

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

of

**Pacific Northwest Title Insurance Company, Inc.
Seattle, Washington**

**NAIC CODE 50970
DECEMBER 31, 2006**

**Participating State:
Washington**

Order No. G 07-0343
Pacific Northwest Title Insurance Company
Exhibit A

SALUTATION

Seattle, Washington
November 20, 2007

The Honorable Alfred E. Gross
Insurance Commissioner
Chair, NAIC Financial Condition (E) Committee
Virginia Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, VA 23219

The Honorable Morris Chavez,
Superintendent, New Mexico Insurance Department
NAIC Secretary, Western Zone
PO Drawer 1269
Santa Fe, NM 87504-1269

The Honorable Mike Kreidler, Commissioner
Commissioner, Washington State Office of the Insurance Commissioner (OIC)
Insurance Building-Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

Dear Commissioners and Superintendent:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Pacific Northwest Title Insurance Company, Inc.

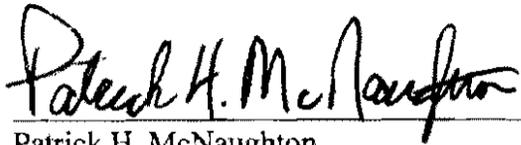
of

Seattle, Washington

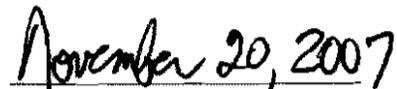
hereinafter referred to as "PNWTIC" or the "Company," at the location of its home office, 215 Columbia Street, Seattle, Washington 98101-1511. This report is respectfully submitted showing the condition of the Company as of December 31, 2006.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Pacific Northwest Title Insurance Company, Inc., of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2006.



Patrick H. McNaughton
Chief Examiner



Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2002 through December 31, 2006 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC) and Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2006 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. Statutory Premium Reserve

The calculation of the statutory premium reserve was overstated by \$1,354,842 as a result of the change in accruals for "premiums written, but not yet reported," not being recognized for prior years and improper rates of fifteen cents per thousand being used for policies with a net retained liability of \$500,000 or greater subsequent to July 24, 2005. RCW 48.29.120(2)(a)(ii)(B) requires the reserve for policies with a net retained liability of \$500,000 or greater to be ten cents per thousand after July 24, 2005.

The Company is instructed to comply with RCW 48.29.120(2)(a)(ii)(B) by applying the prescribed rate of ten cents per thousand for policies with a net retained liability of \$500,000 or greater subsequent to July 24, 2005. An adjustment to increase surplus in the amount of \$918,509 as of December 31, 2006 has been posted to the financial statements in this examination report to correct this overstatement of the premium reserve, net of \$423,613 in federal income taxes.

2. Investment In One Fund Exceeded The Statutory Limit Of 4% Of Assets

In its NAIC 2006 Annual Statement filing, PNWTIC included in its total cash balance the investment in the Columbia Funds Series Trust Money Market Reserves. This fund is a 'Class I' fund listed in the NAIC Securities Valuation Office (SVO) Purposes & Procedures (P&P) Manual as of December 31, 2006 and should have been included on Schedule D-Part 1 Bonds. Adjustment A2 includes the reclassification of the admitted portion of this fund to Bonds in the amount of \$1,156,098. (See Instruction No. 9.c.)

Bond fund shares are subject to RCW 48.13.030(1), which states that an insurer shall not, except with the consent of the commissioner, have at any time any combination of investments in any one person, institution, or municipal corporation (excluding U.S. Government or state government-backed investments) aggregating an amount exceeding 4% of the insurer's assets.

The December 31, 2006 balance for the Company's investment in Columbia Funds Series Trust Money Market Reserves of \$3,137,415 exceeded the Washington State 4% limitation on securities invested in one security by \$1,981,317. The \$1,981,317 should have been reported as a non-admitted asset, reducing the Company's policyholders' surplus as of December 31, 2006. Examination Adjustment A2 includes the non-admission of the \$1,981,317.

The Company is instructed to comply with RCW 48.13.030(1) by non-admitting single issuer investments in excess of the 4% limitation.

3. Premium Master File

During our review of the premium master file, we noted the following discrepancies:

a. Balancing

The net liability, before reinsurance, on the year-end report processed on May 31, 2007, was \$2,548,089 lower than the total of the year-end report processed on January 18, 2007. Investigation revealed that this difference resulted from an audit policy matching routine, which identifies simultaneously issued policies, being run after close. A simultaneously issued policy was identified after close, resulting in the net liability being reduced to zero. It was determined that any resulting adjustment to the financial statements would not be material and no adjustment for this item is proposed.

The total premium on the May 31, 2007 master file was \$182,716 higher than the amount shown on Schedule T. The Company indicated that this difference was because the premium master file is not used as the source of the total premium for financial reporting. The total premium reported on Schedule T was calculated based on premium remitted to the Company.

b. Issue Date

The issue date of the policy did not agree to support or was missing from the master file for twenty-six transactions representing 12% of the transactions in the sample.

c. Agent Premium

Agent premium entered into the master file was incorrect for ten transactions representing 4% of the transactions in the sample as a result of seven errors in source documents and three data entry errors.

d. Gross Liability

Gross liability did not agree to source documents or was blank in the master file for 2 transactions representing 1% of the transactions in the sample.

