REPORT ON EXAMINATION

OF THE

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG

AS OF

DECEMBER 31, 2009

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

I, **Karen Weldin Stewart**, Insurance Commissioner of the State of Delaware, do hereby certify that the attached **Report on Examination**, made as of **December 31, 2009**, of

**MARATHON FINANCIAL INSURANCE COMPANY, INC.,
A RISK RETENTION GROUP**

is a true and correct copy of the document filed with this Department.

Attest By: ____________________

Date: June 30, 2011

Insurance Commissioner of the State of Delaware

LIBERTY AND INDEPENDENCE

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 30th day of June, 2011.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

REPORT ON EXAMINATION

OF

MARATHON FINANCIAL INSURANCE COMPANY, INC.,
A RISK RETENTION GROUP

AS OF

December 31, 2009

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 30th day of June, 2011.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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May 13, 2011

Honorable Karen Weldin Stewart
Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 10-117, dated August 10, 2010, an examination has been made of the affairs, financial condition and management of

MARATHON FINANCIAL INSURANCE COMPANY, INC RRG

hereinafter referred to as "Company" or "MFIC", incorporated under the laws of the State of South Carolina as a stock company. The Company re-domesticated to Delaware on May 7, 2010 with its statutory home office located at 1105 North Market Street, Suite 1300, Wilmington, Delaware 19801. The examination was conducted at the main administrative offices of the Company, located at 1716 Corporate Crossing, Suite 2, O'Fallon, Illinois 62269.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

This examination covered the period from January 1, 2007 through December 31, 2009, and consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This report is presented on an exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed the rules established by the National Association of Insurance Commissioners' (NAIC) Committee on Financial Condition Examiners Handbook, and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware.

HISTORY

The Company was organized as a risk retention group under the laws of the State of South Carolina on January 30, 2001, and commenced business on November 1, 2001. There were four shareholders as of December 31, 2009 with Marathon Administrative Company, Inc. ("MAC") holding 99.4%. The other three owners were Automotive Professionals, Inc. ("API"), now in bankruptcy, United States Warranty Company ("USWC") and Intercontinental Warranty Services, Inc. ("IWSI"). As a risk retention group, MFIC is subject to the Liability Risk Retention Act of 1986. Pursuant to the risk retention act, all shareholders of the Company are required to be policyholders and all policyholders are required to be shareholders. On May 7, 2010, the Company redomesticated to the State of Delaware.

CAPITALIZATION

The Company was authorized to issue 1,000 common zero par value shares. As of December 31, 2009 the Company had 503 shares issued and outstanding as follows:

Marathon Administrative Company, Inc.	500
Intercontinental Warranty Services, Inc.	1
United States Warranty Corporation	1
Automotive Professionals, Inc.	1
Total	503

The Company's outstanding Class A common stock has a stated value of $400 per share. Common Capital Stock as of December 31, 2009 amounted to $201,200. Gross paid in and contributed surplus was $1,143,045.

MANAGEMENT AND CONTROL

The Company's bylaws were originally adopted February 7, 2002. The bylaws state that the business and affairs of the Company shall be managed by a Board of Directors, each of whom is elected at the annual shareholders meeting. The number of directors shall be no more than nine, as amended, and each director shall hold office until the next annual meeting of the shareholders or until removed or their resignation. Company Directors elected and serving at the time its' 2009 Annual Statement was filed were as follows:

Name	Principal Occupation
Allen Duane Kreke	President of the Company
John Shelby Bryan	Treasurer of the Company
James Perry Bryan	Vice President of the Company
Pamela Mae Rakers	Secretary of the Company
Tiffany Marie Kreke	Compliance Officer of the Company
Rebecca Di Pietro	Wilmington Trust SP Services, Inc.

The bylaws state that the Officers of the Company shall include a President, a Secretary, a Treasurer and any additional officers as may be determined by the Board. The same person may simultaneously hold more than one office in the corporation. Company Officers appointed and serving at the time its' 2009 Annual Statement was filed were as follows:

Name	Office
Allen Duane Kreke	President
Stephen Michael Durr	Chief Financial Officer
Pamela Mae Rakers	Secretary
John Shelby Bryan	Treasurer
James Perry Bryan	Vice President
John Bracken Bryan	Vice President

The Company initially failed to provide complete Shareholder and Board of Director meeting minutes. Missing were the 2007 and 2009 Shareholder minutes and the 2007 Board of Director minutes. The minutes were provided subsequent to examination field work and during Supervisory review of this report. Per review of the meeting minutes provided, however, it was shown that the Company held Shareholder and Board of Directors meetings during the period under examination as required by its' bylaws. A review of Director minutes showed that investment transactions were approved quarterly for the years 2009, 2008, and not for 2007.

It is recommended that the Company Board review and approve all investments. It is further recommended that the Company provide complete and accurate records upon examination as required by 18 Del. C. §320 and 18 Del. Admin. Code 301 § 15.1.2.

HOLDING COMPANY SYSTEM

The Company operates as a Risk Retention Group. Each policyholder is required to be a shareholder. There were four shareholders as of December 31, 2009 with Marathon Administrative Company, Inc. holding 99.4% or 500 of the 503 outstanding shares. The other three shareholders were Automotive Professionals, Inc., United States Warranty Company and Intercontinental Warranty Services, Inc. Subsequent to year end 2009, Automotive Professionals, Inc. redeemed its share certificate and is no longer a shareholder.

The following is an organizational listing that reflects the identities and interrelationships between the Marathon Administrative Company, Inc. and the Company as of December 31, 2009:

Marathon Administrative Company, Inc.

OWNS
99.4% of

Marathon Financial Insurance Company, Inc.
A Risk Retention Group

Dividends

There were no dividends declared and paid during the examination period; however, the examination reclassed an intercompany payment made by the Company to the parent as a dividend as noted in Note 5 of this report.

MANAGEMENT AND SERVICE AGREEMENTS

Affiliated Agreements

The following affiliated agreements for the Company were identified as being in effect as of December 31, 2009:

Tax Sharing Agreement

A Tax Sharing Agreement dated July 1, 2008 between the Company and MAC, where participating companies allocate their consolidated federal income tax liability. The agreement stipulates that any overpayment made by the Company of its liability computed on the separate return basis must be settled within 90 days of the filing of the consolidated income tax return, or when a refund is due on the consolidated return, within 90 days of the receipt of such refund.

Expense Sharing Agreement

An Expense Sharing Agreement entered into between the Company and MAC, whereby MFIC agrees to payment on an annual basis for its share of salaries and wages, general administrative expenses, and other expenses. The agreement further stipulates that shared expenses will be re-evaluated on an annual basis. The Company's share, however, was not defined and not determinable in this agreement. The only date showing on the agreement was for the February 1, 2007 payment due date. This agreement had not been submitted to the Delaware Department of Insurance ("DEDOI") for approval.

Second Amended and Restated Administrative Services Agreement

Second Amended and Restated Administrative Services agreement entered into on January 2, 2007 and restated January 1, 2009, between the Company and MAC, whereby MFIC agrees to pay for administrative services such as sales and marketing, screening and processing applications, underwriting, billing and collecting premiums, warranty and service Contract accounting, administering informal complaints and disputes, claim adjudication, maintaining reinsurance, producer audit and support, and such other business operations of the Company incidental to its duties. This agreement had not been submitted to the DEDOI for approval.

It is recommended that the Expense Sharing agreement be modified to more clearly define the method of allocating expenses. It is further recommended that the Expense Sharing and Restated Administrative agreements be modified to reflect MFIC's new state of domicile and all related agreements be submitted to the Delaware Department of Insurance for approval.

Other Agreements

Captive Management Agreement

Effective April 15, 2008, the Company entered into an agreement with Wilmington Trust SP Services, Inc. (Wilmington Trust) to handle certain administrative services in return for an annual fixed fee.

Custody Agreements

Effective April 27, 2007, the Company entered into a Custody Agreement with Deutsche Bank pursuant to which Deutsche Bank will act as a custodian of various assets of the Company.

Effective October 21, 2009, the Company entered into a Custody Agreement with Raymond James and Associates pursuant to which Raymond James and Associates will act as a custodian of various assets of the Company.

