

REPORT OF EXAMINATION
OF THE
SAFEWAY DIRECT INSURANCE COMPANY
AS OF
DECEMBER 31, 2010

Filed June 5, 2012

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
MANAGEMENT AND CONTROL:	2
Management Agreements	4
CORPORATE RECORDS	4
TERRITORY AND PLAN OF OPERATION	5
REINSURANCE:	5
Inter-Company Pooling Agreement.....	5
Assumed.....	6
Ceded	6
FINANCIAL STATEMENTS:.....	7
Statement of Financial Condition as of December 31, 2010	8
Underwriting and Investment Exhibit for the Year Ended December 31, 2010.....	9
Reconciliation of Surplus as Regards Policyholders from December 31, 2005 through December 31, 2010	10
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	11
Losses and Loss Adjustment Expenses	11
Advance Premium.....	11
Aggregate Write-Ins for Liabilities.....	12
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	12
Current Report of Examination.....	12
Previous Report of Examination	12
ACKNOWLEDGMENT.....	14

Los Angeles, California
April 27, 2012

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

SAFEWAY DIRECT INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 222 East Huntington Drive, Suite 200, Monrovia, California 91016.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination was completed as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2010. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This examination was a coordinated examination and was conducted concurrently with the examinations of other insurance entities in the holding company group and included participation from the following states: Illinois (Lead State), Georgia, Louisiana, and Texas.

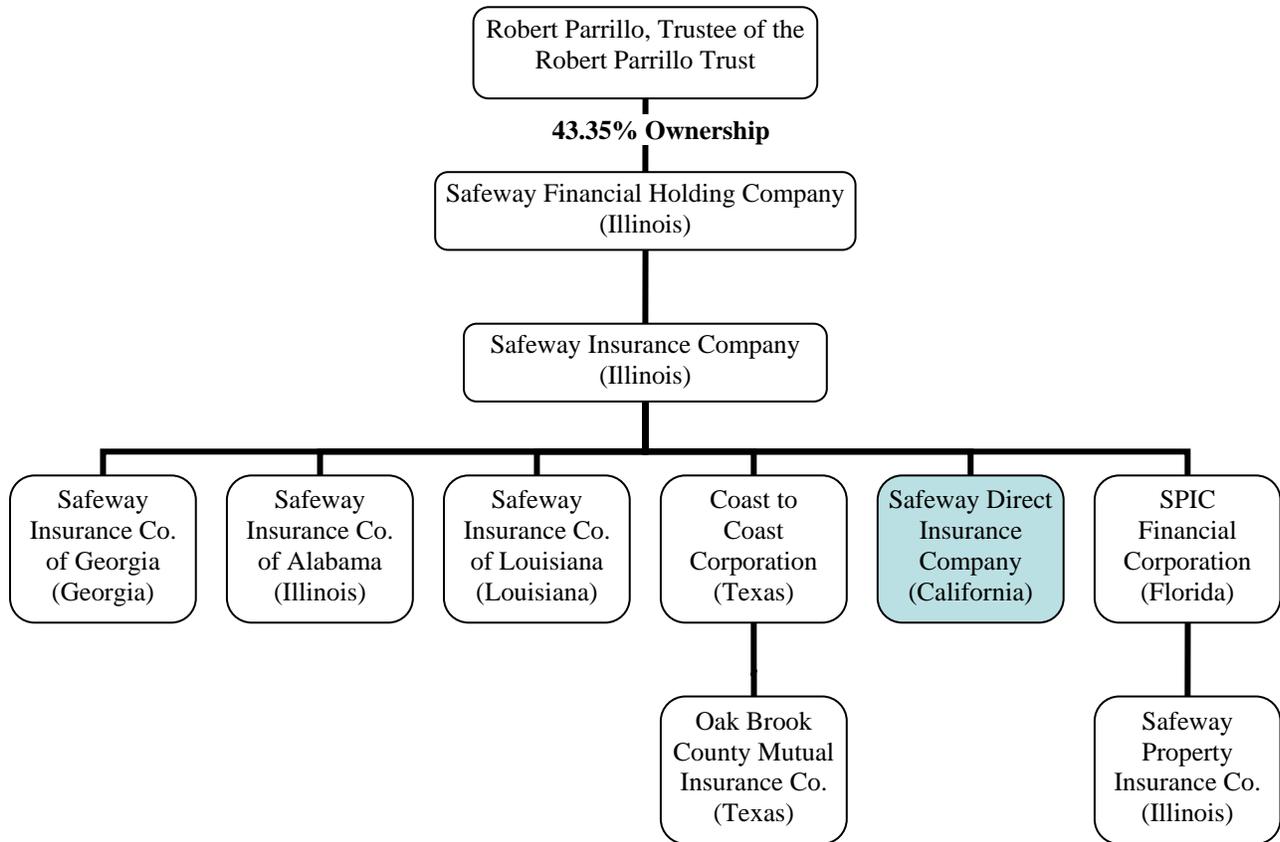
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; statutory deposits; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

