

ASSOCIATION REPORT ON EXAMINATION
OF THE
ZURICH AMERICAN INSURANCE COMPANY
AS OF
DECEMBER 31, 2006

ZONES REPRESENTED

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STATES PARTICIPATING

NEW YORK
CALIFORNIA

EXAMINERS

JAMES CALL
MARIO ADOC



STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

June 6, 2008

Honorable Alfred W. Gross
Chairman, Financial Condition (E) Committee
Commissioner of Insurance
State of Virginia

Honorable Joel Ario
Secretary, Northeastern Zone
Commissioner of Insurance
State of Pennsylvania

Honorable Eric R. Dinallo
Superintendent of Insurance
State of New York

Honorable Morris J. Chavez
Secretary, Western Zone
Commissioner of Insurance
State of New Mexico

Sirs:

Pursuant to your instructions the examination has been made into the condition and affairs of the Zurich American Insurance Company hereinafter referred to as "the Company", at its main administrative office located at 1400 American Lane, Schaumburg, Illinois 60196-1056.

The examination was conducted by the New York State Insurance Department, hereinafter referred to as "the Department" with participation from the State of California representing the Western Zone.

The report on examination is respectfully submitted.

REPORT ON EXAMINATION

OF THE

ZURICH AMERICAN INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT

JUNE 06, 2008

EXAMINER

JAMES CALL, CFE

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

June 6, 2008

Honorable Eric R. Dinallo
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22622 dated March 12, 2007 attached hereto, I have made an examination into the condition and affairs of Zurich American Insurance Company as of December 31, 2006, and submit the following report thereon.

Wherever the designations "the Company" or "Zurich American" appears herein without qualification, it should be understood to indicate Zurich American Insurance Company.

Wherever the designation "ZAIG" appears herein without qualification, it should be understood to indicate Zurich American Insurance Group.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's main administrative office located at 1400 American Lane, Schaumburg, Illinois 60196-1056.

1. SCOPE OF EXAMINATION

The Department has performed an association examination of Zurich American Insurance Company. The previous examination was conducted as of December 31, 2003. This examination covered the three year period from January 1, 2004 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook, which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment and evaluation based upon the Company’s Internal Control Framework (“ICF”) documentation and testing. The Company is not publicly traded and is not required to comply with the Sarbanes-Oxley Act of 2002. The Company has in its place, initiated an ICF process with similar goals and objectives as that of the Sarbanes-Oxley Act with respect to documentation and testing of the Company’s internal control environment. The examiners also relied upon audit work performed by the Company’s independent certified public accountants (“CPA”) when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance

Pensions, stock ownership and insurance plans
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Zurich American Insurance Company ("Zurich American" or "ZAIC") is the lead company in a group of wholly owned property and casualty insurance companies based in the United States of America ("U.S."). All of the outstanding shares of Zurich American are owned by Zurich Holding Company of America, Inc. ("Zurich Holding"), a business corporation domiciled in the state of Delaware, which is 99.87% owned directly by Zurich Insurance Company, Zurich, Switzerland ("ZIC"). ZIC is 100% owned by Zurich Group Holding, Switzerland, which in turn is 100% owned directly and indirectly by Zurich Financial Services, Switzerland ("ZFS").

All of the wholly-owned property and casualty insurance companies directly or indirectly participate in the Zurich American Insurance Companies Intercompany Pooling Agreement (the "Pool" or "Pooling Agreement"). Under the terms of the Pooling Agreement, all transactions included in the net income or loss resulting from underwriting operations and the related asset and liability accounts, after the effects of third-party reinsurance, are distributed 100% to Zurich American. Each of the companies continues to have a direct liability to the insured as well as be liable for the obligations of the Pool on a joint and several basis.

Zurich American was incorporated under the laws of the State of New York on June 1, 1998 and commenced business on December 31, 1998. The Company was organized to provide the vehicle for the domestication under Article 72 of the New York Insurance Law of the United States Branch of Zurich Insurance Company ("Branch"). On December 31, 1998, all of the assets and

liabilities of the Branch were transferred to the Company and the Branch ceased to exist. The Company is a member of the Zurich American Insurance Group.

At December 31, 2006, capital paid in was \$5,000,000 consisting of 5,000 shares of common stock at \$1,000 par value per share. Gross paid in and contributed surplus was \$4,394,131,141. Gross paid in and contributed surplus increased by \$2,188,000,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2003	Beginning gross paid in and contributed surplus	\$2,206,131,141
2004	Capital contribution from ZHCA	\$1,300,000,000
2005	Capital contribution from ZHCA	800,000,000
2006	Capital contribution from ZHCA	<u>88,000,000</u>
	Total Surplus Contributions	<u>2,188,000,000</u>
2006	Ending gross paid in and contributed surplus	<u>\$4,394,131,141</u>

On December 21, 2004, the Department approved the Company's request to issue a New York Insurance Law Section 1307 surplus note in the amount of \$1,000,000,000. The interest rate will be computed on a 30-day month / 360 day year at a rate of 6% per annum, payable semi-annually on June 22 and December 22 of each year on the unpaid balance of the loan. The interest will be calculated based on a principal of \$800,000,000 from December 22, 2004 until and including January 26, 2005. As of January 27, 2005, the principal will be increased by \$200,000,000 amounting to an aggregate of \$1,000,000,000.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen or more than twenty-one members. At December 31, 2006, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
David Alan Bowers Winnetka, IL	Executive Vice President, and Corporate Secretary, Zurich American Insurance Company
Victoria Federici Causa Carmel, NY	Director, Zurich American Insurance Company
James David Engel Medford, NJ	Executive Vice President, Zurich American Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael Thomas Foley Barrington Hills, IL	Executive Vice President, Zurich American Insurance Company
Gary Steven Kaplan Naperville, IL	Executive Vice President, Zurich American Insurance Company
John Arthur Kelm Schaumburg, IL	Executive Vice President, Zurich American Insurance Company
Axel Peter Lehmann Barrington, IL	Chairman and Chief Executive Officer, Zurich American Insurance Company
Robert Anthony Lindemann Arlington Heights, IL	Executive Vice President Zurich American Insurance Company
Tina Gaye Mallie Hamilton, OH	Executive Vice President, Zurich American Insurance Company
Louis James Mannello, Jr. Barrington, IL	President, Zurich American Insurance Company
James William March Forest Hills, NY	Director, Zurich American Insurance Company
Nancy Diane Mueller Kildeer, IL	Executive Vice President and Actuary, Zurich American Insurance Company
Juliet Gloria Nash Brooklyn, NY	Director, Zurich American Insurance Company

The Company's by-laws provide that the board of directors shall meet at least four times each year with one meeting on the day of the annual election of directors by the stockholders. A review of the minutes of the meetings held during the examination period indicated that the board of directors complied with the provisions of its by-laws with regard to board of directors' meetings.

The review of the minutes of those meetings of the board of directors that were held during the examination period indicated that meetings held were generally well attended.

The review of the board of directors and the appointed subcommittee minutes indicated that while the board minutes did reflect that investment transactions of the Company were ratified, there was no detail available in the minutes to support exactly what was approved. Section 1411(a) of the New York Insurance Law states:

“No domestic insurer shall make any loan or investment, except as provided in subsection (h) hereof, unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee’s minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

It is recommended that the Company retain detail documentation of the transactions submitted for approval and provide same upon examination so that compliance with Section 1411(a) of the New York Insurance Law can be verified. It is noted that a recommendation regarding compliance with Section 1411(a) was included in the prior report on examination.

As of December 31, 2006, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Axel P. Lehmann	Chairman & Chief Executive Officer
Louis J. Mannello, Jr.	President
David A. Bowers	Executive Vice President & Corporate Secretary
John C. Treacy	Senior Vice-President & Treasurer
Eleanor S. Barnard	Executive Vice-President
James P. Connors	Executive Vice-President
James D. Engel	Executive Vice-President
Michael T. Foley	Executive Vice-President
Craig J. Fundum	Executive Vice-President
Gary S. Kaplan	Executive Vice-President
John A. Kelm	Executive Vice-President
Robert A. Lindemann	Executive Vice-President
John H. Lynch	Executive Vice-President
Tina G. Mallie	Executive Vice-President
Nancy D. Mueller	Executive Vice President & Actuary
Steven P. Rand	Executive Vice-President

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to write business in all fifty states, the District of Columbia, Guam, Puerto Rico, U.S. Virgin Islands and the Northern Mariana Islands.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
22	Residual value
24	Credit unemployment
26	Gap
27	Prize indemnification
28	Service contract reimbursement
29	Legal services

In addition, the Company is licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under Paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. as amended; 33 USC Section 901 et seq. as amended), and as authorized by Section 4102(c) of the New York Insurance Law, insurance of every kind or description outside of the United States, reinsurance of every kind or description.

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$35,000,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

DIRECT PREMIUMS WRITTEN

	<u>New York State</u>	<u>Total United States</u>	<u>Percentage of Premiums Written in New York State</u>
2004	\$496,834,842	\$5,122,366,160	9.70%
2005	\$473,527,629	\$5,004,955,701	9.46%
2006	\$478,603,486	\$5,216,000,779	9.18%

In 2006, direct written premiums for the Company as well as Zurich American Insurance Group, (“ZAIG”) were produced by a combination of approximately 14,424 independent agents, 255 brokers, 181 general agents, 5 managing general agents and 468 captive agents. Agency produced business accounted for approximately 74% of direct written premiums with the remainder produced by brokers.

Central to the Company's business strategy are its customer-focused business divisions (“Business Divisions”), which are supported by shared service units. The customer-focused Business Divisions operate through independent agents and brokers that have access to products and services through a nationwide network of seven regional offices and 63 branch offices. The Company is divided into two strategic Business Divisions: Global Corporate in North America (“Global Corporate”), which is part of ZFS’s Global Corporate Business Division, and North America Commercial (“NA Commercial”) which represents its own Business Division within ZFS.

Global Corporate

Global Corporate in North America is comprised of two business units, Corporate Customer and Global Energy. Global Corporate features a broad portfolio of solutions and services chosen by the majority of Fortune's Global 100 companies including workers' compensation, general liability, commercial automobile, highly protected risks, property and boiler and machinery.

- Corporate Customer operates in tandem with other ZFS global Business Divisions' to provide a broad variety of insurance and risk management services including custom-tailored casualty programs to large corporate and commercial businesses seeking global and domestic property-casualty solutions.
- Global Energy provides comprehensive risk solutions, risk engineering services and claims support for companies involved in oil and gas, petrochemical, natural resources, mining and power industries virtually worldwide.

Customer service is delivered by a global network of ZFS offices in 50 countries and resources that extend Global Corporate's reach to more than 120 countries worldwide. Global Corporate's

services are supported by the experience of more than 800 risk-engineering professionals and 8,000 claims professional around the globe. As a key Business Division of ZFS, Global Corporate has a significant presence in both North America and Europe, and is the second largest commercial lines carrier in the large corporate business globally.

