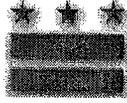


Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA

Re: Report on Examination - **DISTRICT OF COLUMBIA PROPERTY INSURANCE FACILITY** as of December 31, 2004

ORDER

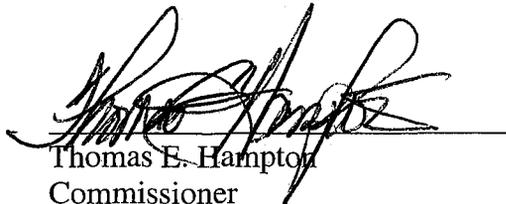
Pursuant to Examination Warrant 2005-1, a Financial Condition Examination of the District of Columbia Property Insurance Facility as of December 31, 2004 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

It is hereby ordered on this 27th day of June, 2006, that the attached financial condition examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.


Thomas E. Hampton
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

DISTRICT OF COLUMBIA PROPERTY
INSURANCE FACILITY

AS OF

DECEMBER 31, 2004

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Washington, D.C.
August 15, 2005

The Honorable Thomas E. Hampton
Commissioner
Government of the District of Columbia
Department of Insurance, Securities and Banking
810 First Street, NE, Suite 701
Washington, D.C. 20002

Dear Sir:

In accordance with the provisions of Sections 31-5006 and 31-1402 of the D.C. Official Code, an examination has been made of the financial condition and activities of the

**DISTRICT OF COLUMBIA PROPERTY INSURANCE FACILITY
1225 I SREET, N.W. SUITE 500
WASHINGTON, D.C. 20005**

(hereinafter called the "Facility") at its administrative offices located at 170 West Ridgely Road, Suite 230, Lutherville, Maryland 21093, and the following Report on Examination is submitted.

SCOPE OF EXAMINATION

This examination, covering the period from January 1, 1999 through December 31, 2004, including any material transactions and/or events noted occurring subsequent to December 31, 2004, was conducted by examiners of the District of Columbia Department of Insurance, Securities and Banking.

Our examination was conducted in accordance with examination policies and standards established by the Department of Insurance, Securities and Banking and procedures recommended by the National Association of Insurance Commissioners and, accordingly, included such tests of the accounting records and such other examination procedures as we considered necessary in the circumstances.

Our examination included a review of the Facility's business policies and practices, management matters, a verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Facility was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Facility was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Facility's financial statements for the years ended December 31, 1999 through December 31, 2004. We placed substantial reliance on the audited financial statements for the years ended 1999 through 2003 and, consequently, performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2004. We reviewed the working papers prepared by the independent public accounting firm relating to the audit for the year ended December 31, 2004, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

Our examination included a review to determine the current status of the one exception condition commented upon in our preceding Report on Examination dated March 22, 2000, which covered the period from January 1, 1994 to December 31, 1998. We determined that this exception condition, regarding the Facility's lack of a custodial agreement, was no longer applicable to the Facility because the Facility did not maintain investments required to be held in a custodial account. In the event the Facility had future investments required to be held in a custodial account, the facility would be required to execute a custodial agreement.

HISTORY

General:

The Facility is established pursuant to Title 31, Chapter 50 ("Insurance Placement") of the D.C. Official Code (the Code). The stated purposes of Title 31, Chapter 50 of the Code are:

1. To assure stability in the property insurance market in the District of Columbia;
2. To assure availability of property insurance in the District of Columbia;
3. To encourage maximum use, in obtaining basic property insurance, of the normal insurance market provided by authorized insurers;
4. To provide for the equitable distribution among insurers of the responsibility for insuring qualified property in the District of Columbia for which insurance cannot be obtained through the normal insurance market and to authorize the establishment of a joint underwriting association in the District of Columbia to provide for insuring and reinsuring of basic property insurance and homeowner's insurance without regard to environmental hazards;
5. To encourage the delivery of essential property insurance, and the homeowner's insurance that is provided by the Facility, at the most reasonable cost possible, provided that insurance pricing by the Facility is
 - (A) actuarially self-supporting, and

(B) does not actively compete with insurance pricing in the normal insurance market provided by authorized insurers.

In accordance with these stated purposes, the primary function of the Facility is to provide property insurance to property owners who cannot obtain insurance in the standard insurance market-place.

In addition to Title 31, Chapter 50 of the D.C. Official Code, the Facility is governed by District of Columbia Municipal Regulations, Title 26 (“Insurance”), Chapter 13 (“Insurance Placement Facilities”), which establishes the “Constitution” of the Facility, and is also governed by the Facility’s “Plan of Operation”, which is required by Title 31, Chapter 50 of the Code. The Facility’s revised “Plan of Operation”, which was approved by the Commissioner and was deemed effective as of April 1, 2004, replaced the prior “Plan of Operation”, which had been effective as of October 1, 1972, and had been amended from its initial version.

The name of the Facility (District of Columbia Property Insurance Facility) is established by its Constitution, which also provides that the facility shall be an unincorporated association.

