

REPORT OF EXAMINATION
OF THE
WESTERN UNDERWRITERS INSURANCE COMPANY
AS OF
DECEMBER 31, 2008

Filed July 14, 2009

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Los Angeles, California
April 29, 2009

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

WESTERN UNDERWRITERS INSURANCE COMPANY

(hereinafter also referred to as the Company) at the Company's statutory home office located at 5757 Wilshire Boulevard, Suite 670, Los Angeles, California 90036.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2008. 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: 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

Effective April 3, 2009, the California Department of Insurance (CDI) approved a Form A filing submitted by an investor in Orange County, California to acquire the majority of the Western Underwriters Insurance Holding Company's (WUIHC) stock. A Purchase Agreement was prepared and signed by shareholders representing approximately 94.5% of the outstanding shares of WUIHC, who directly and wholly owns the Company. The key components of the Purchase Agreement are:

1. The funds being used to acquire WUIHC are the investor's own funds;
2. Upon the approval by the CDI, the investor will acquire a majority interest of WUIHC at a minimum in excess of 80%;
3. The acquisition cost will be the consolidated book value of the Company on the date of close;
4. The date of close will be as soon as reasonably practicable after approval from the CDI;
5. Within one year of the close, the investor plans to infuse additional capital into the Company, and it is anticipated that this initial infusion of capital will raise the Company's surplus in excess of \$25 million; and
6. Within two years of the close, the investor plans to infuse additional capital into the Company, and it is anticipated that this infusion of capital will raise the Company's surplus to in excess of \$50 million.

After the completion of the sale of WUIHC, current management will essentially remain the same, with minor changes to the Board of Directors. Also, the Company's long-standing relationship with its exclusive Managing General Agent, Western Re/Managers Insurance Services, Inc. (WR) will continue, however WR will no longer be an affiliate of the Company.

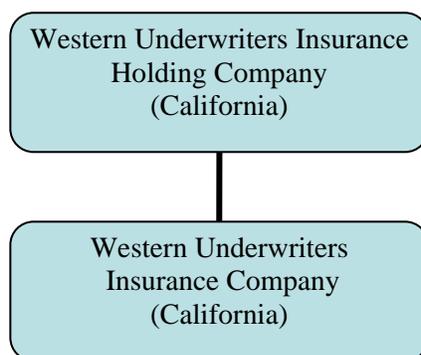
COMPANY HISTORY

The Company was incorporated on August 29, 1996, and received its Certificate of Authority from the California Department of Insurance on April 20, 1998. It commenced business on July 1, 1998.

The Company is authorized to issue 100,000 shares of common stock, and the par value of each share is \$100. The Company has issued 26,000 shares, all of which are owned by Western Underwriters Insurance Holding Company. The original capital contribution was \$5,400,200 (\$2,600,000 of common stock and \$2,800,200 in additional paid-in capital). Subsequent to the original capital contribution, the Company received capital contributions of \$475,000 in 1999, \$4,521,000 in 2003, and \$588,920 in 2004. All of these capital contributions came from the original investors. There were no capital contributions during the examination period.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system and is a wholly-owned subsidiary of Western Underwriters Insurance Holding Company. As of December 31, 2008, the primary investors of Western Underwriters Insurance Holding Company are Western/Re Managers Insurance Services, Inc. (22.5%), Western Holdings (Bermuda) Ltd. (20.2%), Mr. Donald W. Grant (17.7%) and North Shore Management (9.4%). The remaining (30.2%) interest is held by eighteen other investors. The following organizational chart depicts the Company's relationship within the holding company system:



Management of the Company is vested in a five-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>
Wayne Barber Irvine, California	President Western Underwriters Insurance Company
Ed Dziadkowicz Long Beach, California	Treasurer Western Underwriters Insurance Holding Company
Donald W. Grant Los Angeles, California	Chairman Western Underwriters Insurance Holding Company
Richard Lakey St. George, Utah	Chief Financial Officer Western Underwriters Insurance Company
Lon A. Varnadore Palos Verdes Estates, California	Secretary Western Underwriters Insurance Holding Company

Principal Officers

<u>Name</u>	<u>Title</u>
Wayne Barber	President and Chief Executive Officer
Ed Dziadkowicz	Treasurer
Richard Lakey	Chief Financial Officer
Lon A. Varnadore	Secretary

Management Agreements

Administrative Services and Management Agreement: On April 20, 1998, the Company entered into an Administrative Services and Management Agreement with Western/Re Managers Insurance

Services, Inc. (WR). Under the terms of the agreement, WR provides the Company with administrative services such as accounting and human resources, including rent, at no cost to the Company. This Agreement was revised and the revision was filed with the California Department of Insurance (CDI) on June 28, 2006 for approval.