The Company is instructed to comply with: RCW 48.05.280 which requires that every insurer keep full and adequate accounts and records of its assets, obligations, transactions, and affairs; and RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the respective state statutes; and the AP&P and the 2006 NAIC Annual Statement Instructions which require properly and accurately reported financial information.

4. Reinsurance

a. Reinsurance Ceded

The Company cedes (reinsures) all risk in excess of \$2 million under an agreement with an affiliate, First American Title Insurance Company. The reinsurance treaty requires all policies with a ceded liability in excess of \$5 million to be approved by either the president or the senior underwriter at PNWTIC. If the reinsured liability exceeds \$10 million, the reinsurer must approve the policy in writing for the policy to be covered by the treaty. Twenty-six policies, representing all policies reported in 2006 with a ceded liability of \$10,000,000 or more, were reviewed. No documentation of Company or reinsurer approval was available for 6 policies, representing 23% of the items reviewed. The largest policy in 2006 was \$37,750,000. This policy was one of the policies without documentation of Company or reinsurer approval. This put the reinsurer in a position to deny coverage for non-compliance with the terms of the treaty, which would result in a net risk retention of \$32,750,000 (net of the \$5 million automatic cession without documented approvals), as compared to surplus in regards to policyholders at year-end 2006 of \$12,038,746. The Company did provide support for approval of these cessions dated July 2007.

b. Reinsurance Assumed

The Company indicated that it did not assume reinsurance during the exam period and no assumed reinsurance treaty was disclosed in Schedule F, Part 1 of the annual statement filing. Subsequent review revealed a treaty for assuming reinsurance from Law Title Insurance Company effective December 1, 2006. We reviewed Law Title Insurance Company's 2006 NAIC Annual Statement filing noting no disclosure for the reinsurance treaty with PNWTIC. However, Law Title Insurance Company did write business in

2006 and Section 2.2 of the treaty calls for automatic cessions. The 2006 NAIC Annual Statement Instructions require disclosure of reinsurance assumed treaties in Schedule F, Part 1.

There were no reports received from Law Title Insurance Company until June 2007 when two reinsurance assumed reports were received. The April report included cessions for policies written in January through March 2007 and the May report included policies written January through May of 2007. To date, no reinsurance report has included any policies for December 2006. As a result, we were unable to quantify the undisclosed liability relating to this reinsurance treaty as of December 31, 2006.

The Company is instructed to comply with RCW 48.05.280 which requires that every insurer keep full and adequate accounts and records of its assets, obligations, transactions, and affairs and RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the respective state statutes, NAIC Accounting Practices and Procedures Manual and the 2006 NAIC Annual Statement Instructions which includes properly and accurately reporting assumed and ceded reinsurance and retained liabilities.

5. Board Minutes

No issues were disclosed in any of the Company furnished meeting minutes that would materially affect the Company's December 31, 2006 statutory financial statements. However, information that should have been included in the respective minutes during the examination period, such as clarifying in the minutes the explicit decisions and ratifications made by the Board of Directors (BOD) and/or Investment Committee, were missing, incomplete, or not clearly stated, specifically:

- The BOD did not explicitly vote on appointing an actuary.
- The BOD did not explicitly adopt the actuary's report; the BOD minutes did not indicate that the appointed actuary presented the Actuary's report to the BOD, or that the Actuarial Opinion and the Actuarial Report were made available.
- The BOD did not explicitly ratify a new BOD member to join and to participate on the Board.
- The Company's Investment Committee did not ratify the decisions made by its investment custodian.
- The BOD and/or Investment Committee did not approve the two 2006 additions to the mortgage loan investment portfolio which is not managed by the investment custodian.
- The BOD and/or Investment Committee did not explicitly approve the prior year's investment report.
- The BOD did not ratify or approve the Investment Committee minutes.

The Company is instructed to:

- 1. Comply with RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in accordance with the NAIC Accounting Practices and Procedures Manual and the**

NAIC Annual Statement Instructions by keeping full and adequate accounts and records of transactions and affairs;

2. Comply with RCW 48.13.340 and RCW 48.13.350 by explicitly ratifying the investment decisions made by both the investment custodian and the Company's Investment Committee in the respective minutes;
3. Comply with WAC 284-07-050(2), WAC 284-07-060(2)(a) and WAC 284-07-350(3) by explicitly appointing an Actuary and ratifying the approval of the Actuary's reports in the minutes;
4. Comply with RCW 23B.08.100 and the Company's Bylaws Section 4.13 by affirmatively and explicitly ratifying a person filling a vacant Board of Directors or its committees' member positions;
5. Comply with RCW 23B.16.010 by keeping a record of all actions taken by the Company's shareholders or Board of Directors without a meeting and/or a record of all actions taken by a committee of the Board of Directors exercising the authority of the Board of Directors.

6. First American Trust Custodial Agreement

The investment custodial agreement between First American Trust, FSB (FAT) and PNWTIC dated November 17, 2004 referenced Pennsylvania as the Company's state of domicile instead of Washington.

The Company is instructed to comply with RCW 48.05.280, RCW 48.31B.030(1)(b)(iv), RCW 48.31B.030(1)(b)(v) and RCW 48.31B.025(2)(c)(v) by properly filing agreements for material transactions that ultimately may adversely affect the interests of the insurer's policyholders. (See Instruction No. 7.)

