REPORT OF

FINANCIAL EXAMINATION

National States Insurance Company

As of:

DECEMBER 31, 2007

STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS
AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

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February 27, 2009
St. Louis, Missouri

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

Honorable Merle D. Scheiber, Director
Division of Insurance
State of South Dakota
Secretary, Midwestern Zone, NAIC

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

Dear Sirs:

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

National States Insurance Company

hereinafter referred to as "National States" or as the "Company." The Company's office is located at 1830 Craig Park Court, St. Louis, Missouri 63146, telephone number (314) 878-0101. Examination fieldwork began on September 2, 2008, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The last comprehensive financial examination of the Company was performed as of December 31, 2004, by examiners from the state of Missouri.

The current financial examination of the Company covers the period from January 1, 2005, through December 31, 2007, and was conducted by examiners from the state of Missouri. This examination also included material transactions or events occurring subsequent to December 31, 2007.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration (Department) and statutes of the state of Missouri prevailed.

Workpapers of the Company's independent auditor, Brown Smith Wallace, LLC, were made available to the examiners for review. Standard examination procedures were modified as deemed appropriate under the circumstances.

Prior Examination Comments

The general comments and recommendations in the previous examination report and the Company's response and/or subsequent action taken by the Company are listed below.

1. Comment: The Company should develop, update and regularly test a business continuity/disaster recovery plan. The Company still needs to implement a formal disaster recovery plan and especially needs to document backup restoration procedures so that off-site backups can be put to use if the Company's building is destroyed in a disaster and critical information systems personnel are not available. Without a current plan, improved via periodic walk-through/restoration testing, the contingency planning process has diminished value because a variety of unforeseen problems may arise that have not been "refined out" of the recovery process.

Company's Response: We plan to test our disaster recovery plan later this year. We are consulting with several hardware vendors currently and should be able to set a date for the test within the next two months.

Current Findings: As of the examination date, the Company had not yet implemented and tested a disaster recovery plan. However, a plan was put into place and tested in late 2008. Going forward, the Company should periodically evaluate its disaster recovery plan.

2. Comment: The Company should ensure that it completes all questions regarding its holding company system properly in the Quarterly and Annual statements and should also properly report all relationships in the Holding Company Registration statements.

Company's Response: We will comply with this recommendation.

Current Findings: The Company has noted all relationships in the financial statements and Holding Company Registration statements.

3. Comment: The Company should review its accounting treatment for the ALRE treaty and other reinsurance treaties. The ALRE treaty provides for a 5% renewal allowance for maintenance expenses and premium taxes. It is questionable whether this ceding allowance is sufficient to cover anticipated renewal expenses. The Company should demonstrate to the Department that these allowances are sufficient pursuant to Missouri Regulation 20 CSR 200-2.300(4)(A)1, or book a liability as required by this regulation.

Company's Response: The company has reviewed the accounting treatment of its reinsurance treaties and does not believe it is in violation of Missouri Regulation 20CSR 200-2.300(4)(A)(1). The expense allowances paid by the reinsurers include commissions, premium taxes and direct expenses...expected by the company at the time the business is reinsured.

The company has previously provided the Department with documentation on the level of expenses at the time the business was reinsured which indicated an adequacy of the expense allowance for the ALRE treaty.

The renewal expense allowance provision was also reviewed by the Department at the time the treaty was initiated without comment.

Other factors which led the company to conclude the adequacy of the renewal expense allowances include the following:

1. The commission allowance paid by ALRE and subsequently novated to Wilton Re is the maximum commission rate paid by the company. This maximum rate is not paid to all agents on all forms and, therefore, there is an additional margin in the commission allowances.

2. The allowances paid by other reinsurers exceed the 5% paid by Wilton and exceed the company's renewal expense levels. The "anticipated allocable renewal expenses" under the ALRE treaty are met by the 5% renewal allowance. In aggregate, the renewal expense allowances paid by all reinsurers exceed the company's renewal expense levels for the blocks of business reinsured.

The company fully intends to comply with this regulation and maintain adequate documentation of the adequacy of the expense allowance to cover anticipated allocable renewal expenses.

Note also that the Department's Actuary routinely requests a reconciliation of expenses used in support of the Actuarial Opinion and Memorandum. This reconciliation provides documentation of the renewal expense levels of the company.

