REPORT OF EXAMINATION
OF THE

BALBOA INSURANCE COMPANY

AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

Filed June 29, 2010

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Los Angeles, California
May 28, 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

BALBOA INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and the primary location of its books and records, 3349 Michelson Drive, Suite 200, Irvine, California 92612.

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 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 examinations of the Company's subsidiary, Meritplan Insurance Company, an affiliate, Balboa Life Insurance Company, and with the Arizona Department of Insurance's examination of the Company's wholly-owned subsidiary, Newport Insurance Company.

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; business in force by states; loss experience; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

On December 31, 2009, all the assets and liabilities of the Company's wholly-owned Texas insurer, Newport E&S Insurance Company, were transferred to the Company. The California Department of Insurance (CDI) determined that the merger did not require the CDI's approval because there was no impact on the Company's surplus, the financial impact upon the Company was minimal, and the merging non-survivor company was not licensed to transact insurance business in the State of California.

Subsequent to the examination date, the Company reported net realized capital losses of $79.5 million mainly related to its residential mortgage-backed securities (RMBS) $77.1 million, and to a much lesser extent, commercial mortgage-backed securities (CMBS) $2.4 million.

Subsequent to the examination date, the Company reported an increase in surplus of $16.5 million due to the cumulative effect of changes in accounting principles regarding the valuation and impairment of securities. This reported amount is calculated based on Statements of Statutory Accounting Principles (SSAP) No. 43R which supersedes SSAP No. 98 and revises the basis for valuation and impairment requirements from fair value to the cash flows to be collected for the securities.

COMPANY HISTORY

The Company was incorporated in the State of California on February 6, 1948 and commenced transacting property and casualty business on April 15, 1948. On February 26, 2008, Bank of America Corporation (BAC), a publicly traded company on the New York Stock Exchange and incorporated in the State of Delaware, filed a Form A application with the California Department of Insurance (CDI) pursuant to California Insurance Code Section 1215.2 seeking approval to acquire control of the Company, and its two wholly-owned subsidiaries, Meritplan Insurance Company (MIC), and Newport Insurance Company, along with an affiliate, Balboa Life Insurance Company (BLIC). The CDI approved the Form A application on June 16, 2008. On July 1, 2008, BAC acquired the Company's former ultimate parent, Countrywide Financial Corporation (CFC), a publicly traded company incorporated in the State of Delaware, thereby becoming the Company's ultimate parent. On November 7, 2008, one of BAC's subsidiaries, Effinity Financial Corporation (EFC), acquired all but one share of the Company's stock from its previous parent, Balboa Insurance Group, Inc. (BIG), a California holding company. The single share not purchased by EFC is held by the Company's affiliate, BLIC. Thus, after the acquisition, EFC owned the remaining 24,999 outstanding shares of the Company's stock. On April 27, 2009, EFC was merged into NB Holdings Corporation and the Company was transferred within the BAC organization structure from EFC to BA Insurance Group, Inc.

The following transactions did not meet the thresholds requiring CDI approval:

In April 2006, CFC contributed $10 million in cash to BIG, which subsequently contributed $10 million in cash to the Company.

In September 2006, BIG contributed $30 million in cash and securities to the Company, who, in turn, contributed $30 million in cash and securities to its subsidiary, MIC.

