

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
SAFECO INSURANCE COMPANY OF AMERICA  
SEATTLE, WASHINGTON

NAIC CODE 24740  
December 31, 2009

Participating States:  
Washington  
Indiana  
Illinois

Safeco Insurance Company of America  
Order No. 11-154  
Exhibit A

**SALUTATION**

Seattle, Washington  
June 21, 2011

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

The Honorable Joseph Torti, III  
Chair, NAIC Financial Condition (E) Committee  
Superintendent  
State of Rhode Island  
Department of Business Regulation  
Division of Insurance  
1511 Pontiac Avenue, Building 69-2  
Cranston, RI 02920

The Honorable Monica J. Lindeen  
NAIC Secretary, Western Zone  
Commissioner  
Montana Office of the Commissioner of Securities and Insurance  
840 Helena Avenue  
Helena, MT 59601

Dear Commissioners and Superintendent:

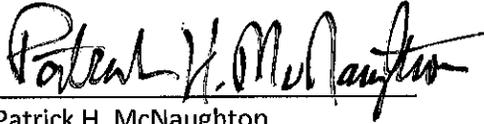
In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

**Safeco Insurance Company of America**  
of  
Seattle, Washington

hereinafter referred to as "SICA," or the "Company" at the home office of the Liberty Mutual group of companies (Liberty Mutual) located at 175 Berkeley Street, Boston, Massachusetts 02116. This report is respectfully submitted showing the financial condition and related corporate matters of SICA as of December 31, 2009.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Financial Examination of Safeco Insurance Company of America of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2009.



Patrick H. McNaughton  
Chief Examiner

6-21-2011

Date

**TABLE OF CONTENTS**

<b>SCOPE OF THE EXAMINATION .....</b>	<b>1</b>
<b>INSTRUCTIONS .....</b>	<b>1</b>
<b>COMMENTS AND RECOMMENDATIONS.....</b>	<b>2</b>
<b>COMPANY PROFILE .....</b>	<b>2</b>
Company History .....	2
Capitalization .....	2
Territory and Plan of Operation .....	3
Growth of Company .....	3
Affiliated Companies .....	4
Intercompany Agreements.....	4
<b>MANAGEMENT AND CONTROL .....</b>	<b>5</b>
Board of Directors (BOD).....	5
Officers .....	5
Conflict of Interest.....	5
Fidelity Bond and Other Insurance.....	5
Officers', Employees', and Agents' Welfare and Pension Plans.....	5
<b>CORPORATE RECORDS .....</b>	<b>6</b>
<b>UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES .....</b>	<b>6</b>
<b>REINSURANCE .....</b>	<b>6</b>
<b>STATUTORY DEPOSITS .....</b>	<b>7</b>
<b>ACCOUNTING RECORDS AND INFORMATION SYSTEM .....</b>	<b>7</b>
<b>SUBSEQUENT EVENTS.....</b>	<b>7</b>
<b>FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS.....</b>	<b>8</b>
<b>FINANCIAL STATEMENTS .....</b>	<b>8</b>
Assets, Liabilities, Surplus and Other Funds.....	9
Statement of Income and Capital and Surplus Account.....	10
Four Year Reconciliation of Surplus.....	11
<b>NOTES TO THE FINANCIAL STATEMENTS .....</b>	<b>12</b>
<b>ACKNOWLEDGMENT.....</b>	<b>13</b>
<b>AFFIDAVIT .....</b>	<b>14</b>

## SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2006 through December 31, 2009 and comprises a risk focused review of the books and records of the Company. The examination followed statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of field work on April 13, 2011.

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 section of this report. In addition, the Company's Certified Public Accountants' (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2009 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

This examination was classified as a coordinated lead state examination. Indiana was designated the lead state of the coordinated examination and examiners from the states of Washington, Indiana, and Illinois participated and assessed the financial condition and corporate affairs of the Company.

