

REPORT ON EXAMINATION

OF THE

NATIONAL CONTINENTAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2007

DATE OF REPORT

MAY 28, 2009

EXAMINER

DENNIS J. MCGOVERN, CFE

## TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1	Scope of examination	2
2.	Description of Company	3
	A. Management	5
	B. Territory and plan of operation	6
	C. Reinsurance	8
	D. Holding company system	10
	E. Significant operating ratios	13
3.	Financial statements	14
	A. Balance sheet	14
	B. Underwriting and investment exhibit	16
4.	Losses and loss adjustment expenses	17
5.	Market conduct activities	18
6.	Subsequent events	18
7.	Compliance with prior report on examination	19
8.	Summary of comments and recommendations	19



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

May 28, 2009

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 30215 dated October 7, 2008 attached hereto, I have made an examination into the condition and affairs of National Continental Insurance Company as of December 31, 2007, and submit the following report thereon.

Wherever the designations "the Company" appears herein without qualification, it should be understood to indicate National Continental Insurance Company.

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 administrative offices located at 6300 Wilson Mills Road, W33 Cleveland, Ohio 44143-2182.

## **1. SCOPE OF EXAMINATION**

The Department has performed a coordinated risk focused examination of National Continental Insurance Company. The previous examination was conducted as of December 31, 2002. This examination covered the five year period from January 1, 2003 through December 31, 2007. 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 Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination is part of the coordinated examination of the Progressive Insurance Group being conducted by the Ohio Department of Insurance (“ODOI”). The examination was conducted in accordance with the proposed risk focused procedures and guidelines prescribed by the National Association of Insurance Commissioners. This examination, for common subject matter, has relied on ODOI to identify the risk classifications and inherent risk of key functional activities. ODOI was also responsible for preparation of matrices that have identified the controls and risk mitigation strategies. Finally, ODOI has determined residual risk and prepared substantive test procedures where deemed necessary.

The Department examiners were responsible for identifying those issues that were required by the New York Insurance Law. In addition, substantive procedures were performed where the Department examiners deemed necessary.

ODOI has created a file that will contain all documents relating to the Group's business and all documents relating to subject matter common to all companies. All participating states were given copies of the files upon completion of the examination.

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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## **2. DESCRIPTION OF COMPANY**

The Company was incorporated as a stock fire insurer on December 24, 1897, under the name Caledonian-American Insurance Company, and commenced business on March 24, 1898, under the laws of the State of New York. Rathbone, King and Seeley, Inc. acquired control of the Company in 1958. At that time the Company's name was changed to American Star

Insurance Company and its administrative office was moved to San Francisco, California. The Seibels Bruce Group, Inc. acquired 100% of the stock of Rathbone, King and Seeley, Inc. in 1981.

In November 1985, financial control of the Company was acquired by The Progressive Corporation (“TPC”), which contributed the stock of American Star Insurance Company to its subsidiary, Progressive Casualty Insurance Company (“PCIC”). The Company’s name was changed to the National Continental Insurance Company and its administrative offices were moved to Cleveland, Ohio. In 1988, the Company’s administrative offices were moved to Mayfield Heights, Ohio. Progressive Casualty Insurance Company transferred the Company’s stock by means of a dividend to The Progressive Corporation on December 29, 1989.

The Company’s administrative offices were moved to Mayfield Village, Ohio in 1994. The relocations were approved pursuant to Section 325(b) of the New York Insurance Law. The Company’s statutory home office is in Melville, New York.

The Company received a surplus contribution of \$20,077,005 from The Progressive Corporation in 1995. This surplus contribution was the return of cash forwarded to The Progressive Corporation pursuant to stock redemption and retirement of common shares on March 22, 1994. This transaction was a condition of the de-pooling agreement approved by the Department on December 20, 1995.

Pursuant to the de-pooling process from the Progressive Pool, beginning in January 1996, the Company primarily acts as a servicing carrier for the commercial auto insurance plans (“CAIP”) and special risk distribution plans (“SRDP”) for selected states.

However in 2005, the Company started writing voluntary commercial auto business in the State of New York and New Jersey then in 2007 in Massachusetts. This voluntary commercial auto business is the primary business of the Company today even though it still services the CAIP plans in many states. The voluntary commercial auto earned premium for 2007 makes up 54% of the Company’s total direct earned premium compared to 2005 when the CAIP servicing carrier premium was 99.5% of the Company’s total direct earned premium.