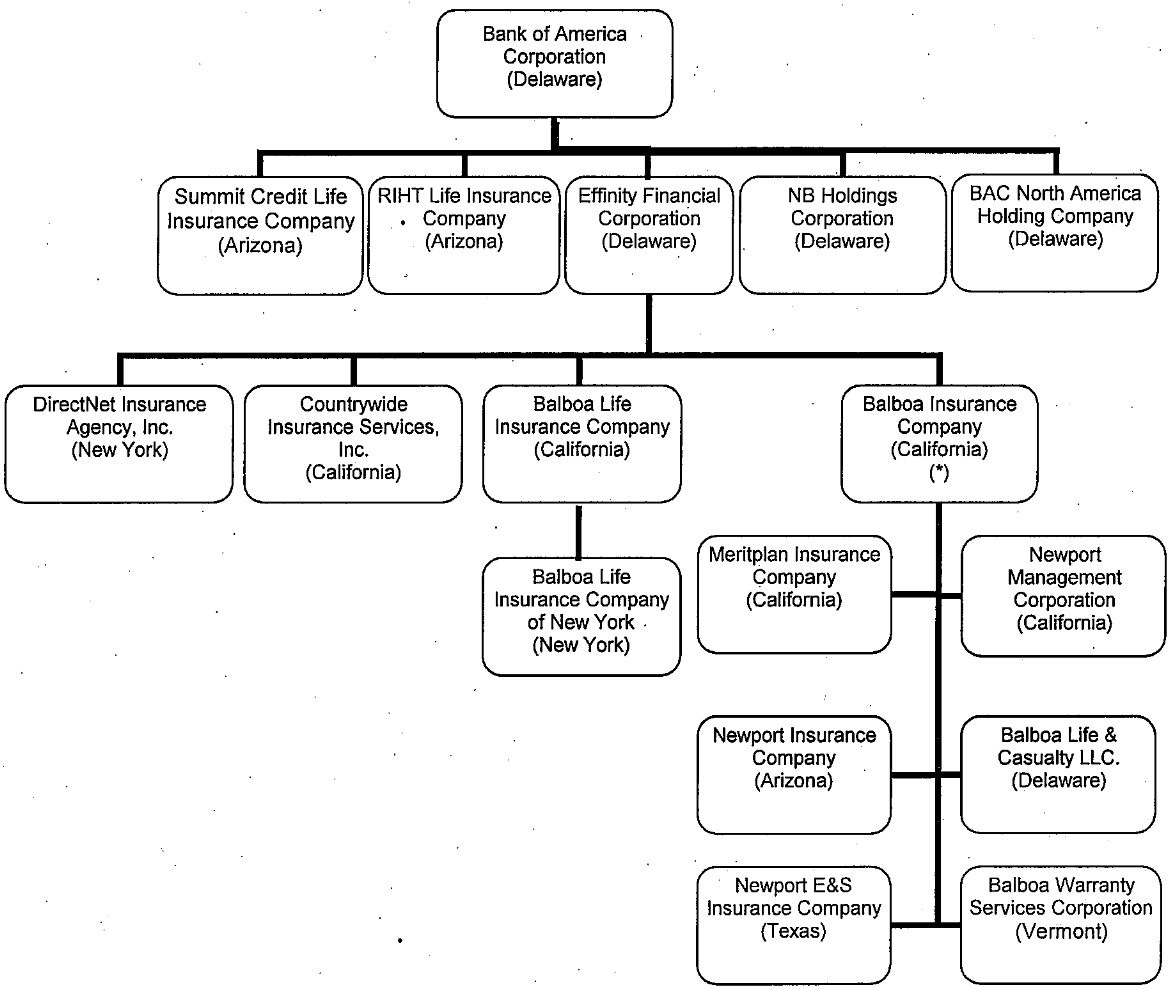
In April 2007, the Company contributed $7.5 million in cash to its subsidiary, Balboa Warranty Services Corporation.

On September 30, 2008, the Company paid a $30 million cash dividend to BIG and BLIC, with BIG and BLIC receiving $29,998,800 and $1,200, respectively.

MANAGEMENT AND CONTROL

The two abridged organizational charts below, illustrated as of December 31, 2008 and December 31, 2009, show the changes in the Company's holding company system as discussed in the Company History section of this report. The charts are limited to the Company's parent, its ultimate controlling parent, some affiliates, and its subsidiary insurance companies, and depict the Company's relationships within the Bank of America Corporation holding company system:

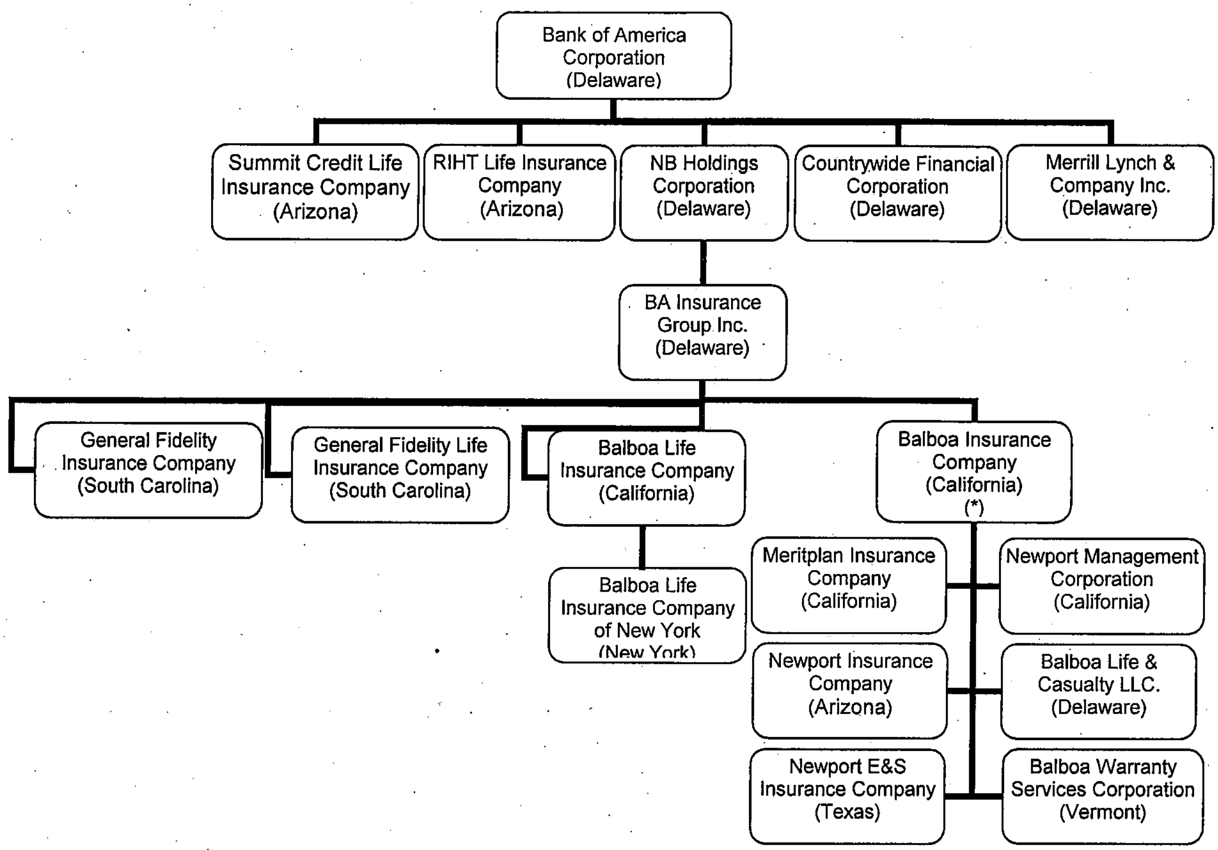
As of December 31, 2008:



(All ownership is 100%, except as otherwise noted)

(*) Balboa Life Insurance Company owns one share of stock out of the 25,000 issued and outstanding shares of the Company

Subsequent to the examination date, and as of December 31, 2009:



(All ownership is 100%, except as otherwise noted)

(*) Balboa Life Insurance Company owns one share of stock out of the 25,000 issued and outstanding shares of the Company

Management of the Company, its wholly-owned subsidiaries, Meritplan Insurance Company and Newport Insurance Company, and its affiliate, Balboa Life Insurance Company is vested in a board of directors with no less than seven members elected annually. The Company was not in compliance with its by-laws regarding the minimum number of directors as of December 31, 2008, but has remediated the deficiency as of the date of this Report of Examination. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

Directors

Name and Residence	Principal Business Affiliation
Franklin T. Dunn (*) Anaheim Hills, California	General Counsel and Secretary BA Insurance Group, Inc.
W. Myron Hendry (**) Irvine, California	Chief Operations Officer BA Insurance Group, Inc.
Robert V. James (***) Dana Point, California	President BA Insurance Group, Inc.
Mark A. McElroy Santa Ana, California	Insurance Executive BA Insurance Group, Inc.
Kenneth L. Mertzel Oak Park, California	Finance Executive BA Insurance Group, Inc.

Principal Officers

Name	Title
Robert V. James (***)	President
Kenneth L. Mertzel	Senior Vice President, Chief Financial Officer
Franklin T. Dunn (*)	Secretary, Chief Legal Counsel
Laurie A. Fitzgerald	Senior Vice President, Chief Risk Officer
Mark A. McElroy	Senior Vice President
Harvey Waite	Senior Vice President, Chief Actuary
W. Myron Hendry (**)	Senior Vice President, Chief Operations Officer

(*) Resigned as Board Member, effective March 1, 2009
(**) Resigned as Senior Vice President, Chief Operations Officer, and Board Member, effective November 27, 2009
(***) Resigned as President and Board Member, effective January 15, 2010

The Company, its subsidiaries, Meritplan Insurance Company and Newport Insurance Company and affiliate, Balboa Life Insurance Company have experienced significant changes in its board of directors and management during and subsequent to the examination period. The resignations have included nine members from the Board and seven executive officers, including the President, Mr. Robert James. As of the date of this Report of Examination, a new President has not been appointed.

Management Agreements

Intercompany Services Agreement: Effective January 1, 2006, the Company entered into an Intercompany Services Agreement (Intercompany Services Agreement). Parties to the Intercompany Services Agreement were: the Company, Balboa Life & Casualty LLC (BLC), Balboa Life Insurance Company (BLIC), Meritplan Insurance Company (MIC), Newport Management Corporation (NMC), Newport Insurance Company (NIC), Newport E&S Insurance Company (Newport E&S), Balboa Life Insurance Company of New York (BLICNY), Balboa Warranty Services Corporation (BWSC), Insurance Automation Corporation (IAC), Countrywide Insurance Services, Inc. (CIS), Countrywide Insurance Services of Arizona, Inc., Countrywide Insurance Services of Texas, Inc., DirectNet Insurance Agency, Inc. (DirectNet), and DirectNet Insurance Agency of Arizona, Inc., collectively known as the Group Members.