## INSTRUCTIONS

The examiners reviewed the Company's filed 2009 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 outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exception noted while performing this review:

### **1. Bank Accounts Not in the Company's Name**

SICA included two bank accounts in its total year-end 2009 cash balance that were legal assets of its two affiliates. The balances of the two bank accounts totaling \$435,533 were reported in error by SICA on its 2009 NAIC Annual Statement, Schedule E-Part 1-Cash. No examination adjustment was necessary due to immateriality.

**The Company is instructed to comply with RCW 48.05.073, RCW 48.05.250, WAC 284-07-050(2), RCW 48.13.020(1), and SSAP 4, paragraph 2(b), by excluding from the NAIC Annual Statement assets that are not registered, recorded, or held under the insurer's name.**

## **2. Amended and Restated Reinsurance Pooling Agreement**

On January 1, 2009, all of SICA's reinsurance agreements were assigned to the lead pool company, Peerless Insurance Company (PIC), as part of the Amended and Restated Reinsurance Pooling Agreement, Article II, Section 202, and the accounts were reported by PIC in 2009. However, the original reinsurance treaties were not changed to reflect the assignment to PIC nor were the activities under the treaties reported in Schedule F of the Company's 2009 NAIC Annual Statement.

**The Company is instructed pursuant to RCW 48.05.280 to adequately disclose the details of the intercompany reinsurance arrangement in the NAIC Annual Statement, Notes to Financial Statements, to accurately reflect the assignment to PIC and to report the legal nature and transfer of liabilities.**

### **COMMENTS AND RECOMMENDATIONS**

None

### **COMPANY PROFILE**

#### **Company History**

The Company was incorporated on September 2, 1953 under the laws of the state of Washington as a stock multiple line property and casualty insurer. The Company operated under the name Selective Auto and Fire Insurance Company of America until November 2, 1953 at which time the present name was adopted. The Company is authorized to write property, inland marine, general casualty, vehicle, surety, and ocean marine insurance.

As of December 31, 2009, SICA was wholly-owned by its parent, Safeco Corporation. On September 22, 2008, all of the outstanding and issued common stock shares of Safeco Corporation were acquired by LIH US P&C Corporation, a Delaware corporation and a direct wholly-owned subsidiary of Liberty Insurance Holdings, Inc. (LIHI), which in turn is a Delaware corporation that at the time was more than 93% owned by Liberty Mutual Insurance Company (LMIC), a Massachusetts domiciled stock insurance company and an indirect, wholly-owned subsidiary of Liberty Mutual Holding Company Inc. (LMHC), with the remaining percentage of LIHI owned by other indirect, wholly-owned subsidiaries of LMHC.

#### **Capitalization**

As of December 31, 2009, the Company's authorized capital was \$5 million, which consisted of 20,000 shares of issued and outstanding common stock at a par value of \$250 per share and all authorized shares were issued and outstanding. Total capital and surplus as of December 31, 2009 was \$1,147,111,899.

There has been no change in the par value or the number of issued and outstanding common shares of the Company since the last examination.

### **Territory and Plan of Operation**

SICA is licensed in all 50 states and Guam. For 2009, the Company's direct business consisted of approximately 35 percent auto, 30 percent homeowners multiple peril and 19 percent surety. Over 52 percent of SICA's direct written premiums were in the states of California, Washington, Colorado, Texas and Kansas.

The Company was a participant with PIC and other Liberty Mutual affiliated insurance companies in the Amended and Restated Reinsurance Pooling Agreement, where the mix of business for the pooled companies was approximately 50 percent commercial lines, 43 percent personal, and 7 percent surety, based on net earned premiums.

With over 57,000 appointed independent agents and brokers nationwide (including over 2,300 in Washington State), SICA is part of Liberty Mutual's Agency Markets (Agency Markets) strategic business unit. Claim offices are maintained throughout the United States to service the Company's claimants.