NA Commercial

NA Commercial provides insurance coverages for the remaining commercial and small business customers in the U.S. which collectively make up the largest business sector in the United States. NA Commercial serves its customers through shared service units, which provide a unified approach to managing claims, managed care, risk engineering, information technology and marketing and other support services. NA Commercial is subdivided into the following four primary business units ("BUs"):

- Commercial Markets
- U.S. Small Business ("US Small")
- Specialties
- Zurich Direct Underwriters ("ZDU")

Commercial Markets

Commercial Markets offers a broad array of insurance and risk management services in the U.S. to serve three primary business sectors: Middle Markets, Construction and Domestic Energy.

- Middle Markets offers property and casualty solutions and risk management programs to meet the needs of the medium-sized commercial enterprise. Middle Market's target segments include manufacturing, services (including hospitality) and public entities.
- Construction specializes in providing products, services and risk financing solutions for project owners, construction managers, contractors and subcontractors. In addition to all standard property-casualty coverages, this sector also provides a number of specialized products such as construction total risk, homebuilders protective policy and professional liability products for project owners, construction managers, contractors and subcontractors.
- Domestic Energy specializes in providing comprehensive risk solutions, risk engineering services and claims support to US customers interested in liability coverages for companies involved in oil and gas, petrochemical, natural resources, mining and power generation.

US Small

US Small also offers a broad array of insurance and risk management services to serve two primary business sectors: Small Business and Programs.

- Small Business provides solutions for small businesses in the retail, wholesale, service, office, institutional, and manufacturing fields. Small Business products are offered through a

network of independent agents with a state of the art web-based automation platform. Product offerings include a comprehensive, customized coverage portfolio of property, liability, commercial auto, and umbrella and, in some locations, workers compensation.

- Programs provides specialized insurance to small and mid-sized commercial and professional markets, servicing a variety of commercial automobile, general liability, professional liability, excess liability and property exposures for various targeted business and industry segments. Targeted businesses include auto rental, independent auto dealer, recreational vehicle and contractors' equipment businesses. Additionally, Program's nationwide network of managing general agents target markets such as long-haul trucking, crop protection, ambulance and tow truck companies as well as general liability classes including tanning salons and security guard companies.

Specialties

Specialties offer a unique set of insurance and risk management services to serve two primary business sectors: Specialties and Surety.

- Specialties offer coverage for emerging, potentially volatile and unique third-party liability exposures. These exposures include professional liability risks of group service providers such as architects and engineers, healthcare organizations, financial institutions, environmental contractors, and information technology firms, along with a wide range of specialty liability coverages, such as management, environmental, excess and umbrella products, volatile general and political risk insurance, accident and health, specialty health and disability programs. Liability solutions are also provided for the healthcare, environmental, financial and rail industries.
- Surety serves the needs of construction project owners, construction contractors and subcontractors and governmental entities, non-profit organizations and commercial enterprises in most industries with a wide array of contract, commercial and environmental surety bond products.

Zurich Direct Underwriters (“ZDU”)

ZDU specializes in providing insurance and financial services to franchised auto, truck, equipment and motorcycle dealerships and automotive-related businesses. ZDU's products and services include property-casualty insurance, risk management services, business life insurance, vehicle service contracts, credit life and disability insurance and income development programs.

In 2007, Zurich Farmers United States Services (“ZFUS”) was formed for the purpose of creating a shared services operating unit to provide transactional and administrative support services to Zurich Financial Services' Farmers, North America Commercial and other North American units. ZFUS, a subsidiary of Zurich Holding Company of America, Inc., is expected to facilitate and accelerate operating efficiencies and economies of scale in areas such as procurement, human resources, real estate and others.

C. Reinsurance

Inter-company Pooling Agreement

Effective January 1, 1999, the Company entered into an amended ZAIG intercompany pooling agreement which includes the Company and seventeen affiliated insurers. Pursuant to the terms of the agreement, the participants cede 100% of all underwriting assets, liabilities and expenses, as well as underwriting income and losses (net of applicable reinsurance) to the Company. There is no retrocession from the Company to any of the pool participants. Subsequent to the January 1, 1999, revised and restated agreement, six amendments each adding or deleting participants in the pool have been made. At December 31, 2006, the following eighteen insurers participated in the pool:

American Guarantee and Liability Insurance Company (NY)
 American Zurich Insurance Company (IL)
 Assurance Company of America (NY)
 Colonial American Casualty and Surety Company (MD)
 Empire Fire & Marine Insurance Company (NE)
 Empire Indemnity Insurance Company (OK)
 Fidelity and Deposit Insurance Company of Maryland (MD)
 Maine Bonding and Casualty Company (ME)
 Maryland Casualty Company (MD)
 Maryland Insurance Company (TX)
 National Standard Insurance Company (TX)
 Northern Insurance Company of New York (NY)
 Steadfast Insurance Company (DE)
 Universal Underwriters Insurance Company (KS)
 Universal Underwriters of Texas Insurance Company (TX)
 Valiant Insurance Company (IA)
 Zurich American Insurance Company (NY)
 Zurich American Insurance Company of Illinois (IL)

Prior to cessions to the pooling agreement, the companies reduce their exposure to losses through facultative and treaty reinsurance. Article V of the pooling agreement provides that ZAIC agrees to be liable, for annual statement and other financial statement purposes, for any amount disallowed any of the companies on account of reinsurance with unauthorized companies and any amount disallowed the companies for non-admitted assets. Accordingly, only ZAIC reports a provision for reinsurance as the liability at December 31, 2006.

Assumed Reinsurance

During 2006, the volume of the premium assumed by ZAIC from non-affiliates was 1.26% of total gross written premium. The majority of the non-affiliated assumptions emanate from facultative arrangements and mandatory pools.

Total premium assumed by the companies participating in the pooling agreement during 2006 represented 57.2% of the total gross written premium by the companies during the year. Of this amount, 99.4% is attributable to the pooling agreement referenced in the preceding section of this summary.

ZAIC, as lead company per the pooling agreement assumed 58.5% of its gross written premium in 2006 compared to 58.2% in 2003. From a pooled perspective, assumed reinsurance for the group accounted for 6.9% and 6.4% of the gross written premiums for 2006 and 2003, respectively. These comparisons are based on data from the 2003 and 2006 combined annual statements of the affiliated property and casualty companies.

Zurich North America's ("ZNA") Global Property Strategic Business Unit provides insurance (referred to as "Home Foreign" business) through non-U.S. affiliates or branches of ZIC to U.S. insureds with worldwide exposures. For ZAIC, American Guarantee and Liability Insurance Company ("AGLIC") and the Illinois and Delaware domiciled pooled companies, the Home Foreign business is assumed on a quota share basis through stand alone Home Foreign affiliate master facultative reinsurance agreements for each of the assuming companies. The Home Foreign affiliate master facultative reinsurance agreements for ZAIC were sent to the Department June 29, 2006. See the ceded reinsurance section below for further information regarding the Company's Affiliated master facultative reinsurance agreements.

Ceded Reinsurance

ZAIC ceded 56.8% of its gross written premium (including amounts assumed from the pool participants) in 2006. Of this amount, 79% or \$5.6 billion are cessions to non-U.S. affiliated companies. The reinsurance recoverable exposures as of December 31, 2006 were \$11.495 billion, with non-U.S. affiliates representing 60% of this balance, third party reinsurers and pools comprised the remaining 40%.

Reinsurance treaty placements are based on the needs of the business units as well as the overall reinsurance strategy of the group. Per the Company, retentions have been increased vertically

as well as horizontally (through increased coinsurance referred to by the Company as “co-participation”) to limit the number of treaties with a retention below \$5 million.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted during the review that the Company entered into several multiple cedant reinsurance contracts where various affiliates, in addition to those participating in the inter-company pooling agreement, were also parties to the agreement. These agreements were not filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

The examination identified several other agreements that contain an "Affiliate" clause permitting any affiliate or subsidiary under the Company's management to participate in the agreement. This clause was silent as to which affiliates or subsidiaries, pooled or not, were under the Company's management.

The examination found that these contracts, where the Company participated in coverage with other non-pooled affiliates, did not contain acceptable language for agreements with multiple reinsureds. It is the Department's position that a domestic insurer cannot participate in a reinsurance agreement wherein there are multiple affiliated cedants who are not parties to an inter-company pooling agreement. The pooling agreement should contain the pooling percentages of each affiliate and the method of its premium allocation. However, the Department has accepted the following wording in lieu of a pooling agreement, which should be contained in such reinsurance agreements, usually as a mutual offset clause:

“Each party to this contract agrees to honor the terms set forth herein as if the contract were a separate agreement between the reinsurer and each individual named reinsured. Balances payable or recoverable by any reinsurer or each individual named reinsurer or individual named reinsured shall not serve to offset any balances payable or recoverable to or from any other reinsured party to the contract. Reports and remittances made to the reinsurer in accordance with the applicable articles are to be in sufficient detail to identify both the reinsurer's loss obligations due each reinsured and each reinsured's premium remittances under the report.”

It is recommended that reinsurance arrangements, where the Company participated in coverage with non-pooled affiliates, be amended to contain acceptable language for agreements with multiple reinsureds.

As noted in the “Assumed Reinsurance” section of this report, ZNA provides insurance coverage, directly and indirectly through non-U.S. affiliates or branches of ZIC, to U.S. insureds that operate internationally. Conversely, coverage of the U.S. exposures of foreign entities written by participants in the pooling agreement is referred to as “Reverse Flow” business. For ZAIC, AGLIC and the Illinois and Delaware domiciled pooled companies, the Reverse Flow business is ceded on a quota share basis through stand alone reverse flow affiliate master facultative reinsurance agreements for each of the ceding companies. The Reverse flow affiliate master facultative reinsurance agreements for ZAIC were sent to the Department June 29, 2006.

Provisions for reinsurance were minimal with penalties of \$38.8 million for unauthorized reinsurers, and \$80.2 million for authorized reinsurers. The total penalty of \$119.1 million represented 1.04% of all ceded exposures.

The treaties in place at December 31, 2006 are summarized below:

Capital Cover

In effect for 2006 was one capital treaty, the whole account quota share (“WAQS”), for the benefit of all business units and writing companies covered under the pooling agreement. This treaty is on a loss occurring basis and attached to the net line after the corporate covers addressed in the following paragraph. This treaty was a 50% quota share treaty with no risk limiting factors and was ceded to Zurich Insurance Company, Bermuda Branch (“ZIBB”), an affiliate. The WAQS treaty was effective July 1, 2001. The 6th amendment to the WAQS treaty was effective January 1, 2005, and the Company obtained a non-objection letter from the Department dated December 20, 2004.

Corporate Covers

A four-layer group property catastrophe (“Cat”) reinsurance agreement provides coverage excess of \$400 million up to \$1.05 billion. Due to the reduction in reinsurance market capacity that resulted from the 2004 and 2005 hurricanes, the Company was not able to complete the desired 95% placement (with one full reinstatement) of the group property Cat program that had been the traditional placement. Several additional coverages were obtained during 2006 that helped fill the gap, mostly on a named peril with no reinstatement basis. The total placements resulted in first event wind coverage of \$792 million part of \$850 million excess of a \$400 million retention and second event coverage of \$738 million part of \$1 billion excess of \$250 million. The main Cat treaty covers all Zurich entities for losses that occur in the U.S., regardless of the location of the Zurich entity writing the underlying risk. Similarly, all foreign exposures written on the Company’s paper

are covered under the European Property Cat treaty. The European Property Cat treaty provides per occurrence coverage of €1.3 billion excess of €10 million (approximately \$1.716 billion excess of \$13.197 million based on exchange rate at December 29, 2006) with an €200 million (\$263.940 million) per occurrence deductible. The European Property Cat cover has one reinstatement at 100% and was placed 100% with Zurich Insurance Company (“ZIC”). The European Property Cat treaty was effective August 14, 2006, and the Company obtained a non-objection letter from the Department dated September 29, 2006.

