

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
SAFECO SURPLUS LINES INSURANCE COMPANY
SEATTLE, WASHINGTON

NAIC CODE 11100
December 31, 2009

Participating States:
Washington
Indiana
Illinois

Safeco Surplus Lines Insurance Company
Order No. 11-157
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 Surplus Lines Insurance Company
of
Seattle, Washington

hereinafter referred to as "SSLIC," 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 SSLIC as of December 31, 2009.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Safeco Surplus Lines Insurance Company 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

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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. Compliance with Investment Limitations in One Entity

RCW 48.13.030(1) limits the investment in any one entity to four percent of the insurer's total admitted assets. The December 31, 2009 balance for the Company's investments in JPMorgan Chase bonds and short-term investments of \$1,930,166 exceeded the admitted asset limitation of the statute by \$621,459. No examination adjustment was necessary due to immateriality.

The Company is instructed to comply with RCW 48.13.030(1) by nonadmitting single issuer investments, other than investments backed fully by the United States (U.S.) government and any state of the U.S., in excess of the four percent limitation.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

The Company was incorporated on August 26, 1983 under the laws of the state of Washington and began active operations in January 1984. The Company is authorized to write property, inland marine, general casualty, vehicle, disability, surety, and ocean marine insurance.

As of December 31, 2009, SSLIC was a wholly-owned subsidiary of Safeco Insurance Company of America (SICA). On September 22, 2008, all of the outstanding and issued common stock shares of SICA's parent, 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 \$31,444,848.

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

SSLIC is licensed only in the state of Washington and is qualified as a surplus lines carrier in all states except New Hampshire and West Virginia. The Company is also a qualified carrier in the U.S. Virgin Islands and Puerto Rico.

In 2009, the Company wrote allied lines, and business in Florida and Texas accounted for more than 99 percent of the Company's direct written premiums. Under an intercompany reinsurance pooling agreement, the direct business written by the Company was ceded 100 percent to an affiliate, Peerless Insurance Company (PIC). The Company is not actively writing new business.

Growth of Company

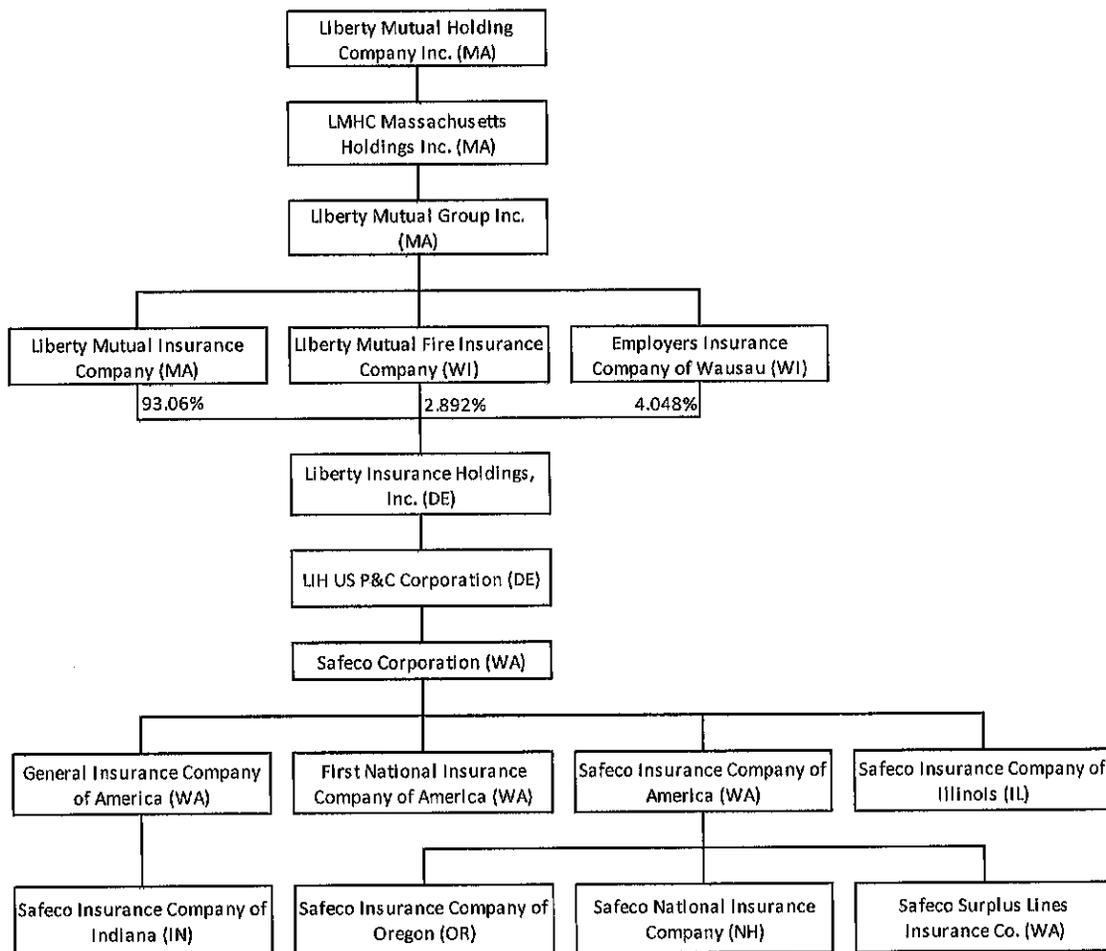
The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the four year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2009	\$32,717,685	\$1,272,837	\$31,444,848
2008	31,479,224	1,079,787	30,399,437
2007	38,273,088	9,391,039	28,882,049
2006	35,190,895	7,134,879	28,056,016

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2009	\$0	\$0	\$1,243,371	\$954,523
2008	0	0	1,428,938	1,156,532
2007	0	0	1,556,769	1,243,634
2006	0	0	1,399,687	1,081,525

Affiliated Companies

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



SSLIC is a wholly-owned subsidiary of SICA, an insurance company incorporated under the laws of the state of Washington. 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

The Company is a member of the Peerless Insurance Company Pool (Peerless Pool), and in accordance with the Peerless Pool's intercompany Amended and Restated Reinsurance Pooling Agreement led by PIC, SSLIC cedes 100 percent of its business to PIC, and SSLIC receives no retroceding business from PIC.

Because SSLIC receives no retroceding percentage from the Peerless Pool, the reserves carried by the Company for unpaid losses and loss adjustment expense reserves were \$0 and \$0, 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 Pool, which includes SSLIC, and concluded that the reserves for the insurance companies in the Peerless Pool are 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

Due to its participation in the Peerless Pool, which was described in the Unpaid Losses and Loss Adjustment Expenses report section, SSLIC reported no net premiums or losses in its 2009 NAIC Annual Statement. As of December 31, 2009, the Company had \$156,965 in aggregate unsecured amounts recoverable from PIC.

STATUTORY DEPOSITS

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

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
Arkansas	Bond	\$ 252,712	\$ 275,078
Connecticut	Bond	100,646	107,906
Louisiana	Bond	172,250	194,321
Massachusetts	Bond	848,950	971,537
New Hampshire	Bond	561,690	673,475
New Mexico	Bond	229,667	259,094
New York	Bond	3,165,478	3,437,212
Oklahoma	Bond	150,000	163,851
Washington	Bond	2,905,335	3,150,188
Total		<u>\$8,386,728</u>	<u>\$9,232,662</u>

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

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 Surplus Lines Insurance Company 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 Surplus Lines Insurance Company
Assets, Liabilities, Surplus and Other Funds
December 31, 2009

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
Assets			
Bonds	\$28,430,602	\$0	\$28,430,602
Cash, cash equivalents, and short-term investments	3,813,785		3,813,785
Subtotals, cash and invested assets	<u>32,244,387</u>	<u>0</u>	<u>32,244,387</u>
Investment income due and accrued	316,333		316,333
Amounts recoverable from reinsurers	156,965		156,965
Total Assets	<u>\$32,717,685</u>	<u>\$0</u>	<u>\$32,717,685</u>
Liabilities, Surplus and Other Funds			
Losses	\$0	\$0	\$0
Current federal and foreign income taxes	168,472		168,472
Net deferred tax liability	10,150		10,150
Ceded reinsurance premiums payable	(1,527)		(1,527)
Payable to parent, subsidiaries and affiliates	159,379		159,379
Aggregate write-ins for liabilities	936,363		936,363
Total Liabilities	<u>1,272,837</u>	<u>0</u>	<u>1,272,837</u>
Common capital stock	5,000,000		5,000,000
Gross paid in and contributed surplus	5,650,000		5,650,000
Unassigned funds (surplus)	20,794,848		20,794,848
Surplus as regards policyholders	<u>31,444,848</u>	<u>0</u>	<u>31,444,848</u>
Total Liabilities, Surplus and Other Funds	<u>\$32,717,685</u>	<u>\$0</u>	<u>\$32,717,685</u>

Safeco Surplus Lines Insurance Company
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>
Underwriting Income			
Premiums earned	\$0	\$0	\$0
Deductions			
Losses incurred			
Loss adjustment expenses incurred			
Other underwriting expenses incurred			
Total underwriting deductions	<u>0</u>	<u>0</u>	<u>0</u>
Net underwriting gain or (loss)	<u>0</u>	<u>0</u>	<u>0</u>
Investment Income			
Net investment income earned	1,266,209		1,266,209
Net realized capital gains or (losses)	<u>(22,838)</u>		<u>(22,838)</u>
Net investment gain or (loss)	<u>1,243,371</u>	<u>0</u>	<u>1,243,371</u>
Other Income			
Net gain or (loss) from agents' or premium balances charged off			
Finance and service charges not included in premiums			
Aggregate write-ins for miscellaneous income			
Total other income	<u>0</u>	<u>0</u>	<u>0</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	1,243,371		1,243,371
Federal and foreign income taxes incurred	<u>288,848</u>		<u>288,848</u>
Net income	<u>\$954,523</u>	<u>\$0</u>	<u>\$954,523</u>
Capital and Surplus Account			
Surplus as regards policyholders, December 31 prior year	<u>\$30,399,437</u>	<u>\$0</u>	<u>\$30,399,437</u>
Gains and (losses) in surplus			
Net income	954,523		954,523
Change in net unrealized capital gains or (losses)	51,735		51,735
Change in net deferred income tax	<u>39,153</u>		<u>39,153</u>
Change in surplus as regards policyholders for the year	<u>1,045,411</u>	<u>0</u>	<u>1,045,411</u>
Surplus as regards policyholders, December 31 current year	<u>\$31,444,848</u>	<u>\$0</u>	<u>\$31,444,848</u>

**Safeco Surplus Lines Insurance Company
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>\$30,399,437</u>	<u>\$28,882,049</u>	<u>\$28,056,016</u>	<u>\$26,883,834</u>
Net income or (loss)	954,523	1,156,532	1,243,634	1,081,525
Change in net unrealized capital gains or (losses)	51,735	(46,889)	(4,846)	
Change in net deferred income tax	39,153	(161,216)	156,206	(59,343)
Change in nonadmitted assets		568,961	(568,961)	150,000
Change in surplus as regards policyholders for the year	<u>1,045,411</u>	<u>1,517,388</u>	<u>826,033</u>	<u>1,172,182</u>
Capital and Surplus, December 31, current year	<u>\$31,444,848</u>	<u>\$30,399,437</u>	<u>\$28,882,049</u>	<u>\$28,056,016</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 Surplus Lines Insurance Company and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, FLMI, CFE, Reinsurance Specialist; Timothy F. Hays, CPA, JD, Investment Specialist; Randy E. Fong, AFE, Examiner-in-Charge; Edsel R. Dino, Financial Examiner; Katy Bardsley, CPA, Financial Examiner; and Zairina Othman, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, and examiners representing the Indiana Department of Insurance and Illinois Department of Insurance, participated in the examination and in the preparation of this report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Tarik Subbagh', is written over a horizontal line.

Tarik Subbagh, CPA, CFE
Property and Casualty Field Supervising Examiner
State of Washington

