

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

Participating State
and Zone:

California

Filed January 26, 2010

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Los Angeles, California
October 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 Insurance Division
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

DANIELSON INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 444 West Ocean Boulevard, Long Beach, California 90802.

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 examination of the Company's parent, National American Insurance Company of California and an affiliate, Danielson National 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; growth of company; business in force by states; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

On October 13, 2009, the Company's parent submitted a California Insurance Code Section 1011(c) filing to the California Department of Insurance (CDI) proposing to merge the Company into its parent company, National American Insurance Company of California (NAICC) with an effective date of December 31, 2009. As of the date of this examination report, the transaction has not yet been approved by the CDI.

COMPANY HISTORY

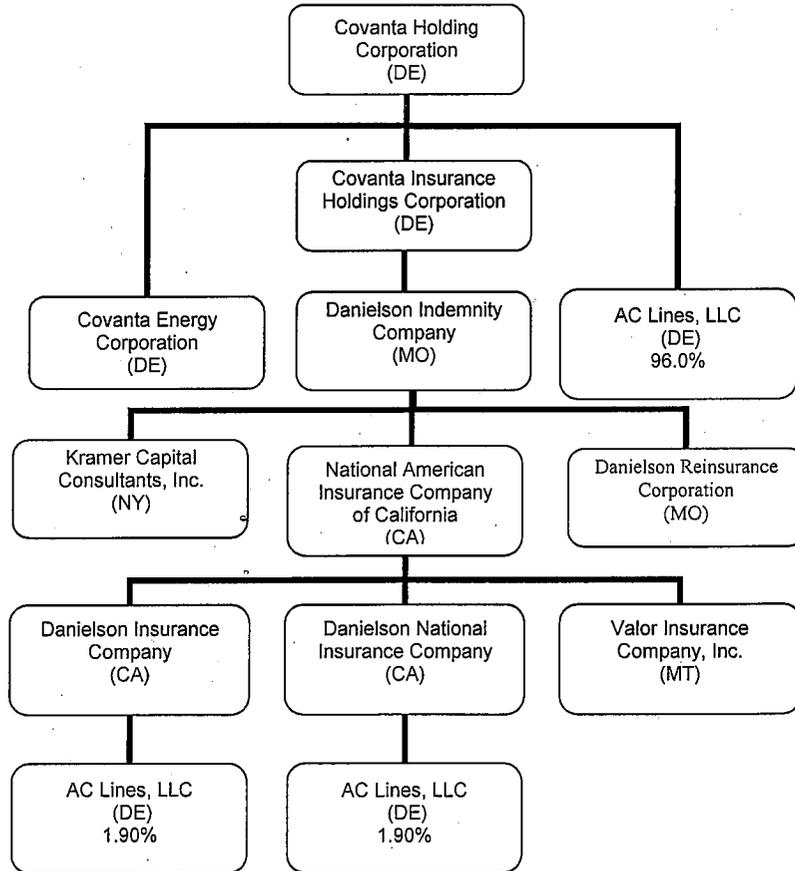
The Company was incorporated in the State of California on June 1, 1948. All outstanding shares of the Company are owned by its parent, National American Insurance Company of California (NAICC). The ultimate controlling parent, Covanta Holding Corporation, is a publicly traded company on the New York Stock Exchange whose main business strategies and measured performance predominantly reflects its performance of waste to energy operations.

On July 13, 2006, a new holding company, Covanta Insurance Holdings Corporation (CIHC), was formed for the purpose of establishing a management equity award program. Under the award

program, Covanta Holdings Corporation may distribute up to 20 percent of its common shares in CIHC to key members of management in the form of restricted stock awards and incentive stock options. CIHC wholly owns the capital stock of Danielson Indemnity Company (DIND), and DIND wholly owns the capital stock of the Company's parent, NAICC. This transaction was approved by the California Department of Insurance on December 13, 2006

MANAGEMENT AND CONTROL

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



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

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>
Anthony J. Orlando New Providence, New Jersey	Chief Executive Officer Covanta Holding Corporation
Jon M. Schneider Signal Hill, California	President and Chief Financial Officer National American Insurance Company of California
Timothy J. Simpson Morristown, New Jersey	Executive Vice President & General Counsel Covanta Holding Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Jon M. Schneider	President and Chief Financial Officer
Kevin M. Grant	Vice President – Automobile Claims
Vahe Khachaturian	Vice President – Information Systems
Regan James	Executive Vice President–Surety Underwriting
Steven R. Kay	Executive Vice President–Surety
Donald G. Hein	Assistant Vice President, Controller and Secretary