The company will continue to monitor compliance with this regulation going forward.

Current Findings: The Company's current agreement with Wilton Re is adequate.

4. Comment: The Company was extremely slow in providing the Paid Claims Runoff. The examiner requested the runoff on June 13, 2005, and the Company provided the file on September 6, 2005. The Company must develop the capability of providing information as basic as a Life Claims Runoff on a more timely basis.

Company's Response: This audit lasted nearly 9 months, and during that time, there were constant requests for information, all of which were provided. To single out one request does not seem material and this should be deleted from the examination report. Further, this point has already been included in a December 22, 2005, letter from Wyatt Sample that summarizes the items not documented in the final examination that require management's attention.

Current Findings: Responses to requests during the current examination were typically made in a timely manner.

5. Comment: The Company should amend its 2004 Annual Statement to properly reflect the classification of certain Home Health Care policies sold in Florida that it reclassified originally on the 2003 Annual Statement. The reclassification of these policies resulted in an overstatement of the Company's Risk Based Capital (RBC) level.

Company's Response: We will comply with this recommendation.

Current Findings: The original 2003 Annual Statement was amended.

HISTORY

General

National States Insurance Company was incorporated on July 22, 1964, under the laws of Missouri as American Independence Life Insurance Company. The Company was licensed and began operations as a joint stock life insurance company on September 14, 1964. In 1967 the Company was reorganized and its name was changed to National States Insurance Company.

The Company is licensed in Missouri and 36 additional states as a life, accident and health insurer. The Company actively markets a variety of life and health products (primarily long term care) through independent general agents, who write all of the Company's business. Written premiums totaling $25.8 and $28.6 million during 2007 and 2006 respectively were produced by one agency. The owner of this agency is a director and stockholder of the Company. These writings account for more than 20% of a major line of the Company's direct business.

Capital Stock

The Company is authorized to issue 6,000,000 shares of common stock with a par value of $2.00 per share. As of December 31, 2007, 3,500,000 shares were issued and outstanding resulting in capital stock of $7,000,000.

Dividends

The Company has declared and paid dividends to stockholders as follows:

	Cash	Stock
Through December 31, 1991	$ 810,000	$ 6,713,330
1992-2007	-	-
Total	$ 810,000	$ 6,713,330

Management

The board of directors consists of nine members duly elected at an annual meeting of the stockholders as authorized by the Company's articles of incorporation. The directors serving as of December 31, 2007, were:

Name	Primary Occupation
Robert A. Bonney St. Charles, Missouri	Partner Blackstone Group
Thomas R. Green St. Louis, Missouri	President National States Insurance Company
Melvin Gross St. Petersburg, Florida	Owner Fidelity Assurance, Inc.
Martin E. Harrington St. Louis, Missouri	Chairman of the Board Royal Banks of Missouri
Rex M. Durington St. Louis, Missouri	Chief Actuary National States Insurance Company
William R. Morrison St. Peters, Missouri	Vice President National States Insurance Company
Patricia I. Curran St. Louis, Missouri	Secretary and Treasurer National States Insurance Company
Mathias D. Renner St Louis, Missouri	President National Real Estate Management Corp.
Dale D. Turvey St. Louis, Missouri	President Dale Turvey and Associates

The officers elected and serving as of December 31, 2007, were:

Name	Office
Thomas R. Green	President
Patricia I. Curran	Secretary and Treasurer
William R. Morrison	Vice President
Rex M. Durington	Chief Actuary
Jack L. Getz	Assistant Vice President
Debra M. Jakubczak	Assistant Vice President
Michael D. Scott	Assistant Vice President
Gordon W. Niehoff	Assistant Secretary/Treasurer

Conflict of Interest

Conflict of interest disclosure statements are executed annually by all directors and officers of the Company. A review of the statements for the years under examination indicated no material conflicts that had not previously been disclosed to the board of directors.

Corporate Records

A review was made of the articles of incorporation and bylaws of the Company. The Company reported no amendments to the articles of incorporation or bylaws.

The minutes of the meetings of the stockholders and board of directors were reviewed for the period under examination. Those minutes provided sufficient documentation of major corporate transactions.

Acquisitions, Mergers, and Major Corporate Events

There were no acquisitions, mergers or major corporate events during the examination period.