Effective November 23, 2009, the Company entered into a Custody Agreement with Morgan Stanley Smith Barney pursuant to which Morgan Stanley Smith Barney will act as a custodian of various assets of the Company.

Per examination review of the three custodial agreements in place, it was found that the agreements did not contain certain protective clauses as recommended by the NAIC Examiner's Handbook, Part 1, Section IV. It was also noted that the agreements were not approved by the Company's Board of Directors.

It is recommended that the Company review and amend its Custodial Agreements to include the recommended clauses per the NAIC Examiner's Handbook, Part 1, Section IV. It is further recommended that the Company's Board of Directors review and approve its custodial agreements.

TERRITORY AND PLAN OF OPERATION

Territory:

As of December 31, 2009, the Company was licensed only in the State of South Carolina. Subsequent to the exam date, the Company became licensed in State of Delaware after re-domestication on May 7, 2010. In 2009, the Company only wrote premium in the State of South Carolina. Prior to 2009, the Company additionally wrote premium in the State of Illinois.

Plan of Operation:

The Company was formed as a South Carolina domiciled risk retention group to provide contractual liability coverage sold through financial institutions and other non-dealer producers. Each of the Company's policyholders is responsible for all administrative and servicing of their respective vehicle service and warranty contracts. The Company is registered as a non-domiciled risk retention group in the District of Columbia and all states except Wisconsin and Minnesota.

The Company writes liability insurance covering automobile warranty administrators/obligors ("AOs") for their liabilities arising out of vehicle service contracts ("VSCs"). The VSCs insured by the Company are sold primarily through financial institutions, internet marketers and secondarily through select automobile dealers.

Prior to January 1, 2009, policy coverage was provided on an excess of loss basis, whereby MFIC is liable for any losses and refunds in excess of the reserves established by the AOs. Through policy endorsements with API, the Company is required to pay all claims if API fails to perform within 60 days of a VSC holder's submission of proof of loss to API's claim administrator. In April 2007, API filed for bankruptcy protection. The settlement agreement between MFIC and the Trustee for API, as approved by United States Bankruptcy Court for the Northern District of Illinois Eastern Division, resulted in MFIC agreeing to continue to fund claims in eight states associated with the noted endorsements and to pay $1,100,000 to the Trustee in three annual installments ($500,000 paid 2010, $300,000 in 2011 and $300,000 in 2012).

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements as adjusted for examination changes:

Year	Admitted Assets	Capital and Surplus	Gross Premium Written	Net Income
2009	$10,923,809	$1,191,263	$36,000,582	($302,997)
2008	$7,452,487	$2,139,119	$1,754,285	($77,726)
2007	$9,542,451	$2,327,616	$1,620,490	($1,270,115)
2006	$10,819,040	$3,138,754	$1,422,240	$437,845

NAIC FINANCIAL RATIOS

The Company failed the following six NAIC Financial Ratios from the Insurance Regulatory Information System:

Gross Premiums Written to Policyholders' Surplus

The Company had $36 million gross written premium verses only $1.2 million in surplus at year end. The $36 million in premium is 100% retroceded to Producer Owned Reinsurance Companies (PORCs) and the cessions are collateralized by trust accounts.

Change in Net Premiums Written

Beginning in 2009, the Company began assuming business on a first dollar basis as required by the South Carolina Department of Insurance. Before 2009 the Company was writing on an excess of loss basis and direct premiums were not flowing through the annual statement. In 2009, the business plan changed where direct premium now flows through MFIC financials and is retroceded 100%. The $53K amount showing as net written in 2009 was actually 2008 premium that came in late. The per-contract fees of $138,176 ($200,676 earned fees less

$62,500 to HannoverRe) are now showing as an offset, which reduces Other Underwriting Expenses.

Two-Year Overall Operating

The Company reported losses and LAE incurred of $709,661 in 2009, which is a decrease of $449,241 (40%) in 2009 from 2008. These underwriting losses were primarily due to MFIC's obligation to pay claims on contracts written by API after its bankruptcy. The underwriting losses incurred of $672,938 consist of $797,938 in loss/claims payments and the $125,000 decrease in the estimated loss reserve for unpaid claims. The Other Underwriting Expenses incurred was $2,357,746, which included a $1,100,000 liability set up for the excess of loss settlement of the API litigation. The Company is still obligated to pay first dollar claims in eight states.