The Facility operates like an insurer and underwrites and issues its own policies and assumes the risk on those policies. The Facility is primarily funded by premium income from policies but is also permitted by Title 31, Chapter 50 of the Code to assess the member insurers for any equity deficit. The last assessment of its members by the Facility occurred in 1998.

The membership of the Facility is comprised of every insurer licensed to write in and is engaged in writing in the District of Columbia, on a direct basis, basic property insurance, or components of such insurance in multi-peril policies. Basic property insurance includes standard fire and homeowner’s coverages.

Management:

Section 31-5005 of the D.C. Official Code provides that the Facility shall be governed by a board of 11 directors, elected annually from among its members by cumulative voting of the members of the Facility. The following member companies/groups comprised the board of directors as of December 31, 2004:

Member Company/Group:

State Farm Fire & Casualty Insurance Company
Travelers Property Casualty Insurance Company
Amica Mutual Insurance Company
Chubb National Insurance Company
CNA Insurance Companies
Erie Insurance Exchange

Designated Board Member:

William Krauter, Chairman
Kenneth Jarvis, Vice Chairman
James M. Mullholland
Bruce Thorne
Ronald Casner
David Freeman

Harford Mutual Insurance Company
The Hartford
Liberty Mutual Insurance Company
Nationwide Mutual Insurance Company
United Services Automobile Association

Robert F. Ohler
John J. Alachnowicz
Douglas Waltz
Judith Martell
Donna L. Leaman

Officers:

According to the Facility's Constitution, the board shall elect from its members a Chairperson and a Vice Chairperson and shall appoint a Secretary. As of December 31, 2004, the following board members were serving as the Facility's Chairman and Vice-Chairman:

William Krauter	Chairman
Kenneth Jarvis	Vice Chairman

However, the minutes to the meetings of the board of directors did not reflect the board's appointment of a Secretary. See the Comments and recommendations section of this Report, under the caption "Corporate Governance and Records" for further comments regarding this condition.

Committees:

According to the Facility's Constitution, the Chairperson may appoint or the board may elect such committees as deemed necessary for the transaction of the board's business. The Chairperson and Vice-Chairperson shall be ex-officio members of all committees of the board with the right to vote. As of December 31, 2004, the Facility's committees were as follows:

Underwriting:

Judith Martell, Chair
William Furr
James M. Mullholland
Robert F. Ohler

Claims:

Robert L. Barber, Chair
William Krauter
Howard Porter

Finance:

Kenneth Jarvis, Chair
William Krauter

Appeals:

Robert L. Barber
Kenneth Jarvis
Judith Martell

Nominating Committee:

Judith Martell, Chair
Kenneth Jarvis

During our examination, we noted that the appointment of the members to the above committees was not clearly documented in the minutes to the meetings of the board of directors. See below under the caption "Governing Records" for further comments regarding this condition.

Manager:

According to the Facility's Constitution, the board shall have responsibility for the administration of the facility and shall make appropriate arrangements for the daily management of the affairs of the Facility. In accordance with these provisions, the Chairman made the following appointment as Manager of the facility for 2004:

Victor L. Mastalski

Conflicts Of Interest:

The Facility has established a formal conflict of interest policy. Under this policy, board members and employees of the Facility are required to annually complete a conflict of interest questionnaire and statement. If possible conflicts are disclosed, the policy requires further scrutiny by the board. The conflict of interest questionnaires completed by the board members and employees of the Facility for the period under examination disclosed no conflicts of interest. In addition, we did not note any potential conflicts of interest during our examination.

However, we noted that for the year 2003, board members and employees of the Facility did not complete conflict of interest questionnaires. According to management, this was an oversight, and management acknowledges the importance of annually completing these questionnaires and indicated the intent to do so. Conflict of interest questionnaires were completed for the year 2004.

Governing Records:

We reviewed the minutes of the meetings of the members, directors and committees for the period under examination. Based on our review, except as noted below, it appeared that the minutes documented the Facility's significant transactions and events, and that the members and directors approved these transactions and events.

1. As previously noted, According to the Facility's Constitution, the board shall elect from its members a Chairman and a Vice Chairman and shall appoint a Secretary. However, the minutes to the meetings of the board of directors did not document the board's appointment of a Secretary.
2. The Facility's Constitution allows for the Chairperson to appoint, or the board of directors to elect, such committees as are deemed necessary for the transaction of the board's business. As previously indicated in this report, as of December 31, 2004, various committees existed as of December 31, 2004. However, the minutes to the meetings of the board of directors did not clearly document the establishing of neither these committees nor the appointment of the committee members.
3. We noted that the Facility's Constitution requires an annual meeting of the Facility's members be held. However, no annual meeting was held in 2003.

See the "Comments and Recommendations" section of this Report, under the caption "Corporate Governance and Records", for additional comments regarding the above conditions.