On March 23, 2012, the Company submitted a Form A acquisition of control filing to the California Department of Insurance (CDI) to transfer 2,702.96 shares, or 27.95% of the issued shares, of Safeway Financial Holding Company, the Company's ultimate parent, from William and Carol Parrillo to Daniel P. Letizia, as Trustee of the William and Carol Parrillo Irrevocable Trust dated September 15, 2010. The filing is currently under review by the CDI.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the parent along with its subsidiary 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 three-member board of directors elected annually. Following are members of the board and principal officers of the Company serving on December 31, 2010:

Directors

Name and Residence

Principal Business Affiliation

Robert M. Bordeman
Hinsdale, Illinois

Secretary and Treasurer
Safeway Insurance Company

William G. Parrillo
Hinsdale, Illinois

Vice President
Safeway Insurance Company

William J. Parrillo

President

Name and Residence
Oak Brook, Illinois

Principal Business Affiliation
Safeway Insurance Company

Principal Officers

Name

Title

Robert M. Bordeman

President and Treasurer

William G. Parrillo

Secretary

William J. Parrillo

Vice President

Management Agreements

Cost Allocation Agreement: Effective August 1, 2007, the Company entered into a Cost Allocation Agreement with its parent, Safeway Insurance Company (SIC). Under the terms of the agreement, SIC provides management and related services to the Company. The Company pays its share of costs and expenses on an actual cost basis without profit and makes quarterly payments to SIC. Payments made to SIC during the examination period were: \$472,742 in 2006, \$346,941 in 2007, \$390,847 in 2008, \$337,349 in 2009, and \$119,245 in 2010. The agreement was approved by the California Department of Insurance on July 19, 2011.

Tax Allocation Agreement: The Company and its affiliates are parties to a tax allocation agreement, dated March 31, 2001, with its parent, SIC. Tax liabilities and recoverables realized by SIC are allocated to the respective entities as if each entity had filed on a separate return basis. The benefit or liability accrued is paid to, or paid by, the member within 30 days after the filing of the consolidated tax return.

CORPORATE RECORDS

California Insurance Code Section (CICS) 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 the prior filed Report of Examination was not presented to the Board of Directors of the Company. This was also noted in the prior report of examination. It is again recommended that the Company comply with CICS 735.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact liability and automobile insurance in California and Illinois. The Company is a direct writer for private passenger automobile preferred and standard risks. In 1999, the Company ceased its direct marketing campaign but continues to service its existing policyholders and write business through renewals and referrals. At December 31, 2010, the Company had direct premiums of \$1,274,015, all of which were private passenger automobile liability and physical damage written in California.