7. Compliance with Holding Company Act

The Custodian Services Agreement dated November 17, 2004, between First American Trust, FSB ("FAT") and Pacific Northwest Title Insurance Company, Inc., was not filed on a Form D in accordance with RCW 48.31B.030(1)(b).

RCW 48.31B.030(1)(b) requires that certain transactions involving a domestic insurer and another entity 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 the transaction and the commissioner declares the notice to be sufficient at least sixty days before, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period.

The Company is instructed to comply with RCW 48.31B.030(1)(b) and RCW 48.31B.025(2)(c)(v) by properly filing agreements subject to the Holding Company Act. (See Instruction No. 6)

8. Management Services Agreement Between the Company and Pacific Northwest Title Holding Company

Item 2 of Amendment No. 1 to Pacific Northwest Title Insurance Company, Inc. Management Services Agreement, dated June 30, 2000, between the Company and Pacific Northwest Title Holding Company (PNWTHC), Section 3.1(b) states that the Company will pay to PNWTHC the estimated monthly management services fee as determined by the agreement on a monthly basis. The Company also asserted the same circumstances in its most recent Form B filing. After reviewing the General Ledger Transactions Report for the inter-company transactions during both 2005 and 2006 between the Company and PNWTHC, the examiners noted that the Company settles its inter-company payables to PNWTHC less frequently than monthly or even on a quarterly basis. By not settling the inter-company payable with PNWTHC monthly, the Company is not following its own management services agreement. Unless interest is paid on amounts held for long periods, the inter-company payable is not fair and reasonable in compliance with RCW 48.31B.030(1)(a)(i).

This results in non-compliance with several provisions of the holding company statutes and the applicable WAC as follows: RCW 48.31B.030(1)(b)(iv) for a management agreement filed with the OIC; RCW 48.31B.030(1)(a)(iii), which requires transactions within a holding company system to be in conformity with customary insurance accounting practices consistently applied; and WAC 284-18-920 since the representations on the filed Form B were not accurate.

The Company is instructed to comply with RCW 48.31B.030(1)(a)(iii) and RCW 48.31B.030(1)(b)(iv) by paying its inter-company payables in accordance with its management services agreement filed with the OIC and with WAC 284-18-920 by certifying and filing an accurate Form B with the OIC.

9. Annual Statement Errors and Misclassifications

The results of the examination disclosed several instances in which the Company's 2006 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the 2006 NAIC Annual Statement Instructions. While the Company needs to correct these practices, none of the following items in this instruction were material to the financial statements and no examination adjustments were made.

a. Cash-Schedule E - Part 1

The Company did not comply with 2006 NAIC Annual Statement Instructions Statement for title insurers when completing Schedule E-Part 1-Cash. The 2006 NAIC Annual Statement instructions for Schedule E-Part 1 require separate listing of deposits in excess of \$100,000, but allow aggregating of deposits not exceeding \$100,000 in federally insured depositories. The Company aggregated all of its 49 accounts on one line without separately listing deposits in excess of \$100,000, as required by the NAIC Annual Statement Instructions. As a result, the required separate account disclosures for rate of interest, amount of interest received during the year, and amount of accrued interest at year-end were not included for these accounts. The five aggregated accounts with balances in excess of \$100,000 were:

- Bank of America main operating account.
- Wells Fargo Washington statutory deposit account.
- Wells Fargo Alaska statutory deposit account.
- Bank of America Columbia Funds Series Trust Money Market Reserves Advisor Class mutual fund account and,
- First American Trust account.

b. Bonds- Schedule D - Part 1

Although the fair values and parameters were listed, the Company did not complete the column for Rate Used to Obtain Fair Value for each bond as required by the 2006 NAIC Annual Statement Instructions.

c. Requirements of the NAIC Securities Valuation Office (SVO)

In the NAIC 2006 Annual Statement General Interrogatories-Part 1, page I5.3, Question 27.1, the Company stated that all the filing requirements of the Purposes and Procedures (P&P) Manual of the NAIC Securities Valuation Office (SVO) have been followed.

As detailed below, the Company had investments in money market funds and incorrectly reported these investments as cash (and included the money market fund balances in Schedule E-Part 1) instead of stocks or bonds in accordance with the NAIC SVO P&P Manual Part 4, Section 8(e):

- The Company's investment in BlackRock Fund TempFund (held in First American Trust account) and Marshall Prime Money Market Fund Class Y shares (held in Midwest Bank account) were filed with the SVO and classified by the SVO as a Class 1 bond fund.
- The Company's investment in Dreyfus Treasury Cash Management Investor (held in Wells Fargo-Washington statutory account) and Wells Fargo Advantage Fund Government Money Market Fund Service Class No. 743 (held in Wells Fargo-Alaska statutory account) were filed with the SVO and classified as a "U.S. Direct Obligations/Full Faith & Credit Exempt" bond fund.
- The Company's investment in Columbia Funds Series Trust Money Market Reserves Advisor Class, CUSIP 19765K696, which is linked to PNWTIC's primary checking/operating account at Bank of America, were not filed with the SVO. However, there was a filing for Columbia Money Market Reserves, CUSIP 19765K688, invested in the same securities as the Columbia Funds Series Trust Money Market Reserves Advisor Class. This fund was a 'Class 1' fund. Based on this, the Columbia Funds Series Trust Money Market Reserves Advisor Class should have been included on Schedule D-Part 1, Bonds.