Management Agreements

Amended and Restated Executive, Professional, Administrative and Loss Adjustment Services Agreement: The Company, its parent, National American Insurance Company of California (NAICC), and affiliates, Danielson National Insurance Company (DNIC) and Valor Insurance Company, Inc. are

parties to an amended and restated administrative services agreement, with an effective date of January 1, 2006. Under the agreement, the Company and its affiliates reimburse the parent, NAICC, for providing the following services: executive, information system support, financial, accounting, marketing, underwriting, human resources, legal, office, allocated and unallocated loss adjustment expenses, and other administrative services. This services agreement was amended to coincide with the changes to the inter-company pooling and reinsurance agreement, also effective on January 1, 2006, as some of the allocations employ the pooling participation as a basis of allocating reimbursement costs. This agreement was approved by the California Department of Insurance (CDI) on March 8, 2006. During the three year examination period, the Company and its affiliate, DNIC, paid the following amounts to the NAICC:

Subsidiary	2006	2007	2008	Total
DNIC	\$1,933,535	\$2,404,360	\$2,007,271	\$6,345,166
Company	1,642,547	1,905,115	1,592,970	5,140,632

Credit Agreement: In December 2007, the Company entered into a \$3 million credit agreement with its parent, National American Insurance Company of California (NAICC). The purpose of the agreement was to provide NAICC with a source of liquidity at terms more favorable than could be otherwise obtained through commercial means, and in addition the Company would earn interest at yields in excess of its typical bond portfolio. During 2008, NAICC borrowed \$3 million and repaid \$500,000 to the Company, resulting in a 2008 year-end receivable balance, including earned interest of \$2,659,191. The full repayment of the outstanding balance is due December 31, 2009. The CDI approved this credit agreement in December 2007.

Consolidated Tax Allocation Agreement: The Company, its parent and affiliates, and its ultimate parent, Covanta Holding Corporation (CHC) file a consolidated federal income tax return. Due to net operating losses during the examination period, the Company did not pay any federal income taxes, and its net operating losses are utilized in the consolidated federal income tax return of its ultimate parent, CHC.

As noted in the prior examination report, the Company submitted its consolidated federal income tax agreement to the CDI for review during the prior examination period. However, approval of the agreement was postponed as a result of the organization's intention to merge the Company into NAICC, a transaction which would have required the submission of an updated consolidated income tax agreement to the CDI. Since the anticipated merger is now scheduled to take place on December 31, 2009, it is recommended that the surviving company, NAICC, submit an updated consolidated tax allocation agreement to the CDI for approval, pursuant to California Insurance Code Section 1215.5(b)(4).

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact multiple lines of property and casualty insurance in the following states: California, Idaho, Kansas, and Oregon. During the examination period, the Company did not write any direct business.

LOSS EXPERIENCE

A review of the Company's loss experience data during the examination period, disclosed a historical trend of net underwriting losses and net losses as follows:

Year	Net Underwriting (Loss)	Net Income or (Loss)	Company Surplus
2006	\$ (221,389)	\$ 134,171	\$ 6,911,222
2007	(1,145,157)	(762,078)	6,003,425
2008	(370,232)	(97,285)	5,890,649
2009(*)	(284,042)	(198,897)	5,633,530

(*) Through June 30, 2009

The Company, its parent, National American Insurance Company of California (NAICC), and its affiliate, Danielson National Insurance Company (DNIC) all reported unfavorable underwriting results during the examination period and all three entities are members of an inter-company pooling

agreement. The underwriting results of its parent, NAICC, were mainly the result of adverse workers' compensation experience. However, due to the fact that the Company and its affiliate, DNIC only have 10 percent shares under the terms of the prior inter-company pooling agreement, their underwriting losses mainly resulted from start up expenses related to the surety line of business. Furthermore, in 2008, the Company's and DNIC's premium volume for the surety and auto lines of business was not sufficient to cover administrative and overhead expenses.

REINSURANCE

Inter-company Pooling Agreement

The Company, its affiliate, Danielson National Insurance Company (DNIC) and its parent, National American Insurance Company of California (NAICC), participate in an Inter-company Pooling and Reinsurance Agreement. Under the terms of the agreement, all business, net of non-affiliated reinsurance, is combined. The Company and DICO each had a 10% participation interest in the pool with the NAICC retaining the remaining 80% interest. Effective January 1, 2006, the participation of the pool was modified with the Company retaining 40%, NAICC 10% and DNIC 50%.

Assumed

Assumed business is limited to the Company's participation in the above referenced Inter-company Pooling Agreement.

Ceded

The Company did not have any ceded reinsurance contracts in-force during the examination period.