In 2005, the ownership was transferred to Progressive Commercial Holdings, Inc. (“PCH”), a subsidiary of TPC.

As of December 31, 2002, paid in capital was \$6,429,106, which consisted of 257,163 shares of common stock at \$25 par value per share and gross paid in and contributed surplus was \$28,642,125. There has been no change in capital structure during the period under review.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of nine members who are elected annually by the Company's sole shareholder, Progressive Commercial Holdings, Inc. The board meets multiple times during each calendar year. At December 31, 2007, the board of directors was comprised of the following 9 members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Patricia O. Bemer Highland Heights, OH	HR Business Leader, Progressive Group
Michael R. Beney Camillus, NY	Regional Manager, Progressive Group
William T. Cassella Kirtland, OH	CAIP Manager, Progressive Group
Suzanne M. Connolly *	Marketing Process Manager, Progressive Group
William R. Kampf Moreland Hills, OH	Marketing General Manager, Progressive Group
Victor (NMN) Politzi Loudonville, NY	New York and New Jersey State Claims Manager, Progressive Group
Christopher J. Rosati Shoreham, NY	Regional Manager, Progressive Group
Ronald E. St.Clair Stow, OH	IT Business Leader, Progressive Group
Dale A. Willis Shaker Heights, OH	Marketing Process Manager, Progressive Group

\* Subsequent to the examination date, this director is no longer with the Company.

The examiner noted that the Company did not hold board meetings during the period covered by this examination. In lieu of formal board meetings, the Company's business was conducted through "Action by Unanimous Consent of Directors Without a Meeting."

According to Section 1 of Article II of the Company's by-laws, the Company is required to hold a meeting of the board of directors to be held in the month of March in each year following the meeting of the stockholders. However, when the annual meeting minutes were reviewed, it stated "Shareholders Written Action Without a Meeting in Lieu of an Annual Meeting."

It is recommended that the Company comply with its charter and/or by-laws and hold at least one regular meeting of the board of directors.

As of December 31, 2007, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
William T. Cassella	President
Patricia M. Corwin	Secretary
Stephen D. Peterson	Treasurer
Patricia O. Bemer	Vice President
Suzanne M. Connolly *	Vice President
Sandra L. Rihvalsky	Vice President
Margaret A. Rose	Assistant Secretary

\* Subsequent to the examination date, this officer is no longer with the Company.

B. Territory and Plan of Operation

The Company is owned by Progressive Commercial Holdings, Inc. ("PCH"), a holding company incorporated in the state of Delaware. PCH is wholly owned by The Progressive Corporation ("TPC") a publicly traded holding company incorporated in the state of Ohio.

As of December 31, 2007, the Company was licensed to transact business in the District of Columbia and in all states except Connecticut and Vermont. The Company's voluntary business is commercial automobile written in New Jersey, New York and Massachusetts. This business began in 2005 and has grown substantially. In addition the Company acts as a servicing carrier for policies written under state mandated involuntary commercial automobile insurance plans ("CAIP") and the special risk distribution plan for the State of New York.



CAIP's are a pooling mechanism established by the states to handle commercial risks. In a CAIP a limited number of insurers act as servicing carriers for eligible risks on behalf of all insurers writing commercial automobile risks in the voluntary market. These carriers record CAIP business experience as direct business and then cede 100% to the appropriate state plan. All underwriting accounts for the CAIP and other state plans are ceded to the plans. The CAIP subscribers' companies assume their proportionate share of the pool's operating results. The Company services the CAIP's for twenty eight states and the District of Columbia.

In 1986, the State of New York established a special risk distribution program ("SRDP") for handling its taxis and limousines policyholders. It was later redefined as the public automobile pool ("PAP") to include all vehicles classified as a public automobile. Participation in the New York SRDP and PAP is voluntary; a company may elect to receive direct assignment of SRDP and PAP type risk, or share in the results of the programs. There is no indemnity risk under these contracts. The risks are ceded 100% to the SRDP's. The Company receives a servicing fee. In addition there is an administrative fee and a claims handling fee. The fee percentages will vary by state.