Surplus Debentures

The Company issued to Thomas Green, a surplus note for $2,000,000 with an interest rate of 4% per annum, dated August 20, 2004, approved by the Department on August 19, 2004 and funded on September 1, 2004. Principal and unpaid interest on the surplus note was $2,266,666 at December 31, 2007.

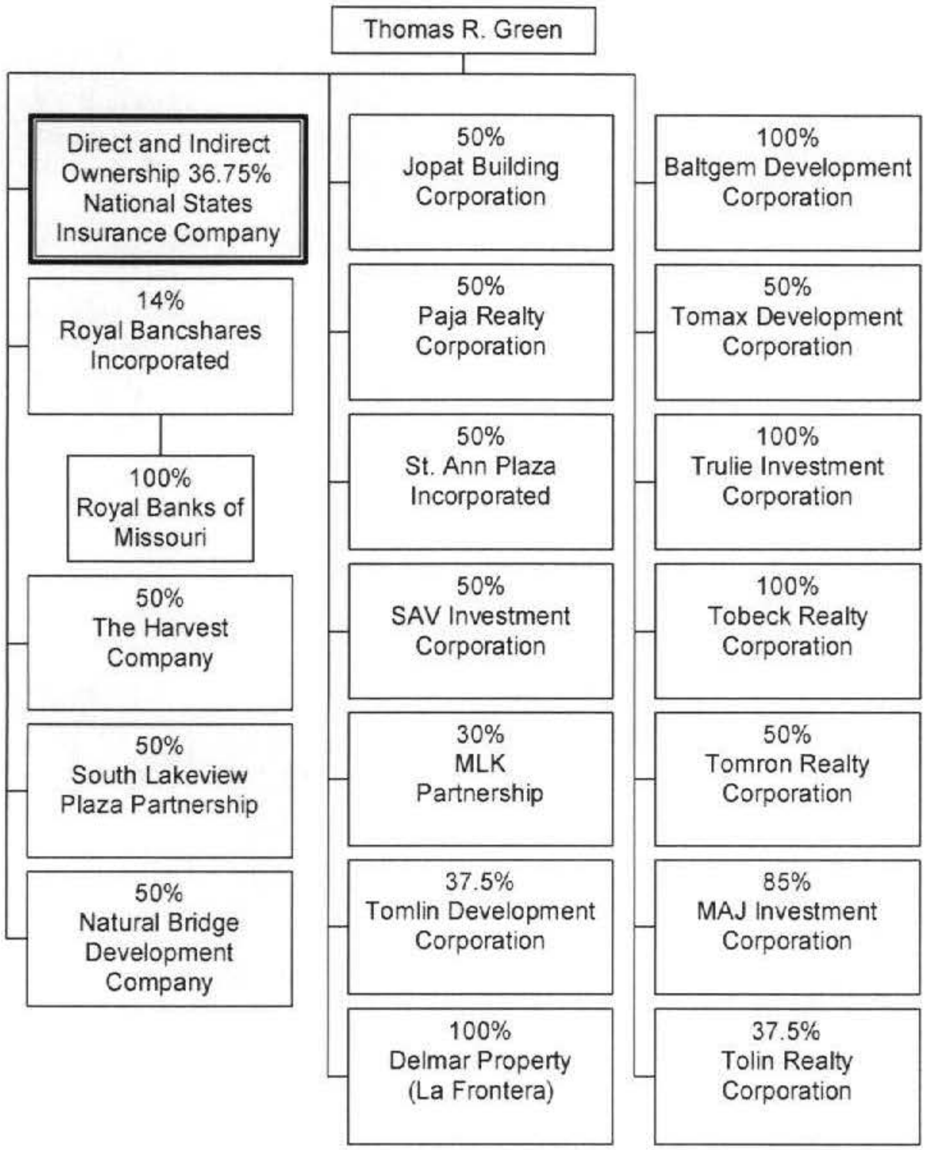
AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

The Company is a member of an insurance holding company system as defined in Section 382.010 RSMo, (Definitions). Annual registration statements were filed as required by Section 382.100 RSMo, (Registration). Mr. Thomas R. Green, an individual and a practicing attorney, is the ultimate controlling entity of the insurance holding company system.

Organizational Chart

The following organizational chart depicts the ownership structure of the Company as of December 31, 2007.



Intercompany Transactions

The Company is involved in business arrangements with related entities. These are discussed as follows:

- **Law Offices of Thomas R. Green**
  Thomas R. Green is a director and president and majority owner of the Company. Each year, the Company's board of directors authorizes the retainer of the Law Offices of Thomas R. Green as legal counsel

  The Law Offices of Thomas R. Green also leases office space from the Company pursuant to a lease agreement in place since 1990.

- **National Real Estate Management Corporation**
  Mathias D. Renner, Mr. Green's son-in-law and a member of the board of directors for National States, operates National Real Estate Management Corporation. National Real Estate Management Corporation acts as the real estate manager for the Company's home office building, which is partially occupied by other tenants. The Company paid management fees and rental commissions to National Real Estate Management Corporation, which in turn paid rent to the Company for office space.

FIDELITY BOND AND OTHER INSURANCE

The Company is insured by a financial institution bond that provides \$1,000,000 aggregate coverage with a \$100,000 per loss deductible. This coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Company also receives protection through insurance policies covering property, general liability, business auto, workers compensation and umbrella coverages.

EMPLOYEE BENEFITS AND PENSION PLAN

The Company offers typical benefits to employees including paid vacation, paid sick leave, paid holidays and funeral leave. The Company makes available, on an optional basis, employees' group insurance extending to hospitalization, medical, dental, disability, and life coverages. The Company contributes seventy-five percent of the cost of covering the employee and contributes fifty percent of the cost of covering the employee's family.

The Company has an employee profit sharing plan under which ten percent of the Company's pre-tax income is allocated to the profit sharing plan. Distribution to employees is made in the following manner: Hourly employees receive twenty percent of the allocation based on longevity and must have completed five years of employment by the end of the year in which the profit was made in order to be eligible. Middle management and salaried employees receive twenty percent of the allocation based on merit. They must have completed one year of service by the end of the year in which the profit was earned. Upper management receives sixty percent of the allocation, also based on merit and completion of at least one year of service.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Department as of December 31, 2007, as reflected below, were deemed sufficient in par and market value to meet the deposit requirements for the state of Missouri in accordance with Section 376.290 RSMo (Trust Deposits).

Security	Par Value	Statement Value	Market Value
US Treasury Bond	$ 750,000	$ 749,584	$ 782,693
US Treasury Bond	1,000,000	990,508	1,014,140
Totals	$ 1,750,000	$ 1,740,092	$ 1,796,833

Deposits with Other States

The Company also has funds on deposit with various other states. Those funds on deposit as of December 31, 2007, were as follows:

State	Security	Par Value	Statement Value	Market Value
Arkansas	FNMA Bond	$ 300,000	$ 285,702	$ 288,468
Florida	US Treasury Bond	700,000	704,526	704,816
Florida	US Treasury Bond	150,000	150,000	155,472
Florida	US Treasury Bond	500,000	500,000	515,820
Georgia	US Treasury Bond	50,000	49,954	51,000
North Carolina	US Treasury Bond	200,000	200,061	205,390
North Carolina	US Treasury Bond	250,000	250,000	259,120
New Mexico	US Treasury Bond	150,000	150,043	154,043
South Carolina	US Treasury Bond	250,000	249,967	256,738
South Carolina	FNMA Bond	300,000	299,216	298,593
Virginia	FNMA Bond	250,000	249,462	250,078
Virginia	FNMA Bond	300,000	299,801	300,564
	Totals	$ 3,400,000	$ 3,388,732	$ 3,440,101

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed in Missouri under Chapter 376 RSMo, (Life, Health and Accident Insurance) to write life and accident and health insurance. The Company is also licensed to write life and accident and health insurance in thirty-six other states.

The Company operates on the general agency plan with approximately 1,700 active independent general and soliciting agents representing the Company.

Treatment of Policyholders

The Department has a market conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent market conduct examination was completed on June 30, 1998, and primarily covered operations in 1997. No market conduct examinations were performed during the current examination period.

REINSURANCE

General

Premiums reported during the period under examination were as follows:

	2005	2006	2007
Direct - Life	$ 36,460,928	$ 35,650,232	$ 33,975,456
Direct - A&H	63,754,762	58,930,953	55,220,126
Reinsurance Assumed	-	-	-
Reinsurance Ceded	17,490,967	29,399,773	28,338,756
Net Premiums	$ 82,724,723	$ 65,181,412	$ 60,856,826

Assumed

The Company did not assume any reinsurance during the period under examination.

