

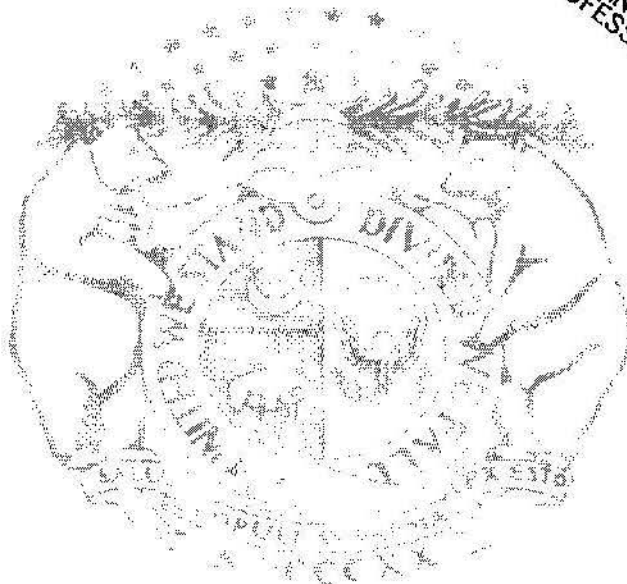
REPORT OF
FINANCIAL EXAMINATION

NATIONAL FIRE AND INDEMNITY EXCHANGE

As Of

December 31, 2008

FILED
JUL 16 2009
DIRECTOR OF INSURANCE
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION



STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS
AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

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June 2, 2009
St. Louis, Missouri

Honorable Alfred W. Gross, Commissioner
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
Chair of the NAIC Financial Condition (E) Committee

Honorable Merle Scheiber, Director
South Dakota Division of Insurance
Secretary of the 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, MO 65101

Dear Gentlemen:

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

National Fire and Indemnity Exchange

also referred to as "the Exchange." The examination was conducted at the Exchange's home office at 6030 Bancroft Street, Saint Louis, Missouri 63109, telephone number (314) 832-1118. This examination began on February 18, 2009 and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope comprehensive financial examination of National Fire and Indemnity Exchange was performed as of December 31, 2004. That examination 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 current full scope association financial examination covers the period from January 1, 2004, through December 31, 2008. The examination was originally scheduled to cover the period from January 1, 2004 through December 31, 2007. As discussed more fully below in Accounts and Records, the examination was expanded to include operating results through year-end 2008. The examination was conducted by examiners from the

state of Missouri representing the Midwestern Zone of the NAIC. No other zones participated in this examination

COMMENTS PRIOR EXAMINATION

Listed below is the comment taken from the prior examination report as of December 31, 2004. The Company's response and the item's current status are also indicated.

Comment: Fidelity Bond and Other Insurance

"The minimum amount of fidelity coverage recommended by the national Association of Insurance Commissioners (NAIC) for an insurer equivalent in size to the Exchange is \$225,000. Corley should increase its fidelity bond coverage to meet the NAIC recommended minimum of \$225,000."

Company Response

"We agree with this recommendation and have increased our fidelity bond coverage to \$225,000 effective May 26, 2006."

Current Finding:

At year-end 2008, the Exchange was covered by a \$225,000 fidelity bond which met the NAIC recommended minimum coverage.

HISTORY

General

National Fire and Indemnity Exchange was formed and commenced business in 1915 as a reciprocal inter-insurance exchange, providing coverage related to cleaning and dyeing operations. Originally titled "The National Association of Dyers and Cleaners Inter-Insurance Exchange," the Exchange changed its name to "National Fire Insurance Exchange" in 1924. As a result of a merger with another exchange, on December 31, 1968, the Exchange adopted its present name. The Exchange is licensed by the Department to write property and liability insurance under Section 379 RSMo (Insurance other than life).

Capital Stock

The Exchange does not issue capital stock. The Exchange is not incorporated nor does it have stockholders.