FIDELITY BOND AND OTHER INSURANCE

The Facility's Constitution requires the Facility to generally indemnify directors and insurer members who may be made party to a proceeding by reason of the director or member's service to the facility in the capacity of member or director, and the Facility's Constitution also provides, at the discretion of the Facility, for the Facility's indemnification of officers or employees of the Facility. In addition, the Facility's Constitution provides that the facility may purchase and maintain insurance or other protection (e.g., surety bond, letter of credit, etc.) to protect against any liability asserted against a member, director, officer or employee. According to the Constitution, any such indemnification provided shall be secondary to any applicable coverages the Facility may have procured covering directors and officers liability or errors and omissions coverage.

As of the time we conducted our examination, the Facility was not a named insured on any fidelity bond or other insurance coverage. However, during our examination, the Facility was added as a named insured on an insurance policy issued to the Facility's management company, the Joint Insurance Association (see the "Territory and Plan of Operation" section of this Report for further comments regarding the Facility's management company). The policy, which covered the period October 1, 2004 to October 1, 2005, provided various coverages and limits, including employee dishonesty up to \$200,000 (this coverage exceeded the minimum amount of fidelity bond coverage recommended by the National Association of Insurance Commissioners for the Facility), business personal property and computers up to \$250,000, and money and securities up to \$50,000. The Facility did not have any other insurance coverage.

PENSION AND INSURANCE PLANS

The Facility has no employees and therefore had no active employee pension or employee benefit insurance plans.

The Facility maintained a noncontributory defined benefit pension plan (the Plan) covering persons who were employed by the Facility and were members of the Plan in 1993 at the time Facility initially entered into a management agreement with the Joint Insurance Association (JIA) and upon which time the employees of the Facility were terminated or were transferred to the JIA. As of December 31, 2004, there were eleven participants remaining in the Plan. Six are retired and collecting pensions and five are vested but not yet eligible to receive benefits.

The Facility makes annual contributions to the Plan as necessary to cover future plan obligations as computed by an independent actuary. During 2004, the Facility contributed approximately \$31,000 to the Plan.

The Facility also provides other post-retirement benefits, primarily health care and life insurance coverage to its retirees. The accrued liability for these benefits is included on the Facility's financial statements. During 2004, the Facility had accrued approximately \$55,000 for post-retirement benefits and during 2004 paid post-retirement benefits totaling approximately \$12,000.

TERRITORY AND PLAN OF OPERATION

As previously noted, the Facility was established for the primary purpose of providing property insurance to property owners in the District of Columbia who cannot obtain insurance in the standard insurance market-place. Any property owner eligible for basic property insurance, if unable to obtain such insurance in the voluntary insurance market, may apply to the Facility.

The Facility operates like an insurer and underwrites and issues its own policies and assumes the risk on those policies. The Facility is primarily funded by premium income from policies but is also permitted to assess the member insurers for any equity deficit if necessary. The last assessment of its members by the Facility occurred in 1998.

The Facility offers residential and commercial fire coverage (including extended coverage covering losses caused by wind, hail, explosion, riot, and other named perils, and including vandalism and malicious mischief coverage), and also offers homeowners coverage (beginning in August 2004). Maximum coverage limits per property are \$1,500,000 for residential and commercial fire, \$455,000 for homeowners dwelling and \$227,500 for homeowners contents.

Approximately 40 percent of the Facility's business is directly written and the remaining 60 percent is written by agents. During 2004, the Facility wrote direct premiums totaling

approximately \$844,000 and as of December 31, 2004, had approximately 1,200 policies in force.

The Facility has no employees and, effective in 1993, entered into a "Management and Services Sharing Agreement" with the Joint Insurance Association (JIA). (Prior to entering into this agreement, the JIA provided accounting services to the Facility.) The JIA is the State of Maryland's equivalent of the District of Columbia Property Insurance Facility. Pursuant to the agreement with the JIA, the JIA provides certain support services and operations to the Facility, including, but not limited to accounting, underwriting, policy assembly, filing, claims handling and adjustment, and management.

Under terms of the agreement, expenses directly attributable to the operation of the Facility are paid directly by the Facility. These expenses include, but are not limited to commissions, director expenses, taxes, and rent for the District of Columbia office of the Facility. For expenses incurred by the JIA that are not directly attributable to either the Facility or the JIA (i.e., overhead expenses), the Facility pays JIA a service fee for each Facility policy produced by JIA.

The service fee per policy is estimated at the beginning of each fiscal year of the JIA. (The JIA fiscal year is October 1 to September 30.) Payments are made by the Facility to the JIA during the year based on this estimate. At the end of the fiscal year, the actual cost per policy is calculated based on overhead costs incurred by the JIA. Amounts paid by the Facility to the JIA during the year are then adjusted to reflect the actual expenses incurred by the JIA on behalf of the facility on a per policy basis. The actual cost per policy calculated at the end of the fiscal year becomes the new estimated cost per policy to be charged in the upcoming fiscal year. The cost per policy paid by the Facility for the period October 1, 2003 to September 30, 2004 was \$149. The facility paid JIA \$203,981 for the period October 1, 2003 to September 30, 2004. The costs incurred by the JIA on behalf of the Facility during this period were calculated to be \$271,716, which was \$198 per policy. For the period January 1, 2004 to December 31, 2004, the Facility incurred costs totaling approximately \$279,000 related to services provided by the JIA.