As of December 31, 2007, the Company was licensed to transact the kinds of business 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 and health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine
21	Marine protection and indemnity
26	Gap insurance

The Company is also licensed to write workers' compensation insurance as may be incidental to the 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.

Based upon 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 \$2,700,000.

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

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a Percentage of Total Premium</u>
2003	\$14,907,190	\$123,806,943	12.04%
2004	\$18,905,492	\$136,710,198	13.83%
2005	\$ 8,647,966	\$101,238,218	8.54%
2006	\$ 7,711,106	\$126,051,216	6.12%
2007	\$43,952,707	\$167,873,665	26.18%

### C. Reinsurance

There were no new contracts entered into during the period under review. The following is a description of the Company's ceded reinsurance program in effect as December 31, 2007:

#### Commercial Automobile Insurance Plans ("CAIP")

The Company participates in a pooled market for commercial risks rejected by the voluntary market. As part of the plan, the Company cedes 100% of its premiums and losses and in return, receives fees for its policy issuance and claims adjustments. The Company administers CAIP's in 28 states and the District of Columbia, mostly through AIPSO (Automobile Insurance Plan Service Office).

In order to be a CAIP service carrier, certain jurisdictions require that the servicing insurer maintain an A.M. Best Rating of at least "A". In 1997, the Company lost its "A" rating

from A.M. Best. To satisfy the rating requirement, effective December 12, 1997, the Company entered into a 100% contingent quota share agreement with United Financial Casualty Company (“UFCC”, an “A” rated insurer), which provided that in the event that NCIC became insolvent, UFCC would cover 100% of the Company’s net retained liabilities to the extent that the Company was unable to pay. Payments by the reinsurer would be made directly to the Company or its conservator, liquidator or statutory successor, except where the contract of insurance or reinsurance or any applicable cut-through endorsement specifically provides another payee of such reinsurance in the event of insolvency of the ceding reinsurer. The agreement covered only certain jurisdictions and was limited to five hundred policies. This agreement was terminated on June 1, 2003.

Effective July 1, 1995, as a condition of the de-pooling agreement approved by the Department, the Company and its affiliate, Progressive Casualty Insurance Company (“PCIC”), entered into an aggregate excess of loss agreement, as follows:

<u>Subject Business</u>	<u>Coverage</u>
All insurance and reinsurance policies, contracts and binders and all other evidence of insurance or reinsurance liability issued or renewed by the Company on or before November 25, 1985	\$45,000,000 excess of \$28,478,300

There are no ceded reserves on this treaty.

At December 31, 2007, the Schedule F Part 3 ceded reserves to PCIC are for the run-off of the pooled business. These reserves are as follows:

Known case reserves	\$504,000
Known case loss adjustment expenses	35,000
Incurred but not reported loss reserves	0
Incurred but not reported loss adjustment expenses	0
Ceded balances payable	<u>(9,000)</u>
Total	<u>\$530,000</u>

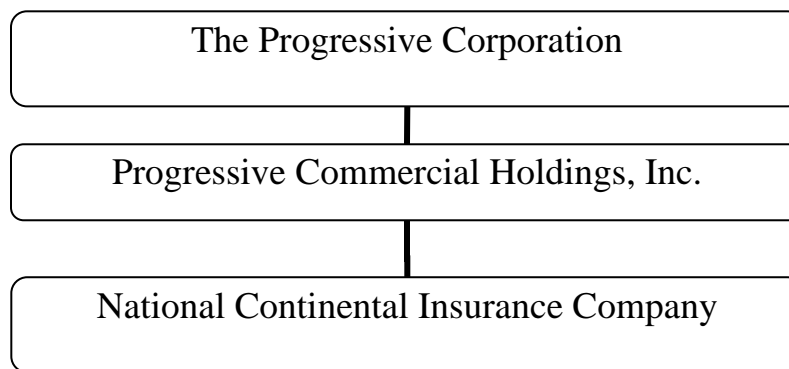
The examiner reviewed the pertinent ceded reinsurance contracts during the examination period to verify that the contracts contain standard clauses, including the insolvency clauses as per Section 1308 of the New York Insurance Law.