Dividends

The Exchange's subscriber dividend policy provides incentives for and rewards policyholder loyalty. Dividend participation factors are based upon subscriber persistency. In April 1995, the Advisory Committee revised the dividend policy, authorizing up to fifty percent (50%) of pre-tax profit to be distributed to policyholders. In July 2001, the Advisory Committee again revised the dividend policy, allowing up to one hundred percent (100%) of pre-tax profit to be declared as dividends or subscriber savings account contributions.

Following are the subscriber dividends incurred during the examination period:

<u>Year</u>	<u>Amount</u>
2005	\$ 3,388
2006	245,916
2007	150,700
2008	<u>(2,836)</u>
Total	<u>\$ 397,168</u>

Management

Through the Subscribers' Agreement, Exchange members appoint an attorney-in-fact to manage the daily operations of the Exchange. From its inception the Exchange has had one attorney-in-fact, John L. Corley, Inc., (f/k/a John L. Corley). The Exchange has no employees; services are provided by employees of John L. Corley, Inc.

An Advisory Committee chosen by the subscribers advises the attorney-in-fact. Advisory Committee members are elected at the annual Subscribers' Meeting. The Advisory Committee consists of seven (7) subscribers and a representative of the attorney-in-fact, who only votes in the event of a tie. In June 2007, the Advisory Committee amended the Governance rules to change the term of Advisory Committee members from one year to three years. The 2008 Advisory Committee election was structured to stagger the terms of the Advisory Committee members. The members elected and serving on the Advisory Committee at December 31, 2008, were as follows:

<u>Director</u>	<u>Affiliation</u>
Aikin, Robert G.	President
Ballwin, MO	John L. Corley, Inc.
Barron, Jack	Owner
El Paso, TX	Coronado Cleaners
Dawson, Gary	Owner
Largo, FL	Belleair Bluffs Cleaners
Miller, Richard	President
Fort Lauderdale, FL	Barton & Miller Cleaners
Petrozzi, Russell	Vice-President
Niagara Falls, NY	Petrozzi Enterprises, Inc.
Soukup, Leo Jr.	Owner
Hastings, NE	C.D. Hoff, Inc.
Wolf, Jeanne	President
St. Louis, MO	Morgenthaler Drapery Cleaners

The officers of the Exchange serving as of December 31, 2008, were as follows:

<u>Name</u>	<u>Office</u>
Aikin, Robert G.	President
Hawkins, Ann	Vice-President
Mouldon, Greg E.	Treasurer
Walter, Carol A.	Secretary

Conflict of Interest

The Exchange requires Advisory Committee members and officers to complete conflict of interest statements annually. Signed conflict of interest statements were reviewed for each year under examination. None of the statements indicated any material conflicts.

Corporate Records

The Governance Rules, which provide guidelines for regulating the internal affairs of the Exchange, were reviewed. There were four amendments to the Governance Rules during the current examination period. In June 2005 the principal office of the Exchange was designated. Also in June 2005 the amendment process was changed to align with the provisions of the Subscribers' Agreement. In June 2006 membership on the Advisory Committee was restricted to a maximum of two members from the same state. In June 2007 the term of membership on the Advisory Committee was changed from one year to three years and the 2008 election was structured to stagger the terms.

The Subscribers' Agreement was also reviewed. As of January 1, 2008, the Subscribers' Agreement was amended to change the term of membership on the Advisory Committee from one year to three years and to stagger the terms in the 2008 election.

The minutes of the Advisory Committee meetings were reviewed for the period under examination. The minutes appear to properly reflect and approve corporate transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

No major events took place during the examination period.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

The Department has determined that the Exchange is not a member of an Insurance Company Holding System as defined by Section 382.010 RSMo (Definitions). However, Statement of Statutory Accounting Principles (SSAP) 25, Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties, defines the attorney-in-fact of a reciprocal reporting entity as a related party.

John L. Corley, Inc. ("Corley"), attorney-in-fact, manages the affairs of the Exchange. The Exchange's subscribers have appointed Corley as the attorney-in-fact in their Subscribers' Agreement.