Under the Intercompany Services Agreement, the Company had the option of providing information system services, electronic data processing, accounting and financial functions, underwriting, claims adjusting and payment processing, legal services, actuarial services, and marketing functions to the Group Members, with the Group Members reimbursing the Company for the actual cost of the services provided. In addition, BLC also had the option of providing the Group Members with the aforementioned services, along with payroll services and facilities on an actual cost basis. Under the terms of the Intercompany Services Agreement, the Company compensated BLC for the 2006, 2007, and 2008 years $100.5 million, $95.8 million, and $110.5 million, respectively. The California Department of Insurance (CDI) approved this agreement on February 27, 2006.

On December 31, 2008, the parties to the Intercompany Services Agreement, terminated the agreement, and the Company entered into an Intercompany Services Agreement (BAC Intercompany Services Agreement), effective January 1, 2009. This new agreement was entered into because of changes in affiliations made under the Bank of America Corporation (BAC) holding company system that became effective July 1, 2008. Under the BAC Intercompany Services Agreement, the Company and BLC continue to provide many of the same intercompany services on an actual cost basis as listed in the prior Intercompany Services Agreement. In addition, under this new agreement, the parties have more flexibility to perform or procure services from any of the participating members. The parties to the BAC Intercompany Services Agreement include: the Company, BLIC, MIC, NMC, NIC, BLICNY, BLC, BWSC, CIS, Countrywide Financial Corporation, Countrywide Home Loans, DirectNet, BA Continuum India Private Limited, BA Continuum Costa Rica, BA Continuum solutions Private Limited, Banc of America Insurance Services, Inc, BA Insurance Services, Inc., Bank of America, N.A., Banc of America Card Servicing Corporation, and BAC. The CDI approved this agreement on April 10, 2009.

Investment Management Agreement: Effective April 17, 2000, the Company, BLIC, MIC, NIC, and IAC entered into an Investment Management Agreement with an affiliate, Countrywide Home Loans, Inc. (CHL). In accordance with the Company's investment guidelines, CHL provided investment management services and was compensated based on actual expenses incurred. The CDI approved this agreement on November 2, 2000. For 2006, 2007, and 2008, the Company paid $1,140,000, $516,089, and $583,372 respectively, in investment and miscellaneous fees to CHL under the terms of this agreement.

Effective November 15, 2008, the Investment Management Agreement with CHL was terminated, and the Company, BLIC, MIC, and NIC entered into an Investment Management Agreement with another affiliate, Columbia Management Advisors, LLC (CMA). Under the terms of this agreement, CMA provides investment advisory services and manages the investment portfolios of the Company, BLIC, MIC, and NIC. CMA is compensated based on an annual asset-based fee calculated at 0.05 percent of all assets under management. The Company, BLIC, MIC, and NIC did not pay any investment or miscellaneous fees to CMA in 2008. The CDI approved this agreement between the Company, BIC, BLIC, MIC, NIC, and CMA on November 7, 2008. Effective May 1, 2010, the long-term fixed income and equity asset management business of CMA was sold to a non-affiliate, RiverSource Investments, LLC, the asset management arm of Ameriprise Financial, Inc. As a part of that sale, the Investment Management Agreements were assigned to RiverSource Investments, LLC.

Consolidated Federal Income Tax Allocation Agreement: Under the terms of a Consolidated Federal Income Tax Allocation Agreement effective on and approved by the CDI on November 2, 2000, the Company, its subsidiaries, various affiliates, and its ultimate parent, Countrywide Financial Corporation (CFC) filed consolidated federal income tax returns through June 30, 2008. This agreement was terminated on June 30, 2008, as Bank of America Corporation (BAC) acquired CFC on July 1, 2008.

Effective July 1, 2008, the Company, various affiliates, and its ultimate parent, BAC, entered into a new Consolidated Federal Income Tax Allocation Agreement. Pursuant to the new agreement, the Company's tax liability is the same as it would have been had it filed on a separate, stand-alone basis. The CDI approved this agreement on December 10, 2009. The Company paid the following taxes during the examination period:

Year	Amount
2006	$ 12,497,857
2007	21,781,086
2008	339,210,184
Total	$373,489,127

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact multiple lines of property and casualty insurance in all 50 states except Louisiana (surplus lines only) and in the District of Columbia, Guam, U.S. Virgin Islands, and the Northern Mariana Islands.