The Washington Mutual Money Market Class A shares, CUSIP 928965714, were not filed with the SVO. The Washington Mutual Money Market fund was not found on the

NAIC Integrated Securities Information System site indicating this security was not considered filing exempt. Therefore, this security should have been filed with the NAIC SVO for 'filing exempt' consideration. Also, since this fund was not listed in either the NAIC SVO P&P Manual or in the SVO mutual fund list as of December 31, 2006, it should have been reported in Schedule D-Part 2-Section 2, Common Stock.

d. Schedule E-Part 3-Special Deposits

In the NAIC 2006 Annual Statement, Schedule E-Part 3, the Company incorrectly reported its Alaska deposit, invested in a bond fund, the Wells Fargo Advantage Government Money Market Service Fund No. 743, as stock.

e. Furniture, Fixtures, and Equipment (FFE) and Electronic Data Processing Equipment (EDP)

The Company listed \$12,275 of FFE in its 2006 NAIC Annual Statement and admitted the full amount. The Company-provided capitalized asset listing did not have any items that may be admitted for statutory purposes as outlined in RCW 48.12.020(5).

The \$12,275 included \$2,485 for a computer and two printers that could have been included as EDP; however, the EDP would still be non-admitted for statutory purposes since it does not meet the requirements of RCW 48.12.010(11).

f. Supplemental Compensation Exhibit

In the NAIC 2006 Supplemental Compensation Exhibit ("Exhibit"), Part 1, filed with the OIC, the Company did not respond to Question 1, which asks whether the Company listed its compensation amount as being paid to officers and employees either (1) by or on behalf of all companies in the group or (2) by allocation to each insurer. The Exhibit did not report any 2006 compensation for the Company's Secretary/Treasurer, who is also the President and CFO of Pacific Northwest Title Holding Company, but should have reported compensation in Part 2 of the Exhibit under either allocation method.

g. Operations and Investment Exhibit and Exhibit of Net Investment Income

In the Operations and Investment Exhibit ("O&I Exhibit"), the Company did not report its Unallocated Loss Adjustment Expenses (LAE) on Line 9 of O&I Exhibit Part 2A-Losses Paid and Incurred and in Column 5 of O&I Exhibit Part 3-Expenses. The Company also did not report its Investment Expenses in Column 7 of O&I Exhibit Part 3-Expenses and on Line 11 of the Exhibit of Net Investment Income. For investment expenses, the Company combined its investment income with investment expenses, then reported the net amount. The Company did not properly report these amounts in its NAIC Annual Statement filings during the entire examination period. We noted that First American Title Insurance Company, an affiliate, properly reported its Unallocated LAE and investment expense amounts in the O&I Exhibit on its NAIC 2006 Annual Statement.

h. Reinsurance

Reinsurance, General Interrogatories Part II, Interrogatory 3.1, asks “Has the reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on the risk or portion thereof, reinsured.” The response was incorrectly shown as “yes”.

The Company is instructed to comply with RCW 48.05.073, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the respective state statutes, NAIC Accounting Practices and Procedures Manual and the 2006 NAIC Annual Statement Instructions.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

The Company was incorporated in 1927 as Commonwealth Title Insurance Company. On March 31, 1993, the Company was purchased by Stewart Holding Company. Prior to the completion of the sales transaction, Commonwealth's assets, liabilities and equity were reduced to cash and near cash items and common stock. On January 1, 1997, Stewart Holding Company changed its name to Pacific Northwest Title Holding Company and changed the name of Commonwealth Title Insurance Company to the Company's current name of Pacific Northwest Title Insurance Company, Inc. PNWTIC did not begin to underwrite title insurance policies until 1994. On June 1, 2004, First American Corporation acquired all of the issued and outstanding shares of stock of PNWTHC, which is the owner of 81.82% of the issued and outstanding stock of Pacific Northwest Title Insurance Company. Immediately after the purchase, the First American Corporation transferred the shares to its wholly-owned subsidiary, First American Title Insurance Company (FATIC).

Capitalization

As of December 31, 2006, the Company's common capital stock, of 49,010 shares issued and outstanding, stated at par value of \$100 per share, reported in the Company's general ledger and the 2006 NAIC Annual Statement was \$4,901,000. PNWTIC was authorized to issue 100,000 common stock shares at par value of \$100 per share.

No preferred stock was authorized, issued, or outstanding as of December 31, 2006.

Territory and Plan of Operation

The Company's Certificates of Authority authorize the Company to transact general abstract and title insurance business in the states of Alaska, Arizona, Idaho, Illinois, Indiana, Oregon, Rhode Island, Texas, Utah and Washington. The Company's agents have issued title insurance policies in Washington, Alaska, Oregon, and Idaho since 1999. In 2006, agents started issuing title policies in Illinois, Indiana, Utah, and Iowa. Iowa does not require the issue of licenses to title insurance companies.

The Company's underwriting agreement with agents states that the Company assumes substantially all liability for losses incurred under title policies issued. The benefits received for the underwriting protection is generally ten percent (10%) of the title insurance fees earned on these policies. Some restrictions on liability appear as agents are responsible for the first \$1,000 up to \$3,500 of losses incurred on a policy, depending on their agency agreement.