REINSURANCE

Inter-Company Pooling Agreement

Effective January 1, 2006, the Company entered into an Inter-Company Pooling Agreement with its affiliates. Under the terms of the agreement, the Company and its affiliates cede 100% of net premiums, losses, and certain underwriting expenses to the lead company, Safeway Insurance Company (SIC). In return, SIC retrocedes net premiums, losses, and certain underwriting expenses to each pool member based on contractually determined pooling percentages. On January 1, 2009, the agreement was amended to update the pooling percentages among the participants. The participants in the Inter-Company Pooling Agreement, and their respective participation percentages as of December 31, 2010, were as follows:

<u>Pool Participants</u>	<u>Percentage</u>
Safeway Insurance Company (Illinois)	48.0%
Safeway Insurance Company of Louisiana (Louisiana)	23.0%
Safeway Insurance Company of Georgia (Georgia)	13.0%
Safeway Insurance Company of Alabama, Inc. (Illinois)	12.5%
Safeway Direct Insurance Company (California)	<u>3.5%</u>
	<u>100%</u>

The Company's pool participation percentage is 3.5%. In 2010, the Company's portion of the assumed business was approximately \$8.0 million. The California Department of Insurance (CDI) approved the original agreement on February 8, 2006, and the amendment on March 3, 2010.

Effective January 1, 2011, the Company amended the Inter-Company Pooling Agreement to increase the Company's pool participation percentage to 4.0%. The CDI approved the agreement on January 27, 2011.

Effective April 1, 2011, the Company entered into an Amended and Restated Inter-Company Pooling Agreement which updated various language and replaced the Inter-Company Pooling Agreement. The CDI approved the Amended and Restated Inter-Company Pooling Agreement on June 22, 2011.

Assumed

Other than the Inter-Company Pooling Agreement, the Company did not assume any reinsurance during the period under examination.

Ceded

Other than the Inter-Company Pooling Agreement, the Company did not cede any reinsurance during the period under examination.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders from December 31, 2005
through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 13,388,071	\$	\$ 13,388,071	
Cash and short-term investments	1,845,821		1,845,821	
Investment income due and accrued	154,966		154,966	
Uncollected premiums and agents' balances in the course of collection	118,142	8,274	109,868	
Net deferred tax asset	260,991	38,716	222,275	
Electronic data processing equipment and software	1,050	1,050	0	
Aggregate write-ins for other than invested assets	<u>2,228</u>	<u>2,228</u>	<u>0</u>	
Total assets	<u>\$ 15,771,269</u>	<u>\$ 50,268</u>	<u>\$ 15,721,001</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 2,576,842	(1)
Loss adjustment expenses			826,715	(1)
Commissions payable, contingent commissions and other similar charges			233,225	
Other expenses			76,103	
Taxes, licenses and fees			3,879	
Current federal income taxes			138,883	
Unearned premiums			1,862,093	
Advance premiums			0	(2)
Amounts withheld or retained by company for account of others			21,546	
Payable to parent, subsidiaries and affiliates			138,131	
Aggregate write-ins for liabilities			<u>81,161</u>	(3)
Total liabilities			5,958,578	
Common capital stock		\$ 1,080,000		
Gross paid in and contributed surplus		10,920,000		
Unassigned funds (surplus)		<u>(2,237,577)</u>		
Surplus as regards policyholders			<u>9,762,423</u>	
Total liabilities, surplus and other funds			<u>\$ 15,721,001</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2010

Statement of Income

Underwriting Income

Premiums earned		\$ 7,923,319
Deductions:		
Losses incurred	\$ 4,293,273	
Loss adjustment expenses incurred	1,403,680	
Other underwriting expenses incurred	<u>2,152,898</u>	
Total underwriting deductions		<u>7,849,851</u>
Net underwriting gain		73,468

Investment Income

Net investment income earned	\$ 444,507	
Net realized capital gain	<u>4,126</u>	
Net investment gain		448,633