The Facility's Constitution provides that the principal office of the Facility shall be in the District of Columbia or at a location approved by the Commissioner. In accordance with this provision, the facility maintains an office in the District of Columbia to serve walk-in customers of the Facility. With the permission of the Commissioner, the Facility's general ledger and all of its accounting records, including the underwriting, policy and claim records are maintained in Lutherville, Maryland, at the home offices of the Facility's manager, the Joint Insurance Association.

INSURANCE PRODUCTS AND RELATED PRACTICES

The District of Columbia's Market Conduct Unit last conducted an examination of the market conduct affairs of the Facility covering the period from January 1, 1998 through December 31, 1999. The market conduct examination included detailed reviews

of the Company's underwriting, claims processing and complaint handling practices and procedures. Our review of the market conduct examination report disclosed no issues impacting the financial condition of the Facility.

The scope of our examination did not include market conduct procedures, including, but not limited to, market conduct procedures in the following areas:

- Policy Forms
- Fair Underwriting Practices
- Advertising and Sales Materials
- Treatment of Policyholders:
 - Claims Processing (Timeliness)
 - Complaints

REINSURANCE

The Facility does not assume or cede reinsurance. As previously noted, the Facility is permitted by the DC Official Code to assess the member insurers for any equity deficit.

ACCOUNTS AND RECORDS

As previously noted, the Maryland Joint Insurance Association ("JIA") maintains the Facility's accounting records. Our review did not disclose any significant deficiencies in these records. However, we noted weaknesses in the Facility's accounting for its premiums receivable. The above weaknesses are addressed in the "Comments and Recommendations" section of this Report, under the caption "Installment Premiums Receivable".

In addition, our review of the Company's electronic data processing system disclosed several areas in which the electronic data processing controls could be improved. See additional comments on these conditions in the "Comments and Recommendations" section of this Report, under the caption "Management Information Systems General Controls."

Section 31-5008 of the DC Official Code requires the Facility to file with the Commissioner, annually on or before the 1st day of March, a statement which shall contain information with respect to its transactions, condition, operations, and affairs during the preceding year. Such statement shall contain such matters and information as are prescribed by the Commissioner and shall be in such form as is approved by him. However, during our examination, we determined that annual filings were not always made in accordance with these provisions. In addition, according to the Facility's management, the content and form of the statement as required by the Commissioner is not clearly documented.

Specifically, in June 2005, the facility provided the Department with both audited and unaudited financial statements for year end 2004. The audited statements were dated April 29, 2005, were prepared on the basis of statutory accounting practices, and were audited by an independent certified public accountant. The unaudited statements did not indicate the basis of accounting under which they were prepared, however, we were informed by management that they were prepared on the basis of statutory accounting practices.

Management indicated that although it could have provided both the audited and unaudited financial statements to the Department at earlier dates, since a financial examination was planned during 2005 and management would therefore have to provide the financial statements to the Department as part of the examination, management did not submit the financial statements to the Department at an earlier date.

During our examination, we agreed with the Facility that the content and form of the financial statement as required by the Commissioner is not clearly documented. However, although we indicated we understood management's reason for not submitting the financial statements to the department prior to June 2005, we indicated the aforementioned section of the DC Official Code was clear regarding the due date of the financial statements.

Therefore, for purposes of the Facility's compliance with the financial statement filing requirements of the above-mentioned section of the DC Official Code, we agreed with management of the Facility as follows: The Facility will file annually with the Commissioner, by March 1, regardless of whether a financial examination is underway or is imminent, complete financial statements (audited or unaudited), prepared on the basis of statutory accounting. These statements will be sent to the Department to the attention of the Chief Financial Analyst. If the financial statements filed by the Facility by the March 1 deadline are unaudited, the Facility will file, by June 1 each year, complete audited financial statements, also to the attention of the Chief Financial Analyst.

In the event the Facility chooses not to, or cannot file such statements prior to the March 1 and/or June 1 deadlines, the Facility will contact the Department prior to the filing date(s) regarding the reason(s) for the delay. The above filing procedures will apply to periods subsequent to the completion and issuance of this Report on Examination of the Facility.

FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Facility as of December 31, 2004, as determined by this examination (See **NOTE 1** in the “Notes to Financial Statements” section of this Report for comments regarding these financial statements):

<u>STATEMENT</u>	<u>PAGE</u>
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The accompanying “Notes to Financial Statements” are an integral part of these financial statements.