Underwriting Managers Agreement: On April 20, 1998, the Company entered into an underwriting managers agreement with its affiliate, Western/Re Managers Insurance Service, Inc. (WR). Under the terms of the agreement, WR solicits and underwrites applications for insurance and reinsurance, issues binders, insurance policies and reinsurance certificates, bills for and collects premiums and in general, manages the Company's business under the Company's supervision. All premiums are remitted by WR to the Company within ninety days from the actual booking month of each transaction. The Company pays WR a 25% commission on direct business. This Agreement was revised and the revision was filed with the CDI on June 28, 2006 for approval.

The following table depicts commissions paid to WR for the examination period:

<u>Year</u>	<u>Commissions Paid to WR</u>
2005	\$16,653
2006	\$23,750
2007	\$82,750
2008	\$87,162

Federal Income Tax Agreement: On May 31, 2002, the Company entered into a Federal Income Tax Agreement with its parent, Western Underwriters Insurance Holding Company (WUIHC). Under the terms of the agreement, WUIHC files a consolidated federal income tax return in which the federal income tax liability is allocated between the two companies in the ratio that each company's separate tax return liability bears to the total consolidated federal tax liability. This agreement was approved by the CDI on August 7, 2007.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in California only and has no plans to apply for admission into any other state. The Company formerly reinsured high-level excess earthquake coverage on a difference in conditions (DIC) basis as well as stand-alone earthquake risks through business ceded by Greenwich Insurance Company. However, that source of business ceased as of January 10, 2007, when Greenwich Insurance Company withdrew from the catastrophe insurance market. Since that date, the Company has been essentially inactive.

The inactivity is a result of the Company's acceptability in the marketplace at large. While the Company does have a Best's rating of A- (Excellent) and has held that rating since 2002, its Financial Size Category is Class V. This reflects the Company's surplus of just under \$17 million.

In order to increase market share as an insurer in the earthquake insurance marketplace, the Company needs to increase its Financial Size Category to Class VII (\$50 million minimum surplus). The Company has been able to write smaller risks with the total premiums written for calendar year 2008 of \$348,651. The source of this business was smaller wholesale insurance brokers.

As previously noted, to increase market share as an issuing carrier and reinsurer for its DIC policies, the Company needs to raise additional capital. The Company plans to raise additional capital by selling majority ownership of Western Underwriters Insurance Holding Company (WUIHC) that directly and wholly owns the Company to an individual investor capable of infusing additional capital into the Company. The Company submitted a Purchase Agreement prepared and signed by shareholders representing approximately 94.5% of the outstanding shares of WUIHC to sell a majority of its stock to an investor in Orange County, California to the CDI on February 2, 2009. The agreement was approved by the CDI on April 3, 2009.

REINSURANCE

Assumed

The Company has not assumed any reinsurance since the arrangement with Greenwich ceased in January 2007. The Company plans to raise additional capital in order to assume business directly from reinsurers.

Ceded

Policies written by the Company in 2008 were reinsured through facultative reinsurance contracts with A rated carriers. The reinsurance is structured to protect the Company from any substantive loss in any one occurrence.

ACCOUNTS AND RECORDS

A review of the 2008 Annual Statement, Schedule Y, Part 2 disclosed that the Company did not report transactions with Western Re/Managers Insurance Services, Inc. (WR), an affiliate, as required by the Annual Statement instructions. The previous examination made a recommendation to comply with the Annual Statement Instructions and disclose all required transactions with affiliates. The Company did not comply with this recommendation. However, upon completing the sale of Western Underwriters Insurance Holding Company, the Company will no longer have an affiliated relationship with WR.

A review of the 2008 Annual Statement, Exhibit of Premiums and Losses (State Page) disclosed that the Company reported incorrect amounts for Direct Premium Earned and Direct Unearned Premium Reserves. It is recommended that the Company comply with the Annual Statement instructions and disclose the correct information.

A review of the 2008 Annual Statement, Notes to Financial Statements, revealed that the Company did not disclose the components of its Deferred Tax Assets (DTA.) It is recommended that the Company comply with the Annual Statement instructions and disclose the components of its DTA.

