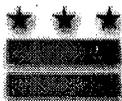


**Government of the District of Columbia**  
**Department of Insurance, Securities and Banking**



Thomas E. Hampton  
Commissioner

**BEFORE THE  
INSURANCE COMMISSIONER OF  
THE DISTRICT OF COLUMBIA**

Re: Report on Examination – Equitable Liability Insurance Company as of December 31,  
2005

**ORDER**

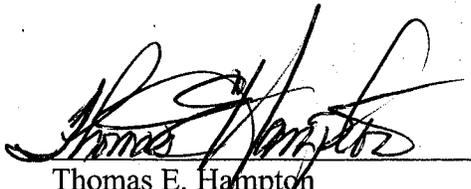
Pursuant to Examination Warrant 2006-5, a Financial Condition Examination of Equitable Liability Insurance Company as of December 31, 2005 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

It is hereby ordered on this 6<sup>th</sup> day of June, 2007, 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

EQUITABLE LIABILITY INSURANCE COMPANY

AS OF

DECEMBER 31, 2005

NAIC COMPANY CODE 10183

## Table of Contents

	Page
Salutation .....	1
Scope of Examination .....	1
Status of Prior Examination Findings .....	2
History .....	2
General .....	2
Capital Stock .....	3
Dividends to Stockholders .....	3
Management .....	3
Board of Directors .....	3
Officers .....	4
Committees .....	4
Conflicts of Interest .....	4
Corporate Records .....	5
Affiliated Companies .....	5
Intercompany Agreements .....	6
Fidelity Bond and Other Insurance .....	8
Pension, Stock Ownership and Insurance Plans .....	8
Statutory Deposits .....	8
Territory and Plan of Operation .....	8
Insurance Products and Related Practices .....	9
Reinsurance .....	9
Accounts and Records .....	9
Financial Statements .....	10
Balance Sheet .....	11
Assets .....	11
Liabilities, Surplus and Other Funds .....	12
Statement of Income .....	13
Capital and Surplus Account .....	14
Analysis of Examination Changes to Surplus .....	15
Comparative Financial Position of the Company .....	16
Notes to Financial Statements .....	17
Comments and Recommendations .....	18
Subsequent Events .....	22
Conclusion .....	23
Signatures .....	24

Washington, D.C.  
April 25, 2007

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

Dear Commissioner:

In accordance with Section 31-1402 of the District of Columbia Official Code, we have examined the financial condition and activities of

**Equitable Liability Insurance Company**

(hereinafter called the Company) at its home office located at 3341 Benning Road N.E., Washington, DC 20019, and the following Report on Examination is submitted.

**SCOPE OF EXAMINATION**

This examination, covering the period from January 1, 2001 to December 31, 2005, including any material transactions and/or events noted occurring subsequent to December 31, 2005, was conducted under the association plan of the National Association of Insurance Commissioners (NAIC) by examiners of the District of Columbia Department of Insurance, Securities and Banking.

The last examination of the Company was a full scope examination, covering the period from January 1, 1998 to December 31, 2000.

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

Our examination included a review of the Company's business policies and practices, management and corporate 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 Company 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 Company was audited annually by an independent public accounting firms. The firms expressed unqualified opinions on the Company's financial statements for calendar years 2001 through 2005. We placed substantial reliance on the audited financial statements for calendar years 2001 through 2004, and consequently performed only minimal testing for that period. We concentrated our examination efforts on the year ended December 31, 2005. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2005, 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 eight recommendations made in our preceding Report on Examination, which covered the period from January 1, 1998 to December 31, 2000.

During our current examination, we repeated one of the eight recommendations made in our prior Report on Examination. See the "Comments and Recommendations" section of this report under the caption "Common Capital Stock and Treasury Stock" for further discussions regarding this recommendation.

### **HISTORY**

#### **General:**

The stock company was incorporated in the District of Columbia on October 27, 1992 and commenced business on December 18, 1994. The purpose of the Company, as stipulated by the Amended Articles of Incorporation, is to insure taxicabs against loss or damage from collision, theft and against liability of owner or user for injury to person or property caused by taxicab, as well as all and every risk or peril to which the subject of insurance may be exposed against, which is not contrary to public policy to insure, including every insurable interest therein, or legal liability thereof or profit or income there from or liability thereon defined in the general laws of the District of Columbia Code.

Pursuant to a Stock Purchase Agreement dated February 14, 2001, and effective March 8, 2001, the Company's stockholders of record transferred all of the Company's issued and outstanding shares of stock to Anacostia Holding Company, Incorporated (the Parent) in exchange for consideration of \$800,000. The transfer of the Company's shares of stock was effective March 8, 2001. The Company shares office space with First Washington Insurance Company, which is also owned by Anacostia Holding Company.

Capital Stock:

As of December 31, 2005 the Company's Articles of Incorporation authorized 1,000 shares of common capital stock with a par value of \$300 per share. All issued and outstanding stock are owned by the Parent. An unreconciled difference was noted between the Company's stock register and the authorized shares at December 31, 2005. Also, the Company reported treasury stock in error at December 31, 2005. For further discussion see the "Comments and Recommendations" section of this report under the caption "Common Capital Stock and Treasury Stock."

Dividends to Stockholders:

The Company did not declare or pay any dividends to stockholders during the period under examination.

Management:

As provided in the By-Laws, the business and affairs of the Company are managed by a Board of Directors, comprised of not less than five persons, unless all of the outstanding shares are owned beneficially and of record by less than three shareholders. In this event, the number of directors shall not be less than the number of shareholders or three, whichever number is greater. Each director shall hold office until the annual meeting of the shareholders next succeeding his election, and until his successor is elected and qualified, or until his prior death, resignation or removal. Vacancies may be filled by a majority vote of the remaining board members. Each director so elected shall serve for the unexpired term of his predecessor, and until his successor is duly elected and qualified.

According to the Bylaws, at any meeting of the Board of Directors, the presence of a majority of the Directors then in office shall be necessary and sufficient to constitute a quorum for the transaction of business. The minutes of all meetings held during the period under statutory examination indicated that a quorum was obtained at all meetings of the Board of Directors during the period under examination.

Directors duly elected and serving at December 31, 2005 follows. Addresses and business affiliations were provided by the Company.

Name and Address

Edith F. Schaeffer  
Washington, District of Columbia

Principal Occupation

President and Chairman  
Equitable Liability Insurance Company

Gerald H. Schaeffer  
Washington, District of Columbia

Treasurer  
Equitable Liability Insurance Company

Jeffrey M. Schaeffer  
Bethesda, Maryland

Secretary and Vice President  
Equitable Liability Insurance Company

The composition of the board of directors at December 31, 2005 was not in compliance with District of Columbia Official Code Section 31-706(c)(3), which requires that not less than 1/3 of the directors of the Company be persons who are not officers or employees of the Company, or of any entity controlling, controlled by, or under common control with the Company (i.e., the directors must be "independent"). For further discussion see the Comments and Recommendations section of this report under the caption "Lack of Independent Directors."

The By-laws provide that the officers of the Company shall consist of a President, a Secretary/Treasurer, and such other officers, including one or more Vice-Presidents. The officers shall be elected by the Board of Directors and shall serve until his/her successor is duly elected and qualified or the officer is removed.

The following were duly elected Officers serving at December 31, 2005:

Edith F. Schaeffer  
Gerald H. Schaeffer  
Jeffrey M. Schaeffer

President and Chairman  
Treasurer  
Secretary and Vice Chairman

#### Committees:

As of December 31, 2005 the Company was not in compliance with District of Columbia Official Code Section 31-706(c)(4), which requires that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. Specifically, the Company did not have such a committee or committees. For further discussion see the "Comments and Recommendations" section of this report under the caption "Lack of Independent Committees of Board of Directors."

#### Conflicts of Interest:

Directors and officers of the Company regularly responded to conflict of interest questionnaires. Our review of the responses to the questionnaires completed for 2005

disclosed no conflicts that would adversely affect the Company. Furthermore, no additional conflicts of interest were identified during the course of our examination.

Corporate Records:

We reviewed the minutes of the meetings of the stockholders and board of directors for the period under examination. Based on our review, it appeared that the minutes documented the Company's significant transactions and events, and that the directors approved those transactions and events.

**AFFILIATED COMPANIES**

The Company is a member of the Anacostia Holding Company system. Gerald H. Schaeffer owns 100% of Anacostia, which owns 100 percent of the stock of the Company and its insurance affiliate, First Washington Insurance Company. These are the only insurance companies within the Holding Company structure. The total holding company structure with all affiliated companies is as follows:

Gerald H. Schaeffer owns 100% of the following:

- Anacostia Holding Company, Inc.
- Liberty Transportation Management Corporation
- Dragonfly, Inc.
- Auto Safety, Inc.
- Auto Management, Inc.
- Anchor Leasing, Inc.
- Diversified Insurance Management, Inc.

Anacostia Holding Company, Inc. owns 100% of the following:

- Equitable Liability Insurance Company (NAIC # 10183)**
- First Washington Insurance Company (NAIC # 14699)

Liberty Transportation Management Corporation owns 100% of the following:

- Allied Associates, Inc.
- Cabs, Inc.
- Taxi Transportation, Inc.
- Transco, Inc.

Dragonfly, Inc. owns 100% of the following:

- Iris, Inc.
- Lilly, Inc.
- Rooster, Inc.
- Triumph, Inc.
- Zeus, Inc.

Gerald H. Schaeffer owns 98%, Edith F Schaeffer (wife) owns 2% of the following:

- 1505 Eastern Avenue, L.L.C.
- 1625 New York Avenue, L.L.C.
- 3101 Rhode Island Avenue, L.L.C.
- 33 New York Avenue, L.L.C.
- 5 Q Street, L.L.C.

Gerald H. Schaeffer owns 67% of the following:

- 3341 Benning Road Limited Partnership
- Washington Benning Road Limited Partnership

Gerald H. Schaeffer owns 60% of the following:

- 9 Fish, L.L.C

Gerald H. Schaeffer owns 50% of the following:

- 1830 Bladensburg Road, L.L.C

Gerald H. Schaeffer owns 33% of the following:

- 1915 New York Avenue Limited Partnership
- 1943 New York Avenue Limited Partnership

Minnesota Avenue & Sheriff Road Limited Partnership

- Mount Olivet Joint Venture
- 3621 Benning Road Limited Partnership
- 1940 Montana Avenue Limited Partnership
- 1729 Bladensburg Road Limited Partnership
- 1400 Maryland Avenue Limited Partnership
- 906 Bladensburg Road Limited Partnership
- 1016 H Street Limited Partnership
- M Street Joint Venture
- 1900 Bladensburg Road Limited Partnership
- Bladensburg & R Limited Partnership
- 1801 Bladensburg Road Limited Partnership
- 1910 Bladensburg Road Limited Partnership
- Liberty Limited Partnership

Gerald H. Schaeffer owns 20% of the following:

- DAG Petroleum Suppliers, L.L.C.
- DAG SPE Managing Member, Inc.
- DAG Energy, L.L.C.
- DAG Oil, L.L.C.
- DAG Power, L.L.C.

## INTERCOMPANY AGREEMENTS

As of December 31, 2005, the Company was a party to the following significant intercompany agreements:

### Expense Sharing Agreement:

The Expense sharing agreement became effective April 25, 2003 and is between the Parent, the Company and First Washington Insurance Company, an insurer affiliate. According to the agreement, the Company and First Washington agree to pay the Parent for costs incurred on their behalves. Per the agreement, management services are charged based on the time actually spent by the Parent's employees based on hourly rates agreed by both parties. The contract specifies that common expenses incurred that benefit both parties will be apportioned based on reasonable methods determined under the best judgment of both parties that reflects the anticipated benefits expected to be derived by each party. During 2005 the Company and First Washington paid the Parent \$135,720 and \$848,120 respectively under the agreement.

Although management began shifting premiums from First Washington to the Company in 2005, there was not a corresponding change in the expense allocation methodology until the period effective January 1, 2007, thus creating a situation where the Company was being undercharged for management services and First Washington was being overcharged in 2005 and 2006 with respect to this contract. As a result, at December 31, 2005 there was a non-compliance issue regarding District of Columbia Code 31-706(a)(1)(B) concerning fairness and reasonableness of intercompany contracts. For further discussion on this matter see the "Comments and Recommendations" section of this report under the caption "Expense Sharing Agreement"

### Master Administration Agreement:

The Master Administration Agreement became effective on July 1, 2001 and was between the Company and First Washington. Originally, according to the agreement, First Washington provided the Company with underwriting, marketing, claims services, facilities management, material management, data systems, accounting and preparation of financial reports, taxes, actuarial services, investment management, and legal services. Once the Expense Sharing Agreement was approved by the Department, First Washington's employees were transferred to the Parent and the Parent began providing the aforementioned services to the Company, except for the sub lease of office space. During 2005 the only payments under this agreement from the Company to First was \$500 per month rent for sub leasing of facilities.

### Tax Sharing Agreement:

Effective March 13, 2001, the Company and First Washington entered into a tax sharing agreement with the Parent. Based on the agreement, the amount of federal income taxes allocable to the subsidiary is determined using the method described in section 1.1502-32(b)(3)(iv)(D) of the Treasury regulations. Thus, the Parent or the subsidiaries are required to pay for any reduction in its separate company liability because of the absorption of losses, credits or other tax attributes of other members. Conversely, the parent or subsidiaries are entitled to compensation to the extent that the absorption of its losses, credits, or other tax attributes reduces the group's consolidated federal income tax liability

### **FIDELITY BOND AND OTHER INSURANCE**

The Company had fidelity bond coverage of \$50,000 with a deductible of \$500. The fidelity bond meets the minimum coverage recommended by the National Association of Insurance Commissioners. The Company was not a named insured on any other policies.

### **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company does not have employees and therefore does not have employee pension, stock ownership and insurance plans.

### **STATUTORY DEPOSITS**

The District of Columbia Department of Insurance, Securities and Banking does not required the Company to maintain a statutory deposit.

### **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2005, the Company was authorized to transact business in the District of Columbia.

The Company writes automobile personal injury and property damage coverage of taxicabs licensed in the District of Columbia. The limits of coverage are \$10,000 each accident for property damage and \$25,000 each person and \$50,000 each accident for personal injury.

Subsequent to December 31, 2005 the Company was approved by the Department to write a six month policy. Also, subsequent to December 31, 2005 the Company entered into an agency agreement with Diversified Insurance Management, Inc., a related party. See the "Subsequent Events" section of this report for further discussion related to these events occurring subsequent to December 31, 2005.

### **INSURANCE PRODUCTS AND RELATED PRACTICES**

The District of Columbia's Market Conduct Unit performed an examination of the Company's business practices for the year 2001. To date, that examination report is not a public document. A market conduct examination would include detailed reviews of the Company's sales and advertising, agent licensing, underwriting, and rating, claims processing and complaint handling practices and procedures.

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**

As of December 31, 2005, the Company had no ceded or assumed business.

### **ACCOUNTS AND RECORDS**

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records. However, the Company did not prepare sufficiently detailed reconciliations between its claims system's reserve report and its Annual Statement's Schedule P case reserves. This is discussed further in the "Comments and Recommendations" section of this Report, under the captions "Reconciliations of Claim System Reports."

In addition, our examination disclosed that minutes of the Stockholders and Directors were not completed on a timely basis during the examination period. This is discussed further in the "Comments and Recommendations" section of this Report, under the caption "Minutes of Stockholders and Directors."

## FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2005, as determined by this examination:

<u>STATEMENT</u>	<u>PAGE</u>
Balance Sheet:	
Assets	12
Liabilities, Surplus and Other Funds	13
Statement of Income	14
Capital and Surplus Account	15
Analysis of Examination Changes to Surplus	16
Comparative Financial Position of the Company	17

The accompanying "Notes to Financial Statements" are an integral part of these financial statements.

BALANCE SHEET

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets	Examination Adjustment Increase (Decrease)	Net Admitted Assets Per Examination
Bonds	\$ 862,464	\$ 0	\$ 862,464	\$ 0	\$ 862,464
Common stocks	296,908		296,908		296,908
Cash (\$1,105,037), cash equivalents (\$0) and short term investments (\$0)	1,105,037		1,105,037		1,105,037
Subtotals, cash and invested assets	\$ 2,264,409	\$ 0	\$ 2,264,409	\$ 0	\$ 2,264,049
Investment income due and accrued	12,121		12,121		12,121
Uncollected premiums and agents' balances in course of collection	11,684		11,684		11,684
Current federal and foreign income tax recoverable	130,218		130,218		130,218
Net deferred tax asset	45,221		45,221		45,221
Totals	\$ 2,463,653	\$ 0	\$ 2,463,653	\$ 0	\$ 2,463,653

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	Amounts per Annual Statement	Examination Adjustments	Amounts per Examination
Losses (NOTE 1)	\$ 957,923	\$	\$ 957,923
Loss adjustment expenses (NOTE 1)	478,925		478,925
Other expenses (excluding taxes, licenses and fees)	340		340
Taxes, licenses and fees (excluding federal and foreign income taxes)	16,313		16,313
Net deferred tax liability	18,390		18,390
Unearned premiums	310		310
Amounts withheld or retained by company for account of others	3,160		3,160
	<hr/>	<hr/>	<hr/>
Total liabilities	\$ 1,475,361	\$ 0	\$ 1,475,361
Common capital stock	\$ 300,000		\$ 300,000
Gross paid in and contributed surplus	350,000		350,000
Unassigned funds (surplus)	380,292	(42,000)	338,292
Less treasury stock at cost (NOTE 2)	42,000	42,000	0
	<hr/>	<hr/>	<hr/>
Surplus as regards policyholders	988,292	0	\$ 988,292
	<hr/>	<hr/>	<hr/>
Total liabilities and surplus	\$ 2,463,653	\$ 0	\$ 2,463,653

## STATEMENT OF INCOME

### Underwriting Income:

Premiums earned \$ 1,195,966

### Underwriting deductions:

Losses incurred \$ 578,531

Loss expenses incurred 322,878

Other underwriting expenses incurred 273,133

Total underwriting deductions \$ 1,174,542

Net underwriting loss \$ 21,424

### Investment Income:

Net investment income earned \$ 35,095

Net realized capital gains (4,200)

Net investment gain \$ 30,895

### Other Income:

Miscellaneous income \$ 26

Total other income \$ 26

Net income after dividends to policyholders and before  
federal and foreign income taxes \$ 52,345

Federal and foreign income taxes incurred (45,221)

Net income \$ 97,566

## CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2000	\$ 663,443
Net income, 2001	\$ 59,619
Change in net unrealized capital gains or (losses)	(18,598)
Change in net deferred income tax	6,323
Change in nonadmitted assets	125,569
Correction of errors in 2000 statement	(67,027)
Net change in surplus as regards policyholders, 2001	<u>105,886</u>
Surplus as regards policyholders, December 31, 2001	\$ 769,330
Net income, 2002	\$ (17,398)
Change in net unrealized capital gains or (losses)	(60,299)
Change in net deferred income tax	20,502
Net change in surplus as regards policyholders, 2002	<u>(57,195)</u>
Surplus as regards policyholders, December 31, 2002	<u>\$ 712,134</u>
Net income, 2003	\$ (33,202)
Change in net unrealized capital gains or (losses)	112,612
Change in net deferred income tax	(38,288)
Capital changes: Paid in	50,000
Net change in surplus as regards policyholders, 2003	<u>91,122</u>
Surplus as regards policyholders, December 31, 2003	<u>\$ 803,256</u>
Net income, 2004	\$ 74,027
Change in net unrealized capital gains or (losses)	13,331
Change in net deferred income tax	(4,532)
Change in nonadmitted assets	(11,878)
Net change in surplus as regards policyholders, 2004	<u>70,948</u>
Surplus as regards policyholders, December 31, 2004	\$ 874,204
Net income, 2005	\$ 97,566
Change in net unrealized capital gains or (losses)	7,040
Change in net deferred income tax	(2,396)
Change in nonadmitted assets	11,878
Surplus Adjustment	(42,000)
Change in treasury stock	42,000
Net change in surplus as regards policyholders, 2005	<u>114,088</u>
Surplus as regards policyholders, December 31, 2005	<u>\$ 988,292</u>

**ANALYSIS OF EXAMINATION CHANGES TO SURPLUS**

Surplus as regards policyholders per Annual Statement, December 31, 2005	\$ 988,292
Correction of error in reporting of Treasury Stock (NOTE 2)	42,000
Decrease in unassigned funds	<u>(42,000)</u>
Surplus as regards policyholders per examination, December 31, 2005	<u>\$ 988,292</u>

## COMPARATIVE FINANCIAL POSITION OF THE COMPANY

The comparative financial position of the Company for the five-year period ended December 31, 2005, is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Assets	\$2,463,653	\$1,753,098	\$1,601,324	1,384,600	1,365,536
Liabilities	1,475,361	878,894	798,068	672,465	596,206
Policyholders surplus	988,292	874,204	803,256	712,134	769,330
Premiums earned	1,195,966	526,174	418,385	431,863	457,569
Net underwriting gain (loss)	21,424	60,582	(43,270)	(2,043)	36,932
Net investment gain (loss)	30,895	21,022	(5,573)	(36,770)	35,598
Net income (loss)	97,566	74,027	(33,202)	(17,398)	59,619

**Note:** Amounts for the years ended December 31, 2002 through 2004 were taken from the Company's Annual Statements as filed with the Department. Amounts for the years ended December 31, 2001 and 2005 are amounts per examination.

## NOTES TO FINANCIAL STATEMENTS

### 1. Losses and Loss Adjustment Expenses:

The Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$957,932 and \$478,925 respectively. These reserves, which represent management's best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2005.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2005, were reviewed as part of our examination. As part of our review, we relied on the Company's independent actuary, who concluded that the methodologies and reserves appeared to be sufficient. In addition, the methodologies utilized by the Company to compute these reserves, and the adequacy of the loss reserves and loss adjustment expense reserves were reviewed by an independent actuary engaged as part of our examination. This independent actuary engaged as part of our examination also concluded that the methodologies and reserves appeared to be sufficient. However, our independent actuary also made certain recommendations related to the Company's loss reserves. See the "Comments and Recommendations" section of this Report, under the caption "Loss Reserves", for further comments regarding these recommendations.

### 2. Treasury Stock

An examination adjustment of \$42,000 was made to reduce to \$0 the \$42,000 reported in the annual statement by the Company as treasury stock. When the Company was acquired by the current owners, 142.856 shares had been lost by the predecessor owners. The 142.856 lost shares were treated by the Company as treasury stock. Since the lost shares are owned by the Parent and not the Company, the lost shares should be reported as common capital stock and not treasury stock.

## COMMENTS AND RECOMMENDATIONS

### Common Capital Stock and Treasury Stock

At December 31, 2005, the Company's stock register accounted for the issuance of 999.991 total shares. 142.856 of those shares were lost by the predecessor owners and were treated as treasury stock by the current owner. The Company was unable to reconcile the .009 difference between the 999.991 shares per the stock register and the 1000 shares issued and outstanding per the Articles of Incorporation. There was also a recommendation related to proper record keeping with respect to common capital stock in the prior Report of Examination.

**The Company should correct its stock register so that it agrees with the 1,000 issued and outstanding shares reflected in the Company's Articles of Incorporation. This can be accomplished by canceling the current issued shares and reissuing a new certificate(s) totaling 1000 shares with a par value of \$300 per share.**

### Lack of Independent Directors:

The Company is not in compliance with District of Columbia Code Section 31-706(c)(3) which states that no less than 1/3 of the directors of a domestic insurer and not less than 1/3 of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or such an entity. As of December 31, 2005, all directors of the Company were officers or employees of the Company.

**Absent any written exemption by the Department for the Company to maintain a composition of its board of directors as stated in the District of Columbia Code, the Company should comply with the requirements of the District of Columbia Code.**

### Lack of Independent Committees of the Board:

Pursuant to District of Columbia Code Section 31-706(c)(4) the board of directors of a domestic insurer shall establish 1 or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer, and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer, and recommending to the board of directors the selection and compensation of the principal officers.

**Absent a written exemption by the Department, the Company must establish committees of the board of directors pursuant to District of Columbia Code 31-706(c)(4).**

Custodial Agreement:

It was noted that the custodial agreement between Merrill Lynch and the Company did not contain an indemnification clause stating that the custodian is obligated for loss of the securities created by negligence or dishonesty of Merrill Lynch employees.

**It is recommended that the custody agreement with Merrill Lynch be revised as follows: The addition of a clause indemnifying Equitable Liability Insurance Company that the custodian is obligated if they incur any loss of securities due to negligence or dishonesty of Merrill Lynch employees.**

Loss Reserves:

As indicated in **NOTE 1** in the "Notes to Financial Statement" section of this Report, the Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$957,932 and \$478,925 respectively. 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, 2005 were reviewed as part of our examination by an independent actuary engaged as part of our examination. Although this independent actuary engaged as part of our examination concluded that these reserves appeared to be sufficient, the actuary noted that the company did not report claim counts in Schedule P, Part 3C, columns 11 and 12, or in Part 1C, column 12. Claim counts in Schedule P, Part 5C were inconsistent. We should expect the counts in Section 3 (reported cases) to equal the counts in Section 1 (closed with payment) plus Section 2 (outstanding) plus the numbers of claims closed without payment. Instead, Section 1 plus Section 2 greatly exceeded Section 3 for each company.

The independent actuary engaged as part of our examination had to wait for December 2006 data to see the run-off of December 2005 reserves because of the company's misunderstanding how to complete Part 3 of the quarterly statements. No amounts paid or of case reserve are shown for claims reported during 2006 for prior accident years.

The company's and its appointed actuary continue to classify loss adjustment expenses using the outdated "allocated" and "unallocated" definitions. Apparently only outside adjusting service expense is classified as "allocated" and reported under "Defense & Cost Containment" while all salary and other operating overhead is reported as "Adjustment & Other."

**The company needs to properly compile and report Schedule P claim count data so that loss adjustment expenses can be estimated using more modern methods. Besides the paid-**

**to-paid ratio methods, insurers can use projected patterns of claim reporting and closing to model claim activity and use trended average transaction costs.**

Expense Sharing Agreement:

Management began transferring premiums from First Washington Insurance Company to Equitable Liability Insurance Company in 2005. However a change in the methodology to allocate expenses under the Expense Sharing Agreement did not coincide with this transfer. The revised percentage of the Parent's expenses allocated to the insurance subsidiaries did not become effective until January 1, 2007. As a result, First Washington was paying an excessive percentage and Equitable Liability was paying an insufficient percentage of the costs for services provided to the insurance subsidiaries during this period and therefore expenses reimbursed to the Parent at December 31, 2005 and for the entire year of 2006 did not meet the fair and reasonable standard of District of Columbia Code 31-706(a)(1)(B).

**Management of the Company should ensure that any basis adopted to apportion expenses shall meet the fair and reasonable requirement of District of Columbia Code 31-706(a)(1)(B) and that changes to underlying methodologies within a related party contract are made to coincide with significant changes within the Company's operations.**

Reconciliations of Claims System Reports

The Company utilized an electronic data processing system to process the majority of its claims applications. Because of limitations in the claim system's functionality, the Company must perform extensive manual operations to arrive at claim counts and case reserves for Annual Statement's Schedule P reporting purposes. These manual processes include performing claim counts by hand for each accident year and reconciling the report for older reserved claims that the Company considers closed but have not been closed in the system (the Company's policy is to consider claims over 42 months past the accident date that are not "in suit" to be closed). The Company did not maintain documentation that could support the accuracy of the reconciliations.

**The Company should prepare and retain documentation that provides a ready trail from the claim system reports to the Annual Statement's Schedule P. Such reconciliations should be on a policy level detailed basis.**

Minutes of the Stockholders and Directors:

Minutes of the meetings of the Stockholders and Directors were not prepared on a timely basis during the examination period. Minutes of the meetings were prepared in 2007 for each of the years covered by the examination.

**Management of the Company should ensure that minutes of the meetings of the Stockholders and Directors are completed within a reasonable timeframe after each meeting.**

Additional Comments and Recommendations

During our examination, in addition to the above Comments and Recommendations, we made other suggestions and recommendations to the Company with regard to record keeping and other procedures relating to its operations. These additional suggestions and recommendations were not deemed significant for purposes of our Report on Examination, and are not included in our Report on Examination.

## SUBSEQUENT EVENTS

The Company applied for, and was approved by the Department of Insurance Securities and Banking, to change its policy form from a biweekly policy to a six month policy. This change was made by the Company to comply with the mandates of District of Columbia Municipal Regulation 26-801. The policy and rate filing were approved by the Department on December 23, 2005 and the new policies became effective January 1, 2006. The Company's new six month policy period begins on January 1<sup>st</sup> and July 1<sup>st</sup> of each year. For a new policyholder, the initial term may be for a period of less than six months, in which case the premium is computed on a pro-rata basis in accordance with District of Columbia Municipal Regulation 26-801.1. Because all six month policies mature on either June 30<sup>th</sup> or December 31<sup>st</sup> of each year, the Company would generally not have an unearned premium reserve on those dates. However, at the end of the first and third quarters the Company should report an unearned premium reserve. The Company did not report an unearned premium reserve in the first and third quarter statements for 2006. The Company has acknowledged that an error was made with those filings and has expressed its intent to properly report this reserve in future filings.

The Company applied to the Department to enter into an agency agreement with Diversified Insurance Management Inc. (a related party). The agreement was approved by the Department on January 20, 2006, retroactive to January 1, 2006. Pursuant to the agreement, Diversified will collect all premium income for the Company and submit biweekly payments in exchange for a commission rate of 5.25%.

During 2006, the Company applied to the Department to have a new employment agreement with Anacostia Holding Company (the Parent). The agreement was approved by the Department on November 15, 2006 to be effective January 1, 2007. Pursuant to the agreement, the Company will pay \$25,770 biweekly to the Parent to cover employment expenses incurred by the Parent.

The Company entered into a lease agreement with 3341 Benning Road Limited Partnership (an affiliate) for a five year period commencing September 1, 2006. Prior to September 1, 2006, the Company's affiliate, First Washington Insurance Company, leased the property and sublet a portion of the premises to the Company. Rent is in the amount of \$61,800 for the first year of the lease, payable in monthly installments of \$5,150. The Company is also responsible for paying all insurance and real estate taxes on the property.

## CONCLUSION

Our examination disclosed that as of December 31, 2005, the Company had:

Admitted assets	<u>\$ 2,463,653</u>
Liabilities	<u>\$ 1,475,361</u>
Common capital stock	\$ 300,000
Gross paid in and contributed surplus	350,000
Unassigned funds (surplus)	338,292
Surplus as regards policyholders	<u>\$ 988,292</u>
Total liabilities, capital and surplus	<u>\$ 2,463,653</u>

Based on our examination, the accompanying balance sheet properly presents the statutory financial position of the Company as of December 31, 2005, 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 District of Columbia Official Code and the National Association of Insurance Commissioners.

Chapters 20 ("RISK-BASED CAPITAL") and 25 ("FIRE, CASUALTY AND MARINE INSURANCE") of Title 31 ("Insurance and Securities") of the District of Columbia Official Code specify the level of capital and surplus required for the Company. We concluded that the Company's capital and surplus funds exceeded the minimum requirements during the period under examination.