BALANCE SHEET

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Cash (\$458,527) and short-term investments (\$494,565)	\$ 953,092	\$ 0	\$ 953,092
Subtotals, cash and invested assets	\$ 953,092	\$ 0	\$ 953,092
Interest income due and accrued	\$ 448	\$	\$ 448
Premiums, agents' balances and installments booked but deferred and not yet due	25,700	12,690	13,010
Aggregate write-ins for other than invested assets (NOTE 2)	97,974	22,401	75,573
Totals	\$ 1,077,214	\$ 35,091	\$ 1,042,123

LIABILITIES AND MEMBERS' EQUITY

Losses (NOTE 3)	\$ 114,905
Loss adjustment expenses (NOTE 3)	11,878
Commissions payable	6,192
Other expenses (excluding taxes, licenses and fees)	231,011
Taxes, licenses and fees	7,535
Unearned premiums	419,478
Advance premiums	15,199
Amounts withheld or retained by company for account of others	7,728
Total liabilities	<u>\$ 813,926</u>
Members' equity	<u>\$ 228,197</u>
Total liabilities and members' equity	<u>\$ 1,042,123</u>

STATEMENT OF INCOME

Underwriting Income:

Premiums earned		\$ 859,075
Underwriting deductions:		
Losses incurred	\$ 179,142	
Loss expenses incurred	43,385	
Other underwriting expenses incurred	492,944	
Total underwriting deductions	<u>715,471</u>	\$ 715,471
Net underwriting gain		<u>\$ 143,604</u>

Investment Income:

Net investment income earned	<u>\$ 6,627</u>	
Net investment gain		\$ 6,627

Other Income:

Aggregate write-ins for miscellaneous income	<u>\$ 439</u>	
Total other income		<u>\$ 439</u>

Net Income		<u><u>\$ 150,670</u></u>
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MEMBERS' EQUITY ACCOUNT

Members' equity, December 31, 1998	\$ <u>366,701</u>
Gains and (losses) in members' equity, 1999	
Net income, 1999	\$ 36,511
Change in nonadmitted assets	1,612
	<u>38,123</u>
Net change in members' equity for the year	\$ <u>38,123</u>
Members' equity, December 31, 1999	\$ <u>404,824</u>
Gains and (losses) in members' equity, 2000	
Net loss, 2000	\$ <u>(29,714)</u>
Net change in members' equity for the year	\$ <u>(29,714)</u>
Members' equity, December 31, 2000	\$ <u>375,110</u>
Gains and (losses) in members' equity, 2001	
Net income, 2001	\$ <u>2,422</u>
Net change in members' equity for the year	\$ <u>2,422</u>
Members' equity, December 31, 2001	\$ <u>377,532</u>
Gains and (losses) in members' equity, 2002	
Net loss, 2002	\$ <u>(234,233)</u>
Net change in members' equity for the year	\$ <u>(234,233)</u>
Members' equity, December 31, 2002	\$ <u>143,299</u>
Gains and (losses) in members' equity, 2003	
Net income, 2003	\$ <u>33,544</u>
Net change in members' equity for the year	\$ <u>33,544</u>
Members' equity, December 31, 2003	\$ <u>176,843</u>
Gains and (losses) in members' equity, 2004	
Net income, 2004	\$ 150,670
Change in nonadmitted assets	(35,091)
Aggregate write-ins for gains and losses in surplus (NOTE 4)	(64,225)
	<u>51,354</u>
Net change in members' equity for the year	\$ <u>51,354</u>
Members' equity, December 31, 2004	\$ <u>228,197</u>

ANALYSIS OF EXAMINATION CHANGES TO MEMBERS' EQUITY

There were no adjustments to members' equity as result of our examination.

COMPARATIVE FINANCIAL POSITION OF THE FACILITY

The comparative financial position of the Facility for the six-year period ended December 31, 2004 was as follows:

	2004	2003	2002	2001	2000	1999
Assets	\$1,042,123	\$1,103,597	\$880,521	\$756,559	\$864,211	\$858,526
Liabilities	813,926	926,754	737,222	379,027	489,101	453,702
Members' equity	228,197	176,843	143,299	377,532	375,110	404,824
Premiums earned	859,075	779,000	632,526	562,780	615,396	714,400
Net underwriting gain (loss)	143,604	27,713	(243,618)	(23,840)	(72,710)	2,014
Investment income	6,627	5,862	9,797	26,157	42,896	34,712
Net income (loss)	150,670	33,544	(234,233)	2,422	(29,714)	36,511

Note: Amounts presented in the preceding financial statements for years ended December 31, 1999 through December 31, 2003 were taken from the facility's unaudited financial statements and from the Facility's audited financial statements as filed with the Department. Amounts for the years ended December 31, 1998 and December 31, 2004 are amounts per examination.

NOTES TO FINANCIAL STATEMENTS

1. Financial Statements:

The Facility is not required to file Annual and Quarterly statements in the format required of licensed insurers (i.e., NAIC Annual and Quarterly statement blanks). Rather, as noted in the "Accounts and Records" section of this Report, the Facility annually files with the Department both audited and unaudited financial statements for the preceding calendar year. These statements filed with the Department are prepared on the basis statutory accounting principles.

The accompanying financial statements in this Report are also prepared on the basis of statutory accounting principles and are prepared for this examination from the both the Facility's unaudited financial statements, which are supported by its trial balance and supporting accounting records, and from the audited financial statements prepared by the Facility's independent certified public accountant.

2. Aggregate Write-Ins For Other Than Invested Assets:

The Facility's "Aggregate write-ins for other than invested assets" was comprised of an intangible pension asset totaling \$75,573 related to its pension obligation, and prepaid pension costs totaling \$22,401, which are nonadmitted.

3. Loss Reserves:

The Facility reported "Losses" and "Loss adjustment expenses" reserves (collectively referred to as "loss reserves"), totaling \$114,905 and \$11,878, respectively. These amounts represent management's best estimate of the present value of the cost of settling all known and unknown claims that have been incurred as of December 31, 2004.

The methodologies utilized by the Company to compute these reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2004, were reviewed as part of our examination. As part of our review, we relied on the Company's independent certified public accountant, who reviewed the Facility's reserves as part of its audit of the Facility's financial statements and who concluded that these reserves appeared to be sufficient.

4. 2004 Surplus Adjustments:

During its audits of the Company's 2003 and 2004 financial statements, the Company's independent certified public accountant advised management of the

Facility of a number of adjustments related to the Facility's pension costs and liabilities. A number of these adjustments are reflected in the Facility's "Statement of Income" and as a result, the Facility's "Members' Equity" account is indirectly impacted. In addition, a number of these adjustment do not flow through the Facility's "Statement of Income", but have a direct impact on the Facility's "Members' Equity". The net effect of these remaining adjustments is a reduction to surplus totaling \$64,225, which is comprised of pension liabilities totaling \$139,798 and an intangible pension asset totaling \$75,573, both of which should have been recognized in years prior to 2004.

COMMENTS AND RECOMMENDATIONS

Corporate Governance and Records:

The Facility is governed by District of Columbia Municipal Regulations, Title 26 (“Insurance”), Chapter 13 (“Insurance Placement Facilities”), which establishes the Facility’s “Constitution”. As previously noted under the “Governing Records” section of this report, we noted a number of instances where the Facility was either not in compliance with its Constitution, or the Facility’s compliance with its Constitution was not clearly documented. Specifically:

1. An annual meeting of the Facility’s members was not held in 2003.
2. The minutes to the meetings of the board of directors did not document the board’s appointment of a Secretary.
3. The minutes to the meetings of the board of directors did not clearly document the establishment of the Facility’s committees or the appointment of the committee members.

We recommend that management ensure compliance with the Facility’s Constitution and that such compliance is clearly documented. In addition, we recommend that the establishment of committees and the appointment of committees be clearly documented in the Facility’s records.

Installment Premiums Receivable:

In August 2004, the Facility began offering an installment premium option. Under this option, 40 percent of the premium is due at the effective date of the policy, 30 percent is due after 90 days and the remaining 30 percent is due after 120 days. As of December 31, 2004, the Facility reported “Premiums, agents’ balances and installments booked but deferred and not yet due” totaling \$25,700. The Facility nonadmitted \$12,690 of this amount, resulting in a net admitted receivable totaling \$13,010.

According to applicable statutory accounting principles, premiums that are over 90 days past due could possibly be nonadmitted for purposes of calculating the Facility’s total assets and members’ equity. Specifically, amounts over 90 days past due that are due directly from policyholders are nonadmitted to the extent there is no corresponding unearned premium. Amounts over 90 days past due that are due directly from agents are nonadmitted regardless of any corresponding unearned premium. Our review disclosed the following:

1. The Facility’s procedure for calculating any nonadmitted portion of its premiums receivable balance was to classify as admitted assets all premium

receivable amounts posted to the premiums receivable balance within the 90 days prior to year end (i.e., all balances originating during the period October 1, 2004 to December 31, 2004) and to nonadmit the remainder of the premiums receivable balance. This procedure did not take into account whether any collections related to the admitted balance had been received during the period October 1, 2004 to December 31, 2004 or whether there was any corresponding unearned premiums on the nonadmitted balances.

2. The Facility's premiums receivable as of December 31, 2004 per the policy administration system maintained by a third-party vendor (\$19,716) did not agree to the premiums receivable balance generated from the Facility's general ledger (\$25,700) and the Facility could not explain or reconcile the difference (\$5,984). As noted above, the Facility nonadmitted \$12,690 of the general ledger balance of \$25,700, therefore, this difference of \$5,984 was essentially nonadmitted.