Attorney-In-Fact

Corley is a privately-held corporation. Robert G. Aikin, President of National Fire & Indemnity Exchange, is the majority stockholder.

In addition to being the Exchange's attorney-in-fact, Corley is also an insurance agency. As an insurance agency, Corley places coverage, including workers' compensation, boiler, commercial auto and umbrella, with other insurance carriers. These policies supplement the commercial multi-peril package policy sold by the Exchange. This supplemental coverage is combined in a portfolio of policies offered by NIE Insurance. NIE Insurance is a fictitious name owned by Corley and registered with the Missouri Secretary of State.

As authorized in the Subscribers' Agreement, Corley receives twenty-five percent (25%) of gross written premium, less amounts written off, as compensation for its services. Corley pays all expenses related to the exchange of insurance contracts. Corley is also responsible for purchasing the necessary books, supplies, records and equipment, which remain the property of the attorney-in-fact.

The Exchange pays the following expenses: license fees; taxes; audit fees; legal fees; Advisory Committee expenses; claim adjustment expenses; expenses or fees mandated by individual states; National Association of Insurance Commissioners fees; Federal Insurance Administration fees; rating bureaus for services and the Exchange's statistical response; underwriting reports; surveys; and advertising expenses.

The Exchange has authorized Corley to pay claims adjusting expenses and advertising expenses on its behalf. The Exchange reimburses Corley up to 2.5% of written premium for claims adjusting expenses and up to 2.5% of written premium for advertising expenses.

The Exchange incurred attorney-in-fact fees for the years under examination as follows:

<u>Year</u>	<u>Fee</u>
2005	\$ 1,709,259
2006	\$ 1,644,615
2007	\$ 1,484,430
2008	\$ 1,306,703
Total	<u>\$ 6,145,008</u>

FIDELITY BOND AND OTHER INSURANCE

The Exchange is a named insured on a \$225,000 financial institution bond issued to the attorney-in-fact, John L. Corley, Inc. The amount of coverage meets the suggested minimum amount recommended by the NAIC. The Exchange is also a named insured on a directors and officers liability policy.

The attorney-in-fact maintains the following coverage: property and liability, workers' compensation and employers' liability, directors' and officers' liability, professional liability and catastrophe liability. The coverage appears to adequately protect the attorney-in-fact's operations.

EMPLOYEE BENEFITS

The Exchange has no employees. The attorney-in-fact, John L. Corley, Inc. provides personnel services as authorized in the Subscribers' Agreement. John L. Corley, Inc. employees receive a variety of benefits including paid time off, medical insurance, dental insurance, group life insurance, accidental death or dismemberment insurance, a profit sharing plan and tuition reimbursement.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Department as of December 31, 2008, as reflected below, were deemed sufficient to meet the \$1,200,000 deposit requirement for the State of Missouri per Section 379.098 RSMo (Securities deposit).

<u>Security</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
U.S. Treasury Note	\$ 240,000	\$ 252,710	\$ 263,794
U.S. Treasury Note	125,000	125,122	128,507
U.S. Treasury Note	50,000	50,334	51,240
St. Louis County Bond	400,000	403,931	409,104
Ladue Missouri School District	240,000	240,827	241,625
Missouri State Envir. Bond	240,000	241,168	245,585
Total	\$ 1,295,000	\$ 1,314,092	\$ 1,339,855

Deposits with Other States

The Company has funds on deposit with other states in which it is licensed to satisfy their statutory deposit requirements. Those funds on deposit as of December 31, 2008, were as follows:

<u>State</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
Arkansas	Certificate of Deposit	\$ 70,000	\$ 70,000	\$ 70,000
Florida	Certificate of Deposit	200,000	200,000	200,000
Louisiana	Certificate of Deposit	20,000	20,000	20,000
Georgia	Evergreen Inst. MM	40,507	40,507	40,507
North Carolina	First American TO	425,000	425,000	425,000
South Carolina	U.S. Treasury Note	150,000	151,638	159,422
Massachusetts	MA State Bond	100,000	106,139	110,851
Ohio	U.S. Treasury Note	255,000	255,969	262,091
Virginia	VA State Bond	200,000	200,000	200,000
Totals		\$ 1,460,507	\$ 1,469,253	\$ 1,487,871

INSURANCE PRODUCTS AND PRACTICES

Territory and Plan of Operations

The Exchange is licensed by the Department as a multiple-line property and casualty insurance carrier under Sections 379.650 through 379.790 RSMo (Reciprocal Exchanges or Interinsurers). The Exchange provides multi-peril coverage for fabric care businesses under Commercial Package Policies (CPP) and Business Owner Policies (BOP). The Exchange writes most of its business directly with little reliance on insurance brokers. At year-end 2008 the Exchange wrote policies in 32 of the 34 states in which it is licensed.

Policy Forms, Rates and Underwriting

The Exchange underwrites its business either internally, with authority restricted to the underwriting supervisor, or externally through inspections contracted to Insurance Service Office (ISO) Commercial Risk Services. The Exchange subscribes to the ISO for rates and policy forms. Deviations from standard forms or rates are applied in accordance with individual state filings.

Advertising

The attorney-in-fact provides advertising on behalf of the Exchange. The Exchange reimburses the attorney-in-fact for incurred advertising expenses up to 2.5% of gross written premium. Advertising is placed under the fictitious name NIE Insurance.

Treatment of Policyholders

The Department has a market conduct staff that performs a review of these issues and generates a market conduct report. There has been no market conduct examination of the Exchange since the prior financial examination. The Exchange appears to have procedures in place for the proper handling of complaints. One complaint has been registered against the Exchange during the current examination period.

REINSURANCE

General

The Company's reinsurance and premium activity on a direct written, assumed and ceded basis for the period under examination is detailed below:

Premium	2005	2006	2007	2008
Direct premium written	\$ 6,863,679	\$ 6,607,660	\$ 5,958,645	\$ 5,282,031
Reinsurance assumed	77,309	104,533	125,454	78,700
Reinsurance ceded	<u>(1,446,799)</u>	<u>(1,433,100)</u>	<u>(1,392,647)</u>	<u>(1,253,596)</u>
Net premium written	<u>\$ 5,494,189</u>	<u>\$ 5,279,093</u>	<u>\$ 4,691,452</u>	<u>\$ 4,107,135</u>

Assumed

Regional Reciprocal Catastrophe Pool

At year-end 2008 the Exchange participated in the Regional Reciprocal Catastrophe Pool ("the Pool"). This participation involves a retrocession arrangement for secondary layer catastrophe coverage between the Pool and a group of reinsurers known collectively as Mutual Reinsurance Bureau (Illinois). Pool participants cede to Mutual Reinsurance Bureau which retrocedes back to the Pool. Each participant is liable for a pro-rata share of each loss covered by the Pool, with maximum coverage of \$30,000,000 per occurrence. The Exchange assumes 1% of the Pool risk, or a maximum of \$300,000 per occurrence.

Ceded

Umbrella Quota Share Agreement

At year-end 2008 the Exchange was party to an umbrella quota share agreement with Platinum Underwriters Reinsurance, Inc. (Maryland), placed by Willis Re, Inc. (Minnesota), the Exchange's reinsurance intermediary. Under the agreement the Exchange cedes 95% of its net liability for contracts classified as Umbrella Liability to Platinum Underwriters Reinsurance, Inc. The Exchange receives a 30% ceding commission.