Investment Yield

The Company is showing gross invested income earned of $318,469 offset by investment expenses of $340,513 for a net loss of $22,044 on average invested assets of approximately $4.6 million.

Adjusted Liabilities to Liquid Assets

The Company has the majority of its assets in Garrison Municipal Partnership. The investment in Garrison Municipal Partnership is not in compliance with 18 Del. C. §1305(1) and §1311. See Accounts and Records.

Gross Agents Balances (in collection) to Policyholders' Surplus

The Company is showing $5,777,304 as an uncollected premium receivable asset, which represents 248% of surplus. The Company is retroceding these premium receivables. The

Company has an offsetting ceded premium payable for the same amount and is utilizing the payable as a reinsurance credit in Schedule F, Part 5.

REINSURANCE

The following is a summary of the Company's reinsurance program at December 31, 2009:

Assumed

The Company entered into a 100% Quota Share agreement with American Resources Insurance Company ("ARIC") on October 13, 2005, whereby MFIC assumed all business related to automobile warranty contracts issued by ARIC. The contract was cancelled in 2006 when ARIC lost its "A-Rating". There is approximately $1.4 million in unearned premium remaining on the contract.

Ceded

The Company operates as a Risk Retention Group issuing First Dollar Quota Share policies to various Administrator/Dealer Obligors ("AOs/DOs"). The AOs/DOs issue various vehicle service contracts to provide auto warranty coverage for auto owners. The First Dollar coverage guarantees the performance of the AOs/DOs if they are unable to fulfill their obligations. Beginning in 2009, the AO/DOs began ceding the premiums to MFIC on a gross basis. MFIC in turn retrocedes 100% of the business to the AO/DO's established Producer Owned Reinsurance Companies ("PORCs"). Each of the 66 PORCs listed in Schedule F, Part 3 are domiciled in the Turk and Caicos Islands and have established a reinsurance trust account where MFIC is the beneficiary.

ACCOUNTS AND RECORDS

A review of the Company's IT systems and controls was performed by INS Services, Inc. The examination, along with INS Services, Inc., reviewed the Company's documented controls, but did not test controls. Substantive procedures were performed throughout the examination. During the course of the examination the following deficiencies in record keeping, accounting practices, Delaware Code, and monitoring were noted:

Unearned Ceding Commission

It was noted in review of Schedule F, Part 3 that the Company is including its unearned ceding commission in reinsurance recoverable on unearned premiums (column 13) rather than an offset to ceded balances payable (column 16).

The NAIC Accounting Practices and Procedures Manual, SSAP 62R, paragraph 53 states that:

"Commissions receivable on reinsurance ceded business shall be included as an offset to Ceded Reinsurance Balances Payable".

It is recommended that the Company include its unearned ceding commissions as an offset to ceded reinsurance balances payable per the NAIC Accounting Practices and Procedures Manual, SSAP 62R, Paragraph 53.

Other Invested Assets

The Company's investment in Garrison Municipal Partners, LP is not within compliance with 18 Del. C. §1305 and §1311.

18 Del. C §1305(1) – One person – "An insurer shall not at any one time have any combination of investments in or loans upon the security of obligations, property or securities of any 1 person (other than its lawful subsidiary) aggregating over 10% of the insurer's assets. This shall not apply as to general obligations of the United States or of any state, or of Canada or any province thereof, or include policy loans made under § 1317 of this title."

> 18 Del. C §1311 – "An insurer may invest in or otherwise acquire and hold a limited partnership interest in any limited partnership formed pursuant to the laws of any state or the United States of America. No limited partnership interest shall be acquired under this section if the cost thereof would exceed 2% of the assets of such insurer nor if such cost, plus the book value on the date of such acquisition of all limited partnership interest then held by such insurer and acquired under this section, would exceed 10% of such assets."

The Company owns 12.45% of the Partnership. The investment represents 200% of the Company's surplus and 35% of total assets.

It is recommended that the Company modify its investments to become compliant with 18 Del. C. §1305 and §1311.