Ceded

Wilton Reassurance Company
Effective January 1, 2001, National States entered into an Automatic Coinsurance Agreement with Annuity and Life Reassurance America Inc. (ALR). Pursuant to this agreement ALR received a 36.1% quota share of all life policies issued through December 31, 2001. Effective December 31, 2002, an amendment to the agreement increased the coinsurance to 46.85% for all policies covered by the agreement. On June

30, 2005, the rights and obligations pertaining to this agreement were novated from ALR to Wilton Reassurance Company.

Munich American Reinsurance Company (Munich)

Effective July 1, 2003, National States entered into an Automatic Reinsurance Agreement on a Coinsurance Basis with Munich. Pursuant to the agreement Munich accepted 50% of the risk on specified policy forms with an upper limit of $17,500 per risk. The agreement applies to policy forms WLI-2, WLI-3 and WLI-4 issued July 1, 2003, through current.

The agreement was amended effective January 1, 2004, to add coverage for the Company's WLI-5 form. The amendment provides for coinsurance of 25% of the risk with a limit of $8,750 per life.

Subsequently, an addendum to the agreement effective January 1, 2005, increased Munich's coinsurance on newly issued WLI-5 policies to 37.5% of the risk up to $13,125 per life. For WLI-5 policies issued in 2004, Munich's coinsurance percentage was reduced to 25% up to $8,750 per life.

Optimum Re Insurance Company (Optimum)

Effective January 1, 2004, National States entered into an Automatic Reinsurance Agreement with Optimum. Pursuant to the agreement, the Company retained 50% of the risk with an upper limit of $17,500 per risk, and Optimum automatically accepted 50% of the remaining risk with a limit of $8,750 per life. Therefore, Optimum accepted 25% of the total risk on the policy forms covered under this agreement, the same as Munich.

Subsequently, as with Munich, an addendum was made to the agreement effective January 1, 2005, increasing Optimum's coinsurance on newly issued WLI-5 policies to 37.5% of the risk up to $13,125 per life for newly issued policies.

Northstar Reinsurance Ireland Limited (Northstar)

Effective September 30, 2005, the Company entered into a Reinsurance Agreement with Northstar Reinsurance Ireland Limited. Under this agreement, Northstar reinsures up to a 90% quota share of all life business not currently reinsured with other companies. The actual percentages reinsured vary based on the plan type and issue date.

Northstar is currently an unauthorized reinsurer in Missouri. The reinsurance agreement with Northstar is secured by a Trust Agreement and an irrevocable Letter of Credit. Under the terms of the agreement, the sum of the market value of the assets in the trust and the Letter of Credit must equal or exceed the statutory reserve of the reinsured policies.

Accident and Health Reinsurance

The Company retains virtually all risk related to its accident and health written premium. There are, however, a few policies that are reinsured under agreements with Reassure America and Employers Reinsurance Corporation. National States Insurance Company is no longer writing new business on the policy forms covered by those reinsurance agreements and therefore the policies in force continue to decline.

ACCOUNTS AND RECORDS

Independent Auditor

The Company's financial statements were audited by the firm of Brown, Smith, Wallace, LLC, for the period covered by this examination.

Company Actuary

The Company's actuarial opinions, for the period under examination, were prepared by its chief actuary, Rex M. Durington, FSA, MAAA.

Consulting Actuary

Timothy F. Harris, FSA, MAAA, of Milliman, Inc., evaluated the adequacy of the Company's loss reserves and premium related reserves

Information Systems Examination Specialist

The Department's Information Systems Examination Specialist, Andrew Balas, evaluated data processing controls.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2007, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the financial statements.

There may have been additional 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 in relation to the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual annual statement item.