A multi-year (December 20, 2006 through December 31, 2009) California Earthquake property layer of 95% of \$200 million excess of \$1 billion was placed with Munchener Ruckversicherungs-Gesellschaft Aktiengesellschaft (“Munich Re”) in December 2006. The treaty between the Company and Munich Re allows for annual reset of the treaty attachment point. This treaty also relies on the Company’s exposures as modeled by their risk management software (“RMS”) Cat modeling software. The use of an annual reset would allow the Company to take advantage of its aggressive Cat accumulation management program with near term earthquake exposures expected to decrease. As part of the original agreement between the Company and Munich Re, Munich Re assigned and granted to the Company a security interest in the collateral account, effectively collateralizing the Company against Munich Re’s default in the event of a loss.

A two layer Policy Claim Service (“PCS”) Property Cat aggregate cover under two contracts was in effect from March 1, 2006 through December 31, 2006, with 100% of the first contract (\$100 million excess of \$400 million layer) and 97.5% of the second contract (\$400 million excess of \$500 million layer) placed with ZIC. The remaining 2.5% of the second layer is reinsured by Munchener Ruckversicherungs-Gesellschaft. The Company obtained a non-objection letter from the Department for both of these contracts dated May 31, 2006. This treaty has a two-risk warranty. The maximum contribution from any one event is \$400 million. This is a frequency cover, not a severity cover, and does not address any losses in excess of the Group Cat Cover limit.

Terrorism coverage was purchased on a per risk and occurrence basis with a limit of \$600 million excess of \$300 million on an aggregate basis. Included in this limit is \$250 million of coverage for acts of terrorism involving nuclear, biological or chemical weapons. This treaty was 100% placed.

Worker's Compensation is covered by a five layer Cat treaty providing coverage of \$275 million excess of \$25 million, all with one reinstatement. The cover is subject to a \$5 million maximum amount of loss to any one person warranty. This treaty was 100% placed.

The Company has an Internal International Catastrophe Excess of Loss contract with Zurich Insurance Company providing \$300 million (subject however, to any reinstatement provision/limitation as may be specified in the contract) excess of a \$100 million deductible ultimate net loss each and every loss occurrence covering Property, Engineering/Technical Insurance, Motor Hull and Marine. The contract provides for one full reinstatement calculated at pro rata of 100% additional premium. The contract was effective November 5, 2006 and was non-objected to by letter dated June 26, 2007.

Business Units

Business is written through five main platforms referred to as “Business Units” or “BUs” as follows: Global Corporate (“GC”), Commercial Markets (“CM”), Specialties (“SP”), Small Business (“SB”), and Universal Underwriters (“UUG”). Each of these entities has stand-alone business unit treaties, and they are outlined below:

Multiunit Coverage

A corporate general property per risk program provides up to \$50 million of coverage per risk/per occurrence on losses in excess of \$25 million. This cover is available to all the business units stated above, with the exception of UUG. The treaty has three free reinstatements for an annual aggregate limit of \$200 million, though an annual sub-limit of \$150 million applies to natural perils. ZAIC has a 10% co-participation on this treaty.

There is an additional shared layer excess of the \$50 million excess of \$25 million that covers GC and Middle Markets (part of CM) for \$75 million excess of \$75 million on a per risk, loss occurring basis. The cover has a \$75 million per occurrence limit, with a \$150 million annual aggregate limit. ZAIC has a 5% co-participation on this treaty.

A commercial property per risk treaty provides \$15 million excess of \$10 million Property per Risk protection for the Middle Markets and SB business units. The treaty’s occurrence limit is \$30 million, with the annual aggregate limit of \$90 million. The treaty includes three free reinstatements and two pro rata. ZAIC has a 33% co-participation on this treaty.

For casualty risks, Middle Markets and SP share a Mid Risk excess of loss of treaty \$10 million excess of \$10 million as well as a top risk excess of loss of \$15 million excess of \$20 million. The specific segments covered under these treaties are SP excess casualty, railroad, fidelity, and construction umbrella as well as excess and umbrella business from Middle Markets.

Global Corporate (“GC”)

Global Corporate has several strategic business units, (“SBUs”) that comprise its North America operation. They are Global Corporate, Structured Solutions Group, Global Energy (property only) and Canada (not covered here as it is not written on US paper).

The Global Corporate BU maintains two property per risk layers above the \$75 million excess of \$75 million layer that they share with Middle Markets. These are risk attaching layers of \$250 million excess of \$150 million (one reinstatement, occurrence/aggregate limit of \$500 million) and \$150 million excess of \$400 million (unlimited aggregate, \$300 million per occurrence limit). Both of these layers are automatic facultative transactions covering business classified by Global Corporate BU as highly protected risks (“HPR”).

In late 2006, an automatic facultative facility was placed for Global Corporate SBU to reinsure its workers’ compensation industrial aid aircraft risks. This agreement provides \$2 million excess of \$100 thousand coverage on a per person basis and \$5 million per occurrence.

The Structured Solution Group SBU of GC maintains a 45% risk attaching quota share on its Integrated Solutions business (property and casualty) with risk limits of \$50 million. In addition, there is a property excess of loss treaty with limits of \$10 million excess of \$15 million subject to a \$10 million aggregate annual deductible (“AAD”) that responds on a loss occurrence basis. This cover has a \$30 million annual limit.

Global energy's property program can be broken into three segments - onshore, offshore exploration and production (“E&P”) and marine:

Onshore

The onshore quota share has two separate treaty agreements for a total quota share cession of 23.5% of the \$75 million limit written any one risk. The treaties are on a risk-attaching basis, and both agreements are subject to a 200% loss ratio cap, as well as a \$150 million natural perils sub-limit. The difference in the agreements is in the manner in which excess of loss of recoveries are handled. The 10% quota share agreement with Validus Reinsurance Ltd., Bermuda, benefits from the excess of loss of protection purchased by the Company, whereas the other quota share agreement does not. The excess of loss that the Company maintains is a 76.5% of \$45 million excess of \$30

million loss occurrence cover, and recoveries from the quota share do not inure to the excess of loss of reinsurers.

Offshore (E&P)

The Offshore (E&P) business is subject to a 70% quota share of the \$75 million limit written, any one risk. The treaty has Gulf of Mexico hurricane sub limits of \$150 million per hurricane, \$500 million for the term of the contract. The E&P excess of loss placement is 30% of \$20 million excess of \$55 million and is on a risk-attaching basis. The excess of loss excludes Gulf of Mexico named storms or hurricanes. Both treaties have an interlocking clause for those occurrence losses with underlying risks that attach from more than one treaty year.

There is an excess facultative reporting cover of \$25 million excess of \$75 million, any one risk, to cover larger individual risks. Gulf of Mexico losses from named storms are excluded.

Marine

The ocean marine segment is covered by a two-layer loss occurring, per occurrence treaty. The \$5 million excess of \$5 million layer has two reinstatements at 100%. The \$15 million excess of \$10 million layer has one reinstatement at 100%. ZAIC's co-participation for each of these layers is 25%.

There is a combination E&P and marine loss occurring Cat treaty that allows a maximum recovery of \$22.5 million each occurrence or \$45 million on an annual aggregate basis. The individual components of the Cat cover are a 30% of \$75 million excess of \$75 million E&P piece, and a 100% of \$15 million excess of \$25 million Marine piece.

Ocean cargo is covered under a facultative reporting facility of \$44 million excess of \$1 million any one risk.

Commercial Markets ("CM")

Commercial Markets has several SBUs that comprise its North America operation. They are construction, environmental, middle markets, global energy (casualty only) and Canada. CM Canadian SBU does not write on U.S. paper and is not included in this overview.

Construction property risks are reinsured under two excess of loss contracts, one below and one above the corporate general property per risk contract. Both are Per Risk covers that attach on a

loss occurring basis. The lower layer is \$15 million excess of \$10 million, of which the ceding company retains 30%. This layer is subject to a \$30 million occurrence limit and a \$45 million annual aggregate limit with the reinstatements prepaid. The upper layer is \$25 million excess of \$75 million, subject to an occurrence limit of \$25 million and annual aggregate limit of \$75 million. Reinstatements on this layer are at 100% of the layer premium.

The Construction SBU's casualty risks arising from home warranty, subcontractors default and professional liability are covered under one treaty. The home warranty section is a 54.5% quota share and is on a risk-attaching basis. The subcontractors default section is \$28 million excess of \$2 million and is on a risk-attaching, per occurrence basis. This coverage sits above the insured's deductible which ranges from \$1.5 million to \$2 million under this business line and is subject to a loss ratio cap of 400%. This section is 34.5% placed and the premium is cession rated. The professional liability section is a 51% quota share with a \$30 million risk limit and a project risk limit of \$25 million. This section contains an implicit ceding commission of 25%.

An overlaying excess of loss, which is 57.5% placed provides \$20 million excess of \$30 million coverage for the subcontractors default and professional liability lines on a risk attaching, per occurrence basis. The annual limit on this treaty is \$40 million. The subcontractors default section is cessions-rated and the professional liability section is flat-rated.

Environmental maintains a 25% quota share with Eastern Alliance Ltd., a group captive that reinsures \$1 million limit storage tank liability, auto liability policies and other specified risks.

Other environmental liability is covered through a two layer per risk excess of loss of treaty of \$7 million excess of \$3 million, and \$20 million excess of \$10 million, both 60% placed. Although these treaties do not cover the losses for policies with limits below \$3 million, the reinsurance premium is based on the entire environmental premium base, including the policies less than \$3 million. This reinsurance includes an aggregate liability for mold of \$27 million.

Middle Markets fidelity losses are covered under a four layer per risk excess of loss of treaty that provides coverage of \$23 million excess of \$2 million. The first layer is \$3 million excess of \$2 million and provides for three reinstatements, two at 25% and one at 50% of the layer's premium. The second layer is \$5 million excess of \$5 million and provides for two reinstatements, one at 25% and one at 50% of the layer's premium. The third layer is \$10 million excess of \$10 million and provides for one reinstatement at 150% of the layer's premium. The fourth layer is \$5 million excess of \$20 million and provides for one reinstatement at 150% of the layer's premium. This treaty is on a

loss discovered basis (by the original insured) which effectively eliminates the majority of incurred but not reported (“IBNR”) after the expiration date.

Middle Markets writes a program for churches that uses an 80% automatic facultative facility to reinsure the property risks excess of \$500 thousand up to \$25 million. This agreement is subject to an occurrence limit of \$50 million.

Middle Markets writes the primary layer for several casualty (workers compensation, general liability, auto liability only) group captives. For four of these group captives, the Company made additional low-level excess placements (limit and retention less than \$1 million).