Trust Accounts

The examination performed testing on a sample of reinsurance trusts and identified that the Company/PORC guidelines for investment asset allocation were not being administered properly and were not in compliance with the trust investment guidelines.

It is recommended that the Company monitor the trust accounts to ensure that the investments are in compliance with trust agreement guidelines.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2009.

Assets
Liabilities, Surplus and Other Funds
Summary of Operations
Capital and Surplus Account
Summary of Examination Changes

The financial statements as presented reflect the statutory financial statements as determined by this examination as of December 31, 2009.

Assets
December 31, 2009

		Ledger Assets		Nonadmitted Assets Non Admitted		Net Admitted Net Admitted Assets	Note
Bonds	$	100,000	$	-	$	100,000	
Cash and short-term investments		1,823,064		-		1,823,064	
Other Invested Assets		4,677,037		-		4,677,037	
Investment income due and accrued		21				21	
Uncollected premiums and agents' balances in course of collection		5,777,304		1,899,214		3,878,090	*1*
Funds held by or deposited with reinsured companies		46,280		-		46,280	
Current federal and foreign income tax recoverable and interest thereon		117,764		-		117,764	
Net deferred tax asset		225,221		-		225,221	
Receivable from parent, subsidiaries and affiliates		49,000				49,000	
Aggregate Writein for other than invested assets		7,332		-		7,332	
Totals	$	12,823,023	$	1,899,214	$	10,923,809	

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Liabilities, Surplus and Other Funds
December 31, 2009

			Note
Losses	$	175,000	*2*
Loss adjustment expenses		15,000	*2*
Other expenses		29,881	
Taxes, licenses and fees due or accrued		139,367	
Unearned Premium		2,314,377	
Ceded reinsurance premiums payable		3,878,090	*1*
Provision for reinsurance		1,201,601	*3*
Aggregate write-ins for liabilities		1,979,230	
Total Liabilities	$	9,732,546	
Common capital stock	$	201,200	
Gross paid in and contributed surplus		1,143,045	
Unassigned funds (surplus)		(152,982)	
Total Capital and Surplus	$	1,191,263	
Total Liabilities, Surplus and Other Funds	$	10,923,809	

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Statement of Income
December 31, 2009

		Note
Underwriting Income		
Premiums earned	$ 2,604,498	
Deductions		
Losses Incurred	$ 672,938	
Loss Adjustment Expenses Incurred	36,723	
Other Underwriting Expenses Incurred	1,257,746	
Aggregate write-ins for underwriting deductions	1,027,000	
Total underwriting deductions	$ 2,994,407	
Net underwriting gain (loss)	$ (389,909)	
Investment Income		
Net investment income earned	$ (22,044)	
Net realized capital gains or (losses)	(48,525)	
Net investment gain (loss)	$ (70,569)	
Other Income		
Miscellaneous	$ 100,000	
Net income before federal income taxes incurred	$ (360,478)	
Federal income taxes incurred	(57,481)	
Net income	$ (302,997)	*4*

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Capital and Surplus Account
December 31, 2008_to December 31, 2009

		Note
Surplus as regards policyholders, December 31, 2008	$ 2,139,119	
Net Income	(302,997)	*4*
Change in net unrealized capital gains or (losses).	509,116	
Change in net deferred income tax	120,626	
Change in provision for reinsurance	(1,201,601)	
Dividend to stockholders	(73,000)	*4*
Net change in surplus as regards policyholders for the year	$ (947,856)	
Surplus as regards policyholders, December 31, 2009	$ 1,191,263	

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Schedule of Examination Adjustments
As of December 31, 2009

Uncollected Premium and Agents' Balances	$ 3,878,090	$ 5,777,304	$ (1,899,214)	*1*
Liabilities:				
Ceded Reinsurance Premium Payable	3,878,090	5,777,304	1,899,214	*1*
Capital and Surplus Account				
Change in Provision for Reinsurance	(1,201,601)	(59,985)	(1,141,616)	*3*
Net Income	(302,997)	(375,997)	73,000	*4*
Dividend to Stockholder	(73,000)	0	(73,000)	*4*
Net Change in Surplus per Examination			$ (1,141,616)	
Surplus per Company			2,332,879	
Surplus per Examination			$ 1,191,263	