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

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 3,867,723	\$	\$ 3,867,723	
Common stocks	206,370		206,370	
Cash and short-term investments	562,562		562,562	
Other Invested asset	183,067		183,067	
Investment income due and accrued	50,814		50,814	
Reinsurance:				
Funds held by or deposited with reinsured companies	579,775		579,775	
Other amounts receivable under reinsurance contracts	225,158		225,158	
Net deferred tax asset	28,826,500	28,753,533	72,967	
Electronic data processing equipment and software	170,384	170,384		
Receivable from parent, subsidiaries and affiliates	<u>2,650,191</u>		<u>2,650,191</u>	
 Total assets	 <u>\$ 37,322,544</u>	 <u>\$ 28,923,917</u>	 <u>\$ 8,398,627</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 1,581,256	(1)
Loss adjustment expenses			254,731	(1)
Unearned premiums			634,990	
Aggregate write-ins for liabilities			<u>37,000</u>	
 Total liabilities			 2,507,977	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		3,936,346		
Unassigned funds (surplus)		<u>(645,696)</u>		
 Surplus as regards policyholders			 <u>5,890,650</u>	
 Total liabilities, surplus and other funds			 <u>\$ 8,398,627</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 4,882,301
Deductions:		
Losses incurred	\$ 2,270,842	
Loss expense incurred	583,336	
Other underwriting expenses incurred	<u>2,398,355</u>	
Total underwriting deductions		<u>5,252,533</u>
Net underwriting loss		(370,232)

Investment Income

Net investment income earned	\$ 294,629	
Net realized capital losses	<u>(21,682)</u>	
Net investment gain		<u>272,947</u>
Net loss		<u>\$ (97,285)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 6,003,425
Net loss	\$ (97,285)	
Change in net unrealized loss	(22,767)	
Change in net deferred income tax	(120,007,322)	
Change in nonadmitted assets	120,009,599	
Aggregate write-ins for gains and losses in surplus	<u>5,000</u>	
Change in surplus as regards policyholders		<u>(112,775)</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 5,890,650</u>

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

Surplus as regards policyholders, December 31, 2005, per Examination			\$ 6,691,041
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss	\$	\$ 725,192	
Change in net unrealized capital gains	36,671		
Change in net deferred income tax		119,726,551	
Change in nonadmitted assets	119,584,681		
Aggregate write-ins for gains in surplus	<u>30,000</u>		
Totals	<u>\$119,651,352</u>	<u>\$ 120,451,743</u>	
Net decrease in surplus as regards policyholders			<u>(800,391)</u>
Surplus as regards policyholders, December 31, 2008, per Examination			<u>\$ 5,890,650</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) 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 intercompany pooling and reinsurance agreement were determined to be deficient by \$2.6 million. The reserve deficiency is primarily related to adverse workers' compensation experience. The Company's share of the reserve deficiency totals \$227,000, and the reserve deficiency amounts for its parent, National American Insurance Company of California (NAICC) and affiliate, Danielson National Insurance Company, total \$2.2 million and \$186,000, respectively.

The Company's parent, NAICC, strengthened its reserves in the first two quarters of 2009 as a result of its own reported adverse development, and made an additional increase to reserves in the third quarter of 2009 based on its own and the CDI's analysis. Additional reserves booked by the Company's parent, NAICC, in the first three quarters of 2009 totaled \$2.9 million.

Based on the parent company's subsequent period remedial action, the CDI did not make any financial statement adjustments to the Company's loss reserves or loss adjustment expense reserves as of December 31, 2008.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Consolidated Federal Income Tax Agreement (Page 5): Although the Company did not pay any federal income taxes during the examination period, it is recommended that

the Company have a consolidated tax allocation agreement in place, approved by the California Department of Insurance, pursuant to California Insurance Code Section 1215.5(b)(4).

Previous Report of Examination

Subsequent Events (Page 2): On July 6, 2006, Danielson Indemnity Company submitted preliminary comments to the CDI concerning the proposed merger of the Company into its parent company, National American Insurance Company of California. As of the current date, this proposed merger has not taken place.

Subsequent Events (Page 2): On July 13, 2006, the organization formed a new holding company, Covanta Insurance Holdings Corporation, which fully owns the capital stock of Danielson Indemnity Company. CIHC was formed to establish a management equity award program. This transaction was approved by the CDI on December 13, 2006.

Bonds (Page 10): As of year-end 2005, two bonds exceeded the limitations prescribed by California Insurance Code (CIC) Section 1197. A review of the bonds during the current examination period noted that the deficiency was corrected, as there were no current exceptions related to CIC Section 1197.

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
Department of Insurance
State of California