

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
MONTGOMERY, ALABAMA

REPORT OF EXAMINATION OF

SAFEWAY INSURANCE COMPANY OF ALABAMA, INC.

BIRMINGHAM, ALABAMA

AS OF DECEMBER 31, 2005

PARTICIPATION:  
SOUTHEASTERN ZONE, NAIC  
MIDWESTERN ZONE, NAIC  
ALABAMA

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STATE OF ALABAMA  
COUNTY OF JEFFERSON

I, Palmer W. Nelson, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Safeway Insurance Company of Alabama for the period of January 1, 2001, through December 31, 2005;

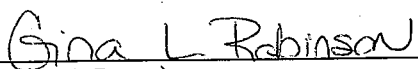
That the following 38 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And that the statements, exhibits and data therein contained are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
Palmer W. Nelson, CFE

Subscribed and sworn to before the undersigned authority this 27th day of December, 2006.

  
\_\_\_\_\_  
(Signature of Notary Public)

  
\_\_\_\_\_, Notary Public  
(Print Name)

in and for the State of Alabama.

My commission expires 10-6-08.



**BOB RILEY**  
GOVERNOR

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**DEPARTMENT OF INSURANCE**  
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COMMISSIONER

DEPUTY COMMISSIONER  
**D. DAVID PARSONS**

CHIEF EXAMINER  
**RICHARD L. FORD**  
STATE FIRE MARSHAL  
**EDWARD S. PAULK**

GENERAL COUNSEL  
**REYN NORMAN**

RECEIVER  
**DENISE B. AZAR**

LICENSING MANAGER  
**JIMMY W. GUNN**

**Birmingham, Alabama**  
**December 27, 2006**

Alessandro Iuppa, Commissioner  
Chairman, Exam Oversight Committee  
Maine Bureau of Insurance  
# 34 State House Station  
Augusta, Maine 04333-0034

Ann Benjamin Womer, Commissioner  
Secretary, Midwestern Zone NAIC  
Ohio Department of Insurance  
2100 Stella Court  
Columbus, Ohio 43215

Honorable Walter A. Bell, Commissioner  
Alabama Department of Insurance  
Post Office Box 303351  
Montgomery, Alabama 36130-3351

Eleanor Kitzman, Commissioner/Director  
Secretary, Southeastern Zone NAIC  
South Carolina Department of Insurance  
300 Arbor Lake Drive, Suite 1200  
Columbia, South Carolina 29223

Dear Commissioners:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

**Safeway Insurance Company of Alabama**  
**Birmingham, Alabama**

as of December 31, 2005, at its home office located at 4200 Colonnade Parkway, Birmingham, Alabama 35243. The report of examination appears herewith.

Where the term "Company" or "Safeway Insurance Company of Alabama" appears herein without qualification, it will be understood to indicate Safeway Insurance Company of Alabama, Inc.

## SCOPE OF EXAMINATION

A full scope examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the five year period ended December 31, 2000. The current examination covers the intervening period from January 1, 2001 through December 31, 2005, and was conducted by examiners from the Alabama Department of Insurance and the Illinois Department of Insurance, representing the NAIC's Midwestern and Southeastern Zones. Where deemed appropriate, transactions subsequent to December 31, 2005, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2005, as shown in the financial statements contained herein. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the Alabama Insurance Code, the Insurance Department's rules and regulations, or statutory accounting principles which were deemed to require comments and/or recommendations.

A signed certificate of representation was obtained during the course of the examination. In the certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2005. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through December 8, 2006, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities. An office copy of the Company's filed Annual Statement as of December 31, 2005, was compared with or reconciled to account balances with respect to ledger items.

The Company's accounts were examined by Deloitte & Touche, LLP, Chicago, Illinois, certified public accountants (CPAs) for each year under examination. The examiners utilized some of the CPAs work papers in conjunction with the examiners' test work to complete some of the audit procedures in instances in which the examiners determined that it was appropriate.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, advertising and marketing, claims, policyholder complaints, agents' licensing practices, and compliance with privacy standards.

### ORGANIZATION AND HISTORY

The Company was incorporated under the laws of the State of Alabama, and on March 24, 1988, the Articles of Incorporation were filed for record in the office of the Judge of Probate of Montgomery County, Alabama.

According to Article III of the Articles of Incorporation, the purpose for which the corporation was organized

to include the transaction of any and all lawful business for which Corporations may be incorporated under the Alabama Business Corporations Act. The main purpose of the Corporation shall be to write and issue policies of: (1) property insurance, (2) casualty insurance, (3) surety insurance, (4) marine insurance, and (5) wet marine and transportation insurance, as those terms are now or hereafter defined by the laws of the State of Alabama.

Article IV of the Articles of Incorporation provided that the authorized capital of the corporation was \$1,000,000, represented by 1,000,000 shares of common capital stock with a par value of \$1 per share. The Company commenced business on October 1, 1988, with a minimum capitalization of \$3,000,000, consisting of \$1,000,000 paid-in capital and \$2,000,000 paid-in surplus, derived from the issuance of 1,000,000 shares of common stock at a subscription price of \$3 per share.

At a special meeting of the Board of Directors on March 23, 1991, the Articles of Incorporation were amended to increase the aggregate number of shares of authorized common stock to 3,000,000 shares with a par value of \$1 per share. On December 31, 1991, the parent company invested an additional \$6,000,000 in the Company. The transaction was accounted for by crediting "Common

capital stock” for \$2,000,000, and “Gross paid in and contributed surplus” for \$4,000,000, which increased “Common capital stock” to an aggregate of \$3,000,000, and “Gross paid in and contributed surplus” to \$6,000,000.

During 2002 the Company received an additional \$3,000,000 surplus contribution from its parent company. At the December 31, 2005 examination date, the Company’s Annual Statement reported outstanding “Common capital stock” totaling \$3,000,000, consisting of 3,000,000 shares of \$1 par value common stock; “Gross paid in and contributed surplus” of \$9,000,000; and \$14,455,294 in “Unassigned funds.”

## MANAGEMENT AND CONTROL

### Stockholders

The Company was a stock corporation with ultimate control vested in its stockholders. The ultimate controlling person was Robert Parrillo, as a trustee of the Robert Parrillo Trust. Mr. Parrillo, as Trustee, owned 44.4% of the issued and outstanding shares of stock of Safeway Financial Holding Company. Safeway Financial Holding Company is the sole owner of Safeway Insurance Company, an Illinois insurer. Safeway Insurance Company is the sole owner of the Company.

### Board of Directors

The By-Laws of the Company provided that its business and affairs shall be managed by a Board of Directors. Article IV of the Amended Corporate By-Laws, adopted on December 30, 1991, set the number of directors at “not less than three (3) nor more than nine (9), the exact number of which shall be fixed by the stockholders.”