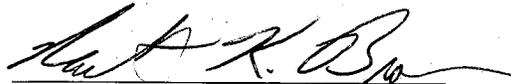
**SIGNATURES**

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

P. Sean O'Donnell, CFE, and Chidinma Ukairo, District of Columbia  
Department of Insurance, Securities and Banking

The actuarial portion of this examination was completed by R. Michael Lamb, FCAS, MAAA, of Michael Lamb, LLC.

Respectfully submitted,



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

# EQUITABLE LIABILITY INSURANCE COMPANY

3341 BENNING ROAD, N.E., WASHINGTON, D.C. 20019  
(202) 398-0519 FAX: (202) 398-0575

May 29, 2007

Philip Barlow  
Associate Commissioner for Insurance  
Government of the District of Columbia  
Department of Insurance, Securities and Banking  
810 First Street NE  
Suite #701  
Washington, DC 20002

Re: Response to a draft copy of the Report on the  
Examination of the affairs and financial condition  
of Equitable Liability Insurance Company as of 12/31/05

Dear Mr. Barlow:

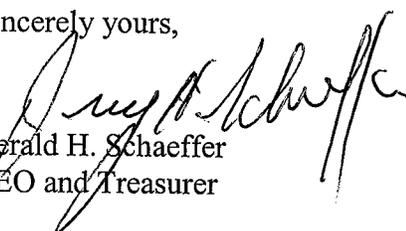
Equitable Liability Insurance Company has received the draft of the Report. The following is our response / comments on the findings contained in the draft:

1. Common Capitol Stock and Treasury Stock We have corrected the error. Attached please see Stock Register and Stock Certificate.
2. Lack of Independent Directors The Company has submitted a request for a waiver (exemption) by the Department to maintain its current composition of the board of directors (please see attached letter).  
  
If the Company is unsuccessful in gaining the waiver, it will need an additional 60 days to screen two individuals that would fit the criteria.
3. Lack of Independent Committees of the Board Please see comments to #2.
4. Custodial Agreement The Company has revised its Custodial Agreement with Merrill Lynch (please see attached Agreement)
5. Loss Reserves The Company will seek the assistance of our actuary Ed Shadman in determining and correcting these deficiencies.

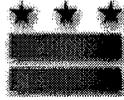
6. Expense Sharing Agreement The Company has reallocated expenses between itself and the First Washington Insurance Company Anacostia Holding Company and all other related companies effective January 1, 2007. These agreements were approved by Samuel Merlo of the Department (attached please see signed approvals).
7. Reconciliation of Claims System Reports The Company is in the process of updating its IT system. The new system will be able to track claims paid and reserves more efficiently (attached please see the Master Professional Services Agreement).
8. Minutes of the Stockholders and Directors Duties for collecting the minutes of the meetings have been given to one of the board members, who will be responsible for maintaining the minutes of all meetings.

Should you have any questions or comments, I may be reached at 202-398-0518.

Sincerely yours,

  
Gerald H. Schaeffer  
CEO and Treasurer

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



**Thomas E. Hampton**  
**Acting Commissioner**

June 6, 2007

Gerald H. Schaeffer  
Chairman of the Board  
Equitable Liability Insurance Company  
3341 Benning Road, N.E.  
Washington, DC 20019

Dear Mr. Schaeffer:

We are in receipt of your response, dated May 29, 2007, which addresses the corrective action taken by Equitable Liability Insurance Company to comply with the recommendations made in the Report on Examination as of December 31, 2005, dated April 25, 2007.

Your May 29, 2007 letter adequately addresses the recommendation made in the Report. During our next examination of the Company, we will review the implementation of the corrective actions taken.

Your request to Associate Commissioner Barlow for an exemption from the requirements of D.C. Official Code, Section 31-706(c)(3) requiring not less than  $\frac{1}{3}$  of the directors of a domestic insurer and  $\frac{1}{3}$  of the members of each committee of the board be comprised of individuals who are independent of the insurer and D.C. Official Code, Section 31-706(c)(4), requiring the establishment of 1 or more committees comprised solely of persons independent of the domestic insurer, is currently under review and will be addressed under separate cover.

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, and will be forwarded electronically to each Commissioner whose name is set forth on Page 1 of the Report, as well as to the National Association of Insurance Commissioners, and to each state in which the Company is licensed, according to your Annual Statement.

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.

Gerald H. Schaeffer  
Equitable Liability Insurance Company  
June 5, 2007  
Page 2 of 2

Please contact me at 202-442-7783 if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Nathaniel K. Brown". The signature is fluid and cursive, with a long horizontal stroke at the end.

Nathaniel Kevin Brown, CFE, CPA  
Supervising Examiner

Enclosures