The Company specializes in lender placed insurance through financial institutions, including automobile collateral protection, property collateral protection, credit involuntary unemployment, and homeowners. The principal lines of business written are fire, allied, auto physical damage, homeowners, and credit. In 2008, the Company wrote direct premiums totaling $1 billion. Approximately half of the business was written in the following three states:

State	Direct Premium Written	Percentage of Total
Florida	$ 302,278,042	30.0%
California	134,618,071	13.2 %
Texas	60,098,593	6.0%

Business is primarily marketed and produced through a combination of agencies affiliated with financial institutions and general and independent agents. Banc of America Insurance Services, Inc., an affiliated general agent, is the largest producer. There are approximately 95 general agents and 5,094 independent agents affiliated with the Company.

On August 1, 2004, the Company, Meritplan Insurance Company (MIC), Newport Insurance Company (NIC), and Newport E&S Insurance Company (Newport E&S) entered into an agency agreement with Arrowhead General Insurance Agency, Inc. (Arrowhead). Under the terms of this agreement, Arrowhead had the authority to accept applications and issue homeowners and automobile insurance policies on behalf of the companies. As compensation, Arrowhead received advance commissions and contingent commissions based on loss experience. Effective December 5, 2007, the previous agency agreement was terminated and the Company, MIC, Newport E&S, and

NIC entered into a Managing General Agency Agreement with Arrowhead. The contract terms were largely unchanged from the previous agency agreement, with the exception of the regulatory requirements specific to managing general agents. In June 2009, subsequent to the examination date, the Company, MIC, NIC, Newport E&S, and Arrowhead reached an agreement to terminate the Managing General Agency Agreement as of June 30, 2010.

Effective April 28, 2005, the Company, MIC, and NIC entered into an agency agreement with Carnegie Agency, Inc. (Carnegie). Under the agreement, Carnegie had the authority to accept applications and issue California automobile insurance policies on behalf of the companies. As compensation, Carnegie received advance commissions and a contingent commission based on earned premiums. Effective March 15, 2007, the agency agreement was terminated and the Company, MIC, and NIC entered into a Managing General Agency Agreement with Carnegie. The contract terms were largely unchanged from the previous agency agreement, with the exception of the regulatory requirements specific to managing general agents. Effective April 8, 2010, subsequent to the examination date, the Company, MIC, NIC, and Carnegie terminated the Managing General Agency Agreement, with the exception of basic renters' policies which were written until May1, 2010.

Effective June 1, 2005, the Company, MIC, and NIC (Balboa Group) entered into a Strategic Alliance Agreement with Atlantic Mutual Insurance Company and Centennial Insurance Company (Atlantic Mutual Group). Under the agreement, the Balboa Group and the Atlantic Mutual Group wrote high-value homeowners insurance and affiliated products developed by the Atlantic Mutual Group. In addition, the Balboa Group marketed policies in certain jurisdictions where the Atlantic Mutual Group did not offer policies. On December 31, 2007, the Atlantic Mutual Group sold its assets to ACE American Insurance Company (ACE). As a result, the Strategic Alliance Agreement was terminated, effective, December 31, 2007. The business written by the Balboa Group through Atlantic Mutual was ceded to ACE through a 100% quota share reinsurance agreement. In addition, all Atlantic Mutual Group homeowner business written on the Balboa Insurance Group paper is being run-off and upon their current policy expiration will not be renewed.

During 2006, 2007, and 2008, Arrowhead, Carnegie, and Atlantic Mutual produced a total of $104.8 million, $201.3 million, and $178.6 million, respectively, in direct written premiums for the Company.

GROWTH OF COMPANY

The Company has experienced significant growth since the last examination through 2009 as shown in the following schedule: (000's omitted)

Year	Admitted Assets	Surplus as Regards Policyholders	Gross Premiums Written	Net Premiums Written	Net Underwriting Gain/(Loss)	Net Income
2005	$ 1,297,173	$ 474,706	$ 1,005,307	$ 813,710	$ (4,031)	$ 4,493
2006	1,533,167	656,040	1,304,333	885,460	120,014	115,516
2007	2,175,411	875,877	1,764,452	1,359,438	247,709	187,124
2008	2,581,547	1,255,055	1,872,626	1,517,590	499,792	392,520
2009	3,120,727	1,741,521	1,936,533	1,660,925	651,249	408,620

The Company has been a leading provider of lender placed insurance to financial institutions and their end customers, firmly establishing itself within this specialized market. This market niche lead to higher premium volumes during the examination period, as its lender placed lines experienced significant growth in real estate business due to the rise in foreclosures.

REINSURANCE

Intercompany Pooling Agreement

The Company and its subsidiaries, Meritplan Insurance Company (MIC) and Newport Insurance Company (NIC), participate in a Property and Casualty Companies Pooling Agreement, effective January 1, 2005. Under the terms of the agreement, all business, net of non-affiliated reinsurance, is pooled. The pooled premiums, losses, and expenses are reapportioned and shared by the three companies, using the following percentages: 92% for the Company, and 4% each for MIC and NIC. The pooling agreement was approved by California Department of Insurance on April 4, 2005.