Multiple Line Excess of Loss Agreement

At year-end 2008 the Exchange was party to a multiple line excess of loss agreement with Platinum Underwriters Reinsurance, Inc. (Maryland), placed by Willis Re, Inc. (Minnesota), the Exchange's reinsurance intermediary. The agreement, which covers policies classified as property and casualty, has three layers. The Exchange retains \$300,000, \$500,000 and \$1,000,000 of each respective level. The property per-occurrence limits are \$600,000, \$1,500,000 and \$3,000,000 per respective level. The casualty per-occurrence limits are \$200,000, \$500,000 and \$1,000,000 per respective level. The Exchange pays a minimum premium of \$456,000 for this coverage.

Semi-Automatic Boiler and Machinery Agreement

At year-end 2008 the Exchange was party to a semi-automatic boiler and machinery agreement with Travelers Indemnity, Inc. (Connecticut). Under the agreement the Exchange cedes 100% of its equipment breakdown coverage. The reinsurer has a \$15 million limit of liability. The agreement also allows the Exchange to cede risk on a facultative basis. The Exchange receives a 32% ceding commission. The Exchange is also eligible for a yearly incentive payment if certain premium growth and loss ratio targets are met.

Property Catastrophe Excess of Loss

At year-end 2008, as part of its participation in the Pool noted above, the Exchange was party to two property catastrophe excess of loss agreements with Mutual Reinsurance Bureau. The agreements cover policies classified by the Exchange as Property or Commercial Auto Physical Damage. Under the first agreement, the Exchange pays a

minimum premium of \$315,000 and retains \$750,000 of exposure; Mutual Reinsurance Bureau provides coverage up to \$4.25 million. Under the second agreement, the Exchange pays a minimum premium of \$109,500 and retains \$5 million; Mutual Reinsurance Bureau provides coverage up to \$5 million. Mutual Reinsurance Bureau has a contract year limit of \$8.5 million under the first agreement and \$10 million under the second agreement.

ACCOUNTS AND RECORDS

General

National Fire and Indemnity Exchange maintains its financial records on a statutory accounting basis. Accounting entries are recorded using QuickBooks accounting software. The Exchange uses AMS Services AFW policy management software.

Independent Accountant

Conner Ash P.C., a public accounting firm, audits the Exchange's financial statements annually. The most recent audit work papers were reviewed. The work papers were used in the course of the examination as deemed appropriate.

Independent Actuary

Robert Scott, FCAS, MAAA, reviewed and certified the 2008 reserves and related actuarial items reported in the financial statements. Mr. Scott is associated with Casualty Actuaries, Inc.

Consulting Actuary

The Department retained a consulting actuary, Jon Michelson, FCAS, MAAA, of Expert Actuarial Services, LLC, to review the adequacy of the Exchange's reserves and related liabilities. Mr. Michelson was originally engaged to opine on the adequacy of the Exchange's 2007 reported reserves. Mr. Michelson found the 2007 reserves to be deficient due to adverse development experienced in 2008. The amount of the deficiency would have triggered an examination change. The Department and the Exchange mutually agreed to roll the examination date forward to December 31, 2008. Mr. Michelson found the year-end 2008 reserves to be adequately stated. Because the adverse development resulted in part from pollution claims, Mr. Michelson recommended that the Exchange segregate its claims into pollution claims and non-pollution claims and perform a more sophisticated analysis of pollution-related reserves. The Department concurs with these recommendations.

Information Systems

In conjunction with this examination, Andrew Balas, Information Systems Financial Examiner with the Department, conducted a review of the Company's information systems. No material exceptions were noted.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2008 and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. The failure of any column to add to its respective total is due to rounding or truncation.

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 concerning their effect on the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual annual statement item.