Other Income

Net loss from agents' or premium balances charged off	(3,652)	
Finance and service charges not included in premiums	<u>\$ 27,746</u>	
Total other income		<u>24,094</u>
Net income before federal income taxes		546,195
Federal income taxes incurred		<u>158,644</u>
Net income		<u>\$ 387,551</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009		\$ 9,366,770
Net income	\$ 387,551	
Change in net unrealized capital gains	1,794	
Change in net deferred income tax	43,821	
Change in nonadmitted assets	<u>(37,513)</u>	
Change in surplus as regards policyholders for the year		<u>395,653</u>
Surplus as regards policyholders, December 31, 2010		<u>\$ 9,762,423</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2010

Surplus as regards policyholders, December 31, 2005, per Examination			\$ 7,353,745
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 2,166,385	\$	
Change in net unrealized capital gains	11,654		
Change in net deferred income tax	250,736		
Change in nonadmitted assets	<u> </u>	<u>20,097</u>	
Total gains and losses	<u>\$ 2,428,775</u>	<u>\$ 20,097</u>	
 Net increase in surplus as regards policyholders			 <u>2,408,678</u>
 Surplus as regards policyholders, December 31, 2010, per Examination			 <u>\$ 9,762,423</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Illinois Department of Insurance (IDOI) actuary conducted a comprehensive actuarial analysis to determine the reasonableness of the loss and loss adjustment expense reserves on a pooled basis as of December 31, 2010. Based on the analysis by the IDOI and the review of their work by a Casualty Actuary from the California Department of Insurance, the Company's December 31, 2010 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

(2) Advance Premium

The Company did not report any advance premiums for premiums received prior to the effective date of the policies. The Company physically holds the premium payments for new policies until the effective date of the policies, then deposits and records the payments in its system. For renewing policies, payments received prior to the effective date are deposited with a corresponding credit to premiums receivable. The Company's accounting methodology for premiums received prior to the effective date of the policies is not in compliance with the National Association of Insurance Commissioners' (NAIC) Quarterly and Annual Statement Instructions nor with Statement of Statutory Accounting Principles (SSAP) 53, paragraph 13. The Company was not able to determine the amount of the advance premiums and stated that the amount would be minimal. This was also noted in the prior report of examination. It is again recommended that the Company comply with the NAIC Quarterly and Annual Statement Instructions and SSAP 53, paragraph 13 for the reporting of advance premiums. The Company is in the process of migrating to a new system which will allow it to identify and properly report advance premiums.

(3) Aggregate Write-Ins for Liabilities

The Company is netting the reinsurance balance sheet items related to premiums and losses from pooling and reporting it as a single presentation in Aggregate Write-Ins for Liabilities. This is not in accordance with SSAP 62 which requires the insurer to report reinsurance balances separately without any available offset. It is recommended that the Company report the reinsurance balances separately in accordance with SSAP 62.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records (Page 4): It is again recommended that the Company comply with California Insurance Code Section 735.

Comments on Financial Statement Items - Advance Premiums (Page 11): It is again recommended that the Company comply with the National Association of Insurance Commissioners' Quarterly and Annual Statement Instructions and Statement of Statutory Accounting Principles (SSAP) 53, paragraph 13 for reporting of advance premiums.

Comments on Financial Statement Items – Aggregate Write-Ins for Liabilities (Page 12): It is recommended that the Company report the reinsurance balances separately in accordance with SSAP 62.

Previous Report of Examination

Management and Control: Management Agreements (Page 4): It was recommended that the Company amend the Cost Allocation Agreement to include a settlement provision and file with the California Department of Insurance. The Company has complied.

Corporate Records (Page 5): It was recommended that the Company comply with California Insurance Code Section 735. The Company has not complied.

Comments on Financial Statement Items - Advance Premiums (Page 11): It was recommended that the Company comply with the NAIC Quarterly and Annual Statement Instructions for reporting of advance premiums. The Company has not complied.

ACKNOWLEDGMENT

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

Respectfully submitted,

_____/S/_____
Deanna Lo, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California