NOTES TO THE FINANCIAL STATEMENTS

<u>(Note 1)</u> Uncollected Premiums and Agents' Balances. **$3,878,090**
Ceded Reinsurance Premiums Payable. . ... **($ 3,878,090)**

The Company's Uncollected Premium and Agents' Balances receivable was decreased by $1,899,214. The Company utilizes all of its uncollected premium and agents' balances in the course of collection receivable as its ceded reinsurance premiums payable. A corresponding adjustment was made to reduce the Ceded Reinsurance Premiums Payable liability.

Per review of the premiums receivable, it was noted that one of the Company's Administrative Obligor programs, AVP does not send premiums directly to the Company, but sends the premium directly to its Producer Owned Reinsurance Company. The exam has nonadmitted AVP's $1,567,364 First Dollar premium receivable for non compliance with SSAP No. 4, Paragraph 3, which states the following:

> *"As stated in the Statement of Concepts, 'The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet,' and are, therefore, considered nonadmitted."*

Additionally, per the examination's review of the premium receivable files that the Company was able to provide, it was noted that $331,850 of the premium receivables contained effective policy dates prior to October 1, 2009. The Company's management stated that if the overdue balances were received subsequent to year end, that they were admitted. These Over-90 premium receivables were nonadmitted for non compliance with SSAP No. 6, Paragraph 11, which states the following:

"Amounts classified as nonadmitted assets collected subsequent to the date of the statutory financial statements shall not be used to adjust the nonadmitted asset otherwise calculated."

It is recommended that the Company obtain all detail data files to properly age its premium receivables and to discontinue admitting over ninety balances that were collected subsequent to the date of the statutory financial statements per NAIC Accounting and Procedures Manual, SSAP 6, paragraph 11.

<u>(Note 2)</u> Losses and LAE...**($ 190,000)**

INS Consultants, Inc. was retained by the Delaware Insurance Department to review the Company's December 31, 2009 actuarial report. The actuarial report was prepared by GPW Actuarial Services, Inc. ("GPWAS"). In conjunction with that review, the examiners performed testing to confirm trust account and or Loss Reserve Fund ("LRF") balances related to both the Excess of Loss policies issued prior to January 1, 2009 and the First Dollar policies, which the Company began issuing in 2009. The examiners also reviewed on a sample basis, policies, the trust agreements and related reinsurance agreements. The following was noted per the examiners' review:

<u>Intercontinental Warranty Services, Inc ("IWSI")</u>

IWSI is an affiliate of Automotive Professionals, Inc. ("API"), which went bankrupt in 2007. With API, MFIC did not control the Loss Reserve Fund ("LRF"). When API filed for bankruptcy, the Trustee of API was able to control the LRF accounts. During 2007, 2008 and 2009, MFIC has paid approximately $5,269,000 for losses under the API program.

The 2009 GPWAS Actuarial Report shows that the Company is utilizing $18,890,278 in Loss Fund balances to offset the $19,117,195 in reserves for IWSI. This reserve covers approximately 146,114 vehicle service contracts and 28,837 guaranteed price refund contracts that IWSI issued. Per MFIC's attorney, there are no trust agreements, reinsurance agreements or custody agreements in place for IWSI insured business.

If there are no agreements in place, MFIC may not be able to access the LRF in case of default on IWSI's part, as was the case with API. As such, there is a credit risk associated with IWSI for which the Company has not established any liability.

The examination also identified IWSI endorsements pertaining to nine states, which changed the policy coverage basis from excess of loss coverage to a first dollar basis. This potential additional liability exposure is not quantified in the GPWS Actuarial Report. Lastly, the examination was unable to confirm all of the LRF accounts due to the fact that the accounts were not in MFIC's name.

Actuarial Review and Comments

The examination's consulting actuary noted that the Company's coverage was modified to a first dollar basis and effective January 1, 2009; MFIC insures all contracts on a first dollar basis and subsequently cedes 100% of the business to producer owned reinsurance companies ("PORCs"). The Vehicle Service Contracts ("VSC") are long duration contracts with terms up to ten years. Under an excess of loss policy, MFIC incurs a direct liability to the AO only in the event claims under the insured VSCs exceed the AO's collected reserves. In VSC vernacular, reserves are equal to the expected loss portion of the VSC cost. MFIC generally requires the AO to deposit the reserves in custodial accounts, which are referred to as Loss Reserve Funds ("LRF").