### **Growth of Company**

The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the four year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	
2009	\$4,327,404,574	\$3,180,292,675	\$1,147,111,899	
2008	3,952,233,210	3,182,407,771	769,825,439	
2007	4,067,248,117	3,228,637,423	838,610,694	
2006	4,522,038,349	3,366,636,926	1,155,401,423	

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2009	\$1,592,432,536	\$ 66,785,318	\$124,731,040	\$104,390,474
2008	1,824,806,360	48,607,927	144,513,610	163,816,762
2007	1,845,356,857	119,854,947	189,293,143	248,386,112
2006	1,856,252,474	214,562,522	177,961,936	288,841,310

## Affiliated Companies

The following is an abbreviated organization chart as of December 31, 2009:



SICA is a wholly-owned subsidiary of Safeco Corporation, a non-insurance holding company incorporated under the laws of the state of Washington. In turn, Safeco Corporation is controlled by its ultimate parent, LMHC, a non-publicly traded corporation incorporated under the laws of the state of Massachusetts.

## Intercompany Agreements

As of December 31, 2009, the Company had the following intercompany agreements in force, with the effective date indicated:

Intercompany Short-Term Borrowing Agreement	November 1, 2007
Federal Tax Sharing Agreement (Amendment No. 4)	September 22, 2008
Investment Management Agreements	September 22, 2008
Cash Management Agreement	September 22, 2008
Management Services Agreement	January 1, 2009
Amended and Restated Reinsurance Pooling Agreement (Endorsement No. 2)	January 1, 2009
Services Agreement (Amendment No. 7)	January 1, 2009

## MANAGEMENT AND CONTROL

### **Board of Directors (BOD)**

Directors of the Company as of December 31, 2009:

Gary R. Gregg	Chairman of the Board
John D. Doyle	
Michael J. Fallon	
Joseph A. Gilles	
Scott R. Goodby	
Christopher C. Mansfield	

### **Officers**

Officers of the Company as of December 31, 2009:

Gary R. Gregg	President and Chief Executive Officer
Michael J. Fallon	Chief Financial Officer and Treasurer
Anthony A. Fontanes	Chief Investment Officer and Executive Vice President
Joseph A. Gilles	Executive Vice President
Scott R. Goodby	Chief Operating Officer and Executive Vice President
Dexter R. Legg	Secretary

### **Conflict of Interest**

All BOD and officers signed a Conflict of interest Statement as of December 31, 2009. The purpose of the statement is to detect any activities or participation on the part of the BOD and officers that could possibly be interpreted as a conflict of interest. No exceptions were noted during our review.

### **Fidelity Bond and Other Insurance**

The Company is a named insured under a financial institution bond that provides \$15 million of directors' and officers' liability insurance issued to LMHC and its subsidiaries. The fidelity coverage carried by the Company exceeds the NAIC minimum recommended amount.

The Company was also a named insured on various insurance policies issued to LMHC and its subsidiaries that provided property coverage for buildings and contents and comprehensive commercial general liability. These policies were in effect during the period covered by this examination and provided coverage for the Company.

### **Officers', Employees', and Agents' Welfare and Pension Plans**

The Company does not have any direct employees, so it does not have any direct obligations for a defined benefit plan, deferred compensation arrangement, compensated absences or other post retirement benefit plans.

Liberty Mutual offers its eligible full-time and part-time employees medical, dental and vision coverage; disability insurance; employee and dependent life insurance and accidental death and dismemberment coverage; retirement benefit plan; and an opportunity to participate in the 401(k) savings plan. Long term care insurance is also offered.

### **CORPORATE RECORDS**

The Company's Articles of Incorporation, Bylaws, and minutes of the BOD and committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes.

### **UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES**

<b><u>Year</u></b>	<b><u>Losses</u></b>	<b><u>Loss Adjustment Expenses</u></b>
2009	\$1,428,845,322	\$340,182,924
2008	1,279,500,807	298,266,655
2007	1,260,744,966	300,168,984
2006	1,245,291,499	317,949,016

As shown above, the reserves carried by the Company for unpaid losses and loss adjustment expenses were \$1,428,845,322 and \$340,182,924, respectively, as of December 31, 2009.