BALANCE SHEET
As of December 31, 2007

Assets		Assets Current Year		Nonadmitted Assets Current Year		Net Admitted Assets Current Year
Bonds	$	55,091,926	$	-	$	55,091,926
Properties occupied by the company		2,287,597		-		2,287,597
Cash		295,603		-		295,603
Contract loans		6,131,812		-		6,131,812
Investment income due and accrued		897,750		-		897,750
Uncollected premiums **Note 1**		1,086,623		-		1,086,623
Deferred premiums		12,001,213		541,372		11,459,841
Current federal income tax recoverable		44,321		-		44,321
Net deferred tax asset		7,318,985		5,788,581		1,530,404
Guaranty funds receivable or on deposit		207,236		-		207,236
EDP equipment and software		8,525		8,525		-
Furniture and equipment		13,535		13,535		-
Health care and other amounts receivable		500		500		-
Aggregate write-ins		187,462		139,962		47,500
Total assets	$	85,573,088	$	6,492,475	$	79,080,613

Liabilities		Current Year
Aggregate reserve for life contracts	$	14,092,105
Aggregate reserve for A&H contracts **Note 1**		31,570,448
Life (contract claims)		348,841
Accident and health (contract claims)		7,271,589
Premiums received in advance **Note 1**		944,511
Other amounts payable on reinsurance		4,763,614
Interest maintenance reserve		97,969
Commissions to agents due or accrued		501,905
General expenses due or accrued		134,326
Taxes, licenses and fees due or accrued		352,160
Amounts withheld or retained by company		481,779
Remittances and items not allocated		139,103
Borrowed money		1,500,604
Asset valuation reserve		269,100
Total liabilities	$	62,468,054
Capital and Surplus		
Common capital stock	$	7,000,000
Surplus notes		2,266,666
Gross paid in and contributed surplus		667,619
Unassigned funds (surplus) **Note 1**		6,678,273
Total of stock and surplus	$	16,612,559
Total liabilities, stock and surplus	$	79,080,613

INCOME STATEMENT
For the year ended December 31, 2007

Premiums and annuity considerations for life and A&H contracts	$	60,856,829		
Net investment income		3,460,651		
Amortization of Interest Maintenance Reserve (IMR)		73,912		
Commissions and expense allowances on reinsurance ceded		6,878,796		
Aggregate write-ins for miscellaneous income		(322,182)		
Total revenues			$	70,948,006
Death benefits		2,947,155		
Annuity benefits		13,246		
Disability benefits and benefits under accident and health contracts		36,370,779		
Surrender benefits and withdrawals for life contracts		425,429		
Increase in aggregate reserves for life and accident and health		5,216,643		
Total benefits				44,973,252
Commissions on premiums		16,501,801		
General insurance expenses		7,041,550		
Insurance taxes, licenses and fees, excluding federal income taxes		2,185,715		
Increase in loading on deferred and uncollected premiums	$	(214,551)		
Total other expenses				25,514,515
Total benefits and other expenses				70,487,767
Net gain from operations before and federal income taxes				460,239
Less: Federal and foreign income taxes incurred				94
Net gain from operations before realized capital gains or (losses)				460,145
Net realized capital gains or (losses)				(1,529)
Net income			$	458,616

CAPITAL AND SURPLUS
Changes for 2007

Capital and surplus, December 31, 2006			$	15,729,303
Net income	$	458,616		
Change in net deferred income tax		118,622		
Change in nonadmitted assets and related items		171,792		
Change in asset valuation reserve		22,853		
Change in surplus notes		80,000		
Examination changes, net		(327,853)		
Aggregate write-ins for gains and losses in surplus	$	359,226		
Net change in capital and surplus for the year				883,256
Capital and surplus, December 31, 2007			$	16,612,559

NOTES TO THE FINANCIAL STATEMENTS

Note 1	Uncollected Premiums	$1,086,623
	Aggregate Reserve for A&H Contracts	31,570,448
	Premium Received in Advance	944,511

The changes as a result of this examination were related to these three accounts. Errors were discovered in the calculation of the unearned premium reserve (part of the Aggregate Reserve for A&H Contracts) and Premium Received in Advance. The unearned premium balance was determined to be understated by $398,948, the Uncollected Premiums balance was overstated by $12,190 and the Premium Received in Advance account was overstated by $83,285.