#### D. Holding Company System

The Company is a member of the Progressive Group. The Company is wholly owned by Progressive Commercial Holdings, Inc. ("PCH"), a Delaware corporation, which is ultimately controlled by the Progressive Corporation.

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 abbreviated chart of the holding company system at December 31, 2007:



The Company does not have employees or facilities. Management operations and claims services are provided under a management agreement with United Financial Casualty Company, an insurance company affiliate domiciled in Ohio. Under the terms of the agreement the Company receives underwriting and loss adjustment services in exchange for a management fee.

The Company has entered into the following agreements with members of its holding company system, all of which have been found non-objectionable by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law:

1. Cash Management Agreement between Progressive Casualty Insurance Company and National Continental Insurance Company

This agreement, effective January 1, 1998, provides for the Company's participation in the Progressive Casualty Insurance Company's central cash management system (cashier account) in which all the cash of the Progressive Holding Company system's companies are deposited. Pursuant to the agreement, Progressive Casualty Insurance Company is responsible in a fiduciary capacity for the Company's cash, and performs all the Company's duties and operations as they pertain to cash, including the recording and payment of the Company's obligations. The balances in the cashier account are to be settled on a quarterly basis, with payment commencing within thirty (30) days of the end of each quarter. The companies will use their best efforts to complete settlement within sixty (60) days after the end of the quarter.

2. Interest Agreement between Progressive Casualty Insurance Company and National Continental Insurance Company

The Company became a participant, effective November 25, 1985, to the existing interest agreement among Progressive Casualty Insurance Company and members of the holding company system. Pursuant to the agreement, the Company agrees to pay Progressive Casualty Insurance Company or to receive credit from Progressive Casualty Insurance Company for any balances owed to Progressive Casualty Insurance Company or owed by Progressive Casualty Insurance Company as a result of the activity in the cashier account per the Cash Management Agreement.

3. Investment Services Agreement between Progressive Capital Management Corp. and National Continental Insurance Company and Other Affiliates

Pursuant to this agreement, effective July 16, 1992, Progressive Capital Management Corp. provides investment management services to the Company as well as other affiliated members. Costs of the investment services are shared among the members of the holding company system.

4. Management (Cost Allocation) Agreement between United Financial Casualty Company ("UFCC") and National Continental Insurance Company (effective January 1, 2005)

The Company entered into a service agreement with UFCC. Pursuant to the agreement, the Company utilizes the personnel, property and facilities of UFCC. UFCC also provides services relating to the insurance operations, including administrative and record keeping for the Company. The Company reimburses UFCC for all its identifiable expenses. The expenses that

are not identifiable, are allocated based on formulas and factors consistent with the provisions of Department Regulation 30.

5. Reinsurance Agreement between National Continental Insurance Company and Progressive Casualty Insurance Company

Effective July 1, 1995, the Company had an excess of loss reinsurance agreement with Progressive Casualty Insurance Company covering losses and expenses from any business the Company wrote or renewed before November 25, 1985.

6. General Agency Agreement between ProgNY Agency, Inc., National Continental Insurance Company and Certain Affiliates (effective August 14, 1996)

This agreement authorized ProgNY agency to sell insurance products for the Company in the State of New York.

7. General Agency Agreement between Progressive Alliances Insurance Agency, Inc. (PAIA), National Continental Insurance Company and Certain Affiliates (effective October 1, 2007)

This agreement authorized PAIA to sell insurance products for the Company in the states of California, Kentucky, Louisiana, Washington and such other states as the parties may agree upon from time to time.

8. Tax Allocation Agreement between The Progressive Corporation ("TPC"), National Continental Insurance Company and Certain Affiliates (effective August 1, 2005)

The Company and other members of its holding company system entered into an income tax sharing agreement with The Progressive Corporation, whereby the companies file a consolidated federal income tax return.

9. Escrow Agreement by and among NCIC, TPC and Progressive Investment Company, Inc. ("PICI") (effective January 1, 1998)

PICI has agreed to place and hold certain of its assets in escrow, when necessary to satisfy certain tax escrow obligations imposed upon NCIC pursuant to New York Insurance Laws.

10. Licensing Agreement between Progressive Casualty Insurance Company ("PCIC") and National Continental Insurance Company and Certain Affiliates (effective 5/1/2002)

The Company participates in a licensing agreement with PCIC for the purpose of using the trademarks of PCIC.