The actuarial consulting firm contracted by the Indiana Department of Insurance, Merlinos & Associates, Inc., reviewed the unpaid losses and loss adjustment expense reserves of the Peerless Insurance Company Pool (Peerless Pool), which includes SICA, and concluded that the reserves for the insurance companies in the Peerless Pool were within a range of reasonable estimates. Therefore, the Company's loss and loss adjustment expense reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2009 NAIC Annual Statement.

### **REINSURANCE**

In accordance with the Peerless Pool's intercompany Amended and Restated Reinsurance Pooling Agreement, SICA cedes 100 percent of its business to PIC before PIC retrocedes to SICA its 15.2 percent pool participation percentage. In its 2009 NAIC Annual Statement, SICA reported \$1,638,380,972 net premiums written and \$658,259,823 net paid losses. As of December 31, 2009, the Company had \$81,169,230 in aggregate unsecured amounts recoverable from PIC.

### **STATUTORY DEPOSITS**

The Company maintained the following statutory deposits as of December 31, 2009:

<b><u>State</u></b>	<b><u>Type</u></b>	<b><u>Book Value</u></b>	<b><u>Fair Value</u></b>
Arizona	Bond	\$ 5,354,698	\$ 6,361,745
California	Bond	88,211,186	93,282,918
Delaware	Bond	94,812	112,554
Georgia	Bond	164,890	195,746
Idaho	Bond	411,917	433,028
Massachusetts	Bond	494,671	587,238
Nevada	Bond	103,056	122,341
New Mexico	Bond	329,781	391,492
North Carolina	Bond	359,682	361,004
Oregon	Bond	13,853,387	14,430,460
Washington	Bond	3,689,409	4,058,600
<b>Total</b>		<b><u>\$113,067,489</u></b>	<b><u>\$120,337,126</u></b>

### **ACCOUNTING RECORDS AND INFORMATION SYSTEM**

The Company maintains its accounting records on a Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young LLP. 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 Company's Information Technology (IT) environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT systems and controls were evaluated to gain an understanding of general IT control risks and assess the effectiveness of these controls. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels.

### **SUBSEQUENT EVENTS**

On March 31, 2010, Safeco Corporation transferred by capital contribution its 100 percent ownership of Safeco Insurance Company of Illinois (SICIL), an affiliated insurance company incorporated under the laws of the state of Illinois, to SICA. SICIL was contributed at statutory book value, at the date of transfer, in the amount of \$224,812,072. Concurrently, Safeco Corporation contributed its 100 percent

ownership of another affiliated insurance company incorporated under the laws of the state of Washington, First National Insurance Company of America (FNICA), to SICIL at statutory book value, which resulted in FNICA becoming an indirect subsidiary of SICA.

Effective April 14, 2010, LIH US P&C Corporation, the parent of Safeco Corporation, was renamed Liberty Mutual Agency Corporation.

On February 1, 2011, the BOD voted to accept Gary R. Gregg's resignation as the Chairman of the BOD, President and Chief Executive Officer, and Director of the Company. J. Paul Condrin, III, President of Liberty Mutual's Commercial Markets strategic business unit, was elected to take Mr. Gregg's place until the next annual meeting or until his successor is elected.

There were no additional 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 instructions and comments have been addressed and corrected.

#### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of Safeco Insurance Company of America as of December 31, 2009:

Assets, Liabilities, Surplus and Other Funds  
Statement of Income and Capital and Surplus Account  
Four Year Reconciliation of Surplus