Revenues received from Washington agents represented approximately 72% of the title premium written during 2006. Revenues received from affiliated agents during 2006 totaled approximately 80% of the total premiums written.

Growth of Company

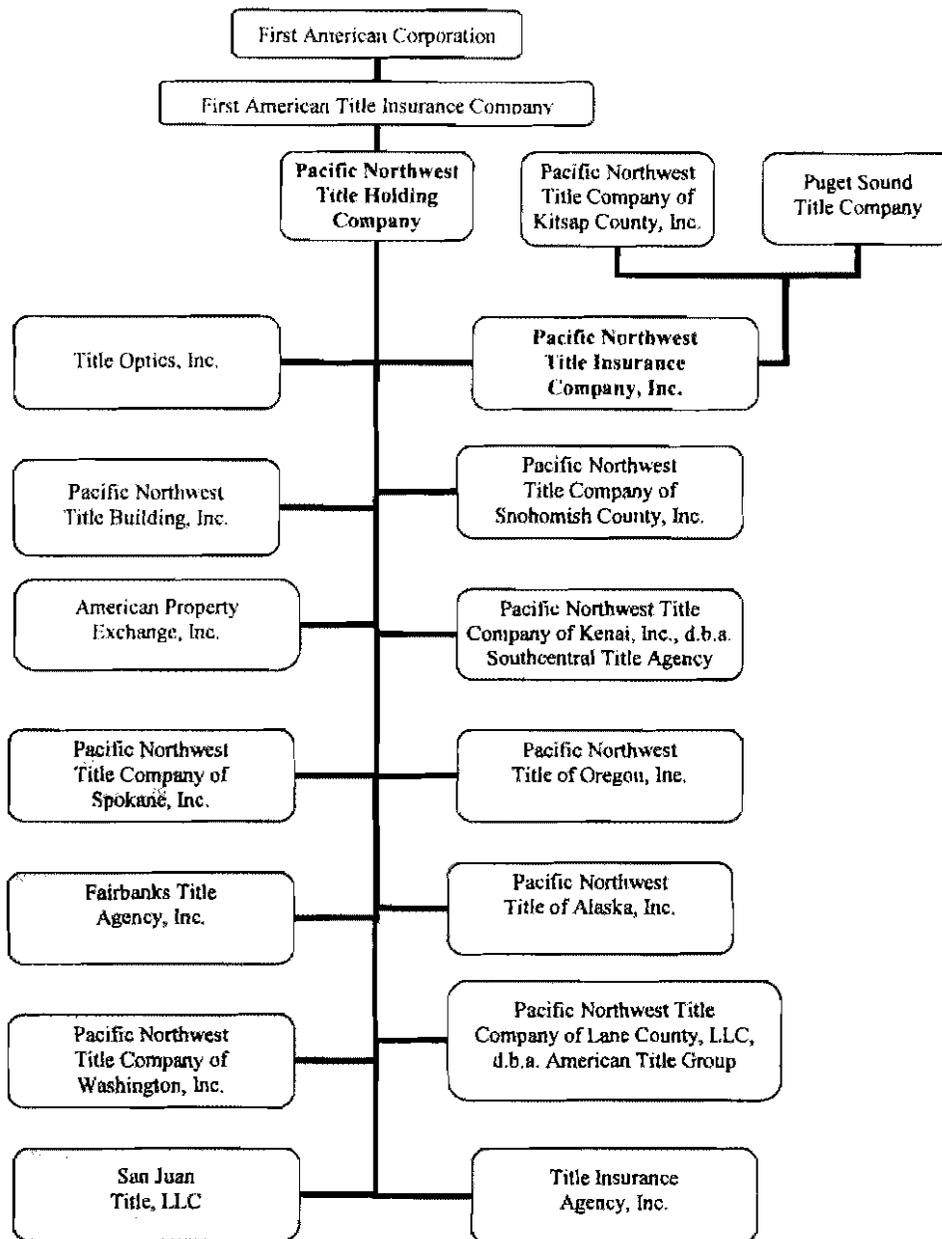
The following schedules include the Company's growth and results of operations as reported in the Company's filed annual statements:

| Year | Admitted Assets | Liabilities | Capital & Surplus |
|-------------|----------------------------|--------------------|----------------------------------|
| 2006 | \$28,902,462 | \$16,863,716 | \$12,038,746 |
| 2005 | 26,568,841 | 17,599,536 | 8,969,305 |
| 2004 | 24,983,428 | 17,106,842 | 7,876,586 |
| 2003 | 22,694,060 | 16,185,015 | 6,509,045 |
| 2002 | 18,475,584 | 11,809,408 | 6,666,176 |

| Year | Operating Income | Net Operating Gain (Loss) | Net Investment Gain (Loss) | Net Income |
|-------------|-----------------------------|--------------------------------------|---------------------------------------|-------------------|
| 2006 | \$62,284,469 | \$3,512,980 | \$1,177,031 | \$2,933,135 |
| 2005 | 50,744,995 | 1,356,376 | 758,213 | 864,768 |
| 2004 | 52,155,625 | 1,295,371 | 327,686 | 1,071,218 |
| 2003 | 71,247,691 | (375,575) | 273,034 | (4,640) |
| 2002 | 56,484,141 | (196,510) | 574,896 | 171,593 |

Affiliated Companies

As indicated earlier, PNWTHC owns 81.82% of PNWTIC. As a member of an insurance holding company system, the Company is required to file registration statements in accordance with RCW 48.31B.025 and WAC 284-18-300. PNWTIC filed the registration statements for each year under examination on behalf of the Company.