11. Licensing Agreement between The Progressive Corporation (“TPC”), Progressive Casualty Insurance Company (“PCIC”) and National Continental Insurance Company (effective 9/28/1994)

The Company participates in a licensing agreement with TPC and PCIC for the purpose of using their name and trademarks.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2007, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	229%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	102%
Premiums in course of collection to surplus as regards policyholders	22%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$121,768,622	114.33%
Other underwriting expenses incurred	83,990,468	78.86
Net underwriting loss	<u>(99,254,382)</u>	<u>(93.19)</u>
Premiums earned	<u>\$106,504,708</u>	<u>100.00%</u>

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2007 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 90,488,615	\$ 0	\$ 90,488,615
Cash, cash equivalents and short-term investments	325,000	0	325,000
Investment income due and accrued	1,169,003	0	1,169,003
Uncollected premiums and agents' balances in the course of collection	11,273,108	641,078	10,632,030
Deferred premiums, agents' balances and installments booked but deferred and not yet due	42,244,004	0	42,244,004
Amounts recoverable from reinsurers	22,446,164	0	22,446,164
Net deferred tax asset	5,488,099	777,227	4,710,872
Guaranty funds receivable or on deposit	0	0	0
Receivables from parent, subsidiaries and affiliates	10,827,573	0	10,827,573
Health care and other amounts receivable	0	0	0
PLIGA receivable	1,772,141	0	1,772,141
State unearned surcharge recoverable	657,091	0	657,091
Alaska CAIP receivable	198,284	0	198,284
Prepaid expenses	<u>23,983</u>	<u>23,983</u>	<u>0</u>
Total assets	<u>\$186,913,065</u>	<u>\$1,442,288</u>	<u>\$185,470,777</u>



<u>Liabilities, Surplus and Other Funds</u>			Surplus Increase (Decrease)
	<u>Examination</u>	<u>Company</u>	
<u>Liabilities</u>			
Losses and loss adjustment expenses	\$ 70,166,995	\$ 58,266,995	\$(11,900,000)
Commissions payable, contingent commissions and other similar charges	119,524	119,524	0
Other expenses (excluding taxes, licenses and fees)	121,042	121,042	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	240,927	240,927	0
Current federal and foreign income taxes	2,498,967	2,498,967	0
Borrowed money and interest thereon	0	0	0
Unearned premiums	55,701,458	55,701,458	0
Advance premium	335,428	335,428	0
Ceded reinsurance premiums payable (net of ceding commissions)	7,130,240	7,130,240	0
Drafts outstanding	5,322,213	5,322,213	0
Unearned fee reserve	4,104,175	4,104,175	
Other liabilities	751,327	751,327	
State plan liability	728,793	728,793	
PLIGA payable	657,090	657,090	
Escheatable property	<u>59,722</u>	<u>59,722</u>	<u>0</u>
Total liabilities	<u>\$ 147,937,901</u>	<u>\$136,037,901</u>	<u>\$(11,900,000)</u>
 <u>Surplus and Other Funds</u>			
Common capital stock	\$ 6,429,106	\$ 6,429,106	\$ 0
Gross paid in and contributed surplus	28,642,125	28,642,125	0
Unassigned funds (surplus)	<u>2,461,645</u>	<u>14,361,645</u>	<u>(11,900,000)</u>
Surplus as regards policyholders	<u>37,532,876</u>	<u>49,432,876</u>	<u>\$(11,900,000)</u>
 Total liabilities surplus and other funds	 <u>\$185,470,777</u>	 <u>\$185,470,777</u>	

NOTES:

1. The Internal Revenue Service has examined the TPC's Federal Income Tax returns through the tax year ended December 31, 2005. Tax years 2004 and 2005 are complete except for one issue (Section 118), which is going through early appeals with a meeting set for April 2008. The examination of tax year 2006 is ongoing. We expect no material issues. The exam of tax year 2007 is part of the CAP real-time audit program and is ongoing. No material issues are expected.

2. The financial statements included herein do not consider any tax benefits that may have resulted from the examination change to losses and loss adjustment expenses.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased by \$690,848 during the five-year examination period January 1, 2003 through December 31, 2007, detailed as follows:

Underwriting Income

Premiums earned		\$106,504,708
Deductions:		
Losses incurred	\$69,279,945	
Loss adjustment expenses incurred	52,488,677	
Other underwriting expenses incurred	<u>83,990,468</u>	
Total underwriting deductions		<u>205,759,090</u>
Net underwriting gain or (loss)		\$ (99,254,382)

Investment Income

Net investment income earned	\$12,764,168	
Net realized capital gain	<u>1,086,793</u>	
Net investment gain or (loss)		13,850,961

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(886,078)	
Finance and service charges not included in premiums	1,114,549	
Service business revenue and other miscellaneous income	<u>150,117,793</u>	
Total other income		<u>150,346,264</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ 64,942,843
Federal and foreign income taxes incurred		<u>29,231,881</u>
Net income		\$ <u>35,710,962</u>

C. Capital and Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 2002			\$38,223,724
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$35,710,962		
Net unrealized capital gains or (losses)	102,744		
Change in net deferred income tax	2,094,805		
Change in nonadmitted assets	786,641		
Change in provision for reinsurance	114,000		
Dividends to stockholders	<u>0</u>	<u>\$39,500,000</u>	
Total gains and losses	<u>\$38,809,152</u>	<u>\$39,500,000</u>	
Net increase (decrease) in surplus			<u>\$(690,848)</u>
Surplus as regards policyholders per report on examination as of December 31, 2007			<u>\$37,532,876</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$70,166,995 is \$11,900,000 more than the \$58,266,995 reported by the Company in its December 31, 2007, filed annual statement. The examination analysis indicates that the Company's net carried reserve is deficient by \$11.9 million, which is 20.4% of the carried reserves and is 24.1% of the surplus. It is noted that as of its March 31, 2009 quarterly statement, the Company recognized a deficiency of \$10.6 million on its net losses and loss adjustment expenses incurred prior to December 31, 2007.

The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and was based on 2007 and 2008 statistical information contained in the Company's internal records and in its filed 2007 and 2008 annual statements as well as its March 31, 2009 quarterly statement and 2008 Actuarial Certification Report.

## 5. 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's complaint handling.

No problem areas were encountered.

## 6. SUBSEQUENT EVENTS

During September 2008, The Progressive Corporation recognized \$1.04 billion in net realized losses. TPC wrote down \$1.1 billion in securities that were determined to have had an "other-than-temporary impairment" in market value, primarily reflecting the continuing market-related issues associated with the disruption in the mortgage and other credit markets.

In December 2008, TPC wrote down an additional \$337.1 million in securities that were determined to have had an other-than-temporary decline in market value. Approximately 85%, or \$283.5 million, of the write-downs were on securities held in insurance subsidiaries. The amount of write-downs TPC took for the entire year 2008 totaled \$1.9 billion. As a result of this decline in investment value, TPC has suspended its dividend for 2008. The Company did not hold any of these securities.

## 7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained two recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
-------------	-----------------

A.	<u>Residual Market Premium</u>	
----	--------------------------------	--

It is recommended that the Company properly report residual market premiums under the appropriate underwriting caption in future annual statement filings.	21
--	----

The examiner notes that this recommendation has not been implemented by the Company. The Company believes that implementation of this recommendation would require a complete change to the corporate accounting policy and procedures. A further review indicates that these items are below our planning materiality level and no further investigation is required.

B.	<u>Certified Public Accountants</u>	
----	-------------------------------------	--

The engagement letter from the Company's independent certified public accountants does not contain the following required provisions pursuant to the Part 89.2 of the Department Regulation 118.	20
--	----

The Company has complied with this recommendation.

## 8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
-------------	-----------------

A.	<u>Management</u>	
----	-------------------	--

It is recommended that the Company comply with its charter and/or by-laws and hold at least one regular meeting of the board of directors.	6
--	---



Appointment No. 30215

STATE OF NEW YORK  
INSURANCE DEPARTMENT

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

**Dennis McGovern**

*as proper person to examine into the affairs of the*

**NATIONAL CONTINENTAL 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 7th day of October, 2008*



*Eric Dinallo*

ERIC R. DINALLO

Superintendent of Insurance