EXAMINATION CHANGES

Total Capital and Surplus per the Company:

Common capital stock	$	7,000,000
Surplus notes		2,266,666
Gross paid in and contributed surplus		667,619
Unassigned funds (surplus)		7,006,126
Total of stock and surplus	$	16,940,412

Examination Changes:		Increase in Surplus		Decrease in Surplus		
Uncollected Premiums			$	12,190		
Aggregate Reserve for A&H Contracts unearned premium				398,948		
Premiums Received in Advance	$	83,285				
Total Changes	$	83,285	$	411,138		
Net Change in Surplus:					$	(327,853)

Total Capital and Surplus per Examination:

Common capital stock	$	7,000,000
Surplus notes		2,266,666
Gross paid in and contributed surplus		667,619
Unassigned funds (surplus)		6,678,273
Total of stock and surplus	$	16,612,559

GENERAL COMMENTS AND RECOMMENDATIONS

Prior Examination Comments Page 2

The Company should periodically test its disaster recovery plan.

Notes to the Financial Statements Page 16

The Company should implement measures to ensure that advance premiums and unearned premiums are calculated and classified correctly. Also, the Company should evaluate the need for a premium deficiency reserve and properly report such reserve in accordance with SSAP No. 54.

Subsequent Events Page 17

The Company should immediately notify the Department with information regarding the outcome of the Northstar arbitration when it is available.

SUBSEQUENT EVENTS

The Company experienced significant losses through the first three quarters of 2008. This was attributed largely to the home health care business in the state of Florida. The Company has been unsuccessful in past attempts to obtain the rate increases necessary to return this business to profitability. As a result of these losses and other factors, the Company's surplus declined by over \$4.2 million since December 31, 2007.

The Company's reinsurance agreement with Northstar Reinsurance Ireland Limited has been in dispute for several years. This dispute (primarily questions about the claims data provided to the reinsurer) is now in arbitration. Although, the reinsurer has yet to assert a monetary claim, the arbitration is proceeding and may be resolved early in 2009. Potential losses, if any, to the Company cannot be determined at this time. The Company should provide the Department with the results of the arbitration when it is available.

ACKNOWLEDGEMENT

The assistance and cooperation extended by the officers and employees of National States Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Timothy Harris and Dick Glatz, of Milliman, Inc., and John Boczkiewicz, CFE, CPA, Doug Daniels, AFE, CPA, and Andrew Balas, CFE, CPA, examiners for the Missouri Department of Insurance, Financial Institutions and Professional Registration, participated in this examination.

VERIFICATION

State of Missouri)
) ss
County of St. Louis)

I, Robert P. Jordan, 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.

Robert P. Jordan

Robert P. Jordan, CFE
Examiner-in-Charge
Missouri Department of Insurance, Financial Institutions and Professional Registration

Sworn to and subscribed before me this 22nd day of January, 2009
My commission expires:
10-3-2012

Julie L. Smith
Notary Public

JULIE L. SMITH
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: October 3, 2012
Commission # 08546579

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.

Michael R. Shadowens

Michael Shadowens, CFE
Audit Manager, St. Louis
Missouri Department of Insurance, Financial Institutions and Professional Registration

National States Insurance
COMPANY

1830 Craig Park Ct., St. Louis, Missouri 63146, Area Code: 314-878-0101
Toll Free: 800-868-6788
Fax: 314-878-8118

March 26, 2009

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

Re: Examination Report for period ending December 31, 2007

Dear Mr. Heese:

As per your letter dated March 11, 2009, I am submitting our responses to the Examination Report in writing. We would like for our responses to be included in the report as a public document.

Page 16 – Prior Examination Comments - Disaster Recovery Plan
We plan to periodically test our disaster recovery plan.

Page 16 – Notes to the Financial Statements
The Company has modified our calculation programs for advance and unearned premium.

Company testing does not indicate the need for a Premium Deficiency Reserve (PDR). The gross premium valuations indicated the shortfall associated with the Florida Home Health Care business is offset by sufficiencies in the other A&H lines. The establishment of PDRs is required as part of solvency regulation. As such, any perceived need for a PDR on a subset of the business is overshadowed by the Asset Adequacy Testing and Risk-Based Capital Plan which more directly relate to the continued solvency of the company. In addition, PDRs are generally associated with known (and unavoidable) losses and lines of business are distinguished by differences in marketing, servicing or measuring. All of the A&H lines of National States are marketed, serviced and measured in a like manner.

Page 16 – Subsequent Evens
The Company will notify the Department regarding the outcome of the Northstar arbitration.

If you have any questions please feel free to give me a call at 314-878-0101 ext. 205 or e-mail me at pcurran@nstates.com.

Sincerely,

Patricia I. Curran

Patricia I. Curran
CFO