Specialties Unit (“SP”)

For SP, healthcare risks are covered under a quota share up to a \$10 million risk limit, and then a risk-attaching per risk excess of loss for \$15 million excess of \$10 million. The quota share treaty is 4% placed and the excess of loss of treaty is 50% placed.

Political and trade credit risks are covered under an 80.95% quota share treaty (risk limit of \$80 million) and a 66.14% quota share treaty (risk limit of \$35 million), respectively. ZIC has a 9.38% share (based on the full loss) of the political risk cession and a 7.149% share of the trade credit risk cession. This risk attaching treaty contains aggregate liability limits for policies by length of contract (for those risks greater than 5 years) and by country. In addition, there is a loss cap ratio of 650% for the treaty year.

SP excess casualty and umbrella business with limits in excess of \$50 million are subject to the Mid Risk and Top Risk quota shares agreements. The Mid Risk variable quota share covers risk limits over \$10 million up to \$20 million and is placed at 68.5%. The Top Risk variable quota share covers limits over \$35 million up to \$50 million and is placed at 65%. The variable quota shares proportionately share the risks (attaching excess of \$50 million) as follows:

<u>Policy limit</u>	<u>Net %</u>	<u>Mid-Risk</u>	<u>Top Risk</u>
\$15M	66.0%	34.0%	0.0%
\$20M	50.0%	50.0%	0.0%
\$25M	40.0%	40.0%	20.0%
\$35M	28.6%	28.6%	42.8%

(Note: The excess of loss of covering this business was outlined in the Multiunit Coverage segment of this summary.)

SP excess casualty group also has an automatic facultative carve-out facility of \$1 million excess of \$1 million on its auto liability business.

SP directors and officers liability policies as well as its employment practices liability policies are covered under a 27.5% quota share for risk limits up to \$25 million.

SP surety exposures are covered on a six layer per risk excess of loss treaty that provides coverage of \$135 million excess of \$15 million. Aggregate bond limits, per principal, are \$750 million for Contract Surety and \$200 million for Commercial Surety. This treaty attaches on a loss-discovered basis with minimal IBNR maintained after the expiration date.

Small Business (“SB”)

The Small Business platform is comprised of two SBUs named the Small Business SBU and the Programs Unit.

The Small Business SBU does not have any stand-alone treaties. Property risks are addressed in the multiunit coverage section above and casualty risks are held net.

The Programs Unit is the only segment currently using Empire Fire and Marine and Empire Indemnity paper (in addition to ZAIC in an agent capacity). The Programs Unit has a property per risk treaty with limits of \$15 million excess of \$10 million. This program is subject to an occurrence limit of \$15 million and an aggregate limit of \$30 million. This treaty covers business written through Empire's SPOPS (“Special Operations”) division as well as risks produced for Empire through American Management Corporation Insurance Services, and Hull & Co. This rewrite also covers the Public Underwriting Corporation (“PUC”) and Waddell Sluder programs serviced by the Programs Unit, previously part of Middle Markets.

Empire Fire and Marine writes crop and hail coverage through Rural Community Insurance Services. Those policies, which are approved and reinsured by the Federal Crop Insurance Corporation are reinsured through a two layer multi-peril stop loss treaty. The first layer is 4% excess of 111% and is ceded to ZIC. The second layer is 10% excess of 115%. The Company has 5% co-participation in both of these layers.

The Programs Unit reinsures its participation in the USAIG aviation pools I and II through a 25% quota share.

The Programs Unit has three property Cat programs. First, the Property Cat treaty covers several Cat perils, including fire and earthquake, with three layers providing coverage of \$135 million excess of \$75 million. As was the case with the corporate program, the reduced capacity in the reinsurance market left this treaty partially placed (\$103 million part of the \$135 million placed). Second, the California Cat covers several Cat perils, including fire and earthquake, and has seven layers placed through two treaties providing coverage of \$290 million excess of \$35 million. Finally, the California Earthquake Cat treaty covers California earthquake perils through a single layer of coverage \$150 million excess of \$500 million. By stacking these three Cat programs, earthquake Cat exposures in California are covered up to \$650 million as follows:

Initial retention	\$35M
CA Cat Cover	\$290M excess of \$35M (95% placed), 7 layers
Interim retention	\$40M
Property Cat	\$135M excess of \$365M (95% placed)
CA EQ Cat	\$150M excess of \$500M (95% placed) (earthquake only)

The Group Corporate Cat treaty would cover losses in excess of the limits provided above. The shortfall referenced in the property Cat remained the case for the peril of hurricane throughout 2006.

Universal Underwriters (“UUG”)

UUG has a three layer per occurrence casualty excess of loss of treaty. The layers are \$2 million excess of \$3 million, \$7 million excess of \$5 million, and \$3 million excess of \$12 million. Above the excess of loss is a per occurrence \$12 million excess of \$25 million non-obligatory facultative agreement.

A \$15 million excess of \$15 million per occurrence casualty clash is also placed that allows for two reinstatements, one at 100% of the layer premium and one free. This treaty contains a \$15 million maximum policy limit warranty.

UUG's Property exposures are addressed through a three layer Property per risk treaty providing \$11 million excess of \$3 million in reinsurance coverage. The first layer is \$3 million excess of \$3 million with a \$4.5 million occurrence limit, an aggregate limit of \$18 million and free reinstatements. The second layer is \$4 million excess of \$6 million with an \$8 million occurrence limit, an aggregate limit of \$16 million and three reinstatements at 0%, 50% and 100% of the layers'

premium. The third layer is \$4 million excess of \$10 million with a \$4 million occurrence limit, an aggregate limit of \$12 million and two reinstatements at 100% of the layers' premium.

UUG's property Cat program is a three layered program providing \$175 million excess of \$25 million and was under placed at inception and was never fully placed.

Authorized/Unauthorized Reinsurers

The Company obtains collateral for its cessions to unauthorized reinsurers so as to reduce its Schedule F penalty ("Provision for reinsurance"). Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114, respectively. This examination conclusions as to the Company's compliance with Department Regulations 114 and 133 are detailed below.

Department Regulation 114 - Trust Account Agreement Requirements

The prior examination noted that the Company maintained several reinsurance trust accounts, which contained multiple beneficiaries. Department Regulation 114, Parts 126.2(a) and 126.3(e) indicate the use of the singular word "beneficiary" and "entity." Further, Opinion No. 99-104 of the Department's Office of the General Counsel indicates that it is not permissible to have multiple beneficiaries on trust accounts utilized to secure reinsurance balances pursuant to Department Regulation 114. Opinion No. 99-104 specifically cites Department Regulation 114, Section 126.2(a) in its argument for sole beneficiaries to trust accounts.

Upon examination, it was again found that the Company has six reinsurance trust accounts that contain multiple beneficiaries.

The trust agreement for the Paramount Insurance Trust states that the governing law is Hawaii. Department Regulation 114, Part 126.3(h) states that the governing law must be New York.

The trust agreements for Rosemont Reinsurance and the WAQS contained a 15 day notification period for changes in trust assets while Department Regulation 114, Part 126.3(f) requires that the beneficiary and grantor be notified within 10 days of changes in trust assets.

It is again recommended the Company ensure that its trust agreements are compliant with the requirements of Department Regulation 114, Part 126.

Letters of Credit Compliance with Department Regulation 133

The prior examination noted that several letters of credit did not contain the required definition of beneficiary pursuant to Department Regulation 133, Parts 79.2(d) and 79.1(b).

In accordance with Department Regulation 133, Part 79.2(d), for a letter of credit to be acceptable, it must “contain a statement that identifies the beneficiary and includes the definition set forth in Section 79.1(b) of this Part.” Upon examination, it was noted that two letters of credit did not contain the required definition of beneficiary pursuant to Department Regulation 133, Parts 79.2(d) and 79.1(b).

Several letters of credit contained wording requiring the beneficiary to submit the original letter of credit as a condition to being able to draw on the letter of credit. Department Regulation 133, Part 79.1(c)(2) provides that a beneficiary need only draw a sight draft under the letter of credit or confirmation and present it to promptly obtain funds and that no other document need be presented. According to the Office of General Counsel opinion issued on May 27, 2003 wording in a letter of credit requiring that the original letter of credit has to be presented as a condition to being able to draw on the letter of credit is a violation of Department Regulation 133, Part 79.1(c)(2).

The Company uses letters of credit that name more than one beneficiary. Pursuant to an opinion by the Department’s Office of General Counsel dated October 20, 2004, a beneficiary, as defined in Department Regulation 133, Part 79.1(b), may include more than one named insurer as long as the beneficiaries are affiliated insurance companies who are parties to an approved intercompany pooling agreement. Upon review, it was noted that some of the multiple beneficiary letters of credit included beneficiaries that are not parties to the ZAIG intercompany pooling agreement.

It is recommended that the Company ensure that the letters of credit it accepts are in compliance with Department Regulation 133, Parts 79.1(b), 79.1(c)(2) and 79.2(d).

Risk Transfer and Finite Risks

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from James Schiro, chief executive officer, Zurich Financial Services (ultimate parent), Michael Kerner, CRO Global Head of Group Reinsurance Zurich Financial Services, Axel

Lehman, chief executive officer, Zurich Holding Company of America and ZAIC and John LaGrassa, senior vice president, ZAIC.

The examination's review indicated that the Company was party to certain reinsurance agreements where the transfer of risk did not satisfy the requirements of NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62 paragraphs 9 through 16. These contracts were not material. The Company accounted for these contracts as deposits pursuant to SSAP No. 75 and made disclosures in the Notes to the Annual Financial Statement accordingly.

Commutations

During the period covered by this examination, the Company commuted various reinsurance agreements where it was a ceding/assuming reinsurer. These commutations resulted in losses to the Company's surplus position of \$3 million, \$200 million and \$22 million for the periods ended December 31, 2004, 2005 and 2006 respectively.

D. Holding Company System

The Company is a wholly-owned subsidiary of Zurich Holding Company of America, a Delaware holding company, which in turn is 99.87% owned by Zurich Insurance Company (Switzerland). Zurich Insurance Company (Switzerland) is wholly-owned by Zurich Group Holding (Switzerland), which in turn is ultimately controlled by Zurich Financial Services (Switzerland).