Shaded boxes above are affiliated agency companies that have agency agreements with PNWTIC. Affiliated agency companies produced approximately 80% of direct written premiums in 2006.

Intercompany Contracts

The following intercompany contracts were in-force as of December 31, 2006:

- Management Services Agreement with PNWTHC dated August 1994.
- Tax Allocation Agreement with PNWTHC dated October 23, 2002.
- Custodial Agreement with First American Trust dated November 17, 2004.

- Agency Agreements with twelve affiliated agents.

MANAGEMENT AND CONTROL

Ownership

As of December 31, 2006, the Company's stock was owned by:

- Pacific Northwest Title Holding Company 81.82%
- Puget Sound Title Company 7.78%
- Pacific Northwest Title Company of Kitsap, Inc. 3.07%
- Other shareholders 7.33%

Board of Directors

Directors of the Company as of December 31, 2006 were as follows:

James R. Gill, Chairman
 Curt A. Caspersen
 Donald R. Kirkland
 Roger L. Johnson
 Raymond L. Davis
 Carl W. Ronhaar
 Gary L. Kermott
 John F. Clearman
 Mark A. Tolimson
 William O. Carter

Investment Committee

Investment Committee members as of December 31, 2006 were as follows:

James Gill, Chairman
 Don Kirkland
 Roger L. Johnson
 Pete Murphy
 Raymond Davis

Officers

Officers of the Company as of December 31, 2006 were as follows:

| <u>Name</u> | <u>Position</u> |
|-----------------------|----------------------|
| Raymond L. Davis | President |
| James R. Gill | Secretary/ Treasurer |
| Donald R. Kirkland | Vice-President |
| Roger L. Johnson | Vice-President |
| Mark A. Tolimson | Vice- President |
| William O. Carter | Vice- President |
| Michael V. Gilbertson | Vice- President |

Conflict of Interest

The Company has a policy that requires all directors and officers to complete a conflict of interest statement annually. The purpose of the statement is to detect any activities or participation on the part of directors or officers that could possibly be interpreted as having the appearance of a conflict of interest. No exceptions were disclosed by the Company.

Fidelity Bond and Other Insurance

PNWTIC, through PNWTHC, has a \$1 million single loss limit fidelity insurance coverage. The Company also has additional \$5 million aggregate fidelity bond support through First American Corporation, which covers all of First American subsidiaries. The fidelity coverage carried by the Company exceeds the NAIC minimum recommended amount.

The Company was also a named insured on various other property and liability insurance coverages issued to First American Corporation.

Officer's, Employees', and Agents' Welfare and Pension Plans

As of December 31, 2006, the Company had six employees. Employee retirement and deferred compensation arrangements are offered through the Company's ultimate parent, First American Corporation. The Company has no legal obligation for benefits under these plans.

The Company did not have any retirement, post retirement, or deferred compensation arrangements in place for its title agents as of December 31, 2006.

CORPORATE RECORDS

The examination and review of corporate records disclosed that the Company maintains and files the minutes of the Board of Directors meetings and maintains a conflict of interest policy among the officers and members of the Board of Directors of the Company. The Company maintains the minutes of the shareholders annual and regular meetings. However, several discrepancies in the BOD minutes were disclosed as a result of the examination. (See Instruction No. 5.)

STATUTORY PREMIUM RESERVE AND THE RESERVE FOR KNOWN CLAIMS

The actuarially determined estimate of total reserves, which include reserves for known claims and Incurred But Not Reported (IBNR) claims was calculated by Milliman Consultants and Actuaries and reviewed and determined to be reasonable by the Company's auditors, PricewaterhouseCoopers. The Company's total reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2006 NAIC Annual Statement.

For title companies, the sum of the statutory premium reserve and the reserve for known claims (excluding IBNR), must be greater than the actuarially determined estimate of total reserves, which include IBNR. If this is not the case, the title company must book additional reserves.

The sum of the adjusted statutory premium reserve (See Instruction No. 1) and the reserve for known claims was greater than the actuarially determined estimate of total reserves.

REINSURANCE

The Company cedes all risk in excess of \$2 million, under one reinsurance contract with an affiliated company, First American Title Insurance Company. Premiums ceded under this treaty during 2006 were \$134,739. The Company entered a reinsurance agreement to assume a portion of direct business written by an underwriter in the state of Illinois during December 2006; however, no 2006 activity related to this treaty was reported through the end of fieldwork of this examination. (See Instruction No. 4.)

STATUTORY DEPOSITS

The Company maintained the following statutory deposits as of December 31, 2006:

| <u>Location</u> | <u>Description of Assets</u> | <u>Book Value</u> | <u>Market Value</u> |
|-----------------|----------------------------------|-----------------------|-------------------------|
| Alaska | Bonds | \$550,000 | \$550,000 |
| Illinois | Bonds | 1,077,528 | 1,063,823 |
| Oregon | Bonds | 110,493 | 108,402 |
| Washington | Bonds | 1,205,101 | 1,194,279 |
| Total | | <u>\$2,943,122</u> | <u>\$2,916,504</u> |

Securities held by the state of Washington and other states were confirmed directly with the Company's authorized custodians.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. Subsequent to the First American purchase, the CPA performing the statutory audit was changed from Ernst & Young LLP to the CPA firm used by First American, PricewaterhouseCoopers. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of Pacific Northwest Title Insurance Company is sufficiently knowledgeable of the information systems process. Systems development, acquisition and maintenance controls were evaluated to gain assurance that appropriate internal controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating

systems and proprietary software in use; back up and recovery facilities employed and the internal controls exercised to maintain data security. Except as noted in Instruction 3, the Company has sufficient internal controls in place to monitor system activity and processes.