Assumed

The majority of the Company's assumed business is a result of the Property and Casualty Companies Pooling Agreement (Pooling Agreement). Of the $857.5 million in premiums assumed in 2008, $837.3 million or 97.6% relates to the Pooling Agreement. The Company also assumes a small amount of creditor placed (motor vehicle) business from Consumers County Mutual Insurance Company and Republic Underwriters Insurance Company.

Under the terms of a Strategic Alliance Agreement (Alliance Agreement), the Company assumed certain in-force and new and renewal policies of Atlantic Mutual Insurance Company and Centennial Insurance Company (Atlantic Mutual Group), effective June 1, 2005. Under the terms of a Portfolio Transfer Agreement (PTA), the Company assumed, on a quota share basis, 50% of the gross liabilities and obligations of the Atlantic Mutual Group on in-force policies as of June 1, 2005. New and renewal policies were assumed through a New and Renewal Treaty on a 100% quota share basis, effective June 1, 2005. The Alliance Agreement was amended and restated as of March 1, 2006. Effective December 31, 2007, the Company and the Atlantic Mutual Group terminated the Alliance Agreement and related quota share agreements (with the exception of the PTA because all premiums with respect to policies reinsured under the PTA had been fully earned). Atlantic Mutual Group and the Company agreed to replace the Company with ACE American Insurance Company in connection with this high value homeowners business. The Company continues to share in the losses occurring up to, but not on or after, January 1, 2008, as per the terms of the reinsurance agreements.

The Company reported assumed liabilities totaling $532 million as of year-end 2008 of which 96% relates to the Pooling Agreement. As of year-end 2009, the Company reported assumed premiums and liabilities of $882.3 million and $588 million, respectively.

Ceded

The largest net amount retained by the Company is $1 million on any one risk for property and casualty lines. The following is a summary of the principal reinsurance agreements in force as of December 31, 2008.

Type of Contracts	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Property – Excess of Loss			
Property Excess of Loss	Various/Authorized (73%) and Unauthorized (27%)	$1 million per risk	$4 million excess of $1 million (1)
Casualty – Excess of Loss			
First Casualty Excess of Loss	Various Authorized	$1 million per risk	$4 million excess of $1 million (2)
Second Casualty Excess of Loss	Various Authorized	None	$5 million excess of $5 million (3)

(1) Not to exceed $10 million as respects any loss occurrence involving two or more risks.
(2) Not to exceed $4 million as respects any one loss occurrence or $8 million in all during the term of the agreement.
(3) Not to exceed $5 million as respects any one loss occurrence or $10 million in all during the term of the agreement.

The Company's retrocession agreement with Atlantic Mutual Insurance Company (Atlantic Mutual) and its quota share agreement wherein the Company ceded 50% of its direct business related to the Alliance Agreement to Atlantic Mutual were terminated, effective December 31, 2007, as the result of the previously mentioned termination of the Strategic Alliance Agreement. ACE American Insurance Company (ACE) agreed to 100% reinsure this direct business under a quota share agreement with the Company, effective December 31, 2007. The Company reported ceded premium and reinsurance recoverables with ACE of $163 million and $81 million, respectively, as of year end 2008 and ($4) million and $19 million, respectively as of year-end 2009.

In addition, the Company discontinued writing inland marine insurance related to lost, stolen or damaged cell phones, and terminated its quota share agreements with Mill River Re Limited (25% quota share) and Exchange Indemnity Company (75% quota share) covering inland marine business, effective December 31, 2007.

The Company continues to cede business under a 100% quota share reinsurance agreement with Yosemite Insurance Company, effective January 1, 2004. The coverage is for lender placed (primarily residential property) and creditor placed (motor vehicle) insurance policies. As of year-end 2008, the total ceded premiums and reinsurance recoverables were $17.0 million and $12.9 million, respectively.

There is an immaterial 100% quota share agreement with Virginia Surety Company, Inc. (Virginia Surety). Under the agreement, the Company cedes business from a home warranty closed book of business that is in run-off, effective March 1, 2008. This agreement will terminate effective March 1, 2011. As of year-end 2008, the Company reported ceded premium to Virginia Surety of $652,000.

Effective January 1, 2007, new or amended fronting agreements are subject to the requirements of California Code of Regulations (CCR) Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.15(b), which requires insurers to retain 10% of direct premiums written per line of business, except for cessions to affiliates. A review of the Company's direct premiums written per line of business and ceded premiums to non-affiliates per line of business, as of year-end 2008, confirms that the Company retained greater than 10% per line of business.