As of year-end 2009, the Annual Statement net and gross loss and LAE reserves were $190,000 and $509,000, respectively. The Annual Statement net and gross booked Unearned

Premium Reserve ("UEPR") reserves were $2.3 million and $31.2 million, respectively. GPWAS indicated net and gross loss and LAE reserves were $175,000 and $585,108, respectively. The indicated UEPR net and gross reserves were $2.3 million and $29.5 million respectively.

GPWAS estimated the present value of future liabilities to be $73.8 million. The aggregate LRF's which cover these liabilities are $133.7 million according to the GPWAS report.

Findings:

The INS review consisted of reading the GPWAS actuarial report and verifying that the applied methodologies and factor selections were reasonable. INS did not perform any independent analyses. The results of their review of the methodologies indicated GPWAS utilized standard actuarial procedures and they were appropriate. For the factor review, the selections by GPWAS also appeared to be reasonable. However, described below are several issues which could potentially impact MFIC's future operations.

The examination staff has identified IWSI endorsements pertaining to nine states which changed the policy coverage basis from excess of loss to first dollar. This potential additional liability exposure is not quantified in the actuarial report. The method used to derive the earned and unearned premium reflects the projected emergence of future losses under the contracts. This method is appropriate since the unearned premium must be sufficient to cover future losses. Industry loss emergence patterns are used when company data is not credible. However, the process assumes that the rates charged are reasonable and that future losses occur and emerge similarly to those of the past. There is additional risk that the company experience will not be similar to the industry

Timing and interest rate risk are apparent in the estimation of the LRF deficits. The LRF deficits are based on the present value of projected future liabilities. There is risk that the timing of future payment of those liabilities and/or the rate of interest earned on the underlying assets will differ from the estimates. Actual claim payments could occur faster or slower than projected or the yield rate could change over time. GPWAS noted in the actuarial report that these contingencies could have a material impact on the accuracy of their estimates. Credit risk increases when MFIC does not have control of the underlying assets in the LRF's for payment of claims up to the attachment point on an insured AO policy.

To the extent that MFIC has uncollateralized exposure below the attachment point, there is credit risk. This risk was listed as a material adverse deviation in the Statement of Actuarial Opinion.

Litigation risk was also listed as a material adverse deviation in the Statement of Actuarial Opinion. There is litigation risk related to the bankruptcy of API. However, in March 2010, the bankruptcy court approved a $1.1 million settlement agreement with MFIC submitted by the API trustee. According to MFIC, the first of three installment payments was made in 2010 with the balance of the settlement amount accrued as of December 31, 2010 so the risk has been significantly reduced.

In summary, listed below are INS' findings:

- The estimation methods and factor selections are reasonable
- The IWSI first dollar endorsement exposure is not quantified in the actuarial report
- There is timing and interest rate risk in the calculation of the LRF deficits which could have a material impact on the accuracy of the estimates
- There is credit risk associated with the LRF's when MFIC does not have control of the underlying assets

<u>(Note 3)</u> Provision for Reinsurance. **$1,201,601**

The above provision for reinsurance amount is $1,141,616 higher than the Company's Annual Statement booked liability. The Company utilizes its premium receivables as ceded premium payables in Schedule F, Part 5 to offset its reinsurance recoverable. The offsetting credit for the portion of premium receivable nonadmitted per Note 1 was disallowed for exam purposes. The examination recalculated the provision for reinsurance penalty on a reinsurer by reinsurer basis, taking into account any excess trust funds that the Company could use in lieu of the disallowed ceded premium payable.

<u>(Note 4)</u> Net Income. .... ($ **302,997)**
Dividends to Stockholders. ....($ **73,000)**

The examination reclassed $73,000 from Net Income to Dividend to Stockholder. MFIC reimbursed Marathon Administrative Company ("MAC") for claims that MAC paid for EJK Robert (part of the AVP program). MAC exhausted its Loss Reserve Fund and paid the $73,000 for the claims, but then recovered the funds from MFIC. Under the excess of loss policy language MFIC would only be responsible if the aggregate reserves for all the programs were insufficient to cover the claims, not on a program by program basis.