As a result of the above conditions, the possibility exists that the net admitted amount of premiums receivable reported by the Facility (\$13,010) was either overstated or understated. **We recommend the following:**

1. **The Facility develop and implement a procedure for aging, on a policy by policy basis, in accordance with applicable statutory accounting principles, its premiums receivable balance.**
2. **The Facility reconcile its premiums receivable per its policy administration system to the premiums receivable balance generated from the Facility's general ledger, and that documentation of this reconciliation be maintained for future review.**

Management Information Systems General Controls:

The Facility uses electronic data processing systems to process the majority of its critical applications. These include the general ledger, premium processing, and claims processing functions. The Facility's manager, the Maryland Joint Insurance Association (JIA), processed these critical applications on behalf of the Facility. Our examination included a limited review and evaluation of the general and security access procedures and controls in place over the systems utilized to process the Facility's transactions. During our review, we noted the following:

1. Review of Outside Service Center:

The JIA out sources a portion of its data processing to a third-party data processing vendor and has entered into a "Master Processing Services Agreement" (the "Agreement") with the vendor. This vendor provides, at its own out-of-state location, the processing systems for the JIA's and the

Facility's premium and claims transactions. The transactions are transmitted electronically between the JIA offices and the vendor's facilities. The Agreement outlines the duties and responsibilities of the parties. For example, the vendor is responsible for providing "reasonable" security over the JIA and Facility data, providing for a disaster recovery plan, and for providing regularly-scheduled data back-ups.

However, neither the Facility nor the JIA verifies that such provisions in the contract are being adhered to by the vendor. Specifically, there is no assurance that the vendor is providing adequate security over the Facility's data, that the vendor's disaster recovery plan is adequate and is periodically tested, or that the vendor is performing back-ups of the facility's data. Such assurance could be gained by the Facility through its own (or the JIA's) review and documentation of the vendor's processing environment, or such assurance could be obtained from independent reviews of the vendor's control environment (i.e., SAS-70 review). **We recommend that the Facility obtain, at least annually, reviews (i.e., SAS-70) of the vendor's data processing control environment.**

2. Contingency Planning Controls:

The outside service center (the "vendor") which processes the Facility's premium and claims transactions has a documented disaster recovery plan outlining the procedures to be followed in the event of a disaster or other event occurring at the vendor's facilities which would render the facilities unusable.

However, a disaster recovery plan for recovery of the Facility's remaining computer systems which are located at the offices of the JIA has not been developed. These systems include the personal computer network on which the Facility's general ledger system is processed. Such a plan should include a contingency plan regarding how to restore computer operations in the event of an emergency or disaster causing prolonged disruption of the computer systems at the JIA offices. The plan would include formal arrangements for alternative processing capabilities at another location with compatible hardware and software, and provision for re-establishing communications with the data processing vendor. As a result of not having a plan, the Facility may be unable to effectively restore critical applications and data processing in the event of a disaster, resulting in prolonged business interruption to the Facility.

In addition, the Facility has not developed a business continuation plan. Such a plan would address areas not specifically included in the disaster recovery plan, such as alternate office facilities in the event that the current offices are unavailable for use, procedures for manual processing of non-automated or less critical business functions, and procurement of other items not included in the disaster recovery plan. Consequently, lack of formal contingency planning

controls increases the risk of a prolonged disruption impairing the operations of the Facility. **We recommend that the Facility develop and implement formal contingency planning controls that include comprehensive disaster recovery and business continuity plans. Furthermore, we recommend that the plans be periodically tested (e.g., annually) to ensure that they are current and function as intended.**

Additional Comments and Recommendations:

In addition to the above Comments and Recommendations, during our examination we made a number of other suggestions and recommendations to the Facility with regard to record keeping and other procedures relating to its operations.

CONCLUSION

Our examination disclosed that as of December 31, 2004, the Facility had:

Admitted Assets	<u>\$ 1,042,123</u>
Liabilities and Reserves	\$ 813,926
Members' Equity	<u>\$ 228,197</u>
Total Liabilities and Members' Equity	<u>\$ 1,042,123</u>

Based on our examination, the accompanying balance sheet properly presents the statutory financial position of the Facility as of December 31, 2004, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the D.C. Official Code, the District of Columbia Municipal Regulations and the National Association of Insurance Commissioners.

SIGNATURES

In addition to the undersigned, Chidinma N. Ukairo, financial examiner with the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Respectfully submitted,



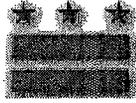
Nathaniel Kevin Brown, CFE
Examiner-in-Charge
District of Columbia Department of
Insurance, Securities and Banking

Under the Supervision of,



P. Sean O'Donnell, CFE
Chief Financial Examiner
District of Columbia Department of
Insurance, Securities and Banking

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

May 25, 2006

Victor L. Mastalski
Manager
District of Columbia Property Insurance Facility
170 West Ridgely Road, Suite 230
Lutherville, Maryland 21093

Dear Mr. Mastalski:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Examination of the affairs and financial condition of the **District of Columbia Property Insurance Facility** as of December 31, 2004.

