MARKET CONDUCT EXAMINATION

OF

UNITED STATES FIRE INSURANCE COMPANY

AS OF

AUGUST 18, 2005

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of AUGUST 18, 2005 of the

UNITED STATES FIRE INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: _____

DATE: 4TH DECEMBER 2006

In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 4TH DAY OF DECEMBER 2006.

_____

Insurance Commissioner

REPORT ON MARKET CONDUCT EXAMINATION

OF THE

UNITED STATES FIRE INSURANCE COMPANY

AS OF

AUGUST 18, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 4TH day of DECEMBER, 2006.

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SALUTATION

November 1, 2006

Honorable Matthew Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner Denn:

In compliance with the instructions in Certificate of Examination Authority Number 05.718, and pursuant to statutory provisions including 18 Del. C. §318-322, a market conduct examination has been conducted of the affairs and practices of:

United States Fire Insurance Company

hereinafter referred to as the "Company" or "United States Fire". United States Fire Insurance Company is incorporated under the laws of the State of Delaware. This examination reviewed the operations of United States Fire Insurance Company. The on-site phase of the examination was conducted at the following location:

- 305 Madison Ave., Morristown, NJ 07960-1973

The examination is as of August 18, 2005.

Examination work was also performed off site and at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or as "DDOI."

The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

The basic business areas that are subject to a Delaware Market Conduct Examination vary depending on the type on insurer. For all insurers these areas include:

Company Operations/Management
Complaint Handling
Marketing and Sales
Producer Licensing
Policyholder Service
Underwriting and Rating
Claims

Each business area has standards that can be examined and measured, typically utilizing sampling methodologies.

This examination is a Delaware Baseline Market Conduct Examination. It is comprised of two components. The first is a review of the Company's countrywide complaint patterns. This is not a pass/fail test. It is aimed at determining if there is a detectable pattern to the complaints the Company receives from all sources.

The second component is an analysis of the management of the various business areas subject to market conduct examination through a review of the written procedures of the Company. This includes an analysis of how the Company communicates its instructions and intentions to its lower echelons, how it measures and monitors the results of those communications, and how it reacts to and modifies its communications based on the resulting findings of the measurement and monitoring activities. The examiners also determine whether this process is dynamic and results in enhanced compliance activities. Because of the predictive value of this form of analysis, focus is then made on those areas where review indicators suggest that the process used by management does not appear to be achieving appropriate levels of statutory and regulatory compliance.

All business areas noted above are addressed to some extent by one or more of the procedures reviewed, thus providing a comprehensive view of the Company and its component operations.

This examination report is a report by test rather than a report by exception. This means that all areas tested are described and results indicated. Substantial departure from the norm may result in a supplemental review focused on the area so noted.

HISTORY AND PROFILE

United States Fire Insurance Company (the "Company") was organized under the laws of the State of New York on April 1, 1824 for the purpose of transacting the business of fire insurance. Effective December 31, 2003, the Company redomesticated, by merger, to the State of Delaware.

The Company has absorbed by merger: Peter Cooper Insurance Company of New York during 1911, Williamsburg City Fire Insurance Company of New York during 1916, the Colonial Assurance Corporation of New York during 1922, the Allemannia Fire Insurance Company of Pittsburgh during 1951, and Southern Fire Insurance Company in 1956.

In 1982, Xerox Financial Services, Inc. acquired the Company's then parent, Crum and Forster, Inc. Xerox Financial Services, Inc. is wholly-owned by Xerox Corporation, the Company's ultimate parent.

During 1992 and 1993, Crum and Forster, Inc., undertook a restructuring of its insurance

operations, which was effective December 31, 1992. Pursuant to such restructuring, Crum and Forster, Inc. was renamed Talegen Holdings, Inc. and seven stand alone insurance holding companies were created. One of these holding companies was Crum & Forster Holdings, Inc., which owned the following insurance companies:

United States Fire Insurance Company
The North River Insurance Company
Crum and Forster Insurance Company
Premier Insurance Company
(Now known as Crum & Forster Indemnity Company)
Crum & Forster Underwriters Co. of Ohio

Also during 1993, the Company repurchased 313,433 shares of its common stock and thereby reduced its common capital stock outstanding by $940,299. At the present time, paid-in capital is $4,586,262 consisting of 1,528,754 shares of common stock with a $3.00 par value per share. The Company has 2,242,187 shares authorized.

On August 13, 1998, Talegen Holdings, Inc. sold Crum & Forster Holdings, Inc. to Fairfax Inc., a wholly-owned subsidiary of Fairfax Financial Holding Limited. On June 5, 2003, Crum & Forster Holdings Corp., a wholly-owned subsidiary of Fairfax Inc., acquired the Company's parent, Crum & Forster Holding Inc., formerly known as Crum & Forster Holdings, Inc.

Additionally, on December 21, 2000, the Company acquired Transnational Insurance Company and changed its name to Crum & Forster Specialty Insurance Company on December 27, 2000.

At the present time, the Company is licensed to transact business in all states of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

The Company is licensed to write the following kinds as business as outlined in Section 903, 904, 906 & 907 of the Delaware Insurance Code:

Health
Property
Surety
Marine & Transportation
Casualty, including:
Vehicle
Liability
Workers' Compensation & Employers' Liability
Burglary & Theft
Personal Property Floater
Glass

Boiler & Machinery
Leakage & Fire Extinguisher Equipment
Credit
Malpractice
Elevator
Congenital Defects
Livestock
Entertainments
Miscellaneous

Pursuant to the Company's charter and by-laws, management is vested in a board of directors. The by-laws of the Company specify that the Board of Directors shall meet annually and at such times as the board may determine. The by-laws allow for the number of directors to be not less than three (3) and not more than seven (7). The Company currently has three (3) directors.

METHODOLOGY

This examination is based on the Standards and Tests for a Market Conduct Examination of a Property Casualty Insurer of the Delaware Market Conduct Examiners' Handbook. This chapter is derived from applicable Delaware Statutes, Rules, and Regulations as referenced herein and the NAIC Market Conduct Examiners' Handbook.

Some standards were measured using a single type of review, while others used a combination of all of the types of review. The types of review used in this examination fall into three general categories: generic, sample, and electronic.

A "Generic" review indicates that a standard was tested through an analysis of general data gathered by the examiner, or provided by the examinee, in response to queries by the examiner.

A "Sample" review indicates that a standard was tested through direct review of a random sample of files using sampling methodology described in the Delaware Market Conduct Examiners' Handbook and the NAIC Market Conduct Examiners' Handbook. For statistical purposes, an error tolerance level of seven percent (7%) was used for claim reviews and a ten percent (10%) tolerance level was used for other types of review. The sampling techniques used are based on a ninety-five percent (95%) confidence level. This means that there is a 95% confidence level that the error percentages shown in the various standards so tested are representative of the entire set of records from which it was drawn. Note that the statistical error tolerance is not indicative of the DDOI's actual tolerance for deliberate errors.

An "Electronic" review indicates that a standard was tested through use of a computer program or routine applied to a download of computer records of the examinee. This

type of review typically reviews one hundred percent (100%) of the records of a particular type.

Standards were reviewed using tests designed to adequately measure how the examinee met the standard. The various tests utilized are set forth in the Delaware Market Conduct Examiners' Handbook for a Property Casualty Insurer. Each standard applied is described and the result of testing is provided under the appropriate standard. The standard, its statutory authority under Delaware law, and its source in the NAIC Market Conduct Examiners' Handbook are stated and contained within a bold border within the report.

Each Standard is accompanied by a "Comment" describing the purpose or reason for the Standard. The "Result" of the review is indicated and the examiners' "Observations" are noted. In some cases a "Recommendation" is made. Comments, Results, Observations and Recommendations are reported within the appropriate Standard.

A. COMPANY OPERATIONS/MANAGEMENT

Comments: There are two standards that are evaluated on a pass/fail basis. Standards A7 and A9 stipulate the following:

- "The Company is licensed for the lines of business that are being written."
- "The Company cooperates on a timely basis with examiners performing the examinations."

The remainder of the examination is analytical with recommendations made, when applicable.

Standard A7

NAIC Market Conduct Examiners' Handbook - Chapter XV, §A, Standard 7 & Chapter XVII. §A, Standard 7.
The Company is licensed for the lines of business that are being written.
18 Del. C. §318(a), §505(b), §508(b).

Comments: The review methodology for this standard is generic. This standard has a direct insurance statutory requirement. This standard is intended to ensure that the Company's operations are in conformance with the Company's certificate of authority.

Results: **Pass**

Observations: The Company is licensed for the lines of business being written.

Recommendations: None

Standard A 09

NAIC Market Conduct Examiner's Handbook - Chapter VIII. §A, Standard 9.
The Company cooperates on a timely basis with examiners performing the examinations.
18 Del. C. §318(a), §320(c), §508(b), §520(b)3.

Comment: Review for this standard is by "generic" methodology. This standard has a direct insurance statutory requirement. This standard is aimed at assuring that the company is cooperating with the state in the completion of an open and cogent review of the company's operations. Cooperation with examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely fashion and minimizing cost.

Results: **Pass**

Observations: During the course of the examination United States Fire Insurance Company was provided with fifty-one (51) Information Requests (IR's) and all responses were returned timely. During the course of the examination, the Company's communication with the examiners was very responsive. The Examiners experienced no delays during the course of the examination.

Recommendations: None

B. COMPLAINTS/GRIEVANCES

Comments: Evaluation of the Standards in this business area is based on the Company's response to various information requests (IR items) and complaint files at the Company. 18 Del. C. §2304(17) requires the Company to "…maintain a complete record of all complaints received." The statute also requires that "this record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint." Delaware's definition of a complaint is: "…any written communication primarily expressing a grievance."

Observations: The Company provided a database with one hundred thirty-one (131) logged complaints for the period of examination. All complaints in the complaint log were reviewed to compare the accuracy of the database and to look for any complaint patterns. After the review was completed no complaint patterns were present in the master log. The review of the complaint process is noted in Procedure 11 below.

REVIEW OF PROCEDURES

The management of well-run companies generally has some processes that are similar in structure. These processes generally take the form of written procedures. While these

procedures vary in effectiveness from company to company, the absence of them or the ineffective application of them is often reflected in the failure of the various Standards that follow this section. These processes usually include:

- a planning function where direction, policy, objectives and goals are formulated;
- an execution or implementation of the planning function elements;
- a measurement function that considers the results of the planning and execution; and
- a reaction function that utilizes the results of measurement to take corrective action or to modify the process to develop more efficient and effective management of its operations.

The absence of written procedures that provide direction for company staff in its various operational areas tends to produce inconsistent application of the intended process. The same is generally true for the absence of a means to measure the results of the application of procedures and to determine that the process is performing as intended.

The reviews in this section are not pass/fail measurements. Rather, they are intended to reflect those management strengths and weaknesses that have a bearing on regulatory compliance issues.

Procedure 01 – Audit Procedure (Internal and External)

Observations: The Company has an external audit performed by PriceWaterhouseCoopers (PWC) on at least an annual basis. The Company provided the audit plan used by PWC in 2004. The audit plan presents the objectives and responsibilities of PWC in performing the audit to express an opinion as to the fair presentation of the financial statements of United States Fire. The document includes the audit approach, engagement team, timetables for deliverables and fees for the audit.

The Company implemented a new internal audit function in January of 2005 which the Company has entitled United States Fire Enterprise Audit Process. This process is a multi-disciplinary audit that is conducted in each of the United States Fire field locations as well as the home office. The physical audit in a particular region takes three to four days, depending on the size of the office. This process is intended to provide a thorough audit and analysis of the functions performed within the Company's regional offices, and to determine their compliance with home office processes, procedures and criteria, as well as a regulatory and Sarbanes-Oxley (SOX) Section 404 requirement. The scope of the audits include areas of marketing, underwriting, claims, loss control, human resources and financial.

Upon completion of a regional audit, a report is generated by the audit team and submitted to senior management in the home office and the management staff of the region. The report includes recommendations for improvements that region must implement, usually within thirty (30) days or less. Approximately six (6) months later, the audit team member of any discipline that generated critical recommendations will re-visit the region for 1.5 to 2 days to confirm that the regional office complied with their

audit recommendations. The results of these subsequent audits will be reported to senior management in the home office and the management staff of the region.

Recommendations: None

Procedure 03 – Company records, central recovery and backup procedure

Tape backup and recovery policies and procedures exist for computer systems hosted in both the AIGT Livingston data center and United States Fire locations. Tape backup is a component of disaster recovery plans and is separate from United States Fire records retention policies. The sole purpose of magnetic tape backup is for the purpose of recovering computer systems that fail or restoring files inadvertently deleted by the owner of the files.

AIGT's backup and recovery controls are described in the latest SAS 70 report. A summary is as follows:

MAINFRAME

United States Fire uses weekly FDR back-ups with no data center generated incrementally.

All back-ups are retained for five (5) weeks offsite.

SERVERS

The standard back-up and retention is six (6) weeks across the board for Full and Incremental back-ups. Any special back-ups for long-term storage need to be requested on a case-by-case basis. Full backups are conducted either on Friday night/Saturday morning or Saturday night/Sunday morning. Incremental back-ups will run the rest of the week.

United States Fire controls for its own Home Office location are described in the internal control documentation for the Company's Home Office. To summarize, the procedures in use for the Company's Home Office are as follows:

- Home Office servers identified as housing financially significant applications are backed up twice each night – once to disk, and separately to tape.
- The current tape rotation scheduled is as follows:

Nightly Differential Backups: four (4) weeks
Weekly Full Backups: three (3) months
Monthly Full Backups: one year
Year-end Full Backups: five (5) years

- Tape restores are performed on an as-needed basis. A formal procedure for requesting a tape restore is documented.
- Any backup job that fails will generate an email alert to the backup administrator and the unit manager, and appropriate follow up action is taken.

All employees of United States Fire must adhere to the records management policies outlined in the United States Fire Retention Manual and Schedules. These retention documents are maintained on-line for easy access by employees. Key elements of the policy include:

- Active records are kept on location; inactive records are stored at the Iron Mountain Warehouse facility or other United States Fire approved vendor.
- Individual departments are responsible for filing and storing all company documents.
- Policy and claim files are individually listed in the Iron Mountain warehouse system for easy access and retrieval.
- Individual offices and departments can retrieve records at any time through their local administrator.
- The Iron Mountain warehouse system automatically generates destruction dates based on originating department and type document. Employees do not assign destruction dates.
- Individual offices and departments cannot destroy records. Final approval for the destruction of records must be obtained from the Home Office Corporate Records Administrator.

Recommendations: None

Procedure 04 – Computer Security Procedure

Observations: United States Fire security procedures are extensive and cover both end-user security as well as standards within the IT organization for monitoring and review of logs, proper protection at the perimeter of the organization, etc. Almost all of the procedures were updated in 2004 in accordance with SOX Section 404 compliance efforts. The various procedures included in this section are as follows:

- End user security policies
- Perimeter security procedures
- Security request procedures (user ids/application access)
- IT general computer controls related to security
- IT application security controls

All security-related general computer controls and application security controls are tested three times each year: two months are sampled for the January – June time frame and

three months are sampled for the July – December time frame, with one of those months representing year-end activities. Sample size is in line with SOX guidance from PWC.

Test results from SOX Section 404 testing completed in 2004 are stored in multiple binders at United States Fire home office in Morristown, NJ. Results are available, in summary, in electronic form, while testing detail sheets are only available in hard copy.

All security-related controls were provided to the Examiners in electronic format in response to IR 004.

Recommendations: None

Procedure 05 – Anti Fraud Procedure

Observations: United States Fire has developed and maintains a comprehensive Anti-Fraud Program that covers all lines of business. The Company's Special Investigations Unit (SIU) has been an integral component of their home office claim department for nearly twenty (20) years. The SIU is a separate and distinct unit from the claims and underwriting functions. They coordinate and conduct anti-fraud activities on a nationwide basis and report to an SIU Manager based in the Company's home office. Assignments to the Company's SIU have increased every year. In 2004 there were a total of 1,557 cases referred for investigation.

The Company's SIU is composed of eight (8) full-time investigators who are based out of regional claim centers throughout the country. Their sole responsibility is to detect, investigate, and deter insurance fraud. The Company's SIU Investigators are visible and accessible team members, not only to claims staff, but also underwriting, loss control, the agents, and policyholders. A regular presence in each claim center allows each investigator to interact regularly with their claim associates.

Averaging twenty-six (26) years of combined insurance claims investigation and law enforcement experience, the Company's SIU staff has a wealth of experience. All are members of the International Association of Special Investigation Units (IASIU) and its local chapters as well as various other local anti-fraud associations. Their active affiliation with these organizations creates a network of resources that facilitate their identification and investigation of insurance schemes and perpetrators.

United States Fire is a long-standing member company of the National Insurance Crime Bureau (NICB). NICB partners with insurers and law enforcement agencies to facilitate training and the identification, detection and prosecution of insurance criminals. United States Fire takes full advantage of the anti-fraud training resources provided by NICB. United States Fire is also a member company of ISO and accesses their industry recognized Claim Search claim history database. Additionally, the Company utilizes numerous commercial public records databases, all of which facilitate the investigation of questionable insurance claims.

The Company's SIU markets anti-fraud awareness internally and externally via customer training, periodic newsletters, success stories, fraud posters, and envelope stuffers. United States Fire funds anti-fraud advertising that helps educate the public about the costs of insurance fraud. They maintain their own fraud hotline that allows for anonymous reporting of suspected fraud and abuse. The Company also receives tips via NICB's nationally publicized fraud hot line.

The SIU conducts thorough field investigations in an effort to validate the claim being presented. SIU's role is to validate the claim presented, not to find fraud. Estimated savings associated with fraud is tracked; however, SIU Investigators have no goals associated with saving fraud dollars, thus ensuring the investigator's objectivity.

Each SIU Investigator documents their investigations electronically via the Company's proprietary case management database. Reports are forwarded from the database directly to the claim handlers. The SIU Manager reviews cases and quality reviews are a component of performance objectives for all SIU personnel.

All meritorious cases are referred to the proper state fraud agencies. Referrals are tracked and monitored through the Company's case management database by the SIU Manager. Compliance with state mandatory reporting is a component of performance objectives for all SIU personnel.

Training

The Company's SIU is responsible for providing annual anti-fraud education for the Company's associates. They keep the associates alert to insurance fraud indicators, trends, and scams, via both formal and informal training. The formal training often includes presentations from industry experts, or certified trainers and materials available through the Company's membership with the National Insurance Crime Bureau.

Continuing education of SIU Investigators is provided on a regular basis. They attend training seminars every year to keep abreast of current insurance fraud schemes and trends. All training is documented in the Company's internal Anti-Fraud Training Database. Anti-Fraud training for claim personnel and continuing education for SIU Investigators are components of the performance objectives for all SIU personnel. The SIU Manager follows up to ensure that all personnel receive appropriate training.

Recommendations: None

Procedure 06 – Disaster Recovery Procedure

Observations: The majority of United States Fire production systems, including the mainframe, AS400, and open systems servers, are hosted by American International Group Technology (AIGT) in the data center in Livingston, New Jersey. Full disaster recovery services for the Company's production environment are part of its contract with AIGT. Fairfax Information Technology Services (FITS) and AIGT coordinate to hold a data recovery test at the Sungard facility every six (6) months. The most recent test was

held from April 24–27, 2005. The final report of that test has not yet been issued but should be available soon.

The Company's Business Continuity Plan was also provided to the Examiners for review. This plan provides the steps to be taken in any unexpected event and covers all known possible threats and the steps to be taken should one of these threats take place.

Recommendations: None

Procedure 07 – MGA Oversight and Control Procedure

Observations: United States Fire does not contract with "MGAs." All underwriting authority is maintained with the Company's underwriting staff.

Recommendations: None

Procedure 08 – Vendor Oversight and Control Procedure

Observations: Not applicable as the Company does not use any MGA's.

Recommendations: None

Procedure 09 – Customer and Consumer Privacy Protection Procedure

Observations: The Company has in place a Customer and Consumer Privacy Protection Procedure. The procedure is unambiguous, clear and readable. The procedure has not been revised during the exam period; however, it is revised if and when any applicable regulation takes place.

United States Fire has developed two Privacy Agreements, one for its Producers and one for Policyholders, which outlines the eligibility to receive Private Data as well as the party's responsibilities regarding its use. Until or unless the Company receives properly executed agreements, release of private data is prohibited, and safeguards have been put in place to prevent inappropriate distribution.

When a Producer or a Policyholder properly completes a United States Fire Privacy Agreement and supervisory personnel in Morristown receive it, that Producer's and/or Policyholder's name will be entered into the United States Fire Privacy Database. This database is the controlling feature that governs whether that Producer or Policyholder receives Private Data on loss runs (RAMS Reports), is granted Claims Information Access (CIA) or may receive Private Data in any other manner, including via a telephone call. All of the Company's employees have access to the privacy database**,** which must be reviewed prior to making any disclosure of Private Data.

RAMS REPORTING

When a loss run (RAMS REPORT) is ordered by the Company's employees, the privacy database governs both what type of report is printed as well as where it is printed.

If no Privacy Agreement has been completed between the Producer and the Company and none between the Policyholder and the Company, loss runs will print out at a customary printing location. However, no protected data will appear on the report. The Company refers to this as a 'restricted' report. The nature of this report is such that one will be free to copy and forward the information to those parties who customarily receive these reports and who are part of the insurance transaction at issue.

If, however, a Privacy Agreement has been completed between the Producer and the Company and/or the Policyholder and the Company, this information will be noted in the Privacy Database, and no matter what person in what branch ordered the report, it will print only to a dedicated, off-site, secured printer. The report will detail whether the Producer is in the Privacy Database, or the Policyholder is in the Privacy Database, or both. The Operations Manger is responsible for mailing these reports directly to the Producer and/or Policyholder, or both, depending upon whether or not an agreement was signed. This report will be "unrestricted" meaning it will contain all relevant loss run data, including the identifying information of the claimant which has traditionally been available on RAMS reports prior to July, 2001. All employees have executed a receipt of having received and reviewed the policy. The policy is included in new employee orientation materials.

Recommendations: None

Procedure 10 – Insurance Information Management Procedure

Observations: The Company has Insurance Information Management Procedures in place. These procedures are unambiguous, clear and readable. These procedures have been provided to and are used by the persons subject to its provisions. These procedures are reviewed as part of the Company's Regional Audit. If there are any areas of concern brought up as a result of these audits a memo concerning these areas is developed and addressed through the audit process (See Procedure 001 above).

Recommendations: None

Procedure 11 – Complaint Handling Procedure

Observations: The Company has established a procedure for handling consumer complaints, both claims and non-claims related. Complaints are routed and distributed according to type, location and subject matter. The Company (specifically, the Administrative Assistant to the CEO) maintains a record of these complaints in an annual log, which is accessible to senior management, and summarizes the critical aspects of

each complaint received by the Company. Additionally, the Company has adopted a Complaint Entry/Disposition Form for completion on every complaint. This form requires information regarding the nature of the complaint, policy information, handling process, disposition information and corrective action. This form must be signed by the Regional Claims Manager, countersigned by the Regional Vice President, and forwarded to Home Office within five (5) days of completion. Copies of the entire complaint file are also forwarded to Home Office where it is maintained for a period of four (4) years. This process is used company wide.

To ensure timeliness, replies are required to be given to all complaints within three (3) working days of receipt of a complaint. Individuals in responsible management positions must make these replies on behalf of the Company. All correspondence received must be date stamped and initialed by the receiver, and individual files must be suspended and followed to conclusion in a timely manner. A full letter of explanation must be given to the complainant detailing the position taken by the Company. The Regional Claims Manager must make an assessment concerning the justified nature of each complaint, and recommend corrective action when necessary.

Recommendations: None

Procedure 13 – Advertising, sales and marketing Procedure

Observations: The Company does not actively engage in advertising through the media, however, the Company does have on retainer the firm of Richartz, Fliss, Clark, and Pope to facilitate with the distribution of Press Releases to key industry sources. In the rare instance where the Company does issue a Press Release, this is controlled by Home Office's Marketing Department.

The Company provided documents that explain the processes for communicating externally for addressing inquiries from any media source. This documentation also addresses the format and style of any created documents for use in communicating the products and services the Company offers. Revision history is not available. When the Company's procedures/materials are updated in the database, the predecessor documents are replaced.

Recommendations: None

Procedure 14 – Agent produced advertising Procedure

Observations: The Company does not authorize their producers to advertise on their behalf, nor do they engage in joint advertising with them.

Recommendations: None

Procedure 15 – Producer Training Procedure

Observations: The Company does not provide producer training since all of their producers are independent agents and brokers.

Recommendations: None

Procedure 20 – Producer Selection, Appointment and Termination Procedure

Observations: The Company has a Producer Selection Appointment and Termination Procedure in place. The procedure is unambiguous, clear and readable. The procedure is compliant with state statutes and regulations.

Appointment & Selection

Effective April, 2004 the Company has a new contract entitled the "Producer-Company Agreement" which will replace the current Agency and Broker agreements. Existing contracted producers will be phased in over time in accordance with the notification requirements of the various states.

Because there is little difference between the Company's current broker and agency agreements, the Company created one contract document to be used for all distribution sources. The Company also eliminated the existing premium accounting/billing addenda and separate producer privacy agreement and incorporated these items into the body of the new contract.

There are separate commission schedules for wholesalers and retailers (this is the only difference in contracting between wholesalers and retailers). All contracts are produced in duplicate form. Once both parties have signed the Agreements, the producer keeps one and the other original is sent to HO Marketing. Copies are maintained at the Company.

It is the responsibility of the Marketing Manager to ensure that producers in their territory are contracted with the correct commission schedule, and that Addendum A specifies only the approved lines of business for each producer.

All original signed agency contracts (agreements, addenda, incentives, etc.) and termination letters are maintained in the home office. The original signed contracts are sent to HO Marketing and a copy is kept at the Company. Files are to be maintained for the term of the contract and six (6) years after termination in the document warehouse.

Termination

Procedures have been developed to outline the process to cancel a producer contract. Sample letters notifying the agency of the contract termination, in addition to a "Termination Checklist" have been provided to the Examiners for review.

Notification is sent to all underwriting and operations staff when a producer's account has been closed so that no new submissions are accepted and entered into the systems. Various databases within Notes and the PMF system get updated to reflect the agency's change in status. The Agency Contacts and Communications Database reflects the date the agent was notified of termination (segment change date) and the "final" close date. The Marketing Comments section of the PMF also reflects this information.

Recommendations: None

Procedure 21 – Producer Defalcation Procedure

Observations: Upon learning of a producer's impropriety the Legal Department is immediately engaged to evaluate the facts and direct the appropriate course of action. Actions against the producer may involve immediate suspension and/or termination depending on the outcome of the investigation.

Recommendations: None

Procedure 22 – Prevention of use of persons with felony conviction Procedure

Observations: United States Fire has established a Code of Business Conduct and Ethics, which is distributed annually to all employees in an electronic format. Employees must complete a Certification attesting to their compliance with the Code of Business Conduct and Ethics and these records are maintained by the Human Resource department. Any positive response on a Certification is reviewed by the Secretary of the Company and a report is provided to the Board of Directors of the Company.

In addition, the Company's directors and officers are required to manually complete a Certification attesting to their compliance with the Code of Business Conduct and Ethics and these records are maintained by the Legal department. Any positive response on a Certification is reviewed by the Secretary of the Company and a report is provided to the Board of Directors of the Company.

Additionally, the Company's Directors and Officers are annually required to respond to conduct questions, specifically regarding felony convictions, in order for the Company to complete a Certificate of Disclosure for the State of Arizona.

It is also Company procedure that all Directors and Officers complete the NAIC's Biographical Affidavit, which asks for the disclosure of criminal offenses, violations of laws, and disciplinary actions.

Recommendations: None

Procedure 23 – Policyholder service Procedure

Observations: The Company has a procedure in place for policyholder service. The procedure is unambiguous, clear and readable. The procedure is in compliance with all applicable statutes and regulations.

Prior to March 24, 2003, United States Fire offered its policyholders the option to pay premiums on a direct bill or agency bill basis. As of March 24, 2003, the Company eliminated the direct bill option for admitted policies in the Primary Casualty division so its policyholders in that division are only billed through brokers and agents. The Company's Special Accounts division differs from the Primary Casualty division in this regard as they continue to use either agency bill or direct bill. On direct bill Special Accounts business, payment is due ten (10) days from the premium invoice date.

The Company's credit policy is outlined in its producer-company agreements. In 2001, the Company had a Broker-Company Agreement and an Agency-Company Agreement as well as addendums pertaining to premium accounting and premium trust issues. These agreements were replaced in 2004 by a Producer-Company Agreement.

United States Fire has underwriting service standards for policy and endorsement issuance. These standards have been regularly communicated to the regions in departmental teleconferences, etc. The Company's service standards are also listed in their Underwriter's Desk Reference Manual.

The Company has standards relative to policy issuance, endorsement processing, renewal quotations, and new submission quotations. Their new business quotation standards have evolved since publication of the Underwriter's Desk Reference Manual in 2001. The Company's target date for new business quotes is now the broker's quote due date. This could be more or less than two weeks in advance of the effective date which was the older standard.

Timeliness of policy issuance and endorsement handling is reviewed as part of the Company's Home Office underwriting audit process. It is also monitored in Home Office by pulling data from the Submission system that tracks the progress of new submissions and renewals.

<u>Policy Cancellations</u>

The Company's Home Office issued a Correspondence Bulletin from the LOB Management Database that discusses the information required and the steps that need to be taken when canceling a policy at the request of the insured. This document was produced March 21, 2002 and is still in effect. Underwriters have been instructed to refer to this bulletin as needed when they are processing cancellations. Proper handling of policy cancellations is measured for effectiveness through the Home Office Underwriting audits that are conducted annually in each region.

The Company's standard is for mail to be sorted and distributed on the same day it is received. The document helps the mailroom personnel determine where to deliver each piece of mail. If the correspondence pertains to a particular underwriting file it will be retained in that underwriting file and is subject to review for proper handling by the production line manager during the region's self audit process or by a Home Office auditor during a Home Office underwriting audit.

The Company's regional underwriting departments receive requests from their agent or policyholder for loss information. Distribution of loss runs is subject to the Company's Privacy Policy and Procedures manual that was distributed in October 2002.

As stated in the manual, a privacy agreement needs to be completed between the Producer and United States Fire and/or the policyholder and the Company in order to receive a non-'restricted' loss report. If no Privacy Agreement exists, a 'restricted' loss report will be provided upon request. With a 'restricted' loss report, no protected data will be provided.

It is United States Fire policy, albeit unwritten, to provide loss runs upon the request of either the insured or the producer of record. The Company will only mail the loss run to the requesting policyholder or producer of record. If another party requests loss information on a present or former United States Fire policyholder, that request would be denied.

Recommendations: None

Procedure 24 – Premium Billing Procedure

Observations: The Company has a formal Premium Billing Procedure which is unambiguous, clear and readable. The procedure is in compliance with all applicable statutes and regulations.

The Company offers two major bill types, Statement and Item billing. The statement bill may be either Agency Statement or Account Current. The specifics (procedure) for this bill type are addressed in the Agency Company Agreement. The major elements of Statement Billing are that a statement is produced ten (10) days following a month end close and is to include all items due and owing for that particular month. The statement is then settled forty-five (45) days following the end of the current month.

Item billing is used for the Company's Special Accounts and Wholesale Brokerage profit centers. A major feature of this bill type is that the premium is due on the effective date of the transaction (Special Accounts) or within thirty (30) days of the effective date of the transaction. Another feature of the item bill type is that invoices (word documents and an access database) are produced during the course of the month and are not produced at the end of the month as is the case with Statement Billing.

Recommendations: None

Procedure 25 – Correspondence routing Procedure

Observations: The Company has a formal correspondence routing procedure in place. The procedure is unambiguous, clear and readable. The procedure is in compliance with all applicable statutes and regulations.

All mail must be stamped with the date of receipt and the department or region, as appropriate. All mail must be handled within two business days of receipt unless there are specific company guidelines regarding the document. Mail that is improperly routed to an individual is to be forwarded by that person to the appropriate person through the use of a "buck slip" that includes the name of the person and department to whom the mail is directed as well as the sender's name. Such mail must be redirected within two business days. If it is not known to whom the mail should be sent it must be directed to the Legal Department.

Recommendations: None

Procedure 26 – Policy Issuance Procedure

Observations: The Company has a written procedure for policy issuance. The procedure is well structured, clear and readable. The current version is dated May 26, 2005. No conflict with Delaware's statutes or regulations was noted.

In its Management Protection Division's Underwriting and Operations Manual, the Company has a section devoted to policy issuance. This section details the process a person would follow with specific instructional steps for typing the policy, setting up the policy and making copies, mailing the policy, and updating the submission in the database.

The Company accepts applications of insurance from independent agents and brokers. Most agents and brokers utilize standard industry ACORD applications, yet others have developed their own applications or specifications. The regions have been instructed to require the Company's agents to use applications that contain proper anti-fraud statements, which can include state specific anti-fraud statements. The Company's regions' acceptance of applications containing anti-fraud statements is monitored through the Home Office Underwriting audit process as well as the region's self audit process.

In June of 2000, the Company's Home Office implemented a requirement that every policy and endorsement issued by the Company must go through a quality control check by the Underwriter and the region's Product Line Manager (PLM) prior to mailing the policy to the Company's producers. This was implemented, in part, to confirm the consistency of the policy and forms as compared to the Company's proposal form. At that time the PLM could delegate the task, however; s/he was held accountable for the accuracy of the policy. The Underwriter is required to sign and date the Company copy

of the policy or endorsement to verify that this quality review took place. The requirement for PLM sign-off on policies is re-emphasized throughout 2004 with the Casualty PLMs on several departmental conference calls. This process is reviewed during the Company's Home Office Underwriting audits, which generally take place once per year.

The Company's policy writing system (Commercial Intellysis) is not updated with new or revised forms or endorsements until state regulators approve them. The Company's State Filings database is used to alert various departments within the Company when new or revised endorsements and forms are approved for use in a state. When the database form is completed and identifies a form as 'approved', an e-mail notification is sent to the Company's regulatory maintenance vendor (MFX). MFX reviews the applicable ISO, NCCI, or independent state circular for programming logic and sends a change request (CSR) to the Company's rating system vendor (Insurity) via the Internet. A tracking number for the CSR is immediately assigned once the CSR is submitted. Weekly status reports listing all CSRs from the prior week are sent by Insurity to MFX for tracking purposes. Once Insurity completes the CSR it is sent as part of a larger 'release' back to MFX. MFX performs testing on the Release to confirm that all CSRs contained in the Release are functioning properly in the rating/policy writing systems. If there is a problem with a particular CSR, the CSR is re-opened and sent back to Insurity for correction and will be released to MFX in a future Release after it is corrected. This process has been in place for several years. The Company does not currently audit this process to measure its effectiveness. The control would be the regions' reviews of the policy form attachment list for accuracy. This is also part of the annual Home Office Underwriting audit review. If it is discovered that a form is missing or an inaccurate form is attached to a policy, it is brought to the attention of MFX and a CSR is created.

The Company does not permit the use of manuscript endorsements. Home Office referral is required if a policyholder has a unique exposure and/or coverage need that may necessitate the development of an endorsement unique to that policy. Policy review for the use of unauthorized endorsements is part of the PLM/Underwriter quality control process, the regional self-audit process, and the annual Home Office Underwriting audit process.

Regarding the timely issuance of policies and endorsements, please refer to Procedure 23 above.

Recommendations: None.

Procedure 27 – Reinstatement Procedure

Observations: During the examination, the Company did not have a procedure for reinstating policies cancelled for non-payment of premiums that are statement billed. However, following the examination, the Company did promulgate and adopt a procedure.

For item billed policies (Special Accounts and Wholesale Billing) the Company's billing procedures do address the reinstatement of a policy that has been cancelled for non-payment when the cancellation effective date has passed. In order to reinstate a policy that has been cancelled for non-payment, the request for reinstatement must be made to the Chief Financial Officer. The Chief Financial Officer will make the decision as to whether or not to reinstate the policy. The exception to this is if the producer, wholesaler or insured can demonstrate to the accounting analyst that payment was made prior to the cancellation effective date. If proof is provided, the premium accounting analyst has the authority to reinstate the policy. No conflict with Delaware's statutes or regulations was noted.

Recommendations: None.

Procedure 28 – Insured or Member Requested Claim History Procedure

Observations: During the examination, the Company maintained no written procedure for an insured's request for claim information. The information provided mentioned two means that an insured has for accessing claim history information: a system generated RAMS report and the Claim Information Access system (CIA). The response noted that both systems were updated in 2001 to reflect current privacy laws; however, no revision history was supplied and the CIA booklet contains no revision date.

It is ambiguous as to whether the CIA booklet is provided to all insured or on a case-by-case basis. Furthermore, the Company does not state the procedure for an insured's ability to access the RAMS report.

The Company makes no mention in its response of the frequency of review for this procedure.

The Company stated that in order for access to be granted to the insured, the Company requires signed documents by the insured.

No conflict with Delaware's statutes or regulations was noted. Since completion of the examination, the Company has promulgated and adopted a written procedure to deal with this issue.

Recommendations: None

Procedure 30 – Premium Determination and Quotation Procedure

Observations: The Company has a written premium determination and quotation procedure. The procedure is clear and readable. It is comprised of several components; the most recent date listed on these documents was 2004. No conflict with Delaware's statutes or regulations was noted.

The rates used on Property policies are obtained from either the ISO rate schedules, specific rates, or the independently filed Large Property Plan, depending on the size and eligibility of the individual risk. The Company plan was designed to allow for flexibility of terms and conditions in order to meet the individual and unique requirements of commercial property insured's.

The actual pricing of the risk is performed by the underwriter according to the individual risk characteristics and the underwriter's authority level. The credits/debits are documented in the electronic and/or paper underwriting file. Rates are applied to the respective premium bases provided in the account submission and applications. Written quotations are sent to the broker/agent on all acceptable submissions usually within seven (7) and thirty (30) days prior to the effective date of coverage. Renewal terms are also sent in writing generally from fourteen (14) to thirty (30) days before the renewal date. Direct commissions on Property business may range from 0% up to fifteen percent (15%). Premiums are adjusted based on the commission used on the individual account.

In addition to the Large Property Filing, exceptions to the ISO manual were also filed in most states. Individual pricing is documented in each underwriting file via a Daily Risk Summary report.

The tables for the rating process are updated by Insurity (the Company's vendor for the Policy writing system Commercial Intellysis, also known as CI) after state approval via request from the Company State Filings to the vendor manager. The process is run in tandem with the regulatory compliance state filings process described in Procedure 33 - Rate and Form Filing Procedure, below. Testing includes regression and focus testing, which is performed to verify that rate requests were appropriately processed, and that the values are correct. Once the test has been certified the service pack is scheduled to move to Production.

A Producer-Company Agreement that is executed with every agency and broker the Company does business with governs the commission rates that the Company pays on its policies. Prior to 2004 the Company had two different types of Agreements: a Broker-Company Agreement for insurance brokers, for which the Commission Schedule for every line of business was on a "to be negotiated" basis and an Agency-Company agreement for the independent retail agents that had a Commission Schedule that identified the maximum commission rate available for each line of business. The Company revised its Producer-Company Agreements in 2004. Currently there is a commission schedule for Wholesalers and a different commission schedule for retail Brokers and Agents. The Wholesaler commission schedule is on a "to be negotiated" basis for every line of business. The Retail commission schedule identifies the maximum commission rate available for each line of business.

Underwriters are expected to develop premiums that are adequate, but not excessive or unfairly discriminatory. The underwriting file should contain sufficient documentation to justify the pricing level selected. Price documentation is reviewed as part of the Company's annual Home Office Underwriting audits.

In the Company's Special Accounts Division, no regional underwriter nor PLM has pricing authority; all pricing decisions in this Division are referred to the Home Office.

The Company's State Filings Department produces a State Filings Report that is kept in the Company's Line of Business Management Database. The report is used by the Company's underwriters to verify the Company's filed loss cost multipliers, deviations, and schedule rating capability in each state.

Regarding the application of Experience and Schedule Rating plans, the Company uses ISO's Experience and Schedule Rating plans in each state. The Experience and Schedule Rating plan is applied to all eligible insureds unless extenuating circumstances exist. In those instances, the underwriter includes documentation and explanations within the file suggesting the decision not to apply this plan. One example might be the inability to secure complete loss information. Proper application and documentation of this rating plan is controlled through the Company's Regional Self Audit Program, which is conducted throughout the year by the Casualty Product Line Manager, and through the Home Office Underwriting audits which occur annually in each region.

R*ecommendations:* None.

Procedure 31 – Policyholder Disclosures Procedure

Observations: The Company has a written procedure for policyholder disclosures that is clear and readable. The most current version of the procedure is dated March 21, 2002. No conflict with Delaware's statutes or regulations was noted.

The Company relies on a regulatory compliance vendor called ODEN to determine for any given state whether anticipated premium or coverage changes for a renewal will require notice of such changes to the policyholder and/or other parties and how much advance notice is necessary. The Company also uses ODEN software to produce any required Conditional Renewal Notices.

The current document simply summarizes premium increase notice requirements for all fifty (50) states. This was distributed on March 23, 2005.

The regions are expected to refer to ODEN prior to processing Conditional Renewal Notices in order to ensure that the Company is in compliance with the most current regulations.

The Company's Home Office also monitors ISO form changes for Automobile and General Liability policies and determines if these ISO form changes necessitate development of a policyholder notice. If ISO does not develop its own policyholder notice for their form change, the Home Office will develop its own and will instruct the

regions to attach such policyholder notices to applicable renewal policies and/or renewal proposals as may be required.

Proper use of Conditional Renewal Notices and/or policyholder notices is reviewed as part of the Company's annual Home Office Underwriting audit process in each region.

R*ecommendations:* None.

Procedure 32 – Underwriting and Selection Procedure

Observations: The Company has a written procedure for underwriting and selection that is clear and readable. The procedure is composed of many parts—the most recent revision of these is dated January 14, 2005. No conflict with Delaware's statutes or regulations was noted.

The Company expects its underwriters to gather sufficient underwriting information in order to have a thorough understanding of the operations and controls of the risk before offering a quotation. The Company requires completed applications, three to five years of loss data, internet home page information (if applicable), financial information, and a completed supplemental application. For Automobile policies, a complete vehicle list is required as part of the application and a driver list is also expected. The Company utilizes its own supplemental applications for Workers' Compensation, Automobile submissions and some General Liability policies for certain industries. The Company will generally utilize these supplemental applications in lieu of Loss Control reports on new prospects in order to determine the type of exposures and the controls the risk presents.

Additional information may be required on some accounts in order for the underwriter to gain a thorough understanding of a risk's operations and controls and how they compare to the average for the class of business. The underwriters are expected to have this information prior to quoting a new account. When the Company is successful in writing a new piece of business, a Loss Control survey is generally requested and received within the first sixty (60) days to validate the risk's acceptability. At renewal, the Company requests updated standard applications (ACORD or equivalent), updated prior carrier loss runs, and other infomation as needed.

The Company's Home Office validates adequate information gathering for risk evaluation as part of its Home Office Underwriting audits that are performed annually in each region. This review is supplemented by the Company's self audit process that is conducted by each region. Results of the self-audit are reported to the Primary Casualty Underwriting department in the Home Office on a quarterly basis.

The Company's Actuarial department monitors its loss experience for each line of business at both the countrywide and regional levels on a quarterly basis. Results are also monitored quarterly based on SIC codes and by State. The Company has used it's SIC loss experience to develop Risk Grades and SIC Tiers which are used to establish

regional authorities for underwriting business. In 2000, the Actuarial department used this SIC loss experience to develop SIC Tiers for the Primary Casualty department. The development of the SIC tiers help guide underwriters on the types of risks the Company prefers to write—not to decline all risks considered "poor" or "restricted".

In April of 2004, the Company developed an Unacceptable and Executive Referral Class list in an effort to make its risk selection process more consistent across all profit centers in the Company. The list was updated in August 2004 and is currently in effect.

In October 2004, Primary Casualty revised the SIC Tiers and Risk Grade manuals and merged them into a single Excel spreadsheet along with the Company's Underwriting Documentation form. The spreadsheet serves as a look-up table to pre-populate the Company's Underwriting Documentation form with Risk Grade and SIC Tier information after the underwriter enters the SIC code on the form. This was designed to minimize the possibility of missing Home Office referral requirements due to SIC code or Risk Grade. A warning will automatically post on the Underwriting Documentation form if the SIC code is subject to Home Office referral.

Proper SIC and Risk Grade assignments and proper referrals of business, when required, are all reviewed as part of the Company's regional self audit process and are conducted throughout the year by the PLM. The Home Office Underwriting audit process in each region is conducted annually.

The accounts written by the Company's regions are tracked through the use of New and Renewal Business Reports (WBRs) as well as Home Office Underwriting audits and the regional self-audit process. Within seven (7) days of binding a new or renewal policy, the region must submit a WBR to Home Office. This is a snapshot of the account's operations, pricing, and experience. These reports allow Home Office to quickly observe if a region is writing accounts that are consistent with the Company's risk selection philosophy. WBRs are also required to be maintained in each underwriting file and are evaluated during the audit process to confirm their accuracy.

The Company does not underwrite mass marketing plans or group programs.

Recommendations: None.

Procedure 33 – Rate and Form Filing Procedure

Observations: The Company has a written procedure for rates and form filing. The procedure is clear and readable. No conflict with Delaware's statutes or regulations was noted.
This procedure is from the Company's regulatory compliance manual. The procedures included within the manual have been developed over the years. Initially compiled in 1996 the manual has been updated to include system upgrades to each process. Most

manual efforts are now being assisted through the use of Lotus Notes Databases and various Internet applications. The most recent update was in 2004 when the Company began electronic filing activity via SERFF. [The NAIC's SERFF system is designed to enable companies to send and states to receive, comment on, and approve or reject insurance industry rate and form filings online.]

The main systems used during the filing process are:

1) State Filings Database
2) CI Customer Support Database
3) Authentic Web for Filing Forms
4) System for Electronic Rate and Form Filing (SERFF)

Correspondence between analysts and the customer departments is done via Lotus Notes.

The documented process has been written to support the various actions that take place during the filing process namely:

1) Supporting the needs of the Product Lines and Profit Centers
2) Communicating Status of filings to Home Office and Regional Management as well as Underwriting
3) Maintaining clear, concise, filing files and records
4) Developing and maintaining relationships with the various DOI personnel to achieve timely approvals
5) Assist and advise Product Line Managers relative to rate, rule and forms development
6) Assist Operations to achieve timely systems support for new products, company initiated filings and bureau initiated filings
7) Provide guidance on the process

The structure of the department was created specifically so that an analyst has primary responsibility for particular states and lines of business. This assures that the Company has a person with expertise in the states particular filings regulations for each by line of business.

R*ecommendations:* None.

Procedure 34 – Termination Procedure

Observations: The Company has a written procedure for termination that is clear and readable. The procedure has several modification dates associated with it, the most recent being April 21, 2005. No conflict with Delaware's statutes or regulations was noted.

Parts of the procedure are a part of systems and services provided by ODEN, a regulatory compliance vendor. The Company has relied on this vendor for several years to

determine for any given state what the proper procedures, reasons, and advance notice requirements are for Declinations, Non-Renewals and Cancellations. The Company utilizes the business application called ODEN Online, which is accessed through the Company's intranet. The Company also uses ODEN software to produce any required Cancellation or Non-Renewal Notices.

The Company requires the Casualty Product Line Manager in the region to review all Cancellation and Non-renewal Notices to verify that the reason used is appropriate.

In March 2002, the Company's Home Office supplemented the information provided in ODEN and produced a Correspondence Bulletin. This document contains instructions to the regional underwriting units on the following topics:

- Cancellation at Insured's Request
- Non-Payment Cancellations
- Cancellation at Company Request (other than non-payment)
- Non-Renewal Procedures
- Notice of Renewal Premium/Policy Change Procedures
- Certificates of Mailing
- Reason for Cancellation or Non-Renewal

Regarding declinations of new submissions, ODEN Online alerts underwriters to any prohibited reasons that may exist in a given state. Historically, the Company required its regions to maintain declination files for a minimum of nine (9) months. These files are now currently maintained on an indefinite basis. Declination files will contain the submission and documentation of the declination with the reason for the declination identified. Declination files are reviewed as part of the Company's annual Home Office Underwriting audit process to confirm proper handling. When a notice of intent to cancel is issued for non-payment, the ODEN application determines the cancellation effective date based upon statutory rules for cancellation notification.

If premium payment is received prior to the cancellation effective date, a rescission of the notice of intent to cancel is issued. If payment is received post cancellation effective date, and in the absence of either the insured or producer substantiating that payment was made prior to the effective date, the cancellation becomes effective. Once the cancellation is effective, the decision to reinstate the policy can only be made by the Chief Financial Officer.

Standard practice calls for the issuance of cancellation and/or non-renewal notices sent to the insured according to State statutes. Reasons for such action are included on each notice. Cancellation endorsements detailing the return premium due are also issued. Declination of submitted risks is usually made in writing to the broker/agent describing the reasons for the declination. Based upon a review of the risk characteristics the underwriter makes the declination decision. Declined files are reviewed as part of the management audit process.

Cancelled, declined and non-renewed files are reviewed for compliance with statutes and regulations as part of the management audit conducted in the field offices. Cancellations are processed in the underwriting area. A copy of the cancellation endorsement showing the unearned premium to be returned is sent to the accounting department. The return premium is then processed according to the procedures of the Accounting Department and the type of billing on the account (direct or agency billed).

Proper use of Cancellation and Non-Renewal Notices are also reviewed as part of the Company's annual Home Office Underwriting audit process.

R*ecommendations:* None.

Procedure 35 – Underwriting File Documentation Procedure

Observations: The Company has a written procedure for underwriting file documentation that is clear and readable. The most recent version portion was dated March 2005. No conflict with Delaware's statutes or regulations was noted.

Since 1997, the standard Primary Casualty underwriting documentation form used by the Company resided in a Lotus Notes database called AMT. Each region has their own AMT database on their servers. An alternative underwriting documentation form was developed in April of 2004; however, this AMT Underwriting File Documentation form is still used by some underwriters, especially on accounts that do not require Home Office referral. When underwriters use the newer documentation form, which is an Excel spreadsheet, they tend to use AMT as the repository for the new underwriting documentation form. A training module for using AMT was developed in 1999 and explains the Company's underwriting documentation standards. The major sections of this document are: referral, insured operations, hazard identifications and controls for lines of business, account considerations, file documentation, and pricing summary. Steps to follow for each section are described in the full procedure.

In early April 2004, the Company developed a new underwriting documentation form with the ability to alert underwriters automatically when SIC codes are on the Unacceptable List or Executive Review list or would otherwise require Home Office referral. This is now the standard underwriting documentation form that is used for most underwriting files.

The Home Office Loss Control department measures proper regional implementation of the Company's Loss Control survey criteria periodically. It is also reviewed closely as part of each region's self audit process by the region's Casualty Product Line Manager, as well as the Home Office Underwriting audit process which takes place annually in each region.

The Company has used motor vehicle reports (MVRs) as an underwriting report on all commercial automobile accounts for approximately ten (10) years. Adherence to these guidelines by each region is monitored through the annual Home Office Underwriting

audits. The Casualty PLM in each region also reviews automobile underwriting files as part of the region's self audit program to confirm compliance with these guidelines. Results of these audits are reported to the Home Office on a quarterly basis.

For property policies, the underwriter prepares a Daily Risk Summary (DRS) for each written account. The DRS outlines the risk exposures, hazards and controls, pricing, loss history and reinsurance purchased, for the specific account. The underwriter also documents their thought process regarding the selection and pricing of the risk. The DRS becomes an integral part of the underwriting file.

R*ecommendations:* None.

Procedure 36 – Underwriting Training Procedure

Observations: The Company has a written process that is a part of its underwriter training procedure. This written process is clear and readable, and its version date is unknown. No conflict with Delaware's statutes or regulations was noted.

As indicated below in Procedure 42, Adjuster Training, the Company currently uses a "Performance Management Guide" that outlines the performance review process that is the primary instrument the Company utilizes to identify the training and skill development needs for all Company personnel. This is an annual process that calls for an evaluation of the individual's performance over the preceding year, and the identification of areas where the employee should upgrade or develop new skills over the upcoming year. Please see the observations noted on Procedure 42 below for more detail.

R*ecommendations:* None

Procedure 40 – Staff Training Procedure

Observations: The Company has a written process that is a part of its staff training procedure. This written process is clear and readable, and its version date is unknown. No conflict with Delaware's statutes or regulations was noted.

As indicated in Procedure 42, the Company currently uses a "Performance Management Guide" that outlines the performance review process that is the primary instrument used to identify the training and skill development needs for all Company personnel. This review is an annual process that calls for an evaluation of the individual's performance over the preceding year, and the identification of areas where the employee should upgrade or develop new skills over the upcoming year. Please see the observations on Procedure 42 for more detail.

The Company does not differentiate between departmental training manuals and departmental policy and procedures manuals. Please refer to other procedures within this report for additional detail.

R*ecommendations:* None.

Procedure 42 – Adjuster Training Procedure

Observations: The Company has a written process that is not specific to, but applies to, adjuster training that is clear and readable; its version date is unknown. No conflict with Delaware's statutes or regulations was noted.

Currently, the Company uses a "Performance Management Guide" that outlines the performance review process that is the primary instrument used to identify the training and skill development needs for all Company personnel—including the claims adjuster staff. This is an annual process that involves an evaluation of the individual's performance over the preceding year, and the identification of areas where the employee should upgrade or develop new skills over the upcoming year.

The evaluation is comprised of four parts: objectives, a personal effectiveness review, an employee development plan, and an employee comments section. Up to ten (10) objectives may be created, but each employee must have at least one. In personal effectiveness there are eight (8) broad categories (9 for managers) reflecting critical skills required to be successful on the job. The employee development plan covers the next twelve (12) months of employment. This section is intended to indicate ways to improve skills for the current position held and/or potential for higher-level positions. Finally, the employee comments section allows employees to note areas of agreement or disagreement on the evaluation.

The Company views it as the Managers' responsibility to provide guidance and to keep employees on track to achieve set goals. Discussions between managers and employees on the progress of skill development throughout the year are expected. This process would identify specific gaps in an employee's knowledge or skills and the corrective training that can be provided to close such gaps.

Information on Company employees is maintained on the Performance Management Database. This database includes complete performance evaluations and information dating back to 2000 for all employees, tools and forms. Evaluations prior to 2000 have been archived. These performance evaluations are accessible only to the Company's managers.

The Company assists employees in furthering their educations. This includes courses leading to designations such as CPCU and IIA.

In addition, the Company is currently developing a variety of materials that are part of the Company's Professional Training Program. The program is specifically for new college

graduates with no insurance experience who will take entry-level positions in underwriting, finance or claims after approximately one year. The preliminary outline for this program includes a self-study portion, with scheduled times for examinations to measure the effectiveness of the training. Aside from the self-study portion there is a preliminary schedule for the integration of classroom insurance training and On-the-Job Training (OJT) during a year-long training program. During OJT a trainee would learn from a variety of modules in various stages of development that are the primary training vehicle for the program. These modules include an overview, automobile, general liability, claims systems, management protection, support units, and Workers' Compensation. The approximate date for the implementation of this new program is unknown.

R*ecommendations:* None.

Procedure 43 – Claim Handling Procedure

Observations: The Company has a written procedure for claim handling. Each line of business has a separate claim-handling manual that describes the claim handling procedures. These lines include liability, automobile material damage, umbrella/excess, workers' compensation, and property. The procedures for these are well structured, clear, and readable. Each claim-handling manual describes the specific requirements and expectations for that specific line of business. Within each manual the claim handling procedure, documentation requirements, and reserve establishment procedures are described (See also Procedure 45: Claim File Documentation and Procedure 47: Reserve Establishment). No conflict with Delaware's statutes or regulations was noted.

Compliance with the claim handling manuals is measured through Home Office Line of Business Audits and through Regional Claim Office internal audits. In the first audit, a random sample of files is reviewed to evaluate the performance of that particular line of business over a particular period of time. In the second (internal) audit, supervisory and management staff perform random file audits of their own staff, focusing more on the performance of the current claim handler.

The various claim handling manuals were initially adopted at least fifteen (15) years ago and are now recertified annually by the line of business Assistant Vice President or Vice President. The most recent revision took place in October 2004.

Please see Procedure 45 - Claim File Documentation for more detail about computer systems utilized by the Company.

R*ecommendations:* None.

Procedure 44 – Internal Claim Audit Procedure

Observations: The Company has a written internal claim audit procedure. The procedure is well structured, clear and readable and was last revised during the last quarter of 2004. No conflict with Delaware's statutes or regulations was noted.

The Company schedules the Claims Cycle Test Plan annually on each claim office. The test plan measures the level of compliance for each of the key claim controls that the Company has deemed to have a significant impact on its financial statements. The test plan details each area within the claims cycle and how it is to be tested. Various criteria are identified for evaluating the Company's key controls in areas such as Claim Notification, Claim Investigations, Coverage Denials, Claim Payments, etc.

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R*ecommendations:* None

Procedure 45 – Claim File Documentation Procedure

Observations: The Company has a written claim file documentation procedure. Each line of business has a separate claim-handling manual that describes the claim handling procedures. These lines include liability, auto material damage, umbrella/excess, workers' compensation, and property. The procedures for these are well structured, clear, and readable. Each claim-handling manual describes the specific requirements and expectations for that specific line of business. Within each manual the claim handling procedure, documentation requirements, and reserve establishment procedures are described (See also Procedure 43 - Claim Handling and Procedure 47 - Reserve Establishment). No conflict with Delaware's statutes or regulations was noted.

The Company uses computerized systems to work with and document their claims files. This includes the use of the Electronic Claim File (ECF) system, forms on the web or CD, the Automated Claim System (ACS), Lotus Notes, and the Client Management System (CMS) depending on the line of business. ACS is a database that provides the user the policy number, insured's name, policy dates, policy limits, the name of the producer, the branch office that writes the policy, and any previous claim numbers. CMS is within ACS. ECF is a tool to document claim-handling information in convenient tabs that can be reviewed by anyone with ECF access.

In the workers' compensation claims procedure for example, it is written that all contacts, diary updates, and claims technician's activities should be documented in the ECF. This documentation should be precise and self-explanatory; it should speak for itself as other claims technicians, supervisors, managers, Home Owners consultants, employers, and agents may need to access the claim. The claim history and activity, including compensability, medical case management, potential recovery, etc., should be understood without the need to review hard copy documents. The documentation includes reports,

forms from templates, notes from Lotus Notes related to the claim files, activity, investigations, etc.

ECF allows the claims technician to classify some information as confidential and thus not accessible to persons outside the Company. Generally, there are two types of information that must be marked confidential (1) personal information on the employee that is unrelated to the claim, and (2) proprietary or confidential information within the Company. Confidential items within the ECF include but are not limited to, information with respect to AIDS, HIV status, or HIV testing or test results.

Compliance with the claim handling manuals is measured through Home Office Line of Business Audits and through Regional Claim Office internal audits. In the first audit, a random sample of files is reviewed to evaluate the performance of that particular line of business over a particular period of time. In the second (internal) audit, supervisory and management staff perform random file audits of their own staff, focusing more on the performance of the current claim handler.

The claim handling manuals were initially adopted at least fifteen (15) years ago and are now recertified annually by the line of business Assistant Vice President or Vice President. The most recent revision took place in October 2004.

See also Procedure 03, Company records, central recovery and backup procedure.

R*ecommendations:* None.

Procedure 46 – Subrogation and Deductible Reimbursement Procedure

Observations: The Company has a written procedure that covers subrogation and deductible reimbursement for the Workers' Compensation and Automobile Material Damage Lines of Business Manuals for Claims Handling. These procedures are clear and readable. No conflict with Delaware's statutes or regulations was noted.

Within the Company's computer system, ACS (see P-45 for more detail on computer systems used by the Company) has a code that is used specifically for subrogation or deductible reimbursement. In addition, the manuals for the previously mentioned lines of business give the user questions to refer to when considering each claim for potential subrogation, and how to achieve subrogation recovery success. The workers' compensation manual also contains a subrogation checklist.

These procedures were initially adopted approximately fifteen (15) years ago. The claim manuals are recertified each year and were last updated in October 2004. Please see Procedure 43 - Claims Handling for further detail on review cycles for this procedure.

R*ecommendations:* None.

SUMMARY

The examination was a limited scope market conduct examination of the following business areas: Company Operations/Management, Complaint Handling, Marketing and Sales, Producer Licensing, Policyholder Service, Underwriting and Rating, and Claims.

LIST OF RECOMMENDATIONS

None.

CONCLUSION

The examination was conducted by Donald P. Koch, Brian T. Tinsley and Nobu Koch and is respectfully submitted.

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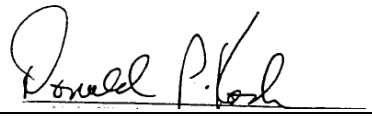

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