The above mentioned quota share cessions, along with other property and casualty reinsurance cessions in force, are reflected in the following table of reinsurers:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Other Property/Casualty Reinsurance Treaties			
100% Quota Share Homeowners, Auto, Umbrella, Valuables, Watercraft and Other	ACE American Insurance Company (Authorized)	0%	100%
65% Quota Share Basic Renters	ICOM Limited (Bermuda) (Unauthorized)	35%	65%
66.5% and 70% Quota Share Leased Equipment	The Equipment Lease Reinsurance Company, Ltd. (Unauthorized)	33.5% and 30%	66.5% and 70%
90% Quota Share Home Rebound	Triton Insurance Company (Authorized)	10%	90%
100% Quota Share Lender and Creditor Placed	Yosemite Insurance Company (Authorized)	0%	100%
100% Quota Share Home Warranty	Virginia Surety Company, Inc. (Authorized)	0%	100%

For property losses from a single catastrophic occurrence such as a hurricane, the Company purchases property catastrophe excess of loss reinsurance. During the 2008 hurricane season, the Company retained the liability for the first $50 million of paid losses for any one loss occurrence and purchased $1.0 billion of reinsurance coverage (in six layers), which includes a three year catastrophe bond of $50 million within the top reinsurance layers. The Company also purchases aggregate coverage that protects the Company against multiple retentions and that has been tailored to the $50 million retention. The coverage provided by the property catastrophe excess of loss reinsurance and aggregate coverage is summarized as follows:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Property – Catastrophe			
First Property Catastrophe Excess of Loss	Various/Authorized (29%) and Unauthorized (71%)	$50 million per occurrence	$75 million excess of $50 million (1)
Second Property Catastrophe Excess of Loss	Various/Authorized (40%) and Unauthorized (60%)	None	$75 million excess of $125 million (2)
Third Property Catastrophe Excess of Loss	Various/Authorized (35.75%) and Unauthorized (64.25%)	None	$150 million excess of $200 million (3)
Fourth Property Catastrophe Excess of Loss	Various/Authorized (28.9%) and Unauthorized (71.1%)	None	$250 million excess of $350 million (4)
Fifth Property Catastrophe Excess of Loss	Various/Authorized (33.1%) and Unauthorized (52.6%)	14.3% participation in the layer ($50 million covered by Cat bond)	$350 million excess of $600 million (5), 85.7% payout

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Sixth Property Catastrophe Excess of Loss	Swiss Re America (Authorized)	None	$100 million excess of $950 million (6)
Catastrophe Bond	VASCO Re 2006 Ltd. (Unauthorized)	None	$50 million
Catastrophe Excess	Florida Hurricane Catastrophe Fund (Authorized)	$36 million, and 10% participation in the layer	$99 million excess of $36 million, 90% payout
First Catastrophe Aggregate	Tokio Millennium Re Ltd (Bermuda) (Unauthorized)	$35 million aggregate retention	$30 million excess of $35 million (maximum of $25 million per occurrence)
Second Catastrophe Aggregate	Various/Authorized (56%) and Unauthorized (44%)	$25 million per occurrence after $25 million aggregate retention	$25 million excess of $25 million (7)

(1) Not to exceed $150 million in the aggregate during the term of the contract.
(2) Not to exceed $150 million in the aggregate during the term of the contract.
(3) Not to exceed $300 million in the aggregate during the term of the contract.
(4) Not to exceed $500 million in the aggregate during the term of the contract.
(5) Not to exceed $700 million (85.7% payout) in the aggregate during the term of the contract.
(6) Not to exceed $200 million in the aggregate during the term of the contract.
(7) Not to exceed $50 million in the aggregate during the term of the contract.

For its entire reinsurance ceded program as of year-end 2008, the Company reported total ceded premium and reinsurance recoverables of $355.0 million and $244.8 million, respectively. As of year-end 2009, the Company reported $275.6 million and $168.0 million, respectively.

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, 2005 through December 31, 2008

Statement of Financial Condition
as of December 31, 2008

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 1,947,135,568	$	$ 1,947,135,568	(1)
Common stocks	201,401,363	14,771,427	186,629,936	
Cash and short-term investments	108,582,187		108,582,187	
Other invested assets	39,026,805		39,026,805	
Receivable for securities	996,191		996,191	
Investment income due and accrued	14,624,091		14,624,091	
Premiums and agents' balances in course of collection	78,085,643	303,446	77,782,197	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	94,524,518		94,524,518	
Reinsurance:				
Amounts recoverable from reinsurers	20,411,565		20,411,565	
Net deferred tax asset	51,500,349		51,500,349	
Guaranty funds receivable or on deposit	879,910		879,910	
Receivable from parent, subsidiaries and affiliates	22,503,263		22,503,263	
Aggregate write-ins for other than invested assets	33,953,898	17,003,357	16,950,541	
Total assets	$ 2,613,625,351	$ 32,078,230	$ 2,581,547,121	