Please call our attention to any errors or omissions. In addition, if this Report on Examination contains a section entitled "Comments and Recommendations" that discloses certain areas requiring action, the Facility shall submit a statement covering the corrective measures which will be taken. If the Facility's position on any of these points is contrary to the Examiner's findings, an explanation should be submitted covering each contested comment and/or recommendation.

If there are no errors or omissions to be brought to our attention, and there are no "Comments and Recommendations" requiring a response, please submit a statement that the Company accepts the Report.

All of your comments concerning these matters must be in writing and shall be furnished to this Department within **thirty (30) days from the date of this letter (June 26, 2006)**.

Sincerely,



Philip Barlow
Associate Commissioner for Insurance

Enclosure

DISTRICT OF COLUMBIA PROPERTY INSURANCE FACILITY

170 W. Ridgely Rd.
Lutherville, MD 21093
1-800-492-5670
Fax 410-244-7268

June 22, 2006

DEPARTMENT OF INSURANCE
SECURITIES AND BANKING

2006 JUN 26 A 9:4

RECEIVED

Mr. Philip Barlow
Associate Commissioner for Insurance
Department of Insurance, Securities and Banking
810 First Street, NE #701
Washington, DC 20002

RE: Report on Examination of the Affairs and Financial Condition of the District of Columbia Property Insurance Facility as of December 31, 2004

Dear Assistant Commissioner Barlow:

Please be advised that the District of Columbia Property Insurance Facility (the "Facility") has received the Draft Report on Examination as of December 31, 2004, which was sent under cover of your letter of May 25, 2006. The Facility accepts the Report and per the Comments and Recommendations Section of the Report the Facility will take the following corrective measures:

1. Corporate Governance and Records

The Facility will adhere to its Constitution and hold Annual Meetings for its Members. Also, the minutes to the Annual Organizational Meeting of the Board of Directors will reflect the appointment of the Secretary of the Facility and various committee members.

2. Installment Premiums Receivable

The Facility will implement procedures for aging its Premium Receivable on a policy by policy basis and reconcile balance posted from the Policy Administration System to its General Ledger

3. Management Information Systems General Controls

a. Review of Outside Service Center

The Facility will require, in conjunction with the Joint Insurance Association, the data processing vendor to adhere to the Master Processing Service Agreement and submit annually, a written report for all reviews undertaken of its data processing control environment.

b. Contingency Planning Controls:

The Facility will develop and implement a Comprehensive Disaster Recovery and Business Continuity Plans for its computer network on which the Facility's General Ledger System is processed and the plans will be tested periodically to ensure they are current and function in accordance with the plans.

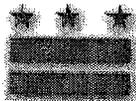
On behalf of the Facility, I would like to thank the examiners for all their help and input and for the professionalism they displayed during the course of the examination.

Sincerely,

A handwritten signature in black ink, appearing to read "Victor Mastalski", with a long horizontal flourish extending to the right.

Victor Mastalski,
Manager

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

June 27, 2006

Victor L. Mastalski
Manager
District of Columbia Property Insurance Facility
170 West Ridgely Road, Suite 230
Lutherville, Maryland 21093

Dear Mr. Mastalski:

We are in receipt your response, dated June 22, 2006, which addresses the corrective action taken by the District of Columbia Property Insurance Facility to comply with the recommendations made in the Report on Examination as of December 31, 2004, dated August 15, 2005. Your response adequately addresses the recommendations made in the Report. However, regarding the response to the following recommendation, we would like to clarify the intent of our recommendation.

Management Information Systems General Controls:

1. Review of Outside Service Center:

We recommended that the Facility obtain, at least annually, reviews (i.e., SAS-70) of the vendor's data processing control environment.

Your response indicated that the Facility will require, in conjunction with the Joint Insurance Association, the data processing vendor to adhere to the Master Processing Service Agreement and submit annually, a written report for all reviews undertaken of its data processing control environment.

However, based on our review of the Agreement, there is no provision for annual written reports for reviews undertaken of the vendor's data processing control environment.

Please note that regardless of the provisions in the agreement, we would expect the Facility to obtain, at least annually, a review (i.e., SAS-70) of the vendor's data processing control environment. Please contact me if you have any questions regarding this recommendation.

Victor L. Mastalski
District of Columbia Property Insurance Facility
June 27, 2006
Page 2 of 2

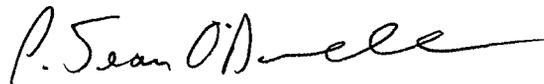
During our next examination of the Facility, we will review the implementation of the corrective actions taken.

The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. After this 10 day period has passed, the Report will be publicly available.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each Company director stating under oath that he or she has received a copy of the adopted examination Report and related Order shall be filed with this Department. Please send these affidavits to my attention here at the Department.

Please contact me at 202-442-7785 if you have any questions.

Sincerely,



P. Sean O'Donnell
Chief Financial Examiner

Enclosures