**Safeco Insurance Company of America**  
**Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2009**

	Balance Per Company	Examination Adjustments	Balance Per Examination
<b>Assets</b>			
Bonds	\$2,928,288,834	\$0	\$2,928,288,834
Stocks			
Preferred stocks	53,009,802		53,009,802
Common stocks	127,831,429		127,831,429
Mortgage loans on real estate			
First liens	30,292,503		30,292,503
Cash, cash equivalents, and short-term investments	328,466,595		328,466,595
Other invested assets	78,516,945		78,516,945
<b>Subtotals, cash and invested assets</b>	<b>3,546,406,108</b>	<b>0</b>	<b>3,546,406,108</b>
Investment income due and accrued	38,227,938	0	38,227,938
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	60,221,355		60,221,355
Deferred premiums, agents' balances and installments booked but deferred and not yet due	427,601,133		427,601,133
Accrued retrospective premiums	2,482,113		2,482,113
Amounts recoverable from reinsurers	81,169,230		81,169,230
Current federal and foreign income tax recoverable and interest thereon	12,325,682		12,325,682
Net deferred tax asset	133,154,300		133,154,300
Guaranty funds receivable or on deposit	2,814,086		2,814,086
Electronic data processing equipment and software	8,201,700		8,201,700
Receivables from parent, subsidiaries and affiliates	1,884,616		1,884,616
Aggregate write-ins for other than invested assets	12,916,313		12,916,313
<b>Total Assets</b>	<b>\$4,327,404,574</b>	<b>\$0</b>	<b>\$4,327,404,574</b>
<b>Liabilities, Surplus and Other Funds</b>			
Losses	\$1,428,845,322	\$0	\$1,428,845,322
Reinsurance payable on paid losses and loss adjustment expenses	92,116,680		92,116,680
Loss adjustment expenses	340,182,924		340,182,924
Commissions payable, contingent commissions and other similar charges	40,489,072		40,489,072
Other expenses	48,066,199		48,066,199
Taxes, licenses and fees	14,570,798		14,570,798
Current federal and foreign income taxes			0
Unearned premiums	699,372,386		699,372,386
Advance premium	4,978,188		4,978,188
Dividends declared and unpaid: Policyholders	1,290,476		1,290,476
Ceded reinsurance premiums payable	122,040,162		122,040,162
Amounts withheld or retained by company for account of others	(662,266)		(662,266)
Drafts outstanding	49,946,080		49,946,080
Payable to parent, subsidiaries and affiliates	206,947,023		206,947,023
Payables for securities	10,807,518		10,807,518
Aggregate write-ins for liabilities	121,302,113		121,302,113
<b>Total Liabilities</b>	<b>3,180,292,675</b>	<b>0</b>	<b>3,180,292,675</b>
Aggregate write-ins for special surplus funds	23,709,935		23,709,935
Common capital stock	5,000,000		5,000,000
Gross paid in and contributed surplus	346,118,108		346,118,108
Unassigned funds (surplus)	772,283,856		772,283,856
<b>Surplus as regards policyholders</b>	<b>1,147,111,899</b>	<b>0</b>	<b>1,147,111,899</b>
<b>Total Liabilities, Surplus and Other Funds</b>	<b>\$4,327,404,574</b>	<b>\$0</b>	<b>\$4,327,404,574</b>

