

REPORT OF EXAMINATION
OF THE
MONTICELLO INSURANCE COMPANY
AS OF
DECEMBER 31, 2005

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

**MONTICELLO INSURANCE COMPANY
(nka Max Specialty Insurance Company)**

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

ATTEST BY: *Antoinette Handy*

DATE: 25 OCTOBER 2007



*In Witness Whereof, I HAVE HEREUNTO SET MY HAND
AND AFFIXED THE OFFICIAL SEAL OF THIS
DEPARTMENT AT THE CITY OF DOVