REPORT OF FINANCIAL EXAMINATION ***AS OF: DECEMBER 31, 2006***

Pinnacol Assurance

7501 East Lowry Boulevard.
Denver, Colorado 81506

Conducted by:

DIVISION OF INSURANCE
STATE OF COLORADO

CERTIFICATE OF COPY

I, **Marcy Morrison**, Commissioner of Insurance of the State of Colorado, do hereby certify that the attached is a true and correct copy of the Financial Examination Report as of December 31, 2006 for **Pinnacol Assurance** now on file as a record of this office.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal of office at the City and County of Denver on this 7th day of January 2008.

Marcy Morrison

Marcy Morrison
Commissioner of Insurance

REPORT OF FINANCIAL EXAMINATION

OF

PINNACOL ASSURANCE

7501 East Lowry Blvd.
Denver, Colorado 80230

AS OF

DECEMBER 31, 2006

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Denver, Colorado
September 19, 2007

Honorable Marcy Morrison, Commissioner
Division of Insurance
State of Colorado
1560 Broadway, Suite 850
Denver, CO 80202

Commissioner:

Pursuant to your instructions and in compliance with Section 8-45-121(4), C.R.S., an examination has been made of the financial condition and affairs of:

PINNACOL ASSURANCE
7501 East Lowry Blvd.
Denver, Colorado 80230

and the report thereon is respectfully submitted.

Pinnacol Assurance, hereinafter referred to as the "Company," was last examined as of December 31, 2003. That examination, as well as the current examination, was conducted by the Colorado Division of Insurance hereinafter referred to as "DOI".

All recommendations contained in the prior examination report have been adequately addressed by the Company.

SCOPE OF EXAMINATION

This examination covers the period from January 1, 2004 through December 31, 2006. During the course of this examination, assets were verified and valued and all known liabilities were established as of December 31, 2006. Accounting and other pertinent records were reviewed to the extent deemed appropriate. The work performed was in accordance with statutory requirements and followed procedures prescribed in the Colorado Examiners Handbook and the National Association of Insurance Commissioners "NAIC" Financial Condition Examiners Handbook. The extent of review on any given account or activity was based on the results of a planning process that included an evaluation of the Company's internal controls, as well as other factors, which included an analytical review of financial data, the Company's financial performance during the examination period, prior examination findings and materiality. Consideration was also given to the use of audit work performed by the Company's independent accounting firm and internal audit staff, and where appropriate has been utilized herein. All phases of the examination were conducted to determine compliance with the insurance laws and regulations of the State of Colorado, and those laws governing the Company found under Title 8, Section 45 of the Colorado Revised Statutes. Specific details pertaining to the various phases of the examination are set forth under the appropriate caption in subsequent sections of this report.

The determination to reflect financial adjustments in the financial statements was dependent upon: the materiality of a particular adjustment; the materiality of the total of all immaterial adjustments; and/or compliance with pertinent laws and regulations. Materiality was determined based upon the Company's surplus, admitted assets and/or operating results.

This examination does not address market conduct issues relating to policy forms, rates, policyholder treatment and claims settlement practices. These issues are addressed in separate market conduct examinations periodically performed by the DOI.

HISTORY AND CAPITAL

History

The Company was created on August 1, 1915, by the General Assembly under the provisions of the Workmen's Compensation Act of Colorado. It was then known as the "State Compensation Insurance Fund."

In 1987, the General Assembly created the State Compensation Insurance Authority, which assumed the responsibilities of the State Compensation Insurance Fund. On July 1, 1990, the Company's name changed to "Colorado Compensation Insurance Authority."

Effective July 1, 2002, the General Assembly repealed and reenacted the substantive provisions of the Workers' Compensation Act of Colorado, creating Pinnacol Assurance which assumed the powers, duties, and functions of the Colorado Compensation Insurance Authority. The Company's primary purpose is to offer workers' compensation and employer's liability insurance to Colorado employers.

Pursuant to Section 8-45-101, C.R.S., the Company is a political subdivision of the state and operates as a domestic mutual insurance company except as otherwise provided by law. The Company is not an agency of state government, nor is it subject to administrative direction by any state agency except as provided in the provisions of Title 8, Article 45, C.R.S.

Pursuant to Section 8-44-101(1), C.R.S., "any employer subject to the provisions of articles 40 to 47 of this title shall secure compensation for all employees in one or more of the following ways, which shall be deemed to be in compliance with the insurance requirements of said articles:

(a) By insuring and keeping insured the payment of such compensation in the Pinnacol Assurance fund;

(b) By insuring and keeping insured the payment of such compensation with any stock or mutual corporation authorized to transact the business of workers' compensation insurance in this state. If insurance is effected in such stock or mutual corporation, the employer or insurer shall forthwith file with the Division of Workers' Compensation, in a form prescribed by it, a notice specifying the name of the insured and the insurer, the business and place of business of the insured, the effective and termination dates of the policy, and when requested, a copy of the contract or policy of insurance;

(c) By procuring a self-insurance permit from the executive director as provided in Section 8-44-201, C.R.S., except for public entity pools, as described in section 8-44-204(3) which shall procure self-insurance certificates of authority from the commissioner of insurance as provided in Section 8-44-204, C.R.S.; and

(d) By procuring a self-insurance certificate of authority from the commissioner of insurance as provided in Section 8-44-205,C.R.S. (Employers Self Insurance Pools for Workers' Compensation)".

The Company provides insurance for those electing to meet this requirement under section (a) as set forth above. The Company shall not refuse to insure any Colorado employer or cancel any insurance policy due to the risk of loss or amount of premium; except as otherwise allowed by statute.

Capital and Dividends

The Company is a statutorily created political subdivision of the State of Colorado pursuant Section 8-45-101. C.R.S. and thus has no authorized stock or outstanding stock. In addition, the Company does not pay shareholder dividends.

Beginning in 2005, the Company paid general policyholder dividends out of excess surplus. The Company has no restrictions placed on the portion of surplus that is paid, as long as Risk-Based Capital "RBC" has been met. The Company's board of directors, at its discretion, determines the amount of policyholder dividends to be declared, based on the Company's overall experience and financial condition. The Company paid a general policyholder dividend to its policyholders in good standing of $56,700,000 and $55,067,000 in 2006 and 2005 respectively.

AFFILIATED COMPANIES

Parent, Subsidiaries and Affiliates

The Company is a political subdivision of the State of Colorado and has no parent, subsidiaries or affiliates.

Acquisitions, Mergers or Sales

During the examination period, there were no corporate acquisitions, mergers or sales.

Holding Company Filings

The Company is not a member of an insurance holding company system and is not subject to the holding company filing requirements of Section 10-3-804, C.R.S., and Colorado Insurance Regulation 3-4-1.

MANAGEMENT AND CONTROL

The business and affairs of the Company are managed by a board of directors, which is fixed by statute at nine members. The board is assigned the power to exercise general supervision over the business affairs of the Company.

Shareholders Meetings

The Company does not have shareholders.

Board of Directors

The members of the board of directors are appointed by the Governor with the consent of the Senate to serve for a period of five years pursuant to the requirements of Section 8-45-101(2)(a), C.R.S.

Of the nine members comprising the board:

- Four must be employers whose liability is insured by the Company of whom one must be a farmer or rancher;
- Three must be employees of employers whose liability is insured by the Company;
- One must be experienced in the management and operation of insurance companies as defined in Section 10-1-102(6), C.R.S., and

- One must be experienced in finance or investments, but shall not be an employer whose liability under Articles 40 to 47 of Title 8 is insured by the Company.

Pursuant to the by-laws, regular meetings of the board are to be held at such times as the board may determine. If no place is designated in the notice of the meeting, the meeting shall be at the principal office of the Company. In compliance with these by-laws, the Company held 36 board meetings during the examination period. Special meetings may be called by the chairman of the board, by any two members of the board or by the chief executive officer. One special meeting was held during the examination period.

Notice of regular meetings of the board is required. Notice of every special meeting of the board must be provided to each member at his or her usual place of business.

A majority of members of the board currently in office constitutes a quorum for the transaction of business. The action of a majority of the directors present at a meeting in which a quorum exists represents the act of the board of directors.

Per Section 8-45-101(3), C.R.S., the board members are to be compensated at $140 per day plus actual and necessary expenses when conducting official business.

Directors serving at December 31, 2006, together with their city and state of residence and business affiliations follows:

Name & Address	Business Affiliations	Term Expires
Gary O. Johnson Lakewood, Colorado	Strategic Insurance Consultants, Inc. Insurer Representative	January 1, 2007 (awaiting reappointment confirmation by Senate)
Bonnie Dean Greeley, Colorado	Bonnie Dean Associates Employer Representative	January 1, 2010
John Mark Eagleton Arvada, Colorado	The Egg & I Restaurant in Arvada Employee Representative	January 1, 2008
David W. Green Fort Collins, Colorado	Platte River Power Authority Employee Representative	January 1, 2008
Ryan L. Hettich Colorado Springs, Colorado	Sundance Capital Inc. Employer Representative	January 1, 2007 (awaiting reappointment confirmation by Senate)
Robert J. Jolly Kit Carson, Colorado	Barbara Jolly & Sons Ranch, LLC Employer and Ranch Representative	January 1, 2008
Debra E. Lovejoy Colorado Springs, Colorado	Employers Resources of Colorado Employee Representative	January 1, 2011

Name & Address	Business Affiliations	Term Expires
David L. Stevens Denver, Colorado	Irongate Financial Services Finance Representative	January 1, 2008
Paul J. Suss Aurora, Colorado	Suss Pontiac GMC, Inc Employer Representative	January 1, 2011

All of the above directors were serving on the board as of the date of this examination. Gary Johnson and Ryan Hettich were reappointed in 2007 but the appointment was informally withdrawn by Governor Bill Ritter. The board members remain on the board and will do so until they are reappointed or new board members are named.

Officers

Pursuant to Section 8-45-101(2)(a), C.R.S., the board shall annually elect a chairman of the board from its membership. The by-laws also provide for the election of a vice chairman from the board's membership.

In addition, Section 8-45-101(5)(a), C.R.S., requires that the board appoint a chief executive officer who may appoint and/or hire such other staff as is deemed necessary. The by-laws provide that in the interim between board meetings, the president is authorized to conduct all of the business and affairs of the Company, subject to the approval of the board.

The senior officers serving at December 31, 2006, were as follows:

Officer	Position
Gary O. Johnson	Chairman of the Board
David L. Stevens	Vice Chairman of the Board
Kenneth Ross	President and CEO
Jeff Tetrick	Vice President - Financial Services/Treasurer
Marcia A. Benshoof	Vice President – Strategic Business Group
Don Collins	Vice President – Sales and Marketing
Michael Erickson	Vice President – Human Resources & Corporate Services
Daniel O'Neil	Vice President – General Counsel
Robert Norris	Vice President – Information Services

All of the officers noted above are currently serving as of the date of this report.

Committees

The by-laws permit the board to form committees, as it deems necessary. Each committee may consist of one or more board members and one or more persons who are not board members. However, a majority of the committee members must be board members. To the extent provided in the board resolution forming the committee and limitations set forth in the by-laws, each committee has the authority of the board. A majority of committee members constitutes a quorum for the transaction of business. An act of a majority of members present at a meeting in which a quorum exists is necessary to carry an action.

Audit Committee:

This committee must be comprised of at least three members, of which at least two must be members of the board. The audit committee facilitates communications among the Colorado Office of the State Auditor, the board of directors, the Company's senior management and the external auditing firm.

The committee addresses material errors in financial reporting and material weaknesses in internal accounting, as well as other aspects relating to the results of the audit conducted by the Colorado Office of the State Auditor. The committee also monitors the internal audit function and related findings. The audit committee has the authority to investigate any organizational activity as it deems necessary and appropriate.

Members of the Audit Committee serving at December 31, 2006, were as follows:

Audit Committee	Title
Jim Nussbaum, Chairman	Outside Advisor
John F. Kent	Former Board Member
Don Moschetti	Former Board Member
Bonnie Dean	Board Member
Ryan Hettich	Board Member
Paul Suss	Board Member
J. Mark Eagleton	Board Member
Gary Johnson	Board Member

Investment Committee:

This committee must be comprised of at least three members of the board and may contain outside advisors and members of management. The investment committee's primary purpose is to assist the board in the development of investment policies and strategies.

Members of the Investment Committee serving at December 31, 2006, were as follows:

Investment Committee	Title
Dave Stevens, Chairman	Board Member
Bonnie Dean	Board Member
Ryan Hettich	Board Member
David Green	Board Member
Paul Suss	Board Member
Debra Lovejoy	Board Member
Larry Howes	Outside Advisor
Bob Bush	Outside Advisor
Jeff Tetrick	Management
Ken Ross	Management

Compensation Committee:

This committee shall consist of three or more directors and is to include the chairman of the board. The purpose of the committee is to establish and oversee the executive compensation policies and practices of the Company on behalf of the board of directors. The committee is also responsible for reviewing, monitoring, approving and recommending compensation policies, plans and actions and making appropriate reports to the board of directors.

Members of the Compensation Committee serving at December 31, 2006, were as follows:

Compensation Committee	Title
Gary Johnson, Chairperson	Board Member
Mark Eagleton	Board Member
R.J. Jolly	Board Member
Dave Stevens	Board Member
Bonnie Dean	Board Member

Ethics Committee:

This committee must be comprised of at least three board members. The committee is responsible for ensuring that appropriate procedures are in place to address related party transactions, conflicts of interest and ethical misconduct.

Members of the Ethics Committee serving at December 31, 2006, were as follows:

Ethics Committee	Title
Debra E. Lovejoy, Chairperson	Board Member
J. Mark Eagleton	Board Member
Bonnie Dean	Board Member
David L. Stevens	Board Member
David Green	Board Member

Conflict of Interest

The Company has an established procedure for the disclosure of any material interest or affiliation that might conflict with the respective duties of all directors, officers and responsible employees.

Members of the board of directors, officers and certain key employees completed annual affidavits for the period under examination.

Service and Management Agreements

On December 1, 2004, the Company entered into an agreement with Conning Asset Management Company for investment advisory services, portfolio management, and investment accounting and reporting services. Pursuant to this agreement, the Company pays a sliding scale fee based on the market value of the investment portfolio. For 2006, the fees paid to Conning totaled $1,397,146.

CORPORATE RECORDS

The by-laws, and all amendments thereto, and minutes of the meetings of the board of directors were reviewed in detail for the period under examination. All meetings were generally well attended and held in accordance with the provisions of the by-laws. The by-laws were amended and restated during the period under review. The amendments were administrative in nature.

During the 1997 Colorado Legislative session, House Bill 1180 was passed which required the Company to file a Surplus Recovery Plan "Plan" with the Commissioner. The purpose of the Plan, which was approved by the DOI in December of 2000, was to strengthen the Company's financial position and to attain an acceptable level of surplus defined by the Plan as 200% of authorized control level. This surplus level was reached as of December 31, 2003. The DOI's Report of Financial Examination, dated October 20, 2004 for the period ending December 31, 2003, stated that the Company had exceeded the acceptable surplus level provided in the Plan. As a result of attaining the acceptable level of surplus, control of the investment portfolio of the Company was transferred from the Colorado State Treasurer to the Company's board of directors on November 20, 2004.

The Company's by-laws provide that the board may establish committees for the performance of delegated or designated functions to the extent permitted by law. The board has established committees for handling the functions of Investments, Ethics, Compensation and Audit. Despite a stipulation in the by-laws that minutes for all meetings be maintained, not all meeting minutes were maintained for the Audit and Ethics committee meetings.

RECOMMENDATION No. 1:

It is recommended that the Company maintain meeting minutes of all committees as specified in the Company's by-laws.

Fidelity Bond and Other Insurance

As of December 31, 2003, the Company obtained a reasonable surplus as set forth in Section 8-45-101, (12), C.R.S., and is now subject to Colorado Insurance Regulation 3-1-1(3) Colorado Insurance Regulation 3-1-1(3) requires insurance companies to obtain a minimum level of fidelity coverage for all directors, officers, and employees who haves access to Company funds.

The Company has obtained appropriate fidelity coverage from an insurance company authorized in Colorado in compliance with Colorado Insurance Regulation 3-1-1(3). The Company maintains its fidelity bond insurance through its commercial crime coverage. The aggregate limit of liability for employee dishonesty coverage is $10,000,000 ($100,000 deductible) for loss caused by embezzlement or wrongful abstraction of money, securities, and other property by employees.

The Company also purchased property, commercial liability, automobile liability, umbrella liability, and other standard business coverages from a commercial insurance carrier, which is licensed in Colorado. The Company insures with itself its workers' compensation coverage for its employees and an independent claims administrator adjusts all employee claims.

Employee and Agents' Welfare

The Company's employees are provided a full range of benefits including health dental, vision, basic life, short-term disability, and long-term disability insurance on a contributory basis. All employees participate in the Public Employees' Retirement Association (PERA) pension plan. Employees may also participate in PERA's 401(k) plan, as well as a 457(b) savings plan. The Company does not provide benefits to its agents.

The Company maintained two incentive plans at December 31, 2006. A gain-sharing plan in which all active full-time and part-time employees participate was first implemented in 1999. Executives who participate in the incentive plan, described in the paragraph below, are not eligible for the gain-sharing plan. This plan provides additional compensation to employees based upon the attainment of certain profitability and customer satisfaction measures. Total amount earned under this plan for 2006 equaled $5,259,792.

The president and executive staff (which includes all officers listed on page 7 except the sales and marketing officer) are eligible for the executive performance plan. This plan calls for an annual incentive payment based upon the attainment of certain profitability, customer satisfaction and business unit objectives. Total amount earned under this plan for 2006 equaled $429,144. The executive performance plan replaces a short-term and long-term incentive plan that was terminated by the board in December 2003.

TERRITORY AND PLAN OF OPERATION

Territory

Pursuant to Section 8-45-101(5)(f), C.R.S., the Company was organized to write workers compensation and employer's liability coverage in the State of Colorado.

Plan of Operation

The Company generates business through direct marketing efforts and through a network of approximately 410 insurance brokers. The Company contracts directly with each broker, who in turn has contracted with any number of independent producers. The Company pays the commission directly to each broker, who is then responsible for the compensation of its individual producer. Approximately 85% of the Company's 2006 writings were placed through brokers. These brokers place coverage for a client's general insurance needs, as well as for coverage of a client's workers' compensation needs. This allows employers to conveniently purchase a package covering all insurance needs from one broker versus purchasing workers compensation coverage directly from the Company and other types of coverage from another producer. The Company has approximately 108 brokerage contracts and those brokers have 304 locations; most of which are along the Front Range. In 2006, brokers received commissions ranging from 10% to 12% for new business, and 5% to 12% for renewal business. The Company does not utilize managing general agents.

In general, producers do not have automatic binding authority. Producers only have binding authority for policies with premiums less than $10,000, if they are quoted through the Company's proprietary internet system. If the premium is in excess of $10,000, or if the online system is not utilized, the application must be submitted to the Company for a quote in order to be bound.

The Company had one commission bonus plan for 2006. The plan is a loss ratio bonus plan. The loss ratio bonus plan rewards brokers for the profitability of their business. In 2006, the brokers received bonuses up to 10% of earned premium based on the loss ratio of the agent's book of business.

The Company's marketing department provides producers with training and management. This department also facilitates the external communications to all Pinnacol stakeholders i.e. producers, policyholders, claimants and medical providers. The marketing department also provides supporting services, such as seminars on safety, to large policyholders, which includes policies issued to associations.

In addition to the home office located in Denver, Colorado, the Company maintains a branch office in Grand Junction, Colorado. This branch office performs marketing, loss prevention, and case management functions. The Company has additional loss prevention professionals located throughout the state to support its marketing and loss prevention programs.

GROWTH OF THE COMPANY

The growth of the Company during the examination period is presented in the following schedule:

Year	Admitted Assets	Liabilities	Surplus
2003*	$1,484,984,462	$1,157,686,281	$327,298,181
2004	1,673,217,259	1,307,423,425	365,793,834
2005	1,828,349,008	1,356,499,899	471,849,109
2006*	2,011,005,045	1,403,531,591	607,473,454

Years identified with an "*" are based on examination results. All other amounts were extracted from annual statements for the corresponding year.

Premiums by State

The Company only operates in the State of Colorado and as such, all direct premiums are allocated to the State of Colorado.

A schedule of direct premiums written, reinsurance assumed and ceded, net premiums written and net premiums earned follows:

Year	Direct premiums written	Reinsurance assumed	Reinsurance ceded	Net premiums written	Net premiums earned
2003*	$497,781,194	$1,612,115	$ 799,839	$498,593,470	$490,035,168
2004	518,636,284	2,149,555	2,753,185	518,032,654	515,470,604
2005	562,796,481	5,658,046	2,641,953	565,812,574	566,470,316
2006*	587,714,160	9,045,999	3,627,195	593,132,964	588,376,311

Years identified with an "*" are based on examination results. All other amounts were extracted from annual statements for the corresponding year.

Loss and Underwriting Experience

The following schedule shows the underwriting results of the Company. The amounts were compiled from the Company's filed annual statements.

Year	Net premiums earned	Loss and loss expense incurred	Underwriting expense incurred	Loss and loss exp. ratio%	Underwriting ratio%	Combined ratio %*
2003**	$490,035,168	$391,570,072	$ 95,084,912	79.90	19.40	99.30
2004	515,470,604	471,363,526	100,737,820	91.44	19.54	110.99
2005	566,470,316	388,294,807	101,817,918	68.55	17.97	86.52
2006**	588,376,311	384,446,052	115,656,442	65.34	19.66	85.00

*A combined ratio of greater than 100% is the result of a net underwriting loss
Years identified with an "**" are based on examination results. All other amounts were extracted from annual statements for the corresponding year.

Year	Total underwriting income	Total underwriting deductions	Net underwriting gain/(loss)	Investment and other income	Net income before dividends and taxes
2003*	$486,922,138	$486,654,984	$ 267,154	$ 87,542,933	$ 87,810,087
2004	515,470,604	572,101,346	(56,630,742)	104,214,049	47,583,307
2005	566,470,316	490,112,725	76,357,591	89,428,858	165,786,449
2006*	588,376,311	500,102,494	88,273,817	94,742,486	183,016,303

Years identified with an "*" are based on examination results. All other amounts were extracted from annual statements for the corresponding year.

REINSURANCE

Ceded

For the period under examination, the Company maintained catastrophic excess of loss coverage. The Company increased its retention from $6,000,000 to $10,0000,000 and has increased the aggregate catastrophic limits from $20,000,000 to $80,000,000 during the examination period. The coverage at the end of the examination period is structured with a first layer of $10,000,000 per occurrence in excess of the retention amount of $10,000,000, a second layer of $20,000,000 in excess of $20,000,000, and a third layer of $40,000,000 in excess of $40,000,000. Each layer carries an ultimate net loss of twice the per occurrence amount. This agreement covers all direct and assumed business. The maximum amount of coverage applicable to any one employee is $5,000,000 and the agreement has a sunset provision which provides that only those losses reported to the reinsurer within seven years following expiration of the agreement will be covered. Coverage under this agreement has been secured through April 30, 2007.

The Company utilizes the services a licensed reinsurance intermediary to procure coverage. The agreement with the intermediary complies with the requirements set forth in Section 10-2-904, C.R.S.

In January of 2004, the Company contracted with a captive reinsurance company to provide coverage for members of an agricultural association. The coverage provides $250,000 of incurred losses subject to an annual aggregate limit of 67% of the gross premiums written.
Compliance with Section 10-3-118, C.R.S. and Colorado Insurance Regulation 3-3-2 were evaluated as part of this examination. It is noted that the reinsurance agreement for which reserve credits are taken

does not provide for notification of the Commissioner if the agreements were not automatically extended as specified in Regulation 3-3-2(VII)(4); however, this regulation was superseded in January of 2007 and automatic extension or notification of the Commissioner are no longer required provisions within the agreements.

Assumed

In March of 2004, the Company executed a reinsurance contract with Argonaut, an unaffiliated commercial carrier, to provide coverage to Colorado employers that have employees located in other states. This agreement represents a fronting arrangement through which the unaffiliated commercial carrier provides coverage to these out of state employees and cedes 100% of this coverage to the Company.

It is noted that, as the assuming company under these fronting arrangements, the Company is considered an unauthorized insurer and as such, is required to provide the ceding insurer security in the amount of the unpaid losses (including IBNR). The Company provided letters of credit issued by a local bank as security for the unpaid loss reserves. As of December 31, 2006, the Company had assets in the amount of $24,793,000 pledged to this bank as collateral for these letters of credit.

STATUTORY AND SPECIAL DEPOSITS

The Company is not required to establish a statutory or special deposit with the DOI.

ACCOUNTS AND RECORDS

The Company operates its own local area network and utilizes network management software. It uses a combination of internally developed and commercial “off the shelf” products for its significant financial/business systems. The Company has established policies and procedures to outline its information system business practices and is proactive in implementing and monitoring its security environment.

A trial balance was prepared from the general ledger for the year ended December 31, 2006, and all balances were traced to the appropriate asset, liability, income statement line and/or supporting schedules of the 2006 annual statement, using work papers prepared by the Company.

A review of income, disbursements and postings to the general ledger was conducted for selected periods. Test checks of postings from original documents to the general ledger revealed no material differences.

The Company is audited annually pursuant to Section 8-45-121(2), C.R.S. The auditor is retained by the State Auditor’s Office, and thus, the Company is not considered to be the auditor’s client. The Company also employs the services of an independent actuarial firm. The actuarial firm is selected and hired by the Company and the Company is considered to be the client. The associated audited financial statements and actuarial opinions were filed with the DOI as required by Colorado Insurance Regulations 3-1-4 and 3-1-3.

The Company also has an internal audit function. The reports and work papers related to internal audits performed were made available to the examiners for use during this examination.

FINANCIAL STATEMENTS

The following pages present a Statement of Assets, Liabilities, Surplus and Other Funds, as of December 31, 2006, as determined by this examination. This statement is followed by supporting statements and reconciliations presented in the following order:

Statement of Income, for the Year Ended December 31, 2006

Capital and Surplus Account, for the Year Ended December 31, 2006

Reconciliation of Capital and Surplus, December 31, 2003 to December 31, 2006

Analysis of Examination Changes, as of December 31, 2006

Comparative Financial Statements, as of December 31, 2003 and December 31, 2006

ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2006

ASSETS

	Assets	Assets not admitted	Net admitted assets
Bonds	$1,631,196,507	$ 0	$1,631,196,507
Common stocks	223,949,267	0	223,949,267
Real estate	22,305,573	0	22,305,573
Cash, cash equivalents and short-term investments	44,163,085	0	44,163,085
Investment income due and accrued	17,065,994	0	17,065,994
Uncollected premiums and agents' balances in course of collection	40,908,421	5,221,570	35,686,851
Installments booked but deferred and not yet due (including earned but unbilled premium)	32,655,449	3,000,000	29,655,449
Accrued retrospective premiums	2,132,476	0	2,132,476
Amounts recoverable from reinsurers	164,510	0	164,510
Funds held by reinsured companies	143,750	143,750	0
Amounts receivable relating to uninsured plans	3,013,294		3,013,294
Electronic data processing equipment	1,672,039	0	1,672,039
Furniture and equipment	3,528,839	3,528,839	0
Prepaid expenses	1,394,617	1,394,617	0
Total assets	$2,024,293,821	$13,288,776	$2,011,005,045

ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS (continued)
DECEMBER 31, 2006

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		$1,040,222,414
Loss adjustment expenses		197,198,765
Commissions payable and other similar charges		21,608,587
Other expenses		8,155,880
Taxes, licenses and fees		11,439,705
Unearned premiums		99,863,950
Policyholder dividends declared and unpaid		13,983,303
Funds held by company under reinsurance treaties		51,650
Amounts withheld or retained by company for account of others		705,679
Remittances and items not allocated		1,783,854
Credit balances due policyholders		8,517,804
Total liabilities		$1,403,531,591
Unassigned funds	$607,473,454	
Surplus as regards policyholders		$ 607,473,454
Total liabilities and surplus		$2,011,005,045

STATEMENT OF INCOME
FOR THE YEAR ENDED 2006

Underwriting income:		
Premiums earned		$588,376,311
Deductions:		
Losses incurred	$359,713,362	
Loss expenses incurred	24,732,690	
Other underwriting expenses incurred	115,656,442	
Total underwriting deductions		500,102,494
Net underwriting gain		$ 88,273,817
Investment income:		
Net investment income earned	$ 92,775,893	
Net realized capital gains	4,688,178	
Net investment gain		97,464,071
Other income:		
Net loss from premium balances charged off	$ (5,144,840)	
Finance and service charges not included in premiums	1,441,310	
Miscellaneous income	$981,945	
Total other income (loss)		(2,721,585)
Net income before dividends to policyholders and federal income taxes		$183,016,303
Dividends to policyholders		65,693,682
Federal income taxes		0
Net income		$117,322,621

CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED 2006

Surplus as regards policyholders December 31, previous year		$471,849,109
Net income	$117,322,621	
Change in net unrealized capital gains	20,829,739	
Change in non-admitted assets	(2,528,015)	
Net change in capital and surplus		135,624,345
Surplus as regards policyholders; December 31 current year		$607,473,454

RECONCILIATION OF CAPITAL AND SURPLUS
DECEMBER 31, 2003 THROUGH DECEMBER 31, 2006

	2003*	2004	2005	2006 *
Surplus as regards policyholders, December 31 prior year	$215,509,992	$327,298,181	$365,793,834	$471,849,109
Net income	$ 87,810,087	$ 39,010,383	$103,496,335	$117,322,621
Change in net unrealized capital gains and (losses)	21,918,598	(1,176,451)	3,483,177	20,829,739
Change in non- admitted assets	2,059,504	661,721	(924,237)	(2,528,015)
Net change in capital and surplus for the year	$111,788,189	$ 38,495,653	$106,055,275	$135,624,344
Surplus as regards policyholders, December 31 current year	$327,298,181	$365,793,834	$471,849,109	$607,473,454

Years identified with an “*” are based on examination results. All other amounts were extracted from annual statements for the corresponding year.

ANALYSIS OF EXAMINATION CHANGES
DECEMBER 31, 2006

Admitted assets	Per annual statement	Per examination	Surplus increase (decrease)
Total assets	$2,011,005,454	$2,011,005,454	$ 0
Liabilities			
Losses	$1,199,421,179	$1,040,222,414	$ 159,198,765
Loss Adjustment Expenses	$ 38,000,000	$ 197,198,765	$(159,198,765)
Total liabilities	$1,403,531,591	$1,403,531,591	$ 0
Capital and surplus			
Total capital and surplus	$ 607,473,454	$ 607,473,454	$ 0
Net change per examination			$ 0
Capital and surplus per annual statement			$ 607,473,454
Net change per examination			0
Capital and surplus per examination			$ 607,473,454

COMPARATIVE FINANCIAL STATEMENT
DECEMBER 31, 2003 AND DECEMBER 31, 2006

ADMITTED ASSETS

	December 31, 2003 *	December 31, 2006 *
Bonds	$1,202,177,741	$1,631,196,507
Common stocks	104,497,818	223,949,267
Real estate – properties occupied by the company	24,488,563	22,305,573
Cash and short-term investments	98,091,227	44,163,085
Investment income due and accrued	12,746,328	17,065,994
Uncollected premiums and agents' balances in course of collection	27,544,512	35,686,851
Installments booked but deferred and not yet due (Including earned but unbilled premium)	9,573,578	29,655,449
Accrued retrospective premium	4,202,751	2,132,476
Amounts recoverable from reinsures	0	164,510
Amounts receivable relating to uninsured plans	114,050	3,013,294
Electronic data processing equipment	1,547,894	1,672,039
Total assets	$1,484,984,462	$2,011,005,045

* The above amounts were determined per examination.

COMPARATIVE FINANCIAL STATEMENT (continued)
DECEMBER 31, 2003 AND DECEMBER 31, 2006

LIABILITIES, SURPLUS AND OTHER FUNDS

	December 31, 2003 *	December 31, 2006 *
Losses (note 1)	$ 990,278,230	$1,040,222,414
Loss adjustment expenses (note 2)	26,924,000	197,198,765
Commissions payable	16,385,025	21,608,587
Other expenses	5,023,107	8,155,880
Taxes, licenses and fees	9,175,304	11,439,705
Unearned premiums	92,335,164	99,863,950
Advance premiums	867,825	0
Policyholder dividends declared and unpaid	1,350,000	13,983,303
Funds held by company under reinsurance treaties	0	51,650
Amounts withheld or retained by company for account of others	489,776	705,679
Remittances and items not allocated	270,466	1,783,854
Credit balances due policyholders	9,050,353	8,517,804
Returned retrospective premiums	5,537,031	0
Total liabilities	$1,157,686,281	$1,403,531,591
Unassigned funds (surplus)	$ 327,298,181	$ 607,473,454
Surplus as regards policyholders	$ 327,298,181	$ 607,473,454
Total liabilities and surplus	$1,484,984,462	$2,011,005,045

* The above amounts were determined per examination.

NOTES TO THE FINANCIAL STATEMENT

Note 1- Losses

The reported balance of Losses as of December 31, 2006 has been decreased by $159,198,765 from $1,199,421,179 to $1,040,222,414 for purposes of this examination. The decrease is attributed to the reclassification of defense and cost containment expenses from losses to loss adjustment expenses, pursuant to the NAIC Annual Statement Instructions, and SSAP No. 55. This reclassification had no overall impact on the surplus reported by the Company.

RECOMMENDATION No. 2:

It is recommended that the Company properly classify defense and cost containment expenses as loss adjustment expenses as prescribed in SSAP No. 55..

Note 2 – Loss Adjustment Expenses

The reported balance of loss adjustment expenses as of December 31, 2006 has been increased by $159,198,765 from $38,000,000 to $197,198,765, for purposes of this examination. This increase is attributed to the reclassification of defense and cost containment expenses from losses to loss adjustment expenses. See Note 1 for additional information.

Note 3- Surplus as Regards Policyholders

The Company’s surplus as regards policyholders, as of December 31, 2006 was determined to be $607,473,454. Pursuant to Section 8-45-117, C.R.S., the Company is subject to regulation by the Commissioner of Insurance which includes the determination and maintenance of reasonable surplus. The Company is required to maintain a minimum surplus amount equivalent to the risk-based capital “RBC” requirements set forth in Section 10-3-201, C.R.S. and Colorado Insurance Regulation 3-1-11. As of December 31, 2006, the Company’s “Company Action Level” RBC was determined to be $149,694,630. As of December 31, 2006, the Company’s surplus as regards policyholders of $607,473,454 exceeded the “Company Action Level” RBC by $457,778,824.

SUMMARY

The results of this examination determined that as of December 31, 2006, the Company had admitted assets of $2,011,005,045, liabilities of $1,403,531,591 and total surplus as regards policyholders (surplus) of $607,473,454. There were no changes to the Company's total surplus as regards policyholders (surplus) resulting from this examination.

RECOMMENDATIONS

Recommendations included in this examination report follow:

Issue	**Rec. No.**	**Page No.**	**Recommendation**
Not all meeting minutes were maintained for the Audit and Ethics committee meetings.	1	10	It is recommended that the Company maintain meeting minutes of all committees, as specified in the Company's by-laws
As a result of this examination, the ledger balance of $159,198,765 for defense and cost containment expenses has been reclassified from losses to loss adjustment expenses. This reclassification had no overall impact on the capital and surplus reported by the Company.	2	24	It is recommended that the Company properly classify defense containment costs as loss adjustment expenses as prescribed SSAP No. 55.

CONCLUSION

The courtesy, assistance and cooperation extended by the officers and employees of the Company during the course of this examination are hereby acknowledged.

Patrick R. Knepler, Actuary, for the Colorado Division of Insurance, conducted the actuarial phase of the examination. Philip Gates, EDP Auditor, conducted the information technology phase of the examination.

In addition to the undersigned, Meri DeLyser, Brent Pearson, and Keith Warburton, examiners for the Colorado Division of Insurance, participated in the examination.

Respectfully submitted,

____

Arthur D. Mowry, CFE
Financial/Credit Examiner III
Division of Insurance
State of Colorado