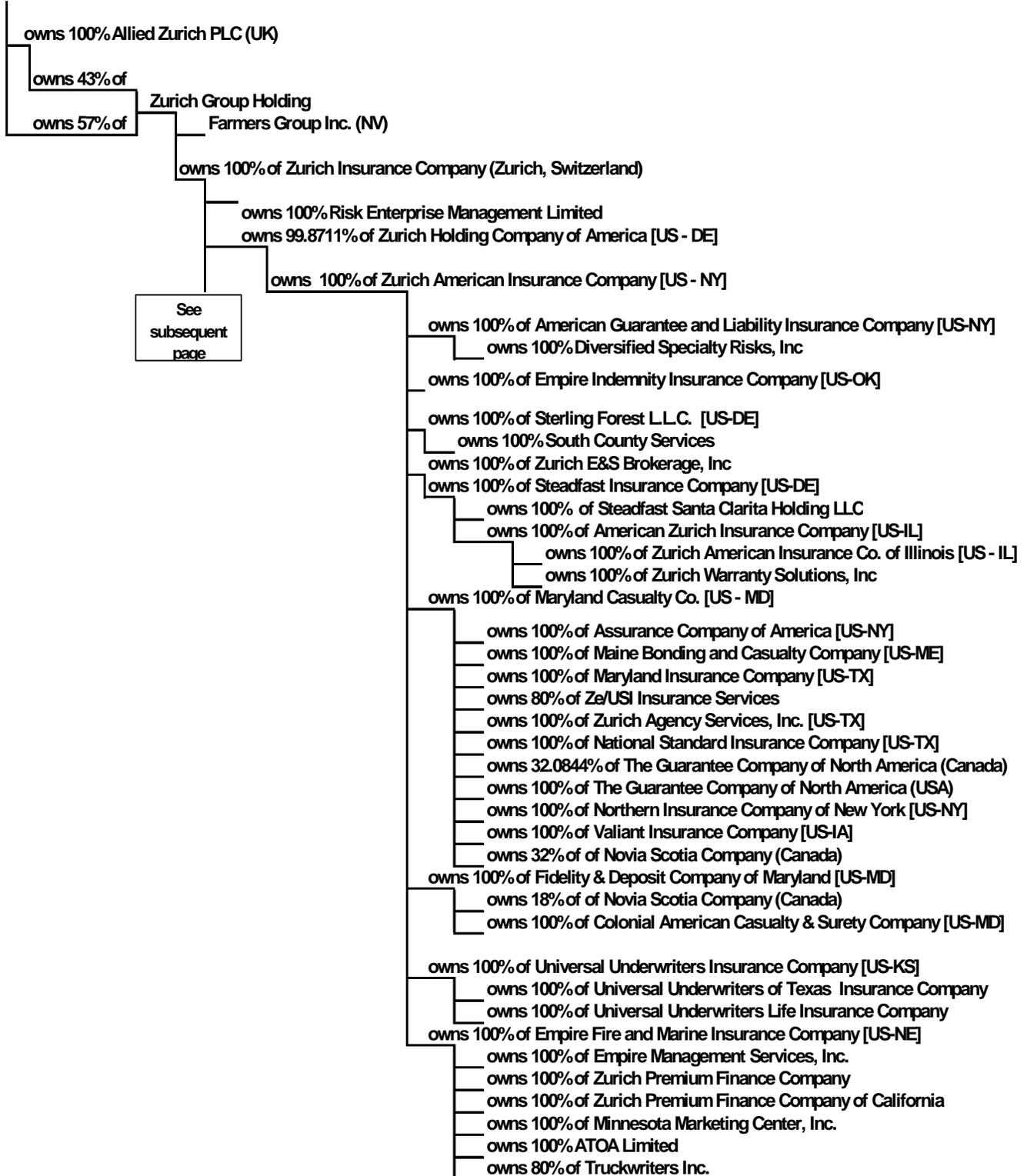
Effective January 1, 1999, the Company became the owner of 100% of the outstanding shares of Maryland Casualty Company when Zurich Insurance Company contributed its 15.8% ownership and Zurich Holding Company of America contributed its 84.2% ownership. The transfer of ownership was made concurrent with the adoption of the amended inter-company pooling agreement, which is detailed in Section 2C of this report.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2006:

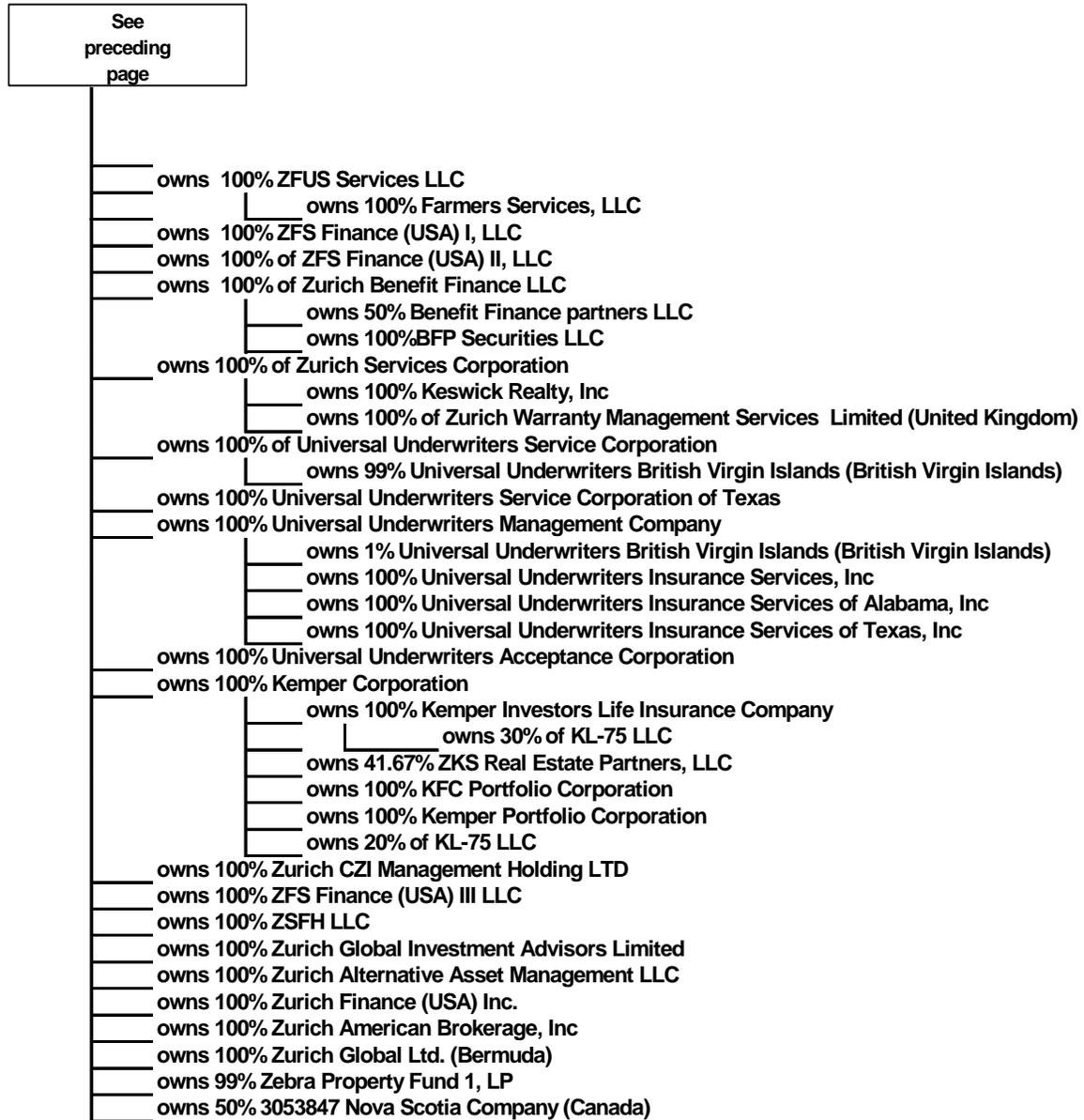
Zurich Group - U.S.
Legal Entities

Zurich Financial Services
(Zurich, Switzerland)



See
subsequent
page

Zurich Group - U.S.
Legal Entities



In addition to the intercompany pooling arrangement previously discussed in the Reinsurance section of this report, the Company was a party to the following agreements with other members of its holding company system at December 31, 2006:

Amended and Restated Tax Allocation Agreement

Since 1998, the Company has been a party to a tax sharing agreement between ZHCA and its subsidiaries. This agreement was amended in January 2006. The amended change made was to clarify that the intercompany tax settlements would be paid in cash or eligible investment securities. The new effective date of the agreement was January 1, 2006. The participants of the agreement record their apportioned tax liabilities and estimated tax payments according to the terms of the agreement. Those terms provide for allocation of the consolidated Federal income tax in an amount equal to the consolidated tax liability multiplied by a fraction, the numerator of which is the separate taxable income of the member and the denominator of which is the sum of the taxable income of all the members of the consolidated group having taxable income. If a member has no taxable income, its share shall be zero. The allocation method is consistent with Financial Accounting Standards (“FAS”) No. 109 as modified by SSAP No. 10.

The agreement provides that when a member exits, a settlement payment shall be made to ZHCA for any benefit realized by the exiting member due to lower tax payments as a result of being part of ZHCA (less than what would have been due on a separate return basis). Conversely, a settlement payment shall be made to the exiting member for any benefit realized by ZHCA resulting from utilization of losses or credits generated by the exiting member. As this provision had the potential for creating significant contingent liabilities for all members of ZHCA, beginning with the year ending December 31, 2000, companies with losses agreed by written declaration to forego tax benefits (rights to settlement payments) related to the use of their losses by ZHCA.

The agreement was submitted to the Department on November 6, 2006.

During the review of the Company’s tax allocation agreement, it was noted that the 2006 amendment to the agreement was not submitted to the board of directors for approval and ratification as required by Department Circular Letter No. 33 (1979).

It is recommended that the Company’s board of directors approve all amendments to their tax allocation agreement in compliance with Department Circular Letter No. 33 (1979).

Investment Advisory Agreement

On January 1, 2003, the Company and its direct and indirect subsidiaries entered into an investment advisory agreement with Zurich Global Investment Advisors Limited and Zurich Investment Services Limited.

Under the terms of the agreement, Zurich Global Investment Advisors provides investment advice and develops investment guidelines for the Company's investment committee. Zurich Investment Services provides record keeping services for the companies. Services include investment accounting and reporting such as, monthly security acquisition and disposition information and investment income summaries. This agreement was submitted to the Department and non-objected to January 6, 2003.

Subsequent to the examination date, May 7, 2007, this agreement was amended to provide that Zurich Global Investment Management, Inc., f/k/a Zurich Global Investment Advisors Limited ("ZGIM") will sub-contract certain investment advisory services to Zurich Group Investments ("ZGI"), a ZIC business unit, to be performed for the benefit of ZAIC. The amendment was non-objected to by Department letter dated May 2, 2007.

Information Technology Services Agreement

The Company participates in an information technology services agreement, which was signed on July 24, 2003. The agreement consolidates and transfers the entire mainframe-based computer processing functions that had been performed by the Company in Schaumburg, Illinois to the Data Center of Farmers Group, Inc. ("FGI"), an affiliate, in Los Angeles, California. This data center consolidation affects the data processing for all of the member companies of ZAIG operating within North America. The primary objective of this data center consolidation is to reduce mainframe hardware and software costs for Zurich Financial Services North American operations.

This agreement was submitted to the Department and non-disapproved on September 9, 2003.

During the examination period, the process of amending and restating this agreement began, but it was not effective until executed by all parties, January 22, 2008. The agreement states that FGI will provide information technology services, including electronic data processing and related services. In return, ZAIC desires to share in the cost of certain information technology services from

FGI, who will be responsible for providing such services, including certain information technology services formerly provided by ZAIC internally. The amendment was non-objected to by Department letter dated September 25, 2006.

Claims Service Agreement

The Company and all pooled affiliates (“Zurich U.S.”), participate in a claims services agreement with Farmers Insurance Exchange with an effective date of September 10, 2005. The agreement was approved by the Department by letter dated September 16, 2005. The service agreement was entered into for the purpose that Farmers Insurance Exchange will provide claims adjusting services with respect to Zurich U.S. issued policies affected by Hurricane Katrina.

