax Sharing Agreement: The Company and certain affiliates are parties to a tax sharing agreement. The agreement provides for participants to file a consolidated federal income tax return with ZNIC. Allocation of taxes is based upon separate return calculations with intercompany tax balances settled in the quarter subsequent to the filing of the consolidated return. The agreement along with an amendment dated October 30, 2006, was approved by the CDI on December 19, 2006.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact multiple lines of property and casualty insurance. The following is a listing of the states in which the Company is licensed:

Arkansas	Texas
California	Utah
Iowa	

In 2008, the Company wrote \$79 million of direct premiums. All of the direct premiums were written in California and were for workers' compensation.

The Company's business is written through approximately 1,600 independent licensed insurance agents. The Company and its parent, Zenith Insurance Company, maintain branch offices in Fresno, Glendale, Los Angeles, Orange, Pleasanton, Sacramento, San Diego, Santa Cruz, and Solana Beach, California. Additionally, the companies maintain branch offices in Birmingham, Alabama; Hollywood, Orlando, and Sarasota, Florida; Lisle and Springfield, Illinois; Charlotte, North Carolina; Blue Bell, Pennsylvania; and Austin, Texas.

GROWTH OF COMPANY

The Company reported significant decreases in direct and net premiums written and a significant increase in surplus during the years under examination as follows:

Year	Direct Premiums Written	Net Premiums Written	Surplus
2009	\$59,729,772	\$9,040,224	\$ 26,858,964
2008	78,548,976	11,808,808	25,850,563
2007	109,884,207	14,349,805	12,174,038
2006	185,834,844	17,794,918	11,966,083

The decrease in premiums written is related to two factors: the decrease in rates and payrolls due to the state of the economy and to the increased competition within the workers' compensation insurance market. The increase in surplus during 2008 was primarily the result of the elimination of \$11.6 million excess statutory reserve for the workers' compensation line of business. Effective January 1, 2008, California enacted legislation (Senate Bill 316) to eliminate the excess statutory reserves required by California Insurance Code Section 11558.

REINSURANCE

Intercompany Pooling Agreement

The underwriting operations of the Company and its parent, Zenith Insurance Company (Zenith), are governed by an Intercompany Pooling Agreement (Pooling Agreement). The Pooling Agreement provides for the pooling and distribution, in fixed percentages, of the companies' underwriting operations, liabilities, expenses, income, and losses directly related to the writing of insurance contracts. Excluded from the Pooling Agreement are intercompany balances, real estate expenses, investment income and expenses, and directors' fees and similar expenses.

Zenith is the lead insurer in the pool. Under the terms of the Pooling Agreement, the Company cedes to Zenith 100% of its net retained underwriting liabilities. Zenith retrocedes to the Company its

proportionate share of the pooled underwriting liabilities. Members of the pool and their respective participation percentages as of year-end 2008 were as follows:

<u>Pool Member</u>	<u>Percentage</u>
Zenith Insurance Company	98%
ZNAT Insurance Company	2%
Total	<u>100%</u>

Both parties to the Pooling Agreement are named participants in all reinsurance agreements with non-affiliated reinsurers, and have a contractual right of direct recovery from the non-affiliated reinsurers.

Assumed

Other than the pooling agreement mentioned above and certain mandatory reinsurance pools, the Company has an immaterial amount of reinsurance assumed as they exited the assumed reinsurance business in September, 2005.