The GPWS Actuary included a letter from MAC acknowledging the action but not agreeing to refund the funds to MFIC. MAC has stopped seeking reimbursement on this program from MFIC.

> **It is recommended that the Company discontinue reimbursing Marathon Administrative Company payment of claims, unless allowed for per policy language.**

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The South Carolina Department of Insurance completed a financial exam as of 12/31/06. As part of the redomestication from South Carolina to Delaware, the South Carolina examiner has been permitted to participate on the 2009 exam to determine if the Company has complied with the South Carolina recommendations. The current examination has coordinated with South Carolina.

SUMMARY OF RECOMMENDATIONS

	Page
Management and Control	
It is recommended that the Company Board review and approve all investments. It is recommended that the Company Board review and approve all investments. It is further recommended that the Company provide complete and accurate records upon examination as required by 18 Del. C. §320 and 18 Del. Admin. Code 301 § 15.1.2.	5
Management and Service Agreements	
It is recommended that the Expense Sharing agreement be modified to more clearly define the method of allocating expenses. It is further recommended that the Expense Sharing and Restated Administrative agreements be modified to reflect MFIC's new state of domicile and all related agreements be submitted to the Delaware Department of Insurance for approval.	7
It is recommended that the Expense Sharing agreement be modified to more clearly define the method of allocating expenses. It is further recommended that the Expense Sharing and Restated Administrative agreements be modified to reflect MFIC's new state of domicile and all related agreements be submitted to the Delaware Department of Insurance for approval.	
It is recommended that the Company review and amend its Custodial Agreements to include the recommended clauses per the NAIC Examiner's Handbook, Part 1, Section IV. It is further recommended that the Company's Board of Directors review and approve its custodial agreements.	8
It is recommended that the Company review and amend its Custodial Agreements to include the recommended clauses per the NAIC	

Examiner's Handbook, Part 1, Section IV. It is further recommended that the Company's Board of Directors review and approve its custodial agreements.

Accounts and Records

It is recommended that the Company include its unearned ceding commissions as an offset to ceded reinsurance balances payable per the NAIC Accounting Practices and Procedures Manual, SSAP 62R, Paragraph 53. 13

It is recommended that the Company modify its investments to become compliant with 18 Del. C. §1305 and §1311. 14

It is recommended that the Company monitor the trust accounts to ensure that the investments are in compliance with trust agreement guidelines. 14

Notes to the Financial Statements

It is recommended that the Company obtain all detail data files to properly age its premium receivables and to discontinue admitting over ninety balances that were collected subsequent to the date of the statutory financial statements per NAIC Accounting and Procedures Manual, SSAP 6, paragraph 11. 21

It is recommended that the Company discontinue reimbursing Marathon Administrative Company payment of claims, unless allowed for per policy language. 25

It is recommended that the Company discontinue reimbursing Marathon Administrative Company payment of claims, unless allowed for per policy language.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

Description	December 31, 2009	December 31, 2006	Increase (Decrease)
Assets	$ 10,923,809	$ 10,819,040	$ 104,769
Liabilities	$ 9,732,546	$ 7,680,286	$ 2,052,260
Capital and Surplus	$ 1,191,263	$ 3,138,754	$ (1,947,491)

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. is acknowledged.

Respectfully submitted,

James Call, CFE
Examiner In-Charge
Representing the State of Delaware

SUBSEQUENT EVENTS

On May 7, 2010, the Company redomesticated to the State of Delaware. In June 2009, MFIC entered into an agreement with the API bankruptcy trustee in the amount of $1.1 million payable in installment payments of $500,000 in 2010, $300,000 in 2011, and $300,000 in 2012. $500,000 was paid in the second quarter of 2010 and the balance remains accrued as of December 31, 2010.

In April, 2011, the Company divested the majority of its investment in Garrison Municipal Partners, LP. The balance remaining in the fund on April 30, 2011 was $573,416.