Liabilities, Surplus and Other Funds			
Losses		$ 212,284,789	(2)
Reinsurance payable on paid loss and loss adjustment expenses		37,832,081	
Loss adjustment expenses		44,029,339	(2)
Commissions payable, contingent commissions and other similar charges		19,119,549	
Other expenses		7,667,617	
Taxes, licenses, and fees		7,733,245	
Current federal and foreign income taxes		60,831,244	
Unearned premiums		782,084,471	
Ceded reinsurance premiums payable		16,229,626	
Funds held by company under reinsurance treaties		9,901,761	
Remittances and items not allocated		65,619,732	
Provision for reinsurance		90,439	
Payable to parent, subsidiaries and affiliates		41,190,381	
Advance premium		7,812,198	
Aggregate write-ins for liabilities		14,065,416	
Total liabilities		1,326,491,888	
Common capital stock	$ 4,250,000		
Gross paid-in and contributed surplus	350,189,664		
Unassigned funds (surplus)	900,615,569		
Surplus as regards policyholders		1,255,055,233	
Total liabilities, surplus and other funds		$ 2,581,547,121	

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

Statement of Income

Underwriting Income		
Premiums earned		$ 1,484,350,076
Deductions:		
Losses incurred	$ 527,363,169	
Loss expense incurred	82,044,128	
Other underwriting expenses incurred	369,851,722	
Aggregate write-ins for underwriting deductions	5,299,200	
Total underwriting deductions		984,558,219
Net underwriting gain		499,791,857
Investment Income		
Net investment income earned	$ 96,719,005	
Net realized capital losses	(3,187,347)	
Net investment gain		93,531,658
Other Income		
Net loss from agents' or premium balances charged off	$ (2,154,026)	
Finance and service charges not included in premiums	6,026,212	
Aggregate write-ins for miscellaneous income	9,703,549	
Total other income		13,575,735
Net income before federal and foreign income taxes		606,899,250
Federal and foreign income taxes incurred		214,379,104
Net income		$ 392,520,146

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		$ 875,876,616
Net income	$ 392,520,146	
Change in net unrealized capital gains	18,364,172	
Change in net deferred income tax	10,979,215	
Change in nonadmitted assets	(13,153,436)	
Change in provision for reinsurance	468,520	
Dividends to stockholders	(30,000,000)	
Change in surplus as regards policyholders		379,178,617
Surplus as regards policyholders, December 31, 2008		$ 1,255,055,233

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

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2005, per Examination			$ 474,705,890
Net income	$695,160,638	$	
Change in net unrealized capital gains	46,466,355		
Change in net deferred income taxes	31,302,852		
Change in nonadmitted assets		5,681,398	
Change in provision for reinsurance	3,100,896		
Surplus adjustments: Paid-in	40,000,000		
Dividends to stockholders		30,000,000	
Totals	$ 816,030,741	$35,681,398	
Net increase in surplus as regards policyholders			780,349,343
Surplus as regards policyholders, December 31, 2008, per Examination			$1,255,055,233

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

A review of the Company's Annual Statement, Schedule D – Part 1, National Association of Insurance Commissioners (NAIC) bond designations was performed, and it was determined that thirty-one reported investment designations were not in compliance with the National Recognized Statistical Rating Organization's (NRSRO) ratings. The Company stated they were utilizing a rating organization that was not on the approved NRSRO list. As a result of this examination finding the Company stated that it remedied the deficiency by changing its investment guidelines to only utilizing rating organizations on the NRSRO list. In addition, any securities incorrectly designated as filing exempt as of December 31, 2008 were filed with the NAIC Securities Valuation Office.

(2) Losses and Loss Adjustment Expenses

The Company's loss and loss adjustment expense reserves were reviewed by a Casualty Actuary from the California Department of Insurance (CDI). Based on the analysis, the loss and loss adjustment expense reserves as of December 31, 2008, for all companies participating in the inter-company pooling agreement, were determined 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

Company History (Page 2): It was recommended that for all future periods, the Company comply with California Insurance Code (CIC) Section 1215.4(e), and report all material transactions to the California Department of Insurance. The Company has complied with this recommendation.

Territory and Plan of Operation (Page 8): It was recommended that the Company and Carnegie Agency, Inc. comply with the provisions of the Managing General Agents Act (CIC Sections 769.80 through 769.87). This finding is a non-issue, as the agency agreement was terminated.

Reinsurance (Page 11): It was recommended that the Company amend its reinsurance agreements to comply with the requirements of Statements of Statutory Accounting Principles 62, Paragraph 7. The Company complied with this recommendation.

Accounts and Records (Page 17): It was recommended that the Company and Balboa Life Insurance Company change their procedures so that premium receipts not associated with the Pooling Agreement are remitted directly to the company that issued the policy. The Company and Balboa Life Insurance 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/

Edward W. Aros, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
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