The members of the Board of Directors that were serving at December 31, 2005, were as follows:

<u>Name/Residence</u>	<u>Principal Occupation</u>
William Joseph Parrillo Oak Brook, Illinois	President and Chairman Safeway Insurance Company
Robert Malcolm Bordeman Hinsdale, Illinois	Chief Executive Officer Safeway Insurance Company

Robert Thomas Hosmer  
Birmingham, Alabama

Vice President and Claims Manager  
Safeway Insurance Company of  
Alabama, Inc.

### Officers

Officers elected by the Board of Directors and serving at December 31, 2005 were as follows:

<u>Name</u>	<u>Title</u>
Robert Malcolm Bordeman	President and Treasurer
William Giles Parrillo	Secretary
William Joseph Parrillo	Vice President
Robert Thomas Hosmer	Vice President

### Management and Service Agreements

#### Pooling Agreement

The Company submitted a pooling agreement to the Alabama Department of Insurance and obtained approval of the agreement with a retroactive effective date of January 1, 2005. However, the Company did not record or report its 2005 results of operations on a pooled basis. Discussions with management indicated that the Company experienced difficulties and delays in obtaining all of the required approvals from each regulatory authority. Company management delayed the implementation date of the pooling agreement until January 1, 2006.

The final and current pooling agreement dated April 18, 2006, was approved by the Alabama Department of Insurance on May 31, 2006. The retroactive effective date of the agreement was January 1, 2006.

The parties to the pooling agreement are the Company, Safeway Insurance Company, Safeway Insurance Company of Georgia, Safeway Insurance Company of Louisiana, and Safeway Direct Insurance Company. The pool members agreed to cede 100% of the net loss reserves and 100% of the reserves for unpaid loss adjustment expenses in connection with each member's automobile insurance including liability, physical damage, uninsured and underinsured motorists' liability, personal injury protection, and miscellaneous coverages. Each member will assume the following respective percentages of the pooled business:



- Safeway Insurance Company 54%
- Safeway Insurance Company of Alabama 12%
- Safeway Insurance Company of Georgia 12%
- Safeway Insurance Company of Louisiana 19%
- Safeway Direct Insurance Company 3%

The Alabama Code requires insurers to obtain prior approval before entering into such transactions with its affiliates. Further discussion of the pooling agreement is included in this report under the captions "SUBSEQUENT EVENTS" and "COMMENTS AND RECOMMENDATIONS."

#### Cost Allocation Agreement

The Company entered into a Tax Allocation Agreement on January 1, 2002, along with its affiliated entities within the holding company structure. The Company agreed to pay an equitable share of costs and expenses for management and related services provided by Safeway Insurance Company, the parent company. The agreement was prepared in accordance with SSAP No. 70. Services provided included, and were limited to:

- Management services in relation to supervision, management, and operation of the Company
- Performance of investments, actuarial data processing, financial and forms management services provided by employees of the parent company
- Legal services related to corporate matters.

Expenses for services provided include:

- Salaries and employee benefits
- Any other expenses

#### Tax Allocation Agreement

The Company entered into a Tax Allocation Agreement on March 31, 2001, with Safeway Insurance Company and its subsidiaries. Together, the parties agreed to file their federal income tax return on a consolidated basis. Members agreed that the tax liability would be "apportioned among them in accordance

with the provisions of Regulation 1.1552-1(a)(2) and Regulation 1.1502-33(d)(3).” Within thirty days after filing, any liability or benefit will be paid to or by that member. Any adjustment of tax liability will be payable to or from any member within thirty days after reconciliation. Any loss or credit due to a member, which is carried back or forward to a year that the member filed a separate return or different consolidated return, will be subject to 172(b)(3) of the Internal Revenue Code. Any acquisition or organization made by the parent or any subsidiary shall be subject to the agreement and made a part of it. The agreement will remain in effect until each and all of the members decide to terminate the agreement. Any payment or refund will be subject to the terms of the agreement for taxable years occurring before termination. The agreement is binding to any successor with respect to the parent company and the subsidiaries.

#### General Agency Agreement with Trigon, Inc.

Trigon, Inc. and the Company entered into a General Agency Agreement on September 1, 1997. The mutual covenants of this agreement were described therein, affirming that the Company appoint Trigon as its general agent. Trigon has the right to market, underwrite, process, and administer insurance contracts on behalf of the Company. This right is given subject to underwriting rules and guidelines issued by the Company, and regulations of the states in which the two parties are authorized to act. The mutual covenants included: Authority to Trigon, Commission, General Agreements, Notification of Legal Proceedings, Processing of Claims, Termination or Suspension, Agency Sale or Transfer, Arbitration, Indemnification and Conditions.

#### Conflicts of Interest

The Company adopted a conflict of interest policy during the examination period that requires that any material interest of its directors or officers that conflict, or might conflict, with the interest of the Company be disclosed to its Board of Directors. In order to implement this policy, the Company requires that its officers and directors execute conflict of interest statements annually. There was no evidence of the Company’s Board of Directors establishing the conflict of interest policy. The minutes of the Board meetings that took place during the examination period did not include any indication that the conflict of interest policy was recognized or established by the Board.

Each of the Company’s officers and directors did not file a signed conflict of interest statement for some of the years under examination. The requirement

is imposed by an Annual Statement filing requirement that requires the Company to disclose conflicts of interest in the Annual Statement General Interrogatories.

Substantially all of the Company's acquisitions and sales of bonds during the examination period were directed through an investment brokerage firm. An employee of such brokerage firm is a relative of an officer of the Company and serves as the account representative of the Company. The officer did not disclose the potential conflict of interest in the conflict of interest statement filings that he signed during the examination period as required by the Company's conflict of interest policy.

### **CORPORATE RECORDS**

The Company's Certificate of Incorporation, By-Laws and related amendments were inspected and found to provide for the operation of the Company in accordance with usual corporate practices.

There were no amendments to the Articles of Incorporation or the By-Laws during the examination period.

### **HOLDING COMPANY AND AFFILIATE MATTERS**

The Company was subject to the Alabama Insurance Holding Company Regulatory Act, as defined in ALA CODE §27-29-1 (1975). In connection therewith, the Company was registered with the Alabama Department of Insurance as Registrant of an Insurance Holding Company System. Appropriate filings required under the Holding Company Act were made from time to time by the Company. A review of the Company's filings during the period under examination indicated that all required filings were made in accordance with the aforementioned section of the Alabama Code and Alabama Department of Insurance Regulation No. 55.

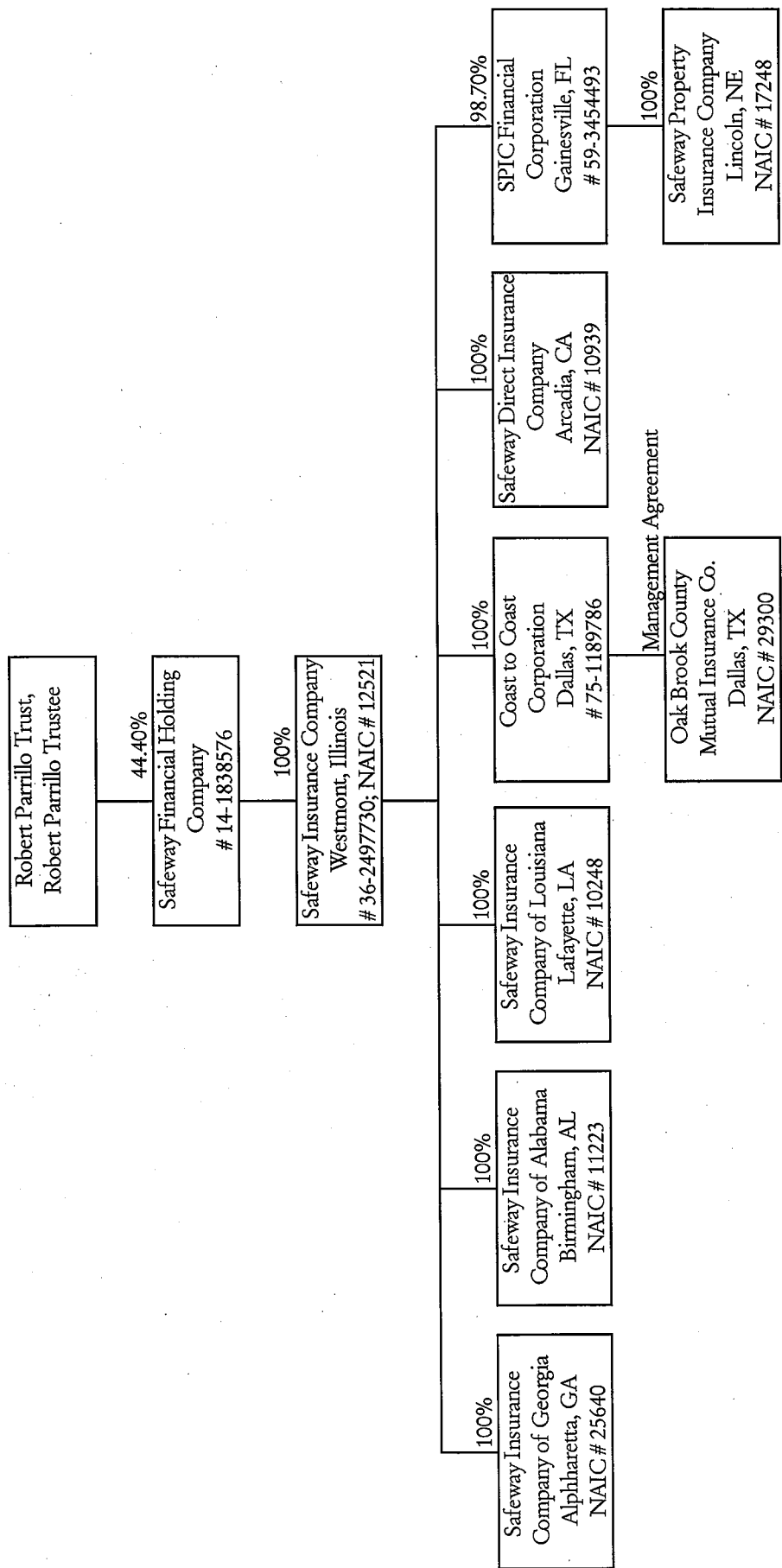
### **Dividends to Stockholders**

The Company did not pay any stockholder dividends during the examination period.

## Organizational Chart

The chart on the following page depicts the insurance holding company system with which the Company was affiliated as of December 31, 2005.

# Safeway Insurance Company of Alabama, Inc. Organizational Chart



## FIDELITY BOND AND OTHER INSURANCE

The Company was insured by a financial institution bond issued by the Hartford Fire Insurance Company of Hartford, Connecticut at year end December 2005. The bond provided coverage for salaried, pensioned and elected officials. The bond also provided coverage for forgery and alterations. However, the bond did not provide coverage for theft of securities. The suggested minimum amount of fidelity coverage was computed based on the guidance given in the NAIC Financial Condition Examiners Handbook. The amount of fidelity coverage carried by the Company exceeded the minimum amount suggested by the NAIC.

In addition to the above coverage, the Company was a named insured on the following policies at December 31, 2005:

- Building and Personal Property
- Electronic Data Processing Property
- Extra Expense
- General Liability
- Workers' Compensation and Employers' Liability
- Commercial Excess and Umbrella Insurance
- Employers' Liability
- Commercial General Liability
- Automobile Liability

The coverages and limits of the Company's insurance were deemed adequate to protect the Company's interests.

## EMPLOYEE AND AGENT WELFARE

The Company does not offer benefits to the independent agents that produce the Company's business. The Company's employees participate in the benefits package of the parent company, Safeway Insurance Company. The following benefits are offered to qualified employees by the parent company:

- Medical and Dental Insurance
- COBRA Insurance
- Profit Sharing and 401(k) Savings Plan
- Short-Term Disability and Long-Term Disability

- Life Insurance
- Accidental Death and Dismemberment Coverage
- Other insurance (Unemployment and Workers' Compensation)
- Sick, Personal and Vacation Leave
- Holidays
- Leaves of Absences (Jury Duty, Military, Bereavement, Disability, Personal, FMLA, Inability to Work, School Visitation)

## STATUTORY DEPOSITS

At December 31, 2005, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows:

<u>State</u>	<u>Book/ Adjusted Carrying Value</u>	<u>Fair Value</u>
Alabama	\$1,557,785	\$1,612,195
Arkansas	309,786	299,964
Total	\$1,867,571	\$1,912,159

## FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005*</u>
Admitted Assets	\$27,952,890	\$32,482,550	\$42,560,315	\$48,342,721	\$46,076,852
Liabilities	13,361,410	16,296,495	22,812,571	23,221,289	20,740,558
Common Capital Stock	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Gross Paid in and Contributed Surplus	6,000,000	6,000,000	9,000,000	9,000,000	9,000,000
Unassigned Funds	5,591,480	7,747,744	7,186,055	13,121,432	13,336,294
Gross Written Premium	22,414,555	31,533,567	45,165,026	52,896,848	42,826,591
Net Underwriting Gain/(Loss)	264,337	1,838,173	(782,676)	6,340,633	421,708

\*Per Examination. Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

## MARKET CONDUCT ACTIVITIES

### Plan of Operation

The Company's direct business consists of nonstandard auto liability and physical damage. The Company assumes private passenger and commercial auto insurance business from a nonaffiliated Arkansas insurer. All of the

Company's direct written premiums were produced in Alabama by one general agent, Trigon, Inc. The Company's general agent's distribution system involves independent agents. The Company had 181 licensed agents that were appointed to write business on behalf of the Company. The assumed business was produced by American Underwriters Insurance Company, an Arkansas insurer.

The examiners' review indicated that the Company did not have a marketing plan or a long term strategic plan.

### **Territory**

At December 31, 2005, the Company was licensed to transact business in the following states:

- Alabama
- Arkansas
- Illinois
- Kentucky
- Tennessee

The Certificates of Authority for the respective jurisdictions were inspected for the examination period and found to be in order.

### **Policy Forms and Underwriting**

A review of the Company's underwriting practices included a review of the underwriting guidelines, declination procedures and cancellation procedures. The information was reviewed to determine if unfairly discriminatory practices were being used and if the Company consistently applied its guidelines to rejected and accepted business.

The Company processed 18,266 cancellations and 21,468 non-renewals in 2005. A sample of 100 was selected from each of the aforementioned categories. These samples were reviewed to determine the reason for cancellation or non-renewal, to identify unfairly discriminatory practices, and to determine whether the Company provided advance notification to consumers and complied with policy provisions and state laws. Generally, policies were cancelled due to non-payment of premiums, per the insured's request, or the policy application was outside of the Company's underwriting guidelines. Policies were non-renewed per the insured's request or the Company's. If the



Company non-renewed a policy, the decision was based on payment issues or was an underwriting decision.

The cancellations and non-renewals were processed in accordance with policy provisions and state laws. There was no indication that unfairly discriminatory practices were being used.

A review of the rejections/declinations could not be performed because the Company does not reject or decline applications. Agents were directed to not submit applications for applicants that did not meet the Company's underwriting criteria. It is the Company's practice to accept all applications. The agent binds the coverage before submitting the application to the Company's home office. If the policy application does not meet the Company's underwriting criteria or information has been falsified by the policyholder, the policy is immediately cancelled.

The examiners verified that the Company had properly filed all of its policy and policy related forms with the Alabama Department of Insurance for approval. The Company provided a file of all of its policy form filings. Each form was date stamped received by the Alabama Department of Insurance. The review did not reveal any known omissions.

A review of the premium rate filings was performed by the examiners. The review indicated that the Company's rate filings file was in good order and appeared to be complete. There were no instances discovered of the Company charging rates other than the rates approved by the Alabama Department of Insurance.

### **Advertising and Marketing**

The Company's distribution system consisted of one general agent, Trigon, Inc. Trigon, Inc. appoints licensed independent agents to solicit business on the Company's behalf.

The Company does not have a formal advertising program. The Safeway Insurance Group, consisting of the Company's parent company, the Company, and five other insurer affiliates, maintained a web site that provided contact information for customers and claimants for the respective companies and provided general information about the Safeway Insurance Group. No specific advertising of the Company's insurance products was practiced by the Company or its agents during the examination period. Agents were prohibited

from advertising the Company's products or advertising the agent's affiliation with the Company by the terms of the agent's agreement that each agent was required to sign.

### Claims Review

The Company paid 7,613 claims in 2005. One hundred claims were selected and reviewed with regard to compliance with policy provisions, timeliness of payment and documentation standards. The claims reviewed were resolved in a prompt manner in accordance with the policy provisions and the claim files were properly documented. Fifty claims were selected from the 2,395 closed without payment or denied claims processed in 2005. The claims were reviewed with regard to compliance with policy provisions, validity of denial, and proper notification of denials to the claimants. The claims were denied as provided for in the policy provisions and claimants were promptly and appropriately notified.

### Policyholder Complaints

The company documented 121 complaints for the examination period. A sample of fifty complaints was reviewed to determine whether the files were adequately documented and whether the Company responded in a timely and proper manner. It was determined that the Company maintained adequate documentation of its complaint files in accordance with the recommended guidelines found in the Market Conduct Examiners Handbook. The review also indicated that policyholders' issues were properly addressed and resolved within a timely manner.

### Compliance with Agents' Licensing Requirements

A review was performed to determine if the agents representing the Company were properly licensed and appointed with the State of Alabama. A register of licensed agents was obtained from the Agents Licensing Division of the Alabama Department of Insurance and was reconciled to the current list of appointed agents provided by the Company. There were 209 licensed and appointed agents as of December 31, 2005. There were no active agents identified that were not properly appointed.

A review was made to determine if each agent was appointed and licensed prior to transacting business. A sample was selected from the new business applications written in 2005. Each agent's appointment date was verified using

the register of licensed agents obtained from the Alabama Department of Insurance. The review indicated that each agent was properly licensed and appointed prior to writing business.

### Privacy Standards

The Company does not share customers' private information with any third parties except those permitted under Sections 14, 15, and 16 of ALA. ADMIN. CODE 482-1-122. The Company can improve upon its controls in place for employees that handled private information by distributing written guidance to the employees. As for the private information that may be shared among the affiliated entities, the Company provided notices to its customers that indicated the types of information collected, the way it was used and the manner in which it was collected.

### REINSURANCE

The Company did not cede any business during the examination period. The Company's reinsurance program consisted of private passenger and commercial auto business assumed on a 75% quota share basis from American Underwriters Insurance Company, an Arkansas insurer. The original agreement became effective July 1, 2003, and the business was commuted back to the cedant at December 31, 2004. A new agreement was executed that became effective January 1, 2005, replacing the agreement governing the commuted business.

The examination found that the reinsurance agreements did not involve a proper transfer of risk for the transactions to qualify for reinsurance accounting. Further discussion of the evaluation of the risk transfer is included in this report under the caption "Note 3 - Losses."

The Company's reinsurance agreement with American Underwriters Insurance Company is not in compliance with SSAP No. 62, paragraph 8(c) because the agreement does not include an entirety clause. The purpose of the entirety clause is to provide conclusive evidence that the agreement is the final, entire, and complete agreement and nothing else may be introduced in court to demonstrate otherwise.

## ACCOUNTS AND RECORDS

The Company's accounting records were maintained primarily on electronic data processing equipment. Management, accounting, and record keeping functions were performed by personnel and facilities of the parent company, Safeway Insurance Company. The parent company's personnel are responsible for preparation of the Company's Annual and Quarterly Statements.

The Company maintains its corporate records and journals, workpapers, and ledgers in duplicate. A copy is maintained in Westmont, Illinois, at the home office of Safeway Insurance Company, as well as at the Company's home office in Birmingham, Alabama.

The Company was audited by the independent certified public accounting (CPA) firm of Deloitte & Touche, LLP, Chicago, Illinois, for the period 1997 - 2005. The partner responsible for the report was changed for the 2000 independent audit. The partner responsible for the report has served in the capacity each year since 2000. The CPA work papers were utilized by the examiners in the examination as deemed appropriate.

Claims functions are performed by the Company's personnel from the office in Birmingham, Alabama. All underwriting functions are performed by Trigon, Inc., a general agent located in Hoover, Alabama.

The review of the minutes of the Board of Directors' meetings did not include a reference to the Board's receipt of the appointed actuary's actuarial opinion or the actuarial report. The board minutes reference is required by the NAIC Annual Statement Instructions, which state,

The appointed actuary must report to the board of directors or the audit committee each year on the items within the scope of the actuarial opinion. The actuarial opinion and the actuarial report must be made available to the board of directors. The minutes of the board of directors should include that the appointed actuary has presented such information to the board of directors or the audit committee and that the actuarial opinion and the actuarial report were made available.

The Company used Mesirow Financial as an investment brokerage firm. An employee of this firm is a relative of an officer of the Company and serves as the account representative for the Company. The Company was not able to provide the examiners with a total of all investment commissions and/or other

fees paid to Mesirov Financial to determine the reasonableness of the expenses. ALA CODE Section 27-27-29(a)(1975) states, in part, "Every domestic insurer shall have, and maintain... complete records of its assets, transactions and affairs..." Further discussion of the issue is included in this report under the caption "Conflicts of interest."

## FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2005. Amounts shown in the comparative statements for the years 2001, 2002, 2003, and 2004 were compiled from the Company's copies of the filed Annual Statements. The statements were presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds	Page 20
Summary of Operations	Page 21
Capital and Surplus Account	Page 22

**Safeway Insurance Company of Alabama, Inc.**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**For the Year Ended December 31, 2005**

**Assets**

	<u>Ledger Assets</u>	<u>Non- admitted Assets</u>	<u>Admitted Assets</u>
Bonds (Note 1)	\$38,648,003		\$38,648,003
Cash, cash equivalents, and short-term investments	4,433,245		4,433,245
Investment income due and accrued	493,042		493,042
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection (Note 2)	1,273,579		1,273,579
Deferred premiums, agents' balances and installments booked But deferred and not yet due	563,411		563,411
Net deferred tax asset	851,218	\$242,326	608,892
Electronic data processing equipment and software	207,530	150,850	56,680
Furniture and equipment, including healthcare delivery assets	143,837	143,837	
Aggregate write-ins for other than invested assets	27,736	27,736	
<b>Total Assets</b>	<b>\$46,641,601</b>	<b>\$564,749</b>	<b>\$46,076,852</b>

**Liabilities, Surplus and Other Funds**

<u>Liabilities:</u>		
Losses (Note 3)		\$10,080,307
Loss adjustment expenses		3,926,620
Commissions payable, contingent commissions and other similar charges (Note 4)		483,651
Other expenses (Note 4)		158,579
Taxes, licenses and fees		(30,971)
Current federal and foreign income taxes		326,734
Unearned premium reserves		5,190,585
Advance premiums (Note 5)		11,831
Drafts outstanding		448,982
Payable to parent, subsidiaries and affiliates		144,240
<b>Total Liabilities</b>		<b>\$20,740,558</b>
<u>Surplus and Other Funds:</u>		
Common capital stock		\$3,000,000
Gross paid in and contributed surplus		9,000,000
Unassigned funds (Note 7)		13,336,294
Surplus as regards policyholders		\$25,336,294
<b>Totals</b>		<b>\$46,076,852</b>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

**Safeway Insurance Company of Alabama, Inc.**  
**Summary of Operations**  
**For the Years Ended December 31, 2001, 2002, 2003, 2004, and 2005**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<b>Underwriting Income</b>					
Premiums earned (Note 6)	\$41,463,306	\$55,968,840	\$41,800,597	\$31,038,782	\$21,721,542
<b>Deductions</b>					
Losses Incurred	\$26,062,042	\$29,538,586	\$24,310,792	\$16,236,416	\$12,028,906
Loss expenses incurred	4,815,842	4,895,689	5,409,622	3,850,036	2,870,638
Other underwriting expenses incurred	<u>13,121,667</u>	<u>15,193,932</u>	<u>12,862,859</u>	<u>9,114,157</u>	<u>6,557,661</u>
Total underwriting deductions	<u>\$43,999,551</u>	<u>\$49,628,207</u>	<u>\$42,583,273</u>	<u>\$29,200,609</u>	<u>\$21,457,205</u>
Net underwriting gain or (loss)	\$(2,536,245)	\$6,340,633	\$(782,676)	\$1,838,173	\$264,337
<b>Investment Income</b>					
Net investment income earned	\$1,644,663	\$1,612,509	\$1,288,029	\$1,290,510	\$1,176,260
Net realized capital gains (losses)	<u>(11,035)</u>	<u>8,340</u>	<u>(54,476)</u>	<u>27,801</u>	<u>19,828</u>
Net investment gain or (loss)	\$1,633,628	\$1,620,849	\$1,233,553	\$1,318,311	\$1,196,088
<b>Other Income</b>					
Net gain or (loss) from agents' or premium balances charged off	\$(23,551)	\$(113,626)			
Finance and service charges not included in premiums (Note 6)	\$1,838,953				
Aggregate write-ins for miscellaneous income	<u>(2,868)</u>				<u>\$(1,225)</u>
Total other income	<u>\$1,812,534</u>	<u>\$(113,626)</u>			<u>\$(1,225)</u>
Net income after dividends to policyholders, after capital gains tax and before all federal and foreign income taxes	\$909,917	\$7,847,856	<u>\$450,877</u>	<u>\$3,156,484</u>	\$1,459,200
Federal and foreign income taxes incurred	<u>706,609</u>	<u>2,128,271</u>	<u>198,520</u>	<u>759,548</u>	<u>440,339</u>
Net income	<u>\$203,308</u>	<u>\$5,719,585</u>	<u>\$252,357</u>	<u>\$2,396,936</u>	<u>\$1,018,861</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.



**Safeway Insurance Company of Alabama, Inc.**  
**Reconciliation of Capital and Surplus**  
**For the Periods Ended as Indicated**

	2005	2004	2003	2002	2001
Surplus as regards policyholders, December 31 prior year	<u>\$25,121,432</u>	<u>\$19,747,744</u>	<u>\$16,186,054</u>	<u>\$14,591,480</u>	<u>\$12,306,211</u>
Net income	\$203,308	\$5,719,585	\$252,357	\$2,396,936	\$1,018,861
Change in net unrealized capital gains or (losses)	(22,260)	1,240	57,210	(64,293)	(38,254)
Change in net deferred income tax	157,867	(513,359)	698,668	82,792	87,007
Change in nonadmitted assets	(124,053)	166,222	(446,545)	(124,435)	(6,162)
Cumulative effect of changes in accounting principles				(696,426)	1,223,817
Transferred to capital			3,000,000		
Change in surplus as regards policyholders for the year	<u>\$214,862</u>	<u>\$5,373,688</u>	<u>\$3,561,690</u>	<u>\$1,594,574</u>	<u>\$2,285,269</u>
Surplus as regards policyholders, December 31 current year	<u>\$25,336,294</u>	<u>\$25,121,432</u>	<u>\$19,747,744</u>	<u>\$16,186,054</u>	<u>\$14,591,480</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 – Bonds

\$38,648,003

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

#### Issue 1

The Company did not comply with the security filing requirements of the NAIC SVO's Practices and Procedures Manual, Part 4, Section 2(c). The Enterprise Oil bond, CUSIP No. 293779AA, held by the Company at year-end 2005, was not rated by any nationally recognized securities rating organizations, and therefore, should have been filed with the NAIC SVO for valuation. The Company assigned the security a "1FE" designation. The security does not meet the filing exempt criteria. The designation was assigned by the Company in error. The security should have been submitted to the NAIC SVO for valuation. Alabama Insurance Regulation No. 98, Section 2, states,

- A. All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO.
- B. Other invested assets, not otherwise valued by statute, shall be valued in accordance with the procedures promulgated by the NAIC Financial Condition (EX4) Subcommittee.
- C. Any security not valued in accordance with this section shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with subsection A and B of this section.

The carried value of the bond at year-end 2005 was \$101,109 which is not material. Due to the adjustment not being material, no changes were made to the Company's financial statements contained in this report.

#### Issue 2

The examiners noted inconsistencies and inaccurate data included in the year ended 2005 investment custodian's statement. The "Date Acquired" and "Cost of Securities" were fields that were found to contain errors. Paragraph 12 of

the custodial agreement states "The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's Annual Statement and supporting Schedules..."

**Note 2 - Premiums and considerations: Uncollected** **\$1,273,579**  
**Premiums and agents' balances in the course**  
**of collection**

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

Issue 1

The Company included thirteen policies totaling \$734 in its admitted balance in which the examiners found the premiums had been past due over 90 days. SSAP No. 6, paragraph 9(a) states, in part, "Uncollected premium— To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted..."

Due to immateriality, no changes were made in the financial statements included in this report for this issue.

Issue 2

At year end 2005 the Company had uncollected premium balances of \$24,206 for policies that had been cancelled and \$2,093 for policies that had expired. The examination indicated that the Company made no effort to collect the premiums due associated with the cancelled and expired policies. There was also, \$131,392 of uncollected premiums balances in which the Company had sent out a ten day notice of cancellation, but the cancellation had not become effective at year end 2005. SSAP No. 6, paragraph 10 states,

After calculation of nonadmitted amounts, an evaluation shall be made of the remaining admitted assets in accordance with SSAP No.5— *Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5), to determine if there is impairment. If, in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible a portion of the balance is

uncollectible and is therefore not written off, disclosure requirements outlined in SSAP No. 5 shall be followed.

Due to immateriality, no changes were made in the financial statements included in this report for this issue.

**Note 3 - Losses**

**\$10,080,307**

The above captioned amount is \$1,119,000 more than the \$8,961,307 reported by the Company in its 2005 Annual Statement.

**Issue 1**

The actuarial examiner requested Company management to provide its support for its carried reserves. Management responded with a general explanation that stated, "Management uses various methods in determining its selected reserves, including but not limited to the loss development method and frequency-severity method. Using these analytical tools, management's selected carried reserves reflect management's best estimate." The Company did not provide any specific calculations documenting the Company's methods and assumptions. The actuarial examiner requested additional support for the selected reserves to which Company management responded with documentation of a review of frequencies and severities by segment. The actuarial examiner reviewed the support provided and determined that the support does not meet the requirement that the reserves "... shall be based upon the estimated ultimate cost of settling the claims" as stipulated by SSAP No. 55, paragraph 8. The support provided by Company management did not demonstrate that their carried reserves were set in accordance with SSAP No. 55.

The examination indicated that the Company changed its level of reserves with respect to the Appointed Actuary's range of reasonable reserves starting with the December 31, 2004 reserves. Through year-end 2003, the Company booked loss and loss adjustment expense reserves near the midpoint of the appointed actuary's range. Beginning with the December 31, 2004 evaluation, the Company carried loss and loss adjustment expense reserves approximately equal to the first quartile of the appointed actuary's range.

The examination actuary reviewed the appointed actuary's approach and concluded that there is no compelling evidence that the low end of the

appointed actuary's range is more reasonable than the high end of the range. SSAP No. 55, paragraph 11 states in part,

In the rare instances when, for a particular line of business, after considering the relative probability of the points within management's estimated range, it is determined that no point within management's estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued...

The \$1,119,000 adjustment reflected above is as a result of recording the loss and loss adjustment expense reserves at the midpoint of the range.

### Issue 2

The Appointed Actuary indicated in the Actuarial Opinion and in the actuarial report that the actuarial data was reconciled to Schedule P - Part 1 of the 2005 Annual Statement. However, the documentation provided to the examiners in the actuarial report demonstrated a reconciliation only of Parts 2 - 4 of Schedule P, which does not provide the same level of detail as Part 1.

### Issue 3

The Company's quota share reinsurance agreement with American Underwriters Insurance Company did not involve a reasonable possibility of a significant loss. The examination indicated that the loss ratios that would generate a significant loss to the Company, the assuming entity, in association with the quota share agreement, are not reasonably possible outcomes. The quota share agreement did not involve a sufficient risk transfer to qualify for reinsurance accounting as stipulated by SSAP 62. The transactions in relation to the quota share agreement do not qualify for reinsurance accounting according to SSAP No. 62. The transactions should have been accounted for as deposits consistent with SSAP No. 75. The prescribed method of accounting is consistent with SSAP No. 62, paragraph 34, which states, in part, "To the extent that a reinsurance agreement does not, despite its form, transfer both components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits..." The quota share agreements involved a provision for the assumed business to be commuted back to the cedant. Due to the commutation provision, the examiners determined it to be unnecessary to make the changes to the financial statements to reflect deposit accounting. No adjustments to the financial statements were made in connection with this issue.

#### Issue 4

In order to verify that drafts outstanding were recorded with corresponding entries to paid losses and loss reserves, the examiners selected a sample of drafts issued for loss payments and traced them to the Company's listing of paid losses and compared the reserve change from the month prior to the payment of loss and to the reserve at the end of the respective month that the payment was made.

The examination indicated that a reserve was not established prior to one claim payment. SSAP No. 55, paragraph 4 states, in part, "... Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income."

The examination indicated that there was one instance that the reserve was not reduced subsequent to the issuance of a draft for a claim payment. The Company utilized the "Draft Issue Method" to record drafts. SSAP No. 2, paragraph 8(a) states, in part, "Draft Issue Method— When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded..."

Due to immateriality, no adjustments were made to the financial statements included in this report.

#### Issue 5

In order to verify the completeness of the Company's loss reserves for reported claims as of December 31, 2005, the examiners selected a sample of claims paid during the first quarter of 2006 of which the date of loss was prior to year end 2005. The examiners identified a number of claims that were reported prior to December 31, 2005, but the Company had not established a reserve for the claims. SSAP No. 55, paragraph 4 states, in part, "Claims, losses, and loss/claim adjustment expenses shall be recognized as expense when a covered or insured event occurs..."

There were no adjustments made to the financial statements included in this report due to immateriality.

Note 4 - Commissions payable, contingent \$483,651  
commissions and other similar charges

Other expenses \$158,579

The above captioned amounts are the same as reported by the Company in its 2005 Annual Statement for each of the respective accounts.

The examination of the detail of the "Other expenses" line item indicated that the account was comprised primarily of commissions payable to Trigon, Inc. The commissions payable included at year end 2005 were \$154,990. The commissions payable should have been recorded in the line item "Commissions payable, contingent commissions and other similar charges."

The misclassification is not material and has no effect upon the Company's surplus. No changes were made to correct this item in the financial statements included in this report.

Note 5 - Advance Premiums \$11,831

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The Company's advance premiums detail was comprised of eight policies. The examination found that seven of the policies in the detail had effective dates during December of 2005. The premiums for the seven policies were not included in the 2005 written premium and an unearned premium reserve was not recorded for the policies. The recording and reporting was not in accordance with SSAP No. 53, paragraph 5, which states, "Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired."

No adjustments were made to the financial statements included in this report for this issue because the overstatement of advance premiums and the understatement of written premiums and the corresponding unearned premium reserve understatement as of December 31, 2005, was determined to be immaterial.

<u>Note 6 - Premiums earned</u>	<u>\$41,463,306</u>
<u>Finance and service charges not included In premiums</u>	<u>\$ 1,838,953</u>

The above captioned amount for "Premiums earned" is \$1,838,953 less than the \$43,302,259 reported by the Company in its 2005 Annual Statement. The above captioned amount for "Finance and service charges not included in premiums" is \$1,838,953 more than the \$0 reported by the Company in its 2005 Annual Statement.

#### Issue 1

The Company included \$1,838,953 of installment fees as part of the direct written premiums. Statutory accounting principles require that flat fee service charges on installment premiums to be reported in the Other Income section of the Underwriting and Investment Exhibit as Finance and Service Charges. SSAP No. 53, paragraph 5 states, in part, "Flat fee service charges on installment premiums (fees charged to policyholders who pay premiums on an installment basis rather than in full at inception of contract) are to be reported in the Other Income section of the Underwriting and investment Exhibit as Finance and Service Charges." The examiners verified that the fees reported by the Company are not refundable to the policyholders and therefore, as required by SSAP No. 53, are to be reported as finance and service charges, not as part of direct written premiums.

The adjustment is to correct a misclassification and does not affect the Company's surplus negatively. The future impact of reporting the income as required will be a positive impact to surplus due to the reduction of the related unearned premium reserves. No changes were made to the Company's surplus in the financial statements included in this report.

#### Issue 2

As a part of the completeness testing the examiners performed of the premiums written and the corresponding unearned premiums, the examiners obtained and reviewed the premiums written during the first quarter of 2006. During the review of the Company's data, it was found that the Company reported \$611,546 of written premium for policies with effective dates in 2005 as part of 2006 written premium. The recording and subsequent reporting was not in accordance with SSAP No. 53, paragraph 5, which states "Written



premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired.”

The misallocation to the proper accounting period was found to involve policies with effective dates during the last few days of the accounting period and was found to be a recurring misallocation. Due to the event being a recurring event (some 2005 reported written premiums should have been allocated to 2004 and some 2006 reported written premiums should have been allocated to 2005), the examiners determined that the financial impact was not material. The examination indicated that the 2005 written premiums were understated by \$611,546 for premiums erroneously allocated to 2006. The examination also indicated that the 2005 written premiums were overstated by \$471,755 representing 2004 written premiums that were erroneously recorded and reported as 2005 written premiums. The net effect was that the Company’s 2005 written premiums were understated by \$139,791.

Due to immateriality, no changes were made to the financial statements included in this report.

**Note 7 - Unassigned Funds** **\$13,336,294**

The above captioned amount is \$1,119,000 less than the \$14,455,294 reported by the Company in its 2005 Annual Statement. The following is a reconciliation of Unassigned funds per this examination.

Unassigned funds per Company	\$14,455,294
Examination (increase)/decrease to liabilities:	
Losses	<u>\$ (1,119,000)</u>
Total Unassigned funds per examination	\$13,336,294

**COMMENTS AND RECOMMENDATIONS**

**Conflicts of Interest - Page 7**

It is recommended that the Company require its Board of Directors to approve the conflict of interest policy.

It is recommended that the Company require its officers and directors to file signed and dated conflict of interest statements on an annual basis in order for

the Company to form a response to the Annual Statement General Interrogatories relating to conflicts of interest.

**It is recommended** that individuals with financial interest in or family members associated with affiliated organizations disclose this information in accordance with the Company's conflict of interest policy.

#### **Plan of Operation - Page 12**

**It is recommended** that Company management develop and maintain a marketing and long term strategic plan.

#### **Privacy Standards - Page 16**

**It is recommended** that the Company provide written guidance for its employees to follow who handle consumers' private information to ensure consumers' private information is protected.

#### **Reinsurance - Page 16**

**It is recommended** that the Company amend its reinsurance agreement with American Underwriter's Insurance Company to add an "entire agreement" clause to its reinsurance agreement. An entire agreement clause is identified by SSAP No. 62, paragraph 8(c) as "Required Terms for Reinsurance Agreements." The aforesaid paragraph states, in part, "The agreement shall constitute the entire contract between the parties..."

#### **Accounts and Records - Page 17**

**It is recommended** that the Company's Board of Directors require the appointed actuary to provide the Board with the Actuarial Opinion and the actuarial report. The receipt of the opinion and report should be recorded in the Board minutes as required by the NAIC Annual Statement Instructions which state,

The appointed actuary must report to the board of directors or the audit committee each year on the items within the scope of the actuarial opinion. The actuarial opinion and the actuarial report must be made available to the board of directors. The minutes of the board of directors should include that the appointed actuary has presented such

information to the board of directors or the audit committee and that the actuarial opinion and the actuarial report were made available.

It is recommended that the Company maintain complete records of its investment commissions and/or fees paid in association with investment brokerage transactions in accordance with ALA CODE Section 27-27-29(a)(1975) which states, in part, "Every domestic insurer shall have, and maintain... complete records of its assets, transactions and affairs..."

### **Bonds - Page 23**

It is recommended that the Company non-admit all securities not valued in accordance with Alabama Insurance Department Regulation 98, which states,

A. All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO.

B. Other invested assets, not otherwise valued by statute, shall be valued in accordance with the procedures promulgated by the NAIC Financial Condition (EX4) Subcommittee.

C. Any security not valued in accordance with this section shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with subsection A and B of this section.

It is recommended that the Company require its custodian to comply with the terms of the custodial agreement which states, "The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's Annual Statement and supporting Schedules..."

### **Premiums and considerations: Uncollected premiums and agents' balances in the course of collection - Page 24**

It is recommended that the Company nonadmit all uncollected premium balances over 90 days past due in accordance with SSAP No. 6, paragraph 9(a) which states, in part, "Uncollected premium— To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted..."

**It is recommended** that the Company evaluate its admitted uncollected premiums balances for impairment and write off all uncollected premiums for cancelled and expired policies and any other balances determined to be uncollectible in accordance with SSAP No. 6, paragraph 10 which states,

After calculation of nonadmitted amounts, an evaluation shall be made of the remaining admitted assets in accordance with SSAP No.5— *Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5), to determine if there is impairment. If, in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible a portion of the balance is uncollectible and is therefore not written off, disclosure requirements outlined in SSAP No. 5 shall be followed.

#### Losses – Page 25

**It is recommended** that the Company document its basis for the carried reserves with specific calculations and/or workpapers in support of the carried reserve if the Company chooses to carry a reserve different from the midpoint of the appointed actuary's reasonable range of reserves. Without any indication that any point within the range is more likely to occur, management is to book its loss and loss adjustment expense reserves at the midpoint of the range consistent with SSAP No. 55, paragraph 11, which states, in part, "In the rare instances when, for a particular line of business, after considering the relative probability of the points within management's estimated range, it is determined that no point within management's estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued..."

**It is recommended** that the Company require its Appointed Actuary to provide documentation of a reconciliation of the actuarial data to Part 1 of Schedule P in the actuarial reports supporting future Statements of Actuarial Opinion.

**It is recommended** that the Company account for reinsurance transactions that originate from contracts that do not involve a sufficient risk transfer by utilizing deposit accounting treatment as stipulated by SSAP No. 75 in accordance with SSAP No. 62, paragraph 34, which states, in part, "To the extent that a reinsurance agreement does not, despite its form, transfer both

components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits... ”

**It is recommended** that the Company establish a loss reserve and a loss adjustment expenses reserve for all reported claims in accordance with SSAP No. 55, paragraph 4 which states, in part, “ ... Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.”

**It is recommended** that the Company record corresponding entries for loss reserves and/or loss adjustment expense reserves when drafts for losses/loss adjustment expenses are issued in accordance with SSAP No. 2, paragraph 8(a) which states, in part, “Draft Issue Method— When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded... ”

**It is recommended** that the Company establish a liability (open a reserve) as soon as the incident that gives rise to a claim is reported to the Company, in accordance with SSAP No. 55, paragraph 4 which states, in part, “Claims, losses, and loss/claim adjustment expenses shall be recognized as expense when a covered or insured event occurs... ”

**Commissions payable, contingent commissions and other similar charges; Other expenses – Page 28**

**It is recommended** that the Company properly report its commissions payable within the Annual Statement line item “Commissions payable, contingent commissions and other similar charges” as required by the NAIC Annual Statement Instructions.

**Advance Premiums – Page 28**

**It is recommended** that the Company record its written premiums in the appropriate accounting period in accordance with SSAP No. 53, paragraph 5, which states, “Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired.”

**Premiums earned; Finance and service charges not included in premiums - Page 29**

It is recommended that the Company properly report its finance and service charges within the "Finance and service charges not included in premiums" line item as required by SSAP No. 53, paragraph 5 which states, in part, "Flat fee service charges on installment premiums (fees charged to policyholders who pay premiums on an installment basis rather than in full at inception of contract) are to be reported in the Other Income section of the Underwriting and investment Exhibit as Finance and Service Charges."

It is recommended that the Company record its written premiums in the same accounting period as the effective date of the contracts in accordance with SSAP No. 53, paragraph 5, which states "Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired."

**Compliance with Previous Recommendations - Page 36**

It is recommended that the Company comply with the Report of Examination recommendations.

**SUBSEQUENT EVENTS - Page 37**

It is recommended that the Company not enter into any transaction involving any person in its holding company system unless the Commissioner is notified in writing of its intention to do so at least 30 days prior thereto, or such shorter period as the Commissioner may permit in accordance with ALA CODE §27-29-5(b)(1975) which states "transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit..."

**CONTINGENT LIABILITIES AND PENDING LITIGATION**

The review of the contingent liabilities and pending litigation included an inspection of representations made by management and a general review of the Company's accounting records and files conducted during the examination,

including a review of claims. These reviews did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

### COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

It was recommended in the most recent Report of Examination that the Company require its key and responsible employees to sign conflict of interest statements as suggested by the Annual Statement General Interrogatories. The review performed by the examiners indicated that each of the Company's officers and directors did not sign and file a conflict of interest statement for each year under examination.

It was recommended in the most recent Report of Examination that individuals with financial interest in or family members associated with affiliated organizations disclose this information in accordance with the Company's Conflict of Interest Agreement and ALA CODE §27-27-26. The examination indicated that the officer did not make the required disclosures in his conflict of interest statements filed during the examination period. Further discussion of the issue is included in this Report under the caption "Conflicts of Interest."

It was recommended in the most recent Report of Examination that the reconciliation be included with the Actuarial Report and/or workpapers that support the Statement of Actuarial Opinion. The examination found that the Company's documentation of the reconciliation to Schedule P reconciles to Parts 2-4, not Part 1 as stipulated in the NAIC Annual Statement Instructions. Further discussion of the omission of a reconciliation of the Company's Schedule P, Part 1 is included in this report under the Caption "Note 3 - Losses."

It was recommended in the most recent Report of Examination that management record its best estimate of its liabilities for unpaid losses and loss adjustment expenses in accordance with SSAP No. 55. It was further recommended that, if management determines that, for a particular line of business, there is no "best estimate" in a range of reasonable estimates, management should record the midpoint of the range in accordance with SSAP No. 55. The examination found that the Company has not complied with the recommendation. Further discussion of the issue is included in this report under the caption "Note 3 - Losses."

## SUBSEQUENT EVENTS

The Company obtained approval during 2005 from the Alabama Department of Insurance to implement a pooling agreement with its insurer affiliates effective retroactively January 1, 2005. The Company experienced difficulty obtaining approval from each of the respective statutory authorities before year end 2005. Company management made the decision to delay the implementation of the pooling agreement until January 1, 2006. Company management delayed the implementation date of the pooling agreement without notifying the Alabama Department of Insurance. The Company submitted its first quarter 2006 financial statements based upon the pooling of business with its affiliates before obtaining prior approval from the Alabama Department of Insurance. The Company subsequently notified the Alabama Department of Insurance that it had entered into the pooling agreement effective January 1, 2006, in its Form D filing on April 18, 2006. The Company received approval from the Department in an approval letter dated May 31, 2006. The Company did not obtain the approval prior to entering into the transaction with its affiliates as required by ALA CODE §27-29-5(b)(1975) which states "transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit..."



## CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by all persons representing Safeway Insurance Company of Alabama during this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Mario Ascic, AFE, Toni Bean, Kate Bolbas, CFE, CPA, Mike Manwaring, John Meikle, AES, CISA, and Rose Vail, examiners representing the Midwestern and Southeastern Zones of the NAIC; and Robert P. Daniel ACAS, MAAA, and Matthew P. Merlino, FCAS, MAAA, FCA, consulting actuaries; representing the Alabama Department of Insurance, participated in this examination of Safeway Insurance Company of Alabama.

Respectfully submitted,



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Palmer W. Nelson, CFE  
Examiner-in-charge  
Alabama Department of Insurance  
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