ASSETS

	Assets	Non- admitted Assets	Net Admitted Assets
Bonds	\$ 7,605,273	\$ -	\$ 7,605,273
Common stocks (stocks)	862,271	-	862,271
Cash and short-term investments	1,304,598	-	1,304,598
Investment income due and accrued	85,327	-	85,327
Uncollected premiums	465,501	-	465,501
Amounts recoverable from reinsurers	341,139	-	341,139
Current federal income tax recoverable	71,735	-	71,735
Net deferred tax asset	228,204	-	228,204
Totals	<u>\$ 10,964,048</u>	<u>\$ -</u>	<u>\$ 10,964,048</u>

LIABILITIES AND SURPLUS

Losses	\$ 1,977,545
Loss adjustment expenses	963,703
Commissions payable	135,466
Other expenses	42,289
Taxes, licenses and fees	17,631
Unearned premiums	2,712,659
Policyholders dividends declared and unpaid	8,085
Provision for reinsurance	65,400
Escheat funds	<u>40,172</u>
Total liabilities	\$ 5,962,950
Unassigned funds (surplus)	<u>5,001,098</u>
Total surplus	\$ 5,001,098
Total liabilities and surplus	<u>\$ 10,964,048</u>

STATEMENT OF INCOME

Premiums earned	\$ 4,564,703
Losses incurred	(1,776,122)
Loss expenses incurred	(1,144,638)
Other underwriting expenses incurred	<u>(2,244,497)</u>
Total underwriting deductions	\$ (5,165,257)
Net underwriting gain (loss)	\$ (600,554)
Net investment income earned	372,719
Net realized capital gains	<u>(33,926)</u>
Net investment gain	\$ 338,793
Net loss from premium balances charged off	(55,220)
Miscellaneous expense	<u>(5,327)</u>
Total other income	\$ (60,547)
Income before dividends and FIT	\$ (322,308)
Dividends to policyholders	2,836
Federal income taxes incurred	<u>(11,394)</u>
Net income	<u>\$ (330,866)</u>

SURPLUS

Surplus as regards policyholders, December 31 prior year	\$ 6,135,319
Net income	(330,866)
Change in net unrealized capital losses	(333,544)
Change in net deferred income tax	(3,701)
Change in provision for reinsurance	(65,400)
Refund of subscriber savings accounts	(400,710)
Examination changes	-
Change in surplus as regards policyholders for the year	<u>\$ (1,134,221)</u>
Surplus as regards policyholders, December 31 current year	<u>\$ 5,001,098</u>

EXAMINATION CHANGES

None.

NOTES TO FINANCIAL STATEMENTS

None.

GENERAL COMMENTS OR RECOMMENDATIONS

Consulting Actuary

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As noted by the consulting actuary, pollution-related claims have significantly contributed to adverse claims development and continue to have the potential to adversely affect the development of the Exchange's claims reserves. The Department's consulting actuary has recommended that the Exchange segregate its claims into pollution claims and non-pollution claims and perform a more sophisticated analysis of pollution-related reserves. The Company should incorporate these or other analysis tools in future actuarial analysis and reports to ensure environmental exposures are adequately included in loss reserve calculations.

SUBSEQUENT EVENTS

None.



June 30, 2009

Frederick G. Heese, CFE, CPA
Chief Financial Examiner & Acting Division Director
Missouri Department of Insurance
P.O. Box 690
Jefferson City, Missouri 65102-0690

RE: December 31, 2008 Examination Report of National Fire and Indemnity Exchange

Dear Mr. Heese:

Thank you for your June 16th letter and copy of the Examination Report referenced above. That Report recommends that,

“...the Exchange segregate its claims into pollution claims and non-pollution claims and perform a more sophisticated analysis of pollution related reserves. The Company should incorporate these or other analysis tools in future actuarial analysis reports to ensure environmental exposures are adequately included in loss reserve calculations.”

We agree with this recommendation. We have segregated pollution claims and non-pollution claims to allow more sophisticated analysis of pollution related reserves. We intend to incorporate these analysis tools in future actuarial analysis reports to ensure environmental exposures are adequately included in loss reserve calculations. We have notified the actuarial firm that reviews our reserves of the above recommendation, of our agreement with this recommendation, and our intent to incorporate these tools in future actuarial analysis reports.

We encourage you to include this response in the Examination Report as a public document.

Very truly yours,

Robert Aikin, President
John L. Corley, Inc.; Attorney-In-Fact
National Fire & Indemnity Exchange