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>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 13,228,220	\$ 13,228,220	(1)
Stocks:			
Preferred stocks	1,401,778	1,401,778	
Cash and short-term investments	1,932,347	1,932,347	
Investment income due and accrued	191,233	191,233	
Premiums and agents' balances in course of collection	56,500	56,500	
Net deferred tax asset	<u>281,096</u>	<u>281,096</u>	
 Total assets	 <u>\$ 17,091,174</u>	 <u>\$ 17,1091,174</u>	
 <u>Liabilities, Surplus and Other Funds</u>			
Losses and loss adjustment expenses		\$ 50,000	(2)
Commissions payable, contingent commissions and other similar charges		18,500	
Other expenses		28,721	
Current federal and foreign income taxes		33,662	
Unearned premiums		<u>46,333</u>	
 Total liabilities		 177,216	
Common capital stock	\$ 2,600,000		
Gross paid-in and contributed surplus	8,385,120		
Unassigned funds (surplus)	<u>5,928,838</u>		
Surplus as regards policyholders		<u>16,913,958</u>	
 Total liabilities, surplus and other funds		 <u>\$ 7,091,174</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 154,691
Deductions:		
Other underwriting expenses incurred	<u>\$ 269,358</u>	
Total underwriting deductions		<u>269,358</u>
Net underwriting loss		(114,667)

Investment Income

Net investment income earned	\$ 694,493	
Net realized capital losses	<u>(79,955)</u>	
Net investment gain		<u>614,538</u>
Net income before federal income taxes		499,871
Federal income taxes incurred		<u>177,812</u>
Net income		<u>\$ 322,059</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 16,680,127
Net income	\$ 322,059	
Net unrealized capital losses	<u>(268,228)</u>	
Change in surplus as regards policyholders		<u>53,831</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 16,913,958</u>

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

Surplus as regards policyholders, December 31, 2004, per Examination		\$ 13,667,514		
	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center;"><u>Gain in Surplus</u></td> <td style="width: 50%; text-align: center;"><u>Loss in Surplus</u></td> </tr> </table>	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
<u>Gain in Surplus</u>	<u>Loss in Surplus</u>			
Net income	\$ 3,792,101	\$		
Net unrealized capital losses	<u> </u>	<u>545,657</u>		
Totals	<u>\$ 3,792,101</u>	<u>\$ 545,657</u>		
Net increase in surplus as regards policyholders		<u>3,246,444</u>		
Surplus as regards policyholders, December 31, 2008, per Examination		<u>\$ 16,913,958</u>		

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds and Preferred Stocks

A review the Company's bonds and preferred stocks disclosed that the Company did not comply with the Securities Valuation Office (SVO) filing guidelines as stated in the Purposes and Procedures Manual of the National Association of Insurance Commissioners (NAIC) SVO that requires all securities not considered filing exempt to be filed with the NAIC SVO. It is recommended that the Company comply with the SVO filing guidelines as stated in the Purposes and Procedures Manual of the NAIC SVO.

(2) Losses and Loss Adjustment Expenses

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

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 7): It is again recommended that the Company comply with the Annual Statement instructions and disclose all required transactions with affiliates. It is recommended that the Company comply with the Annual Statement instructions and disclose the correct information in the Exhibit of Premiums and Losses. It is also recommended that the Company comply with the Annual Statement Instructions and disclose the components of its Deferred Tax Assets in the Notes to the Financial Statements.

Bonds and Preferred Stocks (Page 12): It is recommended that the Company comply with the Security Valuation Office (SVO) filing guidelines as stated in the Purposes and Procedures Manual of the National Association of Insurance Commissioners SVO.

Previous Report of Examination

Management and Control (Page 4): It was recommended that the Administrative Services and Management Agreement be submitted to the California Department of Insurance (CDI) for approval in accordance with the California Insurance Code (CIC) Section 1215 (b) (4). This Agreement was revised and the revision was filed with the CDI on June 28, 2006 for approval.

Management and Control (Page 4): It was recommended that the Company comply with CIC Section 1215.5 (b) (4) and submit its Underwriting Managers Agreement to the CDI for approval. This Agreement was revised and filed with the CDI on June 28, 2006.

Corporate Records (Page 5): It was recommended that the Company comply with CIC Sections 735, 1200 and 1201. The Company has complied with this recommendation.

Reinsurance-Assumed (Page 6): It was recommended that the reinsurance agreement with Greenwich Insurance Company be amended to include specific language as to how the contingent commissions are determined and calculated. This agreement is no longer in force.

Reinsurance-Ceded (Page 7): It was recommended that the Company amend its current reinsurance agreement with Greenwich Insurance Company and Alea London Limited to include an insolvency clause that complies with CIC Section 922.2(a)(2). This agreement is no longer in force.

Accounts and Records (Page 7): It was recommended that the Company comply with the Annual Statement instructions and disclose all required transactions with affiliates. The Company did not comply with this recommendation.

Bonds and Stocks (Page 11): It was recommended that the Company maintain all of its assets in the State of California with a qualified custodian or sub-custodian. In addition, it was recommended

that the Company enter into a custodial agreement with a qualified custodian and submit the custodial agreement to the CDI for approval in compliance with CIC Section 1104.9. The Company complied with this recommendation.

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/

Sayaka T. Dillon, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California