

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 – First Washington Insurance Company as of December 31, 2005

ORDER

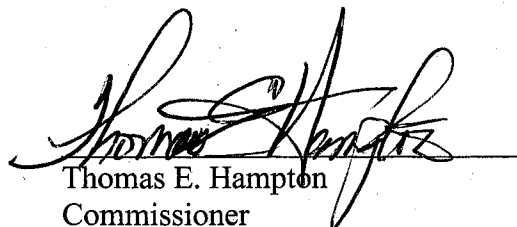
Pursuant to Examination Warrant 2006-4, a Financial Condition Examination of First Washington Insurance Company as of December 31, 2005 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

It is hereby ordered on this 6th 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

FIRST WASHINGTON INSURANCE COMPANY

AS OF

DECEMBER 31, 2005

NAIC COMPANY CODE 14699

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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

First Washington 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, 2002 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, 1999 to December 31, 2001.

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 firm. The firm expressed unqualified opinions on the Company's financial statements for calendar years 2002 through 2005. We placed substantial reliance on the audited financial statements for calendar years 2002 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 dated December 4, 2002, which covered the period from January 1, 1999 to December 31, 2001.

The Company adequately addressed six of the eight previous recommendations. The current examination repeats one of the prior report recommendations regarding incorrect Schedule P summaries. The one remaining recommendation, regarding missing approval documentation no longer applies because the missing approval documentation for this examination relates to the Company's agency agreement. However, the Company is no longer writing business.

HISTORY

General:

First Washington Insurance Company was incorporated on June 3, 1986, in the District of Columbia, as per Act of Congress, Public Law Number 162, 67th Congress. The Company was formed to write multiple lines property and casualty insurance as authorized in Section 31-2502.11 of the District of Columbia Code. The existence of the Company is perpetual. Currently, the Company writes commercial automobile liability coverage on Taxicabs licensed in the District of Columbia. Under an Assumption Agreement approved on December 17, 1990 by the Commissioner of Insurance of the District of Columbia, all assets and liabilities of the Liberty Transportation Management Corporation - Sinking Fund were assumed by the Company.

On May 13, 1999, Anacostia Holdings Company, Inc., a Maryland Corporation, was created. One Thousand shares of Anacostia were issued to Gerald Schaeffer at a cost of \$100. Pursuant to an assignment of rights in Capital Stock of First Washington Insurance Company, Inc., ownership of the Company was transferred from Gerald Schaeffer to the Holding Company.

The Company is currently licensed in the District of Columbia and the State of Maryland, but writes insurance only in the District of Columbia.

Capital Stock:

The Company's Articles of Incorporation originally authorized 10,000 shares of common stock without par value. On April 10, 1991 by an amendment to the Articles of Incorporation, the Company increased its authorized Capital Stock from 10,000 shares without par value to 100,000 shares of common stock with a par value of \$10 per share. At December 31, 2005 there were 50,000 shares issued with 25,000 shares outstanding and 25,000 shares of treasury stock.

Dividends to Stockholders:

During 2005 the Company declared and paid an ordinary dividend of \$425,000 to Anacostia Holding Company. Also, the Company filed a request for an extraordinary dividend with the District of Columbia Department of Insurance, Securities and Banking. That request was approved for \$1,000,000 on July 25, 2005 and \$900,000 was paid during 2005 and the remaining \$100,000 was paid during 2006.

Management:

As provided in the Company's By-laws, the Board of Directors is responsible for the control and management of the affairs, property, and interests of the Company. The number of directors is four unless otherwise determined by the vote of the majority of the directors. The number of directors, however, shall not be less than three.

The following persons were serving as the Company's directors as of December 31, 2005:

<u>Name and Address</u>	<u>Principal Occupation</u>
Edith F. Schaeffer Washington, District of Columbia	Chairman and President First Washington Insurance Company
Gerald H. Schaeffer Washington, District of Columbia	Treasurer First Washington Insurance Company
Jeffrey M. Schaeffer Bethesda, Maryland	Secretary and Vice President First Washington 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 a Treasurer and such other officers, including a Chairman of the Board of Directors, and one or more Vice Presidents.

The following persons were serving as Company officers as of December 31, 2005:

Edith F. Schaeffer	President
Gerald H. Schaeffer	Treasurer
Jeffrey M. Schaeffer	Secretary

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."

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 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:

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

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:

Agency Agreement:

The Company entered into an agency agreement with its affiliate Diversified Insurance Management, Inc., effective April 1, 2000. Based on the agreement, the Company retains Diversified as its licensed resident producer in the District of Columbia for taxicab property and liability insurance. As compensation, Diversified receives a commission of 15.625% after the monies are collected and submitted to the Company for the taxicab sticker period. Diversified is to be paid its commission on a monthly basis. It was noted in the previous examination that the Company did not submit this agreement to the Department for approval prior to implementation. The Company was fined as a result of this oversight. During 2005 the Company paid to Diversified \$303,337.

Expense Sharing Agreement:

The Expense sharing agreement became effective April 25, 2003 and is between the Parent, the Company and Equitable Liability Insurance Company, an insurer affiliate. According to the agreement, the Company and Equitable Liability 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 Equitable Liability paid the Parent \$848,120 and \$135,720 respectively under the agreement.

Although management began shifting premiums from The Company to the Equitable Liability 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 overcharged and Equitable Liability was being undercharged 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 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 Equitable Liability Insurance Company. Originally, according to the agreement, the Company provided Equitable Liability Insurance 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, The Company's employees were transferred to the Parent and the Parent began providing the aforementioned services to Equitable Liability Insurance Company, except for the sub lease of office space. During 2005 the only payments under this agreement from Equitable Liability Insurance Company to the Company was \$500 per month rent for sub leasing of facilities.

Office Lease Agreement:

The Company entered into an office space lease agreement with 3341 Benning Road Limited Partnership (an affiliate) that became effective July 1, 1999. According to the lease agreement, the term is five years and becomes a month to month lease after the expiration of the original lease term. The original lease term expired June 30, 2004 and at December 31, 2005 the lease was month-to-month. Rent was in the amount of \$60,000 annually paid in monthly installments of \$5,000. The agreement also calls for the Company to pay all insurance and real estate taxes on the property. In 2005 the Company paid the parent a total of \$74,652 under the agreement.

Tax Sharing Agreement:

Effective March 13, 2001, the Company and Equitable Liability Insurance Company 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 or 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 \$150,000 with a deductible of \$10,000. 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 offer employee pension, stock ownership or insurance plans.

STATUTORY DEPOSITS

The District of Columbia Department of Insurance, Securities and Banking does not require 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 and the State of Maryland.

The Company writes automobile personal injury and property damage coverage on 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.

Business is produced through its affiliate, Diversified Insurance Management, Incorporated (Diversified). Under an agency agreement, Diversified is paid a commission of 15.625% as the Company's policy writing agent. Premiums are billed and collected under the direct billing method. The Company's agency bills the taxicab fleet operators directly, and payment is made directly to the agency.

Management of the Company decided to cease writing taxicab liability insurance effective January 1, 2006. See the "Subsequent Events" section of this Report for further discussions on this matter.

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:

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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	Examination Adjustment Increase (Decrease)	Net Admitted Assets Per Examination
Bonds	\$ 1,649,872	\$ 0	\$ 1,649,872	\$ 0	\$ 1,649,872
Common stocks	6,858,012		6,858,012		6,858,012
Mortgage loans on real estate – First liens	1,150,285		1,150,285		1,150,285
Mortgage loans on real estate – Other than first liens	528,592	320,000	208,592		208,592
Cash (\$798,565), cash equivalents (\$0) and short term investments (\$0)	798,565		798,565		798,565
Subtotals, cash and invested assets	\$ 10,985,326	\$ 320,000	\$ 10,665,326	\$	\$ 10,665,326
Investment income due and accrued	30,461		30,461		30,461
Uncollected premiums and agents' balances in course of collection	34,318		34,318		34,318
Totals	\$ 11,050,105	\$ 320,000	\$ 10,730,105	\$	\$ 10,730,105

LIABILITIES, SURPLUS AND OTHER FUNDS

	Amounts per Annual Statement	Examination Adjustments	Amounts per Examination
Losses (NOTE 1)	\$ 3,900,682	\$	\$ 3,900,682
Loss adjustment expenses (NOTE 1)	1,715,131		1,715,131
Commissions payable, contingent commissions & other similar charges	17,162		17,162
Other expenses (excluding taxes, licenses and fees)	25,444		25,444
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,359		3,359
Current federal and foreign income taxes	43,327		43,327
Net deferred tax liability	790,980		790,980
Amounts withheld or retained by company for accounts of others	4,910		4,910
Total liabilities	<u>\$ 6,500,995</u>	<u>\$</u>	<u>\$ 6,500,995</u>
Common capital stock	\$ 500,000		\$ 500,000
Gross paid in and contributed surplus	200,000		200,000
Unassigned funds (surplus)	5,529,110		5,529,110
Less treasury stock at cost:	<u>(2,000,000)</u>		<u>(2,000,000)</u>
Surplus as regards policyholders	<u>\$ 4,229,110</u>		<u>\$ 4,229,110</u>
Total liabilities and surplus	<u><u>\$ 10,730,105</u></u>	<u><u>\$</u></u>	<u><u>\$ 10,188,320</u></u>

STATEMENT OF INCOME

Underwriting Income:

Premiums earned	\$ 1,564,590
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Underwriting deductions:

Losses incurred	\$ 403,045
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Loss expenses incurred	344,809
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Other underwriting expenses incurred	706,134
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Total underwriting deductions	\$ 1,453,988
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Net underwriting loss	\$ 110,602
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Investment Income:

Net investment income earned	\$ 212,132
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Net realized capital gains	187,722
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Net investment gain	\$ 399,854
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Other Income:

Rental income	\$ 12,000
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Miscellaneous income	9,071
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Total other income	\$ 21,071
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Net income after dividends to policyholders and before federal and foreign income taxes	\$ 531,527
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Federal and foreign income taxes incurred	237,014
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Net income	\$ 294,513
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CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2001	\$ 2,771,426
Net income, 2002	\$ 295,907
Change in net unrealized capital gains or (losses)	(934,708)
Change in net deferred income tax	317,800
Change in nonadmitted assets	476,734
Net change in surplus as regards policyholders, 2002	155,733
Surplus as regards policyholders, December 31, 2002	\$ 2,927,159
Net loss, 2003	\$ 411,397
Change in net unrealized capital gains or (losses)	1,798,009
Change in net deferred income tax	(611,323)
Change in nonadmitted assets	31,760
Correction of errors	2,112
Net change in surplus as regards policyholders, 2003	1,631,955
Surplus as regards policyholders, December 31, 2003	\$ 4,559,114
Net loss, 2004	\$ 425,559
Change in net unrealized capital gains or (losses)	679,271
Change in net deferred income tax	(230,952)
Change in nonadmitted assets	(345,947)
Net change in surplus as regards policyholders, 2004	527,931
Surplus as regards policyholders, December 31, 2004	\$ 5,087,045
Net income, 2005	\$ 294,513
Change in net unrealized capital gains	222,131
Change in net deferred income tax	(75,526)
Change in nonadmitted assets	25,8947
Dividends to stockholders	(1,325,000)
Net change in surplus as regards policyholders, 2005	(857,935)
Surplus as regards policyholders, December 31, 2005	\$ 4,229,110

ANALYSIS OF EXAMINATION CHANGES TO SURPLUS

There were no changes to the Company's surplus as a result of our examination.

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	\$10,730,105	\$12,601,832	\$12,163,566	9,738,145	9,535,554
Liabilities	6,500,995	7,514,787	7,604,452	6,810,986	6,764,128
Policyholders surplus	4,229,110	5,087,045	4,559,114	2,927,159	2,771,426
Premiums earned	1,564,590	2,731,588	3,019,869	3,155,764	3,457,465
Net underwriting gain	110,602	256,899	145,800	146,255	379,981
Net investment gain	399,854	312,418	297,467	30,629	256,757
Net income	294,513	425,559	411,397	295,907	485,994

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. Loss and Loss Adjustment Expenses:

The Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$3,900,082 and \$1,715,131 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.

COMMENTS AND RECOMMENDATIONS

Lack of Independent Directors:

The Company is not in compliance with District of Columbia Code § 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 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).

Mortgage Loans:

It was noted that the Company does not make a determination that title and hazard insurance are in place on mortgage loans at the inception of the loan or at any time during the duration of the loan. Additionally, it was noted that the Company only determines if property taxes are paid and current on mortgage loans for properties inside of the District of Columbia.

It is recommended that the Company determine that hazard and title insurance policies are in place at the inception, and for the duration of its mortgage loans, and also determine that property tax payments are current for all mortgage loans issued by the Company.

Loss Reserves:

As indicated in **NOTE 1** of the "Notes to Financial Statement" section of this Report, the Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$3,900,682 and \$1,715,131 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. Claims counts in Schedule P, Part 5C was 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 case reserves 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 by the Company 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 reconciliations in a form that was sufficient to provide reasonable assurance that the reconciliations were accurate.

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 Stockholder 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's management has decided to cease writing taxicab liability insurance effective January 1, 2006. Management's decision to cease writing business was in conjunction with District of Columbia Municipal Regulation 26-801, which became effective January 1, 2006, and mandates a six month policy period. All taxicab liability business has been transferred to its insurance affiliate, Equitable Liability Insurance Company. The Company continued to write limousine insurance until March 31, 2006.

As previously discussed in the "Comments and Recommendations" section of this report, the methodology used to calculate the Company's reimbursements due to the parent under the Expense Sharing agreement was revised effective January 1, 2007. The Company paid the Parent \$848,120 under the agreement in 2006 and the projected expense for 2007 is \$167,521.

CONCLUSION

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

Admitted assets	<u>\$ 10,730,105</u>
Liabilities	<u>\$ 6,500,995</u>
Common capital stock	\$ 500,000
Gross paid in and contributed surplus	200,000
Unassigned funds (surplus)	5,529,110
Less treasury stock at cost	2,000,000
Surplus as regards policyholders	<u>\$ 4,229,110</u>
Total liabilities, capital and surplus	<u>\$ 10,730,105</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,

A handwritten signature in black ink, appearing to read "Nathaniel K. Brown", written over a horizontal line.

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

In conjunction with this examination, records of the Diversified Insurance Management, Inc., as of December 31, 2005 were reviewed and summarized in this Addendum to the report.

ADDENDUM

DIVERSIFIED INSURANCE MANAGEMENT, INC.

Diversified Insurance Management, Inc. (hereinafter referred to as the "Agency") was organized in the District of Columbia on November 17, 1986, to collect and disburse insurance premiums and to do any and all acts necessary in the operation of an insurance agency. The Agency's business address is 3341 Benning Road, N.E., Washington, D.C. 20002. The Agency is licensed as a policy-writing agent in the District of Columbia and as a non-resident agent and broker in the state of Maryland. The Agency's original number of authorized capital stock consisted of 100 shares of common stock without par value. 25 shares were outstanding and issued at December 31, 2001. Treasury stock was in the Agency's books at December 31, 2005, for 25 shares acquired from Andrew Schaeffer on July 1, 1996. 25 shares of stock were cancelled on June 30, 1993 and 25 shares of stock were cancelled on June 30, 1989. The shareholder of the 25 outstanding shares of the Agency at December 31, 2005 is Gerald H. Schaeffer.

An agency agreement was renewed with First Washington Insurance Company with an effective date of April 1, 2000 and no stated expiration date. Under this agreement the Agency receives a commission of 15.625% as First Washington Insurance Company's policy-writing agent. In accordance with the terms of the agreement, the Agency shall collect premiums for First Washington and shall remit all funds due to First Washington on at least a monthly basis. The due date shall be fixed so that premiums or installments collected shall be remitted no later than 90 days after the effective date of any policy placed with First Washington.

The Agency's financial statements are prepared in conformity with generally accepted accounting principles, which vary in some respects from statutory accounting principles required of First Washington Insurance Company.

DIVERSIFIED INSURANCE MANAGEMENT, INC.
STATEMENT OF ASSETS
AS OF DECEMBER 31, 2005

Current Assets		
Cash in bank		\$ 1,404
Premiums receivable		
Diplomat	1,944	
Imperial	1,080	
PanAm	54	
Silver	3,672	
USA	28	
VIP	1,080	
World	14,210	
Yourway	<u>2,079</u>	
Total Premiums Receivable		<u>24,147</u>
Other Current Assets		
Notes receivable – Shareholder	35,228	
Prepaid D.C. Income Tax	<u>1,020</u>	
Total Other Current Assets		<u>36,248</u>
Other Assets		
Notes Receivable – Business Partners	<u>58,000</u>	
Total Other Assets		<u>58,000</u>
Total Assets		<u>\$119,798</u>

DIVERSIFIED INSURANCE MANAGEMENT, INC.
STATEMENT OF LIABILITIES AND EQUITY
AS OF DECEMBER 31, 2005

Liabilities

Notes Payable – Anacostia Holdings	99,164
Policy liabilities – Stickers 53 & 54	34,318
Unearned Independent Premiums	3,582
Unearned Limo Premiums	<u>3,276</u>
Total Policy Liabilities	<u>140,340</u>

Equity

Capital Stock	1,000
Retained Earnings	(2,168)
Treasury Stock	(21,000)
Net Income	<u>1,627</u>
Total Equity	<u>(20,541)</u>
<u>Total Liabilities and Equity</u>	<u>119,798</u>

DIVERSIFIED INSURANCE MANAGEMENT, INC.

STATEMENT OF INCOME

AS OF DECEMBER 31, 2005

INCOME

Commission Income	303,337
Returned Check Fee	245
Interest Income	6,955
Other Income	<u>35</u>

TOTAL INCOME 310,572

EXPENSES

Service Fees	240,744
Insurance	880
Interest expense	261
Licenses and Permits	450
Accounting fees	1,423
Consulting fees	29,100
Salaries	35,000
Taxes	<u>1,087</u>

TOTAL EXPENSES 308,944

NET INCOME \$ 1,628

DIVERSIFIED INSURANCE MANAGEMENT, INC.

SERVICE FEES PAID

AS OF DECEMBER 31, 2005

Bay	6,132
Capitol	9,569
Classic	2,769
Courtesy	3,426
Diplomat	10,137
Hilltop	12,761
Imperial	6,128
Independents	26,231
Lincoln	26,494
National	3,794
PanAm	270
Presidential	4,455
Silver	18,929
Transco	36,314
USA	24,751
VIP	5,341
World	36,689
Yourway	<u>6,555</u>
 TOTAL	 <u>\$240,744</u>



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 First Washington Insurance Company as of 12/31/05

Dear Mr. Barlow:

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

1. 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.

2. Lack of Independent Committees of the Board Please see comments to #1.
3. Mortgage Loans The Company is in the process of issuing a Notice to all borrowers, requiring that hazard (property) and title insurance policies be put in place. The Company needs 90 to 180 days to implement this recommendation.

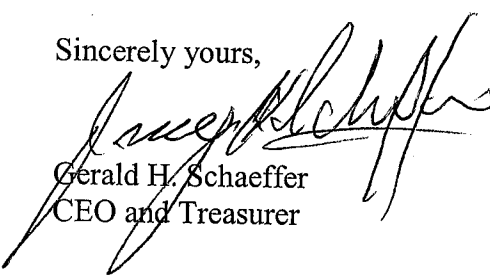
The Company will also expand its search / oversight of real property tax payments to include other jurisdictions outside of the District of Columbia, or even request a proof of payment from mortgagees.

4. Loss Reserves The Company will seek the assistance of our actuary Ed Shadman in determining and correcting these deficiencies.

5. Expense Sharing Agreement The Company has reallocated expenses between itself and the Equitable Liability 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).
6. 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).
7. 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.

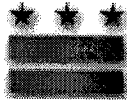
Should you have any questions or comments, I may be reached at 202-398-0518.

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
First Washington 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 First Washington 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.

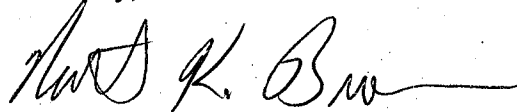
The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. 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
First Washington 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", with a long horizontal flourish extending to the right.

Nathaniel Kevin Brown, CFE, CPA
Supervising Examiner

Enclosures