Ceded

As of year-end 2008, the Company maintained excess of loss and catastrophe reinsurance protection on its direct workers' compensation writings as follows: Excess of loss reinsurance covering losses, per occurrence, in excess of \$5 million up to an aggregate loss of \$150 million and up to \$200 million for catastrophe losses arising out of California earthquakes. The following is a summary of the principal ceded reinsurance treaties in-force as of December 31, 2008:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
First – Fourth Layer	100% Employer Reinsurance Corporation (Westport Insurance Company)	\$5 million	\$5 million Excess of \$5 million
Fifth Layer	16.75% Various Lloyd's of London Syndicates 11.25% Hannover Rueckversicherungs – AG 72% Various reinsurers	\$10 million	\$10 million Excess of \$10 million
Sixth Layer	18.7% Various Lloyd's of London Syndicates 17.5% Hannover Rueckversicherungs – AG 15% Swiss Re America Corp. 12% Axis Specialty Limited 10% Arch Reinsurance Company 10% Transatlantic Reinsurance Company 16.8% Various reinsurers	\$20 million	\$20 million Excess of \$20 million
Seventh Layer	24% Various Lloyd's of London Syndicates 10% Ace Tempest Reinsurance Limited 10% Platinum Underwriters Bermuda Ltd. 56% Various reinsurers	\$40 million	\$35 million Excess of \$40 million
Eighth Layer	15% Axis Specialty Limited 14.6% Various Lloyd's of London Syndicates 13.4% Aspen Insurance UK Limited 13% Ace Tempest Reinsurance Limited 12.5% Swiss Re America Corp. 10% Platinum Underwriters Bermuda Ltd. 21.5% Various reinsurers	\$75 million	\$75 million Excess of \$75 million
California Earthquake Only	25% Various Lloyd's of London Syndicates 17.5% Swiss Re America Corp. 17.5% Aspen Insurance UK Limited 10% Allied World Insurance Company 30% Various reinsurers	\$150 million	\$50 million Excess of \$150 million
Nuclear, Biological, Chemical or Radiological	50% Lloyd's Syndicate 2987 BRT 30% Platinum Underwriters Bermuda Ltd 20% Houston Casualty Company	\$10 million	\$20 million Excess of \$10 million

The Company's reinsurance program also provides protection for acts of terrorism, both domestic and foreign.

As of December 31, 2008, reinsurance recoverables for all ceded reinsurance totaled \$300 million, of which \$281 million was due from Zenith. The remaining \$19 million or 75% of surplus as regards policyholders, are reinsurance recoverables from non-affiliated admitted reinsurers.

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, 1995 through December 31, 2008

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

Statement of Income

Underwriting Income

Premiums earned		\$ 12,146,528
Deductions:		
Losses incurred	\$ 3,887,542	
Loss adjustment expenses incurred	1,710,633	
Other underwriting expenses incurred	<u>4,517,094</u>	
Total underwriting deductions		<u>10,115,269</u>
Net underwriting gain		2,031,259

Investment Income

Net investment income earned	\$ 1,511,155	
Net realized capital losses	<u>(17,185)</u>	
Net investment gain		1,493,970

Other Income

Net loss from agents' or premium balances charged off	\$ <u>(28,477)</u>	
Total other income		<u>(28,477)</u>
Net income before dividends to policyholders and before federal income taxes		3,496,752
Dividends to policyholders		287,533
Federal income taxes incurred		<u>1,020,000</u>
Net income		<u>\$ 2,189,219</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 12,174,038
Net income	\$ 2,189,219	
Change in net deferred income tax	(158,000)	
Change in nonadmitted assets	20,539	
Aggregate write-ins for gains and losses in surplus	<u>11,624,767</u>	
Change in surplus as regards policyholders for the year		<u>13,676,525</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 25,850,563</u>

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

Surplus as regards policyholders, December 31, 2005, per Examination \$ 8,863,248

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$ 12,814,982	\$
Change in net deferred income tax		827,000
Change in nonadmitted assets	47,900	
Change in excess statutory reserves	4,892,572	
Aggregate write-ins for gains in surplus	<u>58,861</u>	<u> </u>
Totals	<u>\$ 17,814,315</u>	<u>\$ 827,000</u>

Net increase in surplus as regards policyholders for the examination 16,987,315

Surplus as regards policyholders, December 31, 2008, per Examination \$ 25,850,563

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2008 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

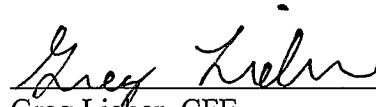
Previous Report of Examination

None.

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, reading "Greg Lieber", is written over a horizontal line.

Greg Lieber, CFE
Examiner-In-Charge
Senior Insurance Examiner (Specialist)
Department of Insurance
State of California