PNWTIC has a formal, written disaster recover plan for the restoration of the information system and a formal, written business continuity plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities, as recommended by NAIC guidelines.

SUBSEQUENT EVENTS

There were no material events impacting the Company between the examination date and the last day of our field work.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report comments or recommendations were satisfactorily addressed.

FINANCIAL STATEMENTS

The following examination financial statements show the financial conditions of Pacific Northwest Title Insurance Company, Inc., as of December 31, 2006:

Assets and Liabilities
Statement of Income
Reconciliation of Surplus for the Period Since the Last Examination
Analysis of Changes in Financial Statements Resulting from the Examination

Pacific Northwest Title Insurance Company, Inc.
Assets, Liabilities, Surplus and Other Funds
December 31, 2006

| Assets | Balance Per Company | Examination Adjustments | Balance Per Examination | Notes |
|---|------------------------|----------------------------|----------------------------|--------|
| Bonds | \$13,891,263 | \$1,156,098 | \$15,047,361 | A2 |
| Preferred stocks | 1,013,863 | | 1,013,863 | |
| Mortgage loans on real estate | 2,102,038 | | 2,102,038 | |
| Cash and short-term investments | 8,545,341 | (3,137,415) | 5,407,927 | A2 |
| Subtotal, cash and invested assets | 25,552,505 | (1,981,317) | 23,571,188 | |
| Title Plants | 1,525,000 | | 1,525,000 | |
| Investment income due and accrued | 131,080 | | 131,080 | |
| Uncollected premiums and agents' balances | 1,445,166 | | 1,445,166 | |
| Net deferred tax asset | 224,953 | (12,720) | 212,234 | A1 |
| Furniture and equipment | 12,275 | | 12,275 | |
| Receivables from parent, subs and affiliates | 10,482 | | 10,482 | |
| Underwriter License | 1,000 | | 1,000 | |
| Total Assets | \$28,902,462 | (\$1,994,037) | \$26,908,425 | |
| Liabilities, Surplus and other Funds | | | | |
| Known claims reserve | \$783,796 | \$0 | \$783,796 | |
| Statutory premium reserve | 13,908,737 | (1,354,842) | 12,553,895 | A1 |
| Commissions and other charges due agents | 426,648 | | 426,648 | |
| Taxes, licenses and fees (excluding FIT) | 118,722 | | 118,722 | |
| Other expenses | 40,433 | | 40,433 | |
| Current federal and foreign income taxes | 1,554,911 | 423,613 | 1,978,524 | A1 |
| Funds held under reinsurance treaties | 28,444 | | 28,444 | |
| Payable to parent, subsidiaries and affiliates | 2,025 | | 2,025 | |
| Total Liabilities | 16,863,716 | (931,229) | 15,932,487 | |
| Common capital stock | 4,901,000 | | 4,901,000 | |
| Gross paid in and contributed surplus | 1,659,393 | | 1,659,393 | |
| Unassigned funds (surplus) | 5,478,353 | (1,062,808) | 4,415,545 | A1, A2 |
| Surplus as regards policyholders | 12,038,746 | (1,062,808) | 10,975,938 | |
| Total Liabilities, Surplus and other Funds | \$28,902,462 | (\$1,994,037) | \$26,908,425 | |

Pacific Northwest Title Insurance Company, Inc.
Statement of Income and Capital and Surplus Account
For the Year Ended December 31, 2006

| | Balance Per Company | Examination Adjustments | Balance Per Examination | Notes |
|---|------------------------|----------------------------|----------------------------|-------|
| Operating Income | | | | |
| Title Insurance premiums earned | \$62,209,469 | \$1,354,842 | \$63,564,311 | A1 |
| Title Plant Income | 75,000 | | 75,000 | |
| Total Operating Income | 62,284,469 | 1,354,842 | 63,639,311 | |
| Deductions | | | | |
| Losses incurred | 1,230,338 | | 1,230,338 | |
| Operating expenses incurred | 57,541,151 | | 57,541,151 | |
| Total underwriting deductions | 58,771,489 | 0 | 58,771,489 | |
| Net operating gain or (loss) | 3,512,980 | 1,354,842 | 4,867,822 | |
| Investment Income | | | | |
| Net investment income earned | 1,210,323 | | 1,210,323 | |
| Net realized capital gains or (losses) | (33,292) | | (33,292) | |
| Net investment gain or (loss) | 1,177,031 | 0 | 1,177,031 | |
| Net Income after capital gains tax before FIT | 4,690,011 | 1,354,842 | 6,044,853 | A1 |
| Federal Income taxes incurred | 1,756,876 | 423,613 | 2,180,489 | A1 |
| Net Income | \$2,933,135 | \$931,229 | \$3,864,364 | |
| Capital and Surplus Account | | | | |
| Prior year surplus | \$8,969,305 | \$0 | \$8,969,305 | |
| Net income | 2,933,135 | 931,229 | 3,864,364 | A1 |
| Change in net deferred income tax | (258,042) | (12,719) | (270,761) | A1 |
| Change in nonadmitted assets | 212,918 | (1,981,317) | (1,768,399) | A2 |
| Paid in Capital | 188,636 | | 188,636 | |
| Paid in Surplus | (7,205) | | (7,205) | |
| Change in surplus for the year | 3,069,441 | (1,062,808) | 2,006,633 | |
| Current year surplus | \$12,038,746 | (\$1,062,808) | \$10,975,938 | |