**Safeco Insurance Company of America**  
**Statement of Income and Capital and Surplus Account**  
**For the Year Ended December 31, 2009**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Underwriting Income</b>			
Premiums earned	\$1,592,432,536	\$0	\$1,592,432,536
<b>Deductions</b>			
Losses incurred	807,604,342		807,604,342
Loss adjustment expenses incurred	189,069,582		189,069,582
Other underwriting expenses incurred	528,724,861		528,724,861
Aggregate write-ins for underwriting deductions	248,433		248,433
Total underwriting deductions	<u>1,525,647,218</u>	<u>0</u>	<u>1,525,647,218</u>
<b>Net underwriting gain or (loss)</b>	<b><u>66,785,318</u></b>	<b><u>0</u></b>	<b><u>66,785,318</u></b>
<b>Investment Income</b>			
Net investment income earned	148,103,660		148,103,660
Net realized capital gains or (losses)	(23,372,620)		(23,372,620)
<b>Net investment gain or (loss)</b>	<b><u>124,731,040</u></b>	<b><u>0</u></b>	<b><u>124,731,040</u></b>
<b>Other Income</b>			
Net gain or (loss) from agents' or premium balances charged off	(7,048,852)		(7,048,852)
Finance and service charges not included in premiums	13,576,651		13,576,651
Aggregate write-ins for miscellaneous income	(13,034,078)		(13,034,078)
<b>Total other income</b>	<b><u>(6,506,279)</u></b>	<b><u>0</u></b>	<b><u>(6,506,279)</u></b>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	185,010,079		185,010,079
Dividends to policyholders	6,813,398		6,813,398
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	178,196,681		178,196,681
Federal and foreign income taxes incurred	73,806,207		73,806,207
<b>Net income</b>	<b><u>\$104,390,474</u></b>	<b><u>\$0</u></b>	<b><u>\$104,390,474</u></b>
<b>Capital and Surplus Account</b>			
<b>Surplus as regards policyholders, December 31 prior year</b>	<b><u>\$769,825,439</u></b>	<b><u>\$0</u></b>	<b><u>\$769,825,439</u></b>
<b>Gains and (losses) in surplus</b>			
Net income	104,390,474		104,390,474
Change in net unrealized capital gains or (losses)	21,223,709		21,223,709
Change in net deferred income tax	(4,014,529)		(4,014,529)
Change in nonadmitted assets	74,431,106		74,431,106
Change in provision for reinsurance	177,619,584		177,619,584
Aggregate write-ins for gains and losses in surplus	3,636,116		3,636,116
<b>Change in surplus as regards policyholders for the year</b>	<b><u>377,286,460</u></b>	<b><u>0</u></b>	<b><u>377,286,460</u></b>
<b>Surplus as regards policyholders, December 31 current year</b>	<b><u>\$1,147,111,899</u></b>	<b><u>\$0</u></b>	<b><u>\$1,147,111,899</u></b>

**Safeco Insurance Company of America**  
**Four Year Reconciliation of Surplus**  
**For the Years Ended December 31,**

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital and Surplus, December 31, previous year	<u>\$769,825,439</u>	<u>\$838,610,694</u>	<u>\$1,155,401,423</u>	<u>\$1,197,874,486</u>
Net income or (loss)	104,390,474	163,816,762	248,386,112	288,841,310
Change in net unrealized capital gains or (losses)	21,223,709	(126,609,775)	(27,037,006)	24,050,522
Change in net unrealized foreign exchange capital gain				(840,772)
Changes in net deferred income tax	(4,014,529)	(72,399,087)	30,551,214	37,844,704
Change in nonadmitted assets	74,431,106	50,546,456	(98,367,778)	(24,695,647)
Change in provision for reinsurance	177,619,584	2,006,156	(19,764,823)	(133,829,059)
Cumulative effect of changes in accounting principles		10,510,414		
Surplus adjustments: Paid in		71,115,235	14,441,552	20,109,090
Dividends to stockholders		(158,000,000)	(465,000,000)	(255,000,000)
Aggregate write-ins for gains and losses in surplus	<u>3,636,116</u>	<u>(9,771,416)</u>		<u>1,046,789</u>
Change in surplus as regards policyholders for the year	<u>377,286,460</u>	<u>(68,785,255)</u>	<u>(316,790,729)</u>	<u>(42,473,063)</u>
Capital and Surplus, December 31, current year	<u>\$1,147,111,899</u>	<u>\$769,825,439</u>	<u>\$838,610,694</u>	<u>\$1,155,401,423</u>

**NOTES TO THE FINANCIAL STATEMENTS**

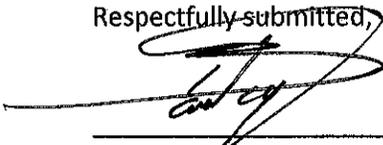
The Company has no special consents or permitted practices from the state of Washington.

**ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Safeco Insurance Company of America and its affiliates during the course of this examination.

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Respectfully submitted,



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