

STATE OF MISSOURI



DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

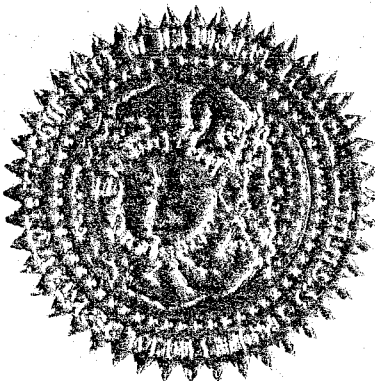
RE: Examination Report of Safeco National Insurance Company as of December 31, 2005

ORDER

After full consideration and review of the report of the financial examination of Safeco National Insurance Company for the period ended December 31, 2005, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, Douglas M. Ommen, Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, the findings and conclusions of the examination report are incorporated by reference and deemed to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo.

Based on such findings and conclusions, I hereby ORDER Safeco National Insurance Company, to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement, and verify compliance with, each item mentioned in the General Comments and/or Recommendations section of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this October 4, 2007.

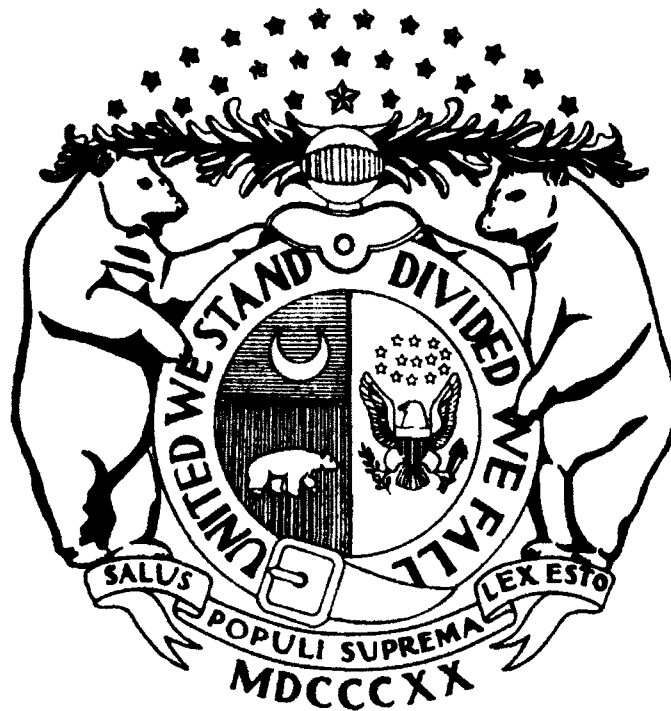


DOUGLAS M. OMMEN, Director
Department of Insurance, Financial Institutions
and Professional Registration

REPORT OF
ASSOCIATION FINANCIAL EXAMINATION

**SAFECO NATIONAL
INSURANCE COMPANY**

AS OF
DECEMBER 31, 2005



STATE OF MISSOURI
DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND
PROFESSIONAL REGISTRATION
JEFFERSON CITY, MISSOURI

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Seattle, Washington
July 5, 2007

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

Honorable Merle Scheiber, Commissioner
South Dakota Division of Insurance
Midwestern Zone Secretary

Honorable Douglas M. Ommen, Director
Missouri Department of Insurance, Financial Institutions, and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65101

Commissioners and Director:

In accordance with your financial examination warrant, an association financial examination has been made of the records, affairs and financial condition of

Safeco National Insurance Company

hereinafter referred to as such, as the "Company," or as "Safeco National." Its main administrative office is located at Safeco Plaza, 4333 Brooklyn Avenue Northeast, Seattle, Washington 98185, telephone number (206) 545-5000.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Safeco National Insurance Company was made as of December 31, 2000 and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with no other zones participating. The prior examination was done in conjunction with the examination that was conducted by the state of Washington's Office of Insurance Commissioner of Safeco Insurance Company of America, General Insurance Company of America, First National Insurance Company of America and Safeco Surplus Lines Insurance Company

The current full scope association financial examination covers the period from January 1, 2001, to December 31, 2005 and was conducted as part of a coordinated multi-state examination of the fifteen (15) property and casualty insurance companies included

in what is hereinafter referred to as the "Safeco Group." The companies (with their states of domicile) included in the Safeco Group are:

- American Economy Insurance Company (Indiana);
- American States Insurance Company (Indiana);
- American States Insurance Company of Texas (Texas);
- American States Lloyds Insurance Company (Indiana);
- American States Preferred Insurance Company (Indiana);
- First National Insurance Company of America (Washington);
- General Insurance Company of America (Washington);
- Insurance Company of Illinois (Illinois);
- Safeco Insurance Company of America (Washington);
- Safeco Insurance Company of Illinois (Illinois);
- Safeco Insurance Company of Indiana (Indiana);
- Safeco Insurance Company of Oregon (Oregon);
- Safeco Lloyds Insurance Company (Texas);
- Safeco National Insurance Company (Missouri); and
- Safeco Surplus Lines Insurance Company (Washington).

Washington was designated as the lead state in this multi-state examination of the Safeco Group, with examiners from the states of Washington, Indiana, Illinois, Missouri, Oregon, and Texas participating in assessing the financial condition and corporate affairs of the affiliated insurance companies of the Safeco Group. Examiners from the State of Missouri primarily reviewed compliance with Missouri-specific statutes and regulations, relying upon work performed by the other states for the majority of the examination procedures.

This examination also included the material transactions and/or events occurring subsequent to the examination date which are noted in this report.

Procedures

This examination followed the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH), the statutory requirements contained in the Washington Administrative Code, and the Revised Code of Washington. Examiners from the State of Missouri reviewed compliance with Missouri-specific statutory requirements where deemed necessary.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

Comments-Previous Examination

Listed below are notes, comments, and recommendations of the previous examination report dated as of December 31, 2000 and the subsequent response or action taken by the Company.

Conflict of Interests

Comment: The Company was directed to develop adequate procedures and controls to ensure that all directors, officers and key employees complete and sign on an annual basis a conflict of interest disclosure statement.

Current Findings: No problems were noted during the current examination with regard to the conflict of interest statements.

Loss and LAE Reserves

Comment: An examination change was made in the prior report to increase the Company's loss and loss adjustment expense reserves by \$9 million. In addition, the Company was instructed to continue to strengthen its reserves.

Current Findings: The Company's loss and loss adjustment expense reserves appear to be adequate as of December 31, 2005.

HISTORY

General

Safeco National Insurance Company was incorporated on September 11, 1972, and commenced business on November 1, 1972, as a stock property and casualty insurance company pursuant to RSMo 379 (Insurance Other Than Life). On July 1, 1980, Safeco National was acquired by Safeco Corporation through a stock dividend from its subsidiary, Safeco Insurance Company of America.

Capital Stock

Safeco National Insurance Company is authorized to issue 20,000 shares of \$125 par value common stock. As of December 31, 2005, all authorized shares of common stock were issued and outstanding for a common capital stock balance of \$2.5 million. The Company's parent organization, Safeco Corporation, owns all of the outstanding common stock shares.

Dividends

During the period under examination, the following stockholder dividends were declared and paid: \$5 million in 2005; \$3 million in 2004; \$5 million in 2003; \$4.5 million in 2002; and no stockholder dividends in 2001.

Management

The management of the Company is vested in a Board of Directors that are elected by the sole shareholder. The Directors of Safeco National Insurance Company elected and serving as of December 31, 2005 were as follows:

<u>Board Member</u>	<u>Principal Occupation</u>
Michael Sean McGavick	Chairman of the Board, Safeco Insurance Companies
Michael Edward LaRocco	Co-President & Chief Operating Officer, Safeco Insurance Companies
Dale Ellis Lauer	Executive Vice President Claims & Service, Safeco Insurance Companies
Christine Barbara Mead	Co-President, Safeco Insurance Companies
Allie Raymond Mysliwy	Executive Vice President - Chief Business Services Officer, Safeco Corporation
Jeffrey Edward Roe	Co-President, Safeco Insurance Companies
Yomtov Senegor	Executive Vice President - Chief Information Officer, Safeco Corporation
Kasey Jo Sweet	Sr. Vice President, Safeco Insurance Companies
Richard Brendan Kelly	Sr. Vice President, Safeco Insurance Companies
Arthur Chong	Executive Vice President - Chief Legal Officer, Safeco Corporation

Safeco National's Finance Committee consisted of the following members as of December 31, 2005: Michael McGavick, Christine Mead, and Richard Kelly. An audit committee exists at the parent company level.

The officers elected and serving as of December 31, 2005 were as follows:

<u>Name</u>	<u>Title</u>
Michael Sean McGavick	President
Neal Andrew Fuller	Treasurer
Stephanie Gayle Daley-Watson	Secretary
Michael Edward LaRocco	Co-President
Christine Barbara Mead	Co-President
Jeffrey Edward Roe	Co-President
Dale Ellis Lauer	Executive Vice President
Gregory Allan Tacchetti	Senior Vice President
Robert Clark Taylor	Senior Vice President
Richard Brendan Kelly	Senior Vice President
Michael Henry Hughes	Senior Vice President
John Ammendola	Senior Vice President
Charles Francis Horne Jr.	Senior Vice President
Teresa Jean Dalenta	Senior Vice President
Eleanor Susan Barnard	Senior Vice President
Willard Myron Hendry	Senior Vice President

Conflict of Interest

The Company has procedures requiring all officers and directors to complete a conflict of interest statement annually. Signed statements of officers and directors were reviewed for the period under examination and no material conflicts were indicated.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws of the Company. The articles were amended June 30, 2003 to change the principal office for the transaction of business to Fenton, Missouri. The Bylaws were amended on November 04, 2004 to provide the Board of Directors with the authority to create the office of the president consisting of one or more co-presidents and to list the duties of the co-presidents and the chairman.

The minutes of the Company's Stockholder and Board of Directors meetings were reviewed. Discussions and approvals were noted in the minutes for significant corporate transactions and events.

Acquisitions, Mergers and Major Corporate Events

In 2004, Safeco Corporation (the parent) completed the sale of its life and investments businesses. On May 1, 2006 the parent sold Safeco Financial Institution Solutions, Inc., an affiliate of the Company.

Surplus Debentures

No surplus debentures were issued or outstanding during the period under examination.

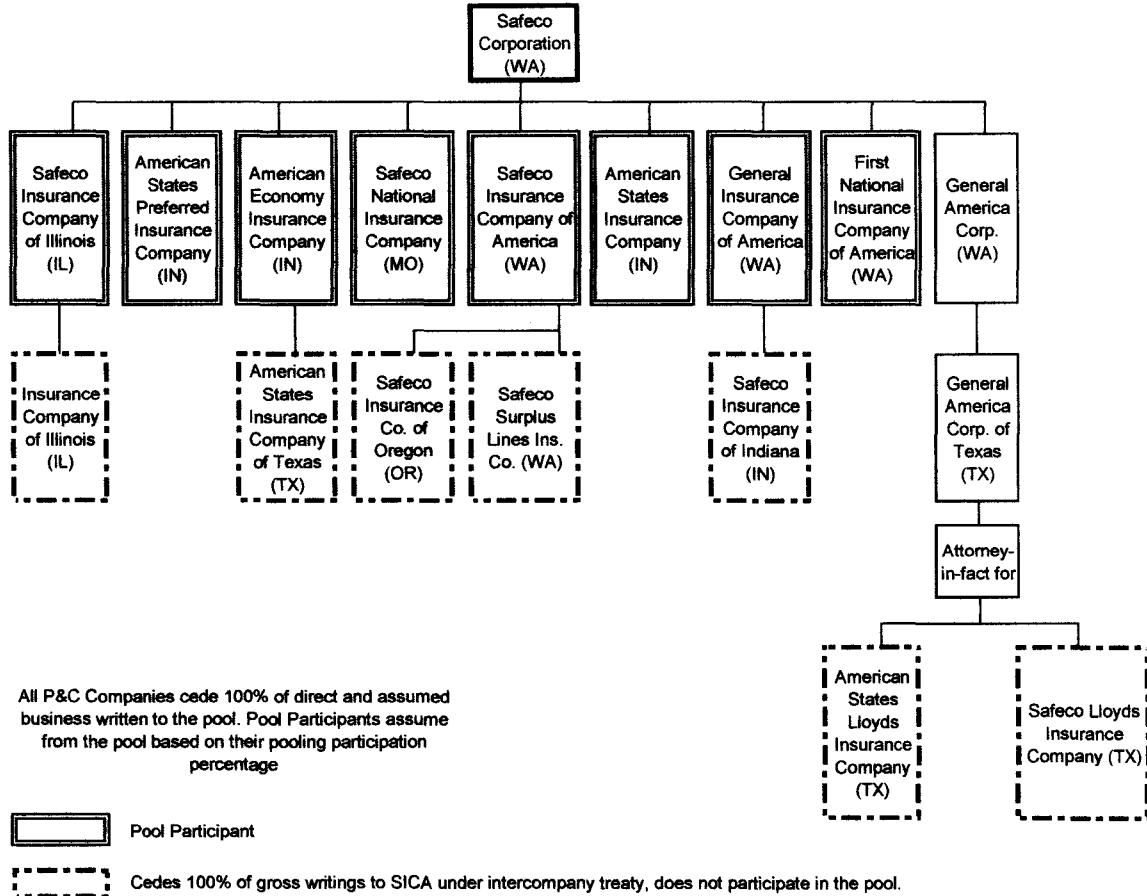
AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

Safeco National Insurance Company is wholly owned by Safeco Corporation and is a member of an insurance holding company system as defined by RSMo Section 382.010 (Definitions). An Insurance Holding Company System Registration Statement was filed on behalf of Safeco National for each year under examination. Safeco Corporation is a holding company incorporated under the laws of the state of Washington. Prior to November 30, 2006, Safeco Corporation was actively traded on the NASDAQ under the ticker symbol SAFC. Beginning on November 30, 2006, Safeco Corporation was actively traded on the New York Stock Exchange (NYSE) under the ticker symbol SAF. Safeco National is a publicly traded company with no single entity directly or beneficially owning ten percent (10%) or more of its stock as of December 31, 2005.

Organizational Chart

The following abridged organization chart shows the affiliated insurance companies:



Intercompany Transactions

Safeco National entered into various intercompany agreements including:

1. Type: Expense Sharing Agreement
 Parties: Safeco Insurance Company of America, American Economy Insurance Company, American States Insurance Company, American States Insurance Company of Texas, American States Preferred Insurance Company, First National Insurance Company of America, General Insurance Company of America, Insurance Company of Illinois, Safeco Insurance Company of Illinois, Safeco Insurance Company of Indiana, Safeco National Insurance Company, and Safeco Surplus Lines Insurance Company
 Effective: March 15, 2001

Terms: The payroll of all employees of the parties to this agreement shall be carried by Safeco Insurance Company of America. If any party to this agreement occupies real estate owned by another party to the agreement, fair and equitable rent shall be charged. Other costs and expenses other than payroll or rent expenses may be paid or incurred by any party to the agreement. Costs shall be allocated to the parties to this agreement in accordance with the uniform accounting instructions adopted by the National Association of Insurance Commissioners.

2. **Type:** Investment Expense Sharing Agreement
Parties: Safeco Insurance Company of America, Safeco National, and other affiliates
Effective: No written agreement
Terms: Safeco Insurance Company of America incurs all investment expenses and then allocates these expenses to the other members of the group. The method of allocating the investments expenses was not clear.
Exception: The examiners were unable to determine if the allocation method is "fair and reasonable" as required by RSMo 382.190 (Transactions with affiliates, how conducted). In addition, this agreement was not been approved by the Missouri DIFP as required by RSMo 382.195 (prohibited transactions, exceptions).

3. **Type:** Agreement of Allocation of Payment of Federal Income Taxes
Parties: Safeco Corporation and its subsidiaries
Effective: February 28, 2000
Terms: Each entity will calculate its tax liability on a stand-alone basis. Amounts due to or from Safeco Corporation shall be determined quarterly.

4. **Type:** Restated Intercompany Short-term Borrowing Agreement
Parties: Safeco Corporation, American Economy Insurance Company, American States Insurance Company, American States Insurance Company of Texas, American States Preferred Insurance Company, First National Insurance Company of America, General Insurance Company of America, Insurance Company of Illinois, Safeco Insurance Company of America, Safeco Insurance Company of Illinois, Safeco Insurance Company of Indiana, Safeco Insurance Company of Oregon, Safeco National Insurance Company, and Safeco Surplus Lines Insurance Company
Effective: October 25, 2002 (July 15, 2002 for Washington companies)
Terms: Each party to the agreement agrees to lend funds to any other party to the agreement when requested. Interest on loans repaid within 30 days shall be paid at the weighted average daily rate earned on overnight investments by Safeco Corporation. Interest on loans repaid after 30 days shall be paid at the rate of the five-year treasury note plus 125 basis points. The maximum allowed loan duration is twelve months. The maximum loan amount varies by the party. The loan amount for Safeco National is limited to a maximum of the lesser of 3% of admitted

assets or 25% of surplus as reported by Safeco National as of December 31 of the preceding year.

In addition to the above, Safeco National is a party to an Intercompany Reinsurance Pooling Agreement effective January 1, 1998 and amended effective May 30, 2002. Under the pooling agreement, the participants share all underwriting liabilities and income and expenses relating to all insurance and reinsurance policies issued by or on behalf of the affiliated Companies. Pooled accounts do not include investments, dividends to stockholders, federal income taxes, and other liabilities not incurred in connection with underwriting and claim operations. This agreement is discussed in the Reinsurance section of this report.

FIDELITY BOND AND OTHER INSURANCE

Safeco National is a named insured under a financial institution bond that provides \$15 million of directors' and officers' (D&O) liability insurance. The policy was issued to Safeco Corporation and covers all subsidiaries and affiliates. The fidelity coverage carried by the Company exceeds the NAIC minimum recommended amount.

The Company was also a named insured on various insurance policies issued to Safeco Corporation that provided property coverage for buildings and contents and comprehensive commercial general liability. These policies were in effect during the period covered by this examination and provided coverage for the Company.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

Safeco National Insurance Company has no direct employees. All services are provided to the Company by Safeco Insurance Company of America in accordance with the provisions of an Expense Sharing Agreement explained in greater detail in the Intercompany Transactions section of this report. Safeco Insurance Company of America provides a variety of benefits to its employees, including a Cash Balance Defined Benefit Pension Plan, a Defined Contribution Plan, a Postretirement Healthcare and Life Insurance Program, and a Deferred Compensation and Supplemental Benefit for Executives, all sponsored by Safeco Corporation. The expenses for these benefits are charged to Safeco National through intercompany service fees. Other than any unpaid billings under intercompany agreements at year-end 2005, Safeco National had no additional liability for the benefits provided.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance, Financial Institutions and Professional Registration as of December 31, 2005, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with RSMo Section 379.098 (Insurance other than life-Security deposits). The funds on deposit as of December 31, 2005 were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. Treasury Bonds	\$3,425,000	\$3,905,984	\$3,585,289

Deposits with Other States

The Company also has funds on deposit with various other states. Those funds on deposit as of December 31, 2005 were as follows:

<u>State or Territory</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Stmt Value</u>
Georgia	U.S. Treasury Note	\$125,000	\$128,633	\$125,665
Louisiana	U.S. Treasury Note	20,000	23,881	21,323
Nevada	U.S. Treasury Bond	300,000	353,813	318,900
New Mexico	U.S. Treasury Notes	150,000	162,359	153,231
Virginia	U.S. Treasury Note	<u>125,000</u>	<u>128,633</u>	<u>125,665</u>
Totals		<u>\$720,000</u>	<u>\$797,319</u>	<u>\$744,784</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Safeco Group operates as a property and casualty insurance company throughout the United States, through four segments: personal insurance, business insurance, surety, and property casualty other. The personal insurance segment offers auto, homeowners, and other property and specialty insurance products for individuals. The business insurance segment offers business owners' policies, commercial auto, commercial multi-peril packages, commercial property, general liability, and workers' compensation policies to small and medium-sized businesses. The surety segment offers bonds that provide payment and performance guarantees primarily for construction businesses and corporations. The property and casualty other segment includes those commercial business accounts currently in runoff. The Safeco Group markets its products primarily to drivers, homeowners, and small and medium sized businesses through approximately 8,500 independent agents and brokers nationwide. Claims offices are maintained throughout the United States.

The mix of business is approximately 66% personal lines, 30% commercial, and 4% surety, based on net written premiums. Personal automobile is the dominant line, followed by homeowners, commercial multi-peril, and commercial automobile liability coverage. Approximately 47% of the Safeco Group's premiums are written in the states of California, Washington, Texas, Florida and Oregon.

Policy Forms and Underwriting, Advertising & Sales Material, Treatment of Policyholders

The Missouri Department of Insurance, Financial Institutions and Professional Registration has a market conduct staff which performs a review of these issues and generates a separate market conduct report. The Market Conduct Examination Reports

prepared by Missouri and other states for the Safeco Group during the examination period were reviewed. No findings were noted which would have a material impact on the financial condition of the Company.

REINSURANCE

General

The Company's reinsurance and premium activity during the period under examination are as follows:

<u>Premiums Written</u> <u>(in thousands):</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Direct Business	\$49,388	\$109,340	\$121,213	\$30,679	\$34,129
Reinsurance Assumed:					
Affiliates	88,784	91,693	102,286	113,517	116,280
Non-Affiliates	0	0	0	0	0
Reinsurance Ceded:					
Affiliates	(49,388)	(109,340)	(121,213)	(30,679)	(34,129)
Non-Affiliates	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Premiums Written	<u>\$88,784</u>	<u>\$91,693</u>	<u>\$102,286</u>	<u>\$113,517</u>	<u>\$116,280</u>

Pooling

Safeco National is a member of the Safeco Group and participates in an inter-company reinsurance pool for which Safeco Insurance Company of America (SICA) acts as the lead pool reinsurer. Members of the pool and their respective percentages of participation as of December 31, 2005 are as follows:

<u>Company Name</u>	<u>Pooling Percentage</u>
Safeco Insurance Company of America	33.00%
General Insurance Company of America	23.00%
American States Insurance Company	19.00%
American Economy Insurance Company	14.00%
Safeco Insurance Company of Illinois	5.00%
First National Insurance Company of America	2.00%
Safeco National Insurance Company	2.00%
American States Preferred Insurance Company	<u>2.00%</u>
Combined Group Total	100.00%

The pooling process is accomplished in three steps. First, each affiliate identified above cedes 100% of its direct and assumed business to SICA pursuant to the terms of an inter-company pooling agreement. In addition, seven other affiliated companies also cede 100% of their direct and assumed business to SICA via individual 100% inter-company reinsurance agreements but do not assume any share of the combined "pool". Those companies are as follows:

Safeco Surplus Lines Insurance Company
Safeco Lloyds Insurance Company
Safeco Insurance Company of Indiana
Safeco Insurance Company of Oregon
Insurance Company of Illinois
American States Insurance Company of Texas
American States Lloyds Insurance Company

Second, SICA combines the business assumed from its affiliates with its own direct and external assumed business and then cedes excess of loss and catastrophe reinsurance to various unrelated reinsurers and various state-operated residual market reinsurance facilities (external reinsurance). Any uncollected external reinsurance balances are ultimately shared in proportion to designated pooling percentages.

Third, in its capacity as lead pool insurer, SICA then cedes (or retrocedes) back to each participant its applicable pooling percentage, as shown above. The respective shares of each participant of the pool have not changed throughout the current examination period.

Assumed

Other than transactions pertaining to inter-company pooling Safeco National had no other assumed business.

Ceded

Safeco National cedes 100% of its direct and assumed business to SICA, pursuant to the above described intercompany reinsurance agreement.

Safeco National is contingently liable for all reinsurance losses ceded or retroceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under its reinsurance agreement with the Company.

ACCOUNTS AND RECORDS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and

the controls exercised to maintain the confidentiality, integrity and availability of data. Sufficient internal controls are in place and monitored by the Company. The Company's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed business continuity and disaster recovery plan.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the year ending December 31, 2005. Any examination adjustments to the amount reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements." (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There were differences found in the course of this examination which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements. Therefore they were communicated to the Company and/or noted in the workpapers for each individual Annual Statement item.

Assets

	<u>ASSETS</u>	<u>ASSETS NOT ADMITTED</u>	<u>NET ADMITTED ASSETS</u>
Bonds	\$170,818,742		\$170,818,742
Preferred stocks	993,555		993,555
Common stocks	27,442,397		27,442,397
Receivables for securities	7,787	3,328	4,459
Investment income due and accrued	2,215,850		2,215,850
Premiums and considerations	30,374,608	698,284	29,676,325
Amounts recoverable from reinsurers	1,724,736		1,724,736
Net deferred tax asset	5,844,573	381,974	5,462,599
Guaranty funds receivable or on deposit	117,976		117,976
Receivable from affiliates	3,755,000		3,755,000
Aggregate write-ins for other assets	<u>65,053</u>	<u>9,028</u>	<u>56,025</u>
Total Assets	<u>\$243,360,278</u>	<u>\$1,092,614</u>	<u>\$242,267,664</u>

Liabilities, Surplus and Other Funds

Losses	\$78,815,232
Reinsurance payable on paid loss and loss adjustment expenses	5,816,264
Loss adjustment expenses	19,382,814
Commissions payable, contingent commissions and other similar charges	2,839,396
Other expenses (excluding taxes, licenses and fees)	918,773
Taxes, licenses and fees (excluding federal and foreign income taxes)	773,528
Current federal and foreign income taxes	2,574,646
Unearned premiums	43,097,565
Advance premiums	1,073,356
Policyholders dividends declared and unpaid	51,760
Ceded reinsurance premiums payable (net of ceding commissions)	2,341,267
Amounts withheld or retained by company for account of others	348,830
Payable to parent, subsidiaries and affiliates	150,887
Aggregate write-ins for liabilities	<u>5,203,323</u>
Total Liabilities	<u>\$163,387,641</u>
Common capital stock	2,500,000
Gross paid in and contributed surplus	21,000,000
Unassigned funds (surplus)	<u>55,380,023</u>
Surplus as regards policyholders	<u>\$78,880,023</u>
TOTAL LIABILITIES AND SURPLUS	<u>\$242,267,664</u>

Statement of Income

Underwriting Income		
Premiums earned		\$116,275,526
Deductions		
Losses incurred	\$57,734,073	
Loss expenses incurred	14,726,330	
Other underwriting expenses incurred	<u>33,203,741</u>	
Total underwriting deductions		<u>105,664,145</u>
Net underwriting gain/(loss)		10,611,381
Investment Income		
Net investment income earned	9,177,848	
Net realized capital gains or (losses)	<u>293,035</u>	
Net investment gain or (loss)		9,470,883
Other Income		
Net (loss) from agents' or premium balances charged off	(450,540)	
Finance and service charges not included in premiums	<u>623,014</u>	
Total other income		<u>172,474</u>
Net income before policyholders' dividends & fed'l inc taxes		20,254,738
Dividends to policyholders		<u>56,992</u>
Net income before federal income taxes		20,197,746
Federal and foreign income taxes incurred		<u>7,145,531</u>
Net income		<u>\$13,052,215</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$72,298,698
Net income	\$13,052,215	
Change in net unrealized capital losses less capital gains tax	(602,323)	
Change in net deferred income tax	(1,304,414)	
Change in nonadmitted assets	435,847	
Dividends to stockholders	<u>(5,000,000)</u>	
Change in surplus as regards policyholders for the year		<u>6,581,325</u>
Surplus as regards policyholders, December 31, 2005		<u>\$78,880,023</u>

NOTES TO THE FINANCIAL STATEMENTS

No adjustments were made to the financial statements of Safeco National as a result of this examination.

EXAMINATION CHANGES

No adjustments were made to the financial statements of Safeco National as a result of this examination.

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Intercompany Transactions (page 7)

As of December 31, 2005, Safeco National was a party to an intercompany investment expense sharing agreement. This agreement was not in writing and the examiners were unable to determine if the allocation method was "fair and reasonable." The Company should file this agreement for approval with the Missouri DIFP as required by RSMo 382.195 (prohibited transactions, exceptions) ensuring it complies with RSMo 382.190 (Transactions with affiliates, how conducted).

SUBSEQUENT EVENTS

There were no material events adversely impacting the Company between the examination date and the last day of our fieldwork.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Safeco National Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Examiners representing the Washington State Office of the Insurance Commissioner; the Indiana Department of Insurance; the Illinois Department of Financial and Professional Regulation, Division of Insurance; the Oregon Department of Consumer and Business Services, Insurance Division; and the Texas Department of Insurance participated in the examination of the Safeco Group, which includes Safeco National. The Washington State Insurance Commissioner's casualty actuarial staff reviewed the Unpaid Losses and Loss Adjustment Expense reserves of the Safeco Group and concluded that the Safeco Group's reserves, on a net basis, are within a range of reasonable estimates.

VERIFICATION

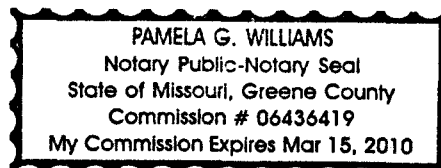
State of Missouri)
County of)

I, Vicki L. Denton, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Vicki L. Denton
Vicki L. Denton, CFE
Examiner-In-Charge
Missouri Department of Insurance, Financial
Institutions and Professional Registration

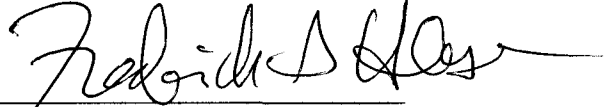
Sworn to and subscribed before me this 10 day of July, 2007.

My commission expires: 3-15-2010 *Pamela G. Williams*
Notary Public



SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.



Frederick G. Heese, CFE, CPA

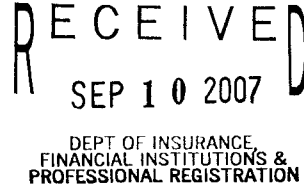
Audit Manager

Missouri Department of Insurance, Financial
Institutions and Professional Registration



September 7, 2007

Frederick G. Heese, CFE, CPA
Acting Chief Financial Examiner
State of Missouri Department of Insurance
301 West High Street, Room 530
P.O. Box 690
Jefferson City, MO 65102-0690



RE: Examination Report of Safeco National Insurance Company as of December 31, 2005

Dear Mr. Heese:

We are in receipt of the draft examination report of Safeco National Insurance Company as of December 31, 2005. Management's response to the examination comments are as follows:

As of December 31, 2005, Safeco National was a party to an intercompany investment expense sharing agreement. This agreement was not in writing and the examiners were unable to determine if the allocation method was "fair and reasonable." The Company should file this agreement for approval with the Missouri DIFP as required by RSMo 382.195 ensuring it complies with RSMo 382.190.

The Company's position has consistently been that no such agreement was required because it has handled investments in its own name and on its own behalf. Regardless, subsequent to this exam's completion, the Company contracted with a third party to handle investments and no intercompany agreement is required.

Thank you for the opportunity to review the examination report and to respond to these findings. Please include the Company response above in the final report as a public document.

Sincerely,

A handwritten signature in black ink that reads "Kris L. Hill".

Kris L. Hill
Vice President & Controller
Safeco Insurance Companies