Pacific Northwest Title Insurance Company, Inc.
Reconciliation of Surplus for the Period since Last Examination
For the Years Ended December 31,

| | 2002 | 2003 | 2004 | 2005 | 2006 |
|-----------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|----------------------------|
| Prior year surplus | \$6,961,283 | \$6,666,176 | \$6,509,045 | \$7,876,586 | \$8,969,305 |
| Net income | 171,593 | (4,640) | 1,071,218 | 864,768 | 2,933,135 |
| Change in net deferred income tax | 39,835 | (63,046) | (119,861) | 738,375 | (258,042) |
| Change in non-admitted assets | 0 | (273,690) | 113,342 | (671,974) | 212,918 |
| Paid in capital | 104,075 | 184,245 | 302,842 | 161,328 | 188,636 |
| Paid in surplus adjustment | | | | 222 | (7,205) |
| Dividends to stockholders (cash) | (610,610) | | | | |
| Examination adjustments | | 0 | 0 | 0 | (1,062,808) |
| Change in surplus for the year | <u>(295,107)</u> | <u>(157,131)</u> | <u>1,367,541</u> | <u>1,092,719</u> | <u>2,006,633</u> |
| Current year surplus | <u><u>\$6,666,176</u></u> | <u><u>\$6,509,045</u></u> | <u><u>\$7,876,586</u></u> | <u><u>\$8,969,305</u></u> | <u><u>\$10,975,938</u></u> |

Pacific Northwest Title Insurance Company, Inc.
 Analysis of Changes in Financial Statements Resulting from the Examination
 December 31, 2006

| | Balance Per Company | Balance Per Examination | Notes | Increase (Decrease) In Surplus | Total |
|---|------------------------|----------------------------|-------|--------------------------------------|---------------------|
| Capital and Surplus, 12/31/2006 Per Annual Statement | | | | | \$12,038,746 |
| <u>Assets</u> | | | | | |
| Bonds | \$13,891,263 | \$15,047,361 | A2 | \$1,156,098 | |
| Cash and short term investments | 8,545,341 | 5,407,926 | A2 | (3,137,415) | |
| Net deferred tax asset | 224,953 | 212,234 | A1 | (12,719) | |
| <u>Liabilities</u> | | | | | |
| Statutory premium reserve | 13,908,737 | 12,553,895 | A1 | (1,354,842) | |
| Current federal income taxes | 1,554,911 | 1,978,524 | A1 | 423,613 | |
| Change in surplus | | | | | (1,062,808) |
| Capital and Surplus, 12/31/2006 Per Examination | | | | | \$10,975,938 |

NOTES TO THE FINANCIAL STATEMENTS

The Company has no special consents, permitted practices, or orders from the state of Washington.

Examination adjustments were as follows:

A1. Statutory Premium Reserve

The calculation of the statutory premium reserve was overstated by \$1,354,842. This overstatement resulted from the change in accruals not being recognized in prior years for premiums written but not yet reported, and improper rates applied to premiums for policies with a net retained liability of \$500,000 or greater subsequent to July 24, 2005. RCW 48.29.120(2)(a)(ii)(B) requires the reserve for policies with a net retained liability of \$500,000 or greater to be ten cents per thousand after July 24, 2005. The Company used a rate of fifteen cents per thousand for these policies.

This adjustment was posted as a decrease to the "Statutory Premium Reserve" and "Current Federal Income Taxes" accounts as of December 31, 2006. The Company booked the entry in the second quarter 2006 NAIC Quarterly Statement. (See Instruction No. 1)

A2. Investment in One Fund Exceeded the Statutory Limit of 4% of Assets

The investment in the Columbia Funds Series Trust Money Market Reserves was reported as Cash and Short Term Investments. This fund should have been reported on Schedule D-Part 1, Bonds. This adjustment includes the reclassification of \$3,137,415 from Cash and Short Term Investments to Bonds.

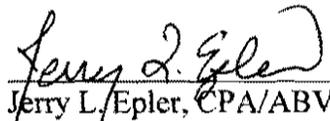
The fund shares are subject to RCW 48.13.030(1), which requires non-admitting certain investments in one security exceeding 4% of the insurer's assets. This adjustment includes non-admitting the \$1,981,317 in excess of the 4% limitation of the reclassified bonds. (See Instruction No. 2)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Pacific Northwest Title Insurance Company, Inc., during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timoteo L. Navaja, CFE, CIE, Property and Casualty Field Supervisor; Randy E. Fong, Financial Examiner; and John Jacobson, AFE, CISA, AES, Automated Examination Specialist, all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



Jerry L. Epler, CPA/ABV, CFE
Examiner in Charge
State of Washington