Zurich U.S. is responsible for issuing all settlement checks and establishing necessary reserves. Zurich U.S. shall make available to FIE all papers, documents, and records of any kind bearing upon each existing claim against Zurich, NA which may be within the terms of the agreement.

Farmers Insurance Exchange shall handle, adjudicate, and adjust all Zurich, NA claims pursuant to the agreement in accordance with customary and usual claims handling procedures and applicable law.

Intercompany Service Agreement ZAIC – ZAAM

The Company participates in an intercompany services agreement with Zurich Alternative Asset Management, LLC, and effective July 1, 2006. The agreement was not objected to by the Department by letter dated July 13, 2006.

Under the terms of the agreement, Zurich American Insurance Company provides Zurich Alternative Asset Management, LLC certain services such as accounting, payroll, human resources, real estate, payor, tax, and information technology.

Marketing, Administrative, and Support Services Agreement

ZAIC and its pooled affiliates participate in a marketing, administrative, and support services agreement with Zurich Services Corporation (“ZSC”), effective November 17, 2003. The services to be performed by ZAIC and its pool members shall be to develop and present to ZSC, for its consideration, a marketing program, along with administrative and support services to assist ZSC in

the provision of managed care services to insureds and claimants under insurance policies issued by the ZAIC and the pooled companies.

Pursuant to the agreement, the services provided to ZSC will be at cost. Settlement will be based on monthly reports and payment is to be received within 15 days of receipt.

This agreement was non-objected to by the Department by letter dated October 22, 2003.

Workers' Compensation Services Agreement

ZAIC and its pooled affiliates participate in a workers' compensation services agreement with Zurich Services Corporation, effective November 17, 2003. The services to be performed by the ZSC include arranging network access services, medical management and consulting services, utilization review service and, as requested, medical director services. ZAIC and its pooled affiliates shall compensate ZSC for the performance of its obligations under this agreement on an actual cost basis for the fair and reasonable value of services rendered.

This agreement was non-objected to by the Department by letter dated October 22, 2003.

ZAIC – ZSC Contract for Services

ZAIC and its pooled affiliates participate in a Contract for Services Agreement with Zurich Services Corporation, effective November 17, 2003. The services to be performed by the ZSC include arranging network access services, medical management and consulting services, utilization review service and, as requested, medical director services. ZAIC and its pooled affiliates shall compensate ZSC for the performance of its obligations under this agreement on an actual cost basis for the fair and reasonable value of services rendered. This agreement was non-objected to by the Department by letter dated October 22, 2003.

Intercompany Service Agreement ZAIC – Centre Group Holdings (U.S.) Limited

The Company participates in an intercompany service agreement with Centre Group Holdings (U.S.) Limited, effective January 1, 2004. The agreement was non-objected to by the Department by letter dated May 5, 2006.

Under the terms of the agreement, Zurich American Insurance Company provides Centre Group Holdings (U.S.) Limited certain services such as accounting, payroll, human resources, real estate, payor services, tax, and information technology.

Intercompany Service Agreement ZAIC – Zurich Global Investment Advisors, LLC

The Company participates in an intercompany service agreement with Zurich Global Investment Advisors, LLC, effective July 1, 2006. The agreement was non-objected to by the Department by letter dated July 13, 2006.

Under the terms of the agreement, Zurich American Insurance Company provides Zurich Global Investment Advisors, LLC certain services such as accounting, payroll, human resources, real estate services, payor services, tax, and information technology.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2006, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	101%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	112% *
Premiums in course of collection to surplus as regards policyholders	38%

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The Company's liability to liquid assets ratio of 112% was 7 percentage points above the benchmark range.

The underwriting ratios presented below are on an earned/incurred basis and encompass the 3 year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$14,462,311,701	81.86%
Other underwriting expenses incurred	3,444,514,404	19.50
Net underwriting loss	<u>(239,048,499)</u>	<u>(1.35)</u>
Premiums earned	<u>\$17,667,777,606</u>	<u>100.00%</u>

F. Accounts and Records

The general books of the Company are maintained by the use of electronic data processing equipment and applicable pre-programmed insurance related software packages. Basic data consists of cash receipts documents, cash disbursements vouchers, working papers, reports of premium and losses and various other documents and memoranda of a journal nature. Standardized insurance accounting procedures are employed in transactions involving premiums, losses, expenses and valuation of assets and liabilities resulting from the operation of the company.

During the course of the review of the Company's accounts and records, the operational and organizational controls in place were analyzed. In general, it appears the Company has a sufficient level of controls in place.

However, the following record keeping deficiencies were noted during the course of the current examination:

Securities lending cash collateral

Upon examination it was noted that the Company reported the underlying collateral for its loaned securities as cash on Schedule E - Part 1 of its NAIC Annual Financial Statement. The Company should report the collateral based on the underlying nature of the invested security.

It is recommended that the Company report the collateral held for securities loans based on the underlying nature of the invested security.

Park 80 West Plaza annual statement presentation

The Company reported its investment in Park 80 West in Saddle Brook, NJ as an investment in Schedule A, Part 1. Park 80 West is actually owned by L & L Park 80 Investors, of which the Company has a 90% interest through its wholly-owned subsidiary, ZI Park 80 LLC. The remaining 10% of L & L Park 80 Investors is owned by unaffiliated third parties. The NAIC Accounting Practices and Procedures Manual, SSAP No. 48, paragraph 6 states in part that investments in joint ventures, partnerships and limited liability companies shall be reported in Other Invested Assets in the financial statements.

It is recommended that the Company record its investment in L & L Park 80 Investors in Schedule BA in compliance with SSAP No. 48, paragraph 6.

Advance premium

The 2003 report on examination contained a recommendation which cited SSAP No. 53, paragraph 13, which states:

“Advance Premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.”

The Company improperly reported their Advance premiums of \$85,532,197 as written premium with an offset to unearned premium.

It is again recommended that the Company recognize and set up the liability for Advance premiums for those premiums received prior to the effective date of a policy in accordance with SSAP No. 53, Paragraph 13.

Hybrid Preferred Stocks

ZAIC is not in compliance with NAIC Annual Statement Instructions and guidance from the NAIC Hybrid RBC Working Group as securities defined and classified by the SVO as “hybrid” preferred stocks are improperly designated and misclassified by the Company as filing exempt long-term bonds on Schedule D, Part 1.

It is recommended that the Company reclassify \$36,869,485 from Bonds (Schedule D, Part 1) to Preferred Stocks (Schedule D, Part 2, Section 1) in accordance with guidance from the NAIC Working Group and Annual Statement Instructions.

Contract for Services with Independent Auditors

Review of the Company’s written contract for services with its independent auditors finds that the contract does not contain all the wording required by Regulation 118, Part 89.2 and it was not executed by both parties. A similar comment was made in the prior Report on Examination (2003).

It is again recommended that the Company comply with Department Regulation 118, Part 89.2 and incorporate the appropriate language in all future contracts with its certified public accountants (“CPA”) firm, which all parties have executed.

Inventory of Deferred Tax Assets

During our review of the Deferred tax asset and liability (“DTA”/“DTL”) inventory for ZAIC, we noted that no DTA was recorded for the Company’s Net operating loss carryforwards (“NOL”). SSAP No. 10 requires all temporary reversing differences, unused tax credits and loss carryforwards to be included on the inventory of temporary reversing differences and the tax effect of those differences to be included in the Gross DTA/DTL amounts. If the NOL DTA were included in the deferred tax inventory there would be no change to the reported DTA due to the admitted balance being limited to the amount that is expected to be realized.

It is recommended that the Company include its available NOL carryforwards on the inventory of temporary reversing differences and to include the tax effect of those differences in the Gross DTA/DTL amounts.

In determining its 2006 net deferred tax asset, the Company failed to consider the effect of the unused Net operating losses (“NOL”) of other members of the consolidated filing group pursuant to the Declarations to Forego Benefits signed by those members. The Company noted during examination that pursuant to the Tax Sharing Agreement and the Declarations to Forego Benefits, no other members of the consolidated group besides ZAIC had specific claims to the consolidated NOL carryovers at December 31, 2006. Therefore, the Company believes they are in compliance with SSAP 10, which the Department disagrees. However, due to the disagreement on the interpretation of SSAP 10 and the fact that the Company subsequently realized the benefit of the tax deferred asset, no financial change will be made in the Report.

It is recommended that the Company properly limit the net admitted DTA to no more than the amount expected to be realized within one year of the balance sheet date in compliance with SSAP No 10, paragraph 10(b).

Failure to Comply with Circular Letter No. 10 (2001)

Department Circular Letter No. 10 (2001) provides for the proper method for collecting and paying premium tax on workers' compensation and employers' liability policies containing deductibles in New York State. The letter advises that the amount of deductible paid by the policyholder to the insurer should be treated as a premium paid to the insurer for the purpose of Section 1510 of the New York Tax 49 Law. Examination review revealed that the participants of the

ZAIG Pool did not recognize the reimbursements as premiums. A similar comment was made in the prior examination report.

It is again recommended that the ZAIG Pool, and specifically the Company, comply with Department Circular Letter No. 10 (2001) and treat the amount of deductible paid by the policyholder to the insurer under high deductible policies as premium paid to the insurer for the purpose of Section 1510 of the New York Tax Law.

It is noted that the Company has filed a petition with the New York Division of Tax Appeals regarding the characterization of New York workers' compensation deductible reimbursements as premiums for premium tax purposes. Zurich American Insurance Company, American Guarantee & Liability Insurance Company, American Zurich Insurance Company, Maryland Casualty Company, Northern Insurance Company of New York, and Universal Underwriters Insurance Company have filed a petition for hearing before the New York Division of Tax Appeals for redetermination of a deficiency/revision of a determination or for refund under Article 33 of the Tax Law for the Tax Years 2003, 2004, and 2005, as applicable.

G. Risk Management and Internal Controls

The Company has implemented only the procedures for separation of duties ("SOD") for the corporate audit application/servers and is currently preparing for physical changes required to fully lockdown the environment. A full lockdown includes the removal of application support staff from servers. The corporate audit applications/servers are as follows:

ARS	CDW	CESAR
CIID	COS/eZSB	EDW
MECCA	PRIDE	RAMS
RCS	REALM	RELAY
Schedule F	ZEUSS	ZORBA

The remaining applications are recognized as requiring the same separation of duties controls. The following applications should be incorporated under the full lockdown controls:

ASPIRE	DBL
PMS	Premium Audit
PS	ZLPRS
APAC	

Allowing business users administrative responsibilities within applications creates a separation of duties concern. Without proper restrictions, users granted these high privileges could make unauthorized changes to production.

The Company responded that they have completed implementation for several of the noted systems and that they agree with the lock-down concepts presented as they apply to the remaining (ASPIRE, ZLPRS, premium audit) applications and will establish plans to implement the required controls over the next 18 months. These applications will be approached on an impact / risk basis starting with ASPIRE.

It is recommended that the Company complete its implementation of the required controls for the ASPIRE, ZLPRS and Premium Audit applications.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2006 as determined by this examination and as reported by the Company. Due to rounding the columns may not total.

<u>Assets</u>	<u>Assets</u>	<u>Examination</u>	Net Admitted	<u>Company</u>	Surplus
		Assets Not <u>Admitted</u>	<u>Assets</u>	Net Admitted <u>Assets</u>	Increase <u>(Decrease)</u>
Bonds	\$18,073,352,872	\$0	\$18,073,352,872	\$18,073,352,872	\$ 0
Common stocks	2,849,618,678	0	2,849,618,678	2,849,618,678	0
Real Estate: Properties held for the production of income	30,557,423	0	30,557,423	30,557,423	0
Cash, cash equivalents and short-term investments	2,834,277,792	0	2,834,277,792	2,834,277,792	0
Other invested assets	299,554,188	0	299,554,188	299,554,188	0
Aggregate write-ins for invested assets	80,328,263	0	80,328,263	80,328,263	0
Investment income due and accrued	155,518,130	0	155,518,130	155,518,130	0
Uncollected premiums and agents' balances in the course of collection	2,311,485,787	240,680,079	2,070,805,709	2,100,562,417	(29,756,708)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,413,248,089	20,542,515	1,392,705,574	1,392,705,574	0
Accrued retrospective premiums	1,054,582,314	67,622,607	986,959,707	986,959,707	0
Amounts recoverable from reinsurers	1,213,858,365	0	1,213,858,365	1,213,858,365	0
Funds held by or deposited with reinsured companies	17,616,017	0	17,616,017	17,616,017	0
Net deferred tax asset	1,226,750,414	680,002,095	546,748,319	546,748,319	0
Guaranty funds receivable or on deposit	54,375,869	0	54,375,869	54,375,869	0
Electronic data processing equipment and software	137,207,092	136,322,301	884,791	884,791	0
Furniture and equipment, including health care delivery assets	18,486,044	18,486,044	0	0	0
Receivables from parent, subsidiaries and affiliates	183,598,191	9,436,394	174,161,797	174,161,797	0
Aggregate write-ins for other than invested assets	<u>847,829,595</u>	<u>145,491,674</u>	<u>702,337,922</u>	<u>702,337,922</u>	<u>0</u>
Total assets	<u>\$32,802,245,125</u>	<u>\$1,318,583,709</u>	<u>\$31,483,661,416</u>	<u>\$31,513,418,125</u>	<u>\$(29,756,708)</u>

Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Losses and loss adjustment expenses	\$14,456,306,727	\$14,149,869,727	\$(306,437,000)*
Reinsurance payable on paid losses and loss adjustment expenses	394,524,981	394,524,981	0
Commissions payable, contingent commissions and other similar charges	119,963,062	119,963,062	0
Other expenses (excluding taxes, licenses and fees)	738,637,794	738,637,794	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	256,960,568	256,960,568	0
Current federal and foreign income taxes	35,410,569	35,410,569	0
Unearned premiums	4,622,977,469	4,622,977,469	0
Policyholders (dividends declared and unpaid)	6,716,053	6,716,053	0
Ceded reinsurance premiums payable (net of ceding commissions)	957,965,095	957,965,095	0
Funds held by company under reinsurance treaties	250,851,383	250,851,383	0
Amounts withheld or retained by company for account of others	220,316,422	220,316,422	0
Remittances and items not allocated	243,556,654	243,556,654	0
Provision for reinsurance	119,083,992	119,083,992	0
Drafts outstanding	20,575,516	20,575,516	0
Payable to parent, subsidiaries and affiliates	329,287,394	329,287,394	0
Aggregate write-ins for liabilities	<u>3,009,925,673</u>	<u>3,009,925,673</u>	<u>0</u>
Total liabilities	<u>\$25,783,059,353</u>	<u>\$25,476,622,353</u>	<u>\$(306,437,000)</u>
 <u>Surplus and Other Funds</u>			
Aggregate write-ins for special surplus funds	\$ 91,218,180	\$ 91,218,180	0
Common capital stock	5,000,000	5,000,000	0
Surplus notes	2,014,300,000	2,014,300,000	0
Gross paid in and contributed surplus	4,394,131,141	4,394,131,141	0
Unassigned funds (surplus)	<u>(804,047,258)</u>	<u>(467,853,549)</u>	<u>(336,193,709)</u>
Surplus as regards policyholders	<u>\$ 5,700,602,063</u>	<u>\$ 6,036,795,772</u>	<u>\$(336,193,709)</u>
 Total liabilities, surplus and other funds	 <u>\$31,483,661,416</u>	 <u>\$31,513,418,125</u>	

NOTES:

* This examination change reflects reserve deficiencies which have already been recognized by the Company in its December 31, 2007 Annual Statement on its net loss and loss adjustment expenses incurred prior to December 31, 2006.

(1) The Internal Revenue Service (“IRS”) has completed its audits of the Company’s consolidated Federal Income Tax returns through tax year 2004 and issued a Revenue Agents Report to which the Parent disagreed. The Group is currently seeking resolution of the disputed issues through the Appeals Division of the IRS. A contingent Federal Income Tax liability of approximately \$40,300,000 as of December 31, 2006 has been established for the companies participating in the Consolidated Tax Agreement. The liability is management’s estimate of the companies’ ultimate settlement of these adjustments. All material adjustments pertaining to the pooled companies, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 2005 and 2006 are currently under examination.

(2) The Company has issued the following New York Insurance Law Section 1307 surplus notes to affiliates in exchange for cash as of December 31, 2006:

<u>Note Number</u>	<u>Date Issued</u>	<u>Interest Rate</u>	<u>Par Value (Face Amount of Notes)</u>	<u>Carrying Value of Note</u>	<u>Total Principal and/or Interest Paid</u>	<u>Unapproved Principal and/or Interest Due as of 12/31/06</u>
1	9/30/2002	5.75%	\$453,000,000	\$453,000,000	\$ 0	\$110,701,875
2	9/30/2002	0.00%	131,300,000	131,300,000	38,700,000	0
3	12/31/2002	5.25%	80,000,000	80,000,000	0	16,835,000
4	12/29/2003	5.00%	350,000,000	350,000,000	0	51,437,502
5	12/22/2004	6.00%	<u>1,000,000,000</u>	<u>1,000,000,000</u>	<u>0</u>	<u>120,166,667</u>
Totals			<u>\$2,014,300,000</u>	<u>\$2,014,300,000</u>	<u>\$38,700,000</u>	<u>\$299,141,044</u>

All of the surplus notes are held by Zurich Holding Company of America. Each payment of interest on and repayment of principal of the surplus notes may be made only with the prior approval of the New York Superintendent of Insurance. Repayment can only be paid out of the free and divisible surplus of the Company. The Department pre-approved the repayment of surplus note #2 as long as the Company's risk based capital ratio is greater than 250%.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$6,445,901,591 during the three-year examination period January 1, 2004 through December 31, 2006, detailed as follows:

Underwriting Income

Premiums earned		\$17,667,777,606
Deductions:		
Losses and loss adjustment expenses incurred	\$14,462,311,701	
Other underwriting expenses incurred	<u>3,444,514,404</u>	
Total underwriting deductions		<u>17,906,826,105</u>
Net underwriting gain or (loss)		\$(239,048,499)

Investment Income

Net investment income earned	\$2,163,237,170	
Net realized capital gain	<u>103,706,943</u>	
Net investment gain or (loss)		2,266,944,113

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(117,422,301)	
Finance and service charges not included in premiums	29,172,189	
Aggregate write-ins for miscellaneous income	<u>(650,991,794)</u>	
Total other income		<u>(739,241,905)</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$1,288,653,708
Dividends to policyholders		<u>21,456,516</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$1,267,197,192
Federal and foreign income taxes incurred		<u>(34,429,414)</u>
Net income		<u>\$1,301,626,606</u>

C. Capital Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 2003			\$(1,053,938,846)
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$1,301,626,606		
Net unrealized capital gains or (losses)	320,821,094		
Change in net unrealized foreign exchange capital gain (loss)	462,011		
Change in net deferred income tax	260,147,335		
Change in nonadmitted assets	1,385,783,676		
Change in provision for reinsurance	336,400,188		
Change in surplus notes	961,300,000		
Surplus adjustments paid in	<u>2,188,000,000</u>	<u>0</u>	
Total gains or losses in surplus	<u>\$6,754,540,910</u>	<u>\$0</u>	
Net increase (decrease) in surplus			<u>6,754,540,910</u>
Surplus as regards policyholders per report on examination as of December 31, 2006			<u>\$5,700,602,064</u>

4. UNCOLLECTED PREMIUMS AND AGENTS' BALANCES IN THE COURSE OF COLLECTION

The examination admitted asset of \$2,070,805,709 is \$29,756,708 less than the \$2,100,562,417 reported by the Company as of December 31, 2006.

The Company performs a manual review of a systems generated report that shows all premiums more than ninety days past due. Utilizing a Company developed series of rules based on management's interpretation of Statutory Accounting Principles, the Company then restores such overdue balances to its admitted assets pursuant to a process identified as "purification."

The examination change represents the non-admitted portion of receivables under the Company's Purification Rule 35 -Purification of Future Installments. The Company recorded a non-admitted amount of \$38,476,530 which represented the non-retro portion of Purification Rule 2, and a non-admitted amount of \$37,004,941 which represented the non-retro policies in Purification Rule 3. Any related future installments purified under Rule No. 35 should also be reported as not admitted. The Company did not non-admit any amount of Rule 35. The Company should have non-admitted an additional amount of \$29,756,708 at December 31, 2006 for the Rule 35 adjustment.

5. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$14,456,306,727 is \$306,437,000 more than the \$14,149,869,727 reported by the Company in its December 31, 2006, filed annual statement. The examination change is due to the following:

Based on a review by the Department's actuaries of the Company's subsequent loss and loss adjustment expense reserve development, it was determined that the Company's loss and loss adjustment expense reserves were deficient by \$306,437 million as of December 31, 2006. This examination change reflects reserve deficiencies which have already been recognized by the Company in its December 31, 2007 Annual Statement on its net loss and loss adjustment expenses incurred prior to December 31, 2006. The deficiency represents 5.1% of the Company's policyholder surplus and 2.2% of its carried reserves as of December 31, 2006.

The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Company's internal records and in its filed annual statements.

6. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

Complaint log

The Company's Complaint log is not in compliance with the requirements of Circular Letter No. 11 (1978). The following columns were found to be missing:

- The dates of correspondence to the Department's Consumer Services Bureau.
- Chronology of further contacts with the Department.
- Remarks about internal remedial action taken as a result of the investigation.

It is again recommended that the Company fully comply with the requirements of Circular Letter No. 11 (1978) and going forward maintain a complaint log that encompasses the eleven subject matters required in this circular letter.

Complaint reports

The Company's complaint log is forwarded to the Customer Inquiry Center ("CIC") on a quarterly basis. Further forwarding of the complaint log reports to business unit managers and the Company's president is not done as required by Department Circular Letter No. 11 (1978).

It is recommended that the Company fully comply with the Department Circular Letter No. 11 (1978) by forwarding quarterly reports from the complaint logs to heads of respective operating units and to the Company's president.

7. SUBSEQUENT EVENTS

As of January 1, 2007, the Company and Universal Underwriters Management Company ("UUMC") merged their Qualified and Nonqualified Pension Plans. As a consequence, the Company is now the sponsor of the unified pension plan. The merger of the plans is not expected to have any material impact on capital stock and surplus of the Company.

The Internal Revenue Service ("IRS") completed its examination of the Company for tax years 2003 and 2004, and in March 2007 issued a Revenue Agent's Report. In December 2006, the Internal Revenue Service issued a Notice of Proposed Adjustment proposing to disallow under Section 162(c) of the internal revenue code deductions for contingent commissions the Company incurred in the amount of \$53.4M for the 2003 tax year and \$30.1M for the 2004 tax year. Per review of the LeBoeuf, Lamb, Greene & MacRae LLP Legal Letter obtained, it was noted that Zurich Holding does not agree with certain findings in the revenue agents report and will seek resolution of those findings through the Appeals Division of the IRS. Management believes it has adequately provided for tax adjustments through the tax contingency reserve. The tax accrual workpapers contain the rollforward of the tax contingency balance. Based upon the review of those workpapers,

Price Waterhouse Coopers (“PWC”) tax concludes that the amount reflects a reasonable assessment of the tax contingencies given the current knowledge regarding tax exposures.

In February 2007, the Company sold its investment in Truckwriters Inc., a wholly-owned subsidiary, resulting in a gain on sale of \$6.8 million. This non-consolidated affiliate owned by the Company at December 31, 2006 was valued under SSAP 88 (Part 8(b)(iii)), or based on audited GAAP equity. This entity was not audited at December 31, 2006 and thus was treated as a non-admitted asset at year end.

Settlement agreements were entered into subsequent to the filing of the 2005 combined annual statement, the settlement expenses of \$248,704,000 and their related impact on deferred taxes and nonadmitted assets, were reflected as a reconciling item between the 2005 Combined Statutory Financial Statements and the 2005 Combined Annual Statement. The settlement expenses were recorded in the 2006 Combined annual statement and hence the effect of recording the settlement expenses and their related impact on deferred taxes and nonadmitted assets, they are reflected as a reconciling item between the 2006 Combined Statutory Financial Statements and 2006 Combined Annual Statement.

Effective July 1, 2007, ZAIC entered into a master services agreement with ZFUS Services, LLC, approved by the NY Department on June 22, 2007. Under the terms of this agreement, ZAIC and ZFUS Services entered into a transfer agreement, to which ZFUS Services, either directly or through ZFUS Services designee ZNA Services, LLC acquire from ZAIC the transferred property and assume the assumed liabilities. Whereas, ZFUS services may from time to time delegate to ZNA Services and/or ZFUS Services other subsidiary, Farmers Services, LLC, some or all of its obligations to perform services under the master services agreement.

On April 9, 2008, the Company and its subsidiaries Maryland Casualty Company, Northern Insurance Company of New York, American Zurich Insurance Company, and Assurance Company of America, and their respective affiliates proposed to sell the Small Business Solutions unit operated by the SBS Insurers to Truck Insurance Exchange, or one or more of its designees. As part of the transaction, the Company and ZFUS Services, LLC will enter into an initial asset purchase agreement, which was ratified and approved by the Company’s Board of Directors on April 9, 2008.

On January 23, 2008, the Company purchased surplus notes including accrued interest issued by Farmers Insurance Exchange, Truck Insurance Exchange and Fire Insurance Exchange from alien affiliates of the Company. The purchase was approved by the Superintendent, of this Department.

<u>Issuer</u>	<u>Principal</u>	<u>Accrued Interest</u>	<u>Total</u>
Farmers Ins. Exchange	\$280,000,000	\$8,275,167	\$288,275,167
Truck Ins. Exchange	\$136,500,000	\$4,034,144	\$140,534,144
Fire Ins. Exchange	\$107,000,000	\$3,162,296	\$110,162,296

On February 26, 2008, Universal Underwriters Life Insurance Company (“UULIC”), a wholly owned subsidiary of Universal Underwriters Insurance Company (“UUIIC”), a wholly owned subsidiary of the Company, entered into an agreement with plaintiffs in the Tony Pierce vs. UULIC case filed in the Superior court of Muscogee County, State of Georgia, to settle an action related to failure to refund unearned premiums on single premium credit life and credit disability policies issued in conjunction with retail installment loans. The settlement agreement contemplates payment of \$49,000,000 into a settlement fund to be used to make payments to class members, to compensate class counsel and to pay all costs of class administration.

The settlement agreement has been fully provided for in the December 31, 2007 financial statements of UULIC. However, due to the timing of the settlement agreement, not all of the effects of the quota share credit accident and health (“A&H”) treaty between UULIC and UUIIC have been reflected in the statutory annual statement of UUIIC. As such, approximately \$1,078,000 of the reduction in assumed premium by UUIIC has not been recorded in the statutory annual statement of UUIIC. This has no impact to the statutory surplus of UUIIC due to the pooling arrangement with ZAIC. The surplus of ZAIC is overstated by \$1,078,000 due to the timing of the above settlement agreement impacting ZAIC’s ability to record all appropriate adjustments in the December 31, 2007 statutory statements prior to submission on March 1, 2008.

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company retain detail documentation of the transactions submitted for approval and provide same upon examination so that compliance with Section 1411(a) of the New York Insurance Law can be verified. It is noted that a recommendation regarding compliance with Section 1411(a) was included in the prior report on examination.	6
B. <u>Reinsurance</u>	
i. It is recommended that reinsurance arrangements, where the Company participated in coverage with non-pooled affiliates, be amended to contain acceptable language for agreements with multiple reinsureds.	13
ii. It is again recommended the Company ensure that its trust agreements are compliant with the requirements of Department Regulation 114, Part 126.	23
iii. It is recommended that the Company ensure that the letters of credit it accepts are in compliance with Department Regulation 133, Parts 79.1(b), 79.1(c)(2) and 79.2(d).	24
C. <u>Holding Company</u>	
It is recommended that the Company's board of directors approve all amendments to their tax allocation agreement in compliance with Department Circular Letter No. 33 (1979).	28
D. <u>Accounts and Records</u>	
i. It is recommended that the Company report the collateral held for securities loans based on the underlying nature of the invested security.	33
ii. It is recommended that the Company record its investment in L & L Park 80 Investors in Schedule BA in compliance with SSAP No. 48, paragraph 6.	33
iii. It is again recommended that the Company recognize and set up the liability for Advance premiums for those premiums received prior to the effective date of a policy in accordance with SSAP No. 53, Paragraph 13.	34
iv. It is recommended that the Company reclassify \$36,869,485 from Bonds (Schedule D, Part 1) to Preferred Stocks (Schedule D, Part 2, Section 1) in accordance with guidance from the NAIC Working Group and Annual Statement Instructions.	34
v. It is again recommended that the Company comply with Department Regulation 118, Part 89.2 and incorporate the appropriate language in all	34

ITEMPAGE NO.

future contracts with its certified public accountants (“CPA”) firm, which all parties have executed.

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|-------|--|----|
| vi. | It is recommended that the Company include its available NOL carryforwards on the inventory of temporary reversing differences and to include the tax effect of those differences in the Gross DTA/DTL amounts. | 35 |
| vii. | It is recommended that the Company properly limit the net admitted DTA to no more than the amount expected to be realized within one year of the balance sheet date in compliance with SSAP No 10, paragraph 10(b). | 35 |
| viii. | It is again recommended that the ZAIG Pool, and specifically the Company, comply with Department Circular Letter No. 10 (2001) and treat the amount of deductible paid by the policyholder to the insurer under high deductible policies as premium paid to the insurer for the purpose of Section 1510 of the New York Tax Law. | 36 |
| E. | <u>Risk Management and Internal Controls</u> | |
| | It is recommended that the Company complete its implementation of the required controls for the ASPIRE, ZLPRS and Premium Audit applications. | 37 |
| F. | <u>Market Conduct</u> | |
| i. | It is again recommended that the Company fully comply with the requirements of Circular Letter No. 11 (1978) and going forward maintain a complaint log that encompasses the eleven subject matters required in this circular letter. | 44 |
| ii. | It is recommended that the Company fully comply with the Department Circular Letter No. 11 (1978) by forwarding quarterly reports from the complaint logs to heads of respective operating units and to the Company’s president. | 44 |

Respectfully submitted,

_____/s/_____
James Call, CFE

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

JAMES CALL, being duly sworn, deposes and says that the foregoing report, subscribed by him,
is true to the best of his knowledge and belief.

_____/s/_____
James Call

Subscribed and sworn to before me
this _____ day of _____, 2009.

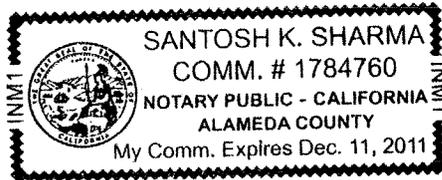
Respectfully submitted,

Mario Adoc
Mario Adoc

STATE OF CALIFORNIA)
) SS.
)
COUNTY OF SAN FRANCISCO)

MARIO ADOC, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Santosh K.
Sharma
Notary Public



Mario Adoc
Mario Adoc

Subscribed and sworn to before me
this 8th day of July 2009.

ACKNOWLEDGMENT

State of California
County of San Francisco)

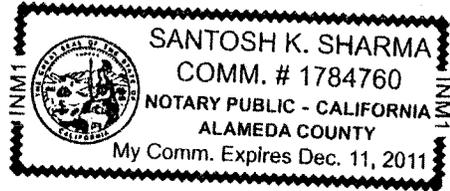
On July 8, 2009 before me, Santosh K. Sharma
(insert name and title of the officer)

personally appeared Mario Alconcel Adoc,
who proved to me on the basis of satisfactory evidence to be the person(~~s~~) whose name(~~s~~) is/~~are~~
subscribed to the within instrument and acknowledged to me that he/~~she~~/they executed the same in
his/~~her~~/~~their~~ authorized capacity(~~ies~~), and that by his/~~her~~/~~their~~ signature(~~s~~) on the instrument the
person(~~s~~), or the entity upon behalf of which the person(~~s~~) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing
paragraph is true and correct.

WITNESS my hand and official seal.

Signature Santosh K. Sharma (Seal)



Statement of Mario Alconcel Adoc is attached to
this acknowledgement.

Appointment No. 22622

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

I, Eric R. Dinallo, Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

James Call

as proper person to examine into the affairs of the

ZURICH AMERICAN INSURANCE COMPANY

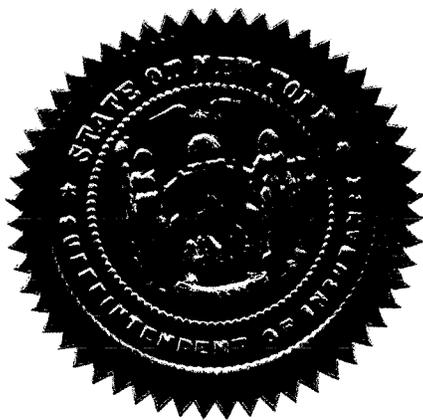
and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York,

this 12th day of March, 2007



A handwritten signature in cursive script, appearing to read "Eric R. Dinallo".

ERIC R. DINALLO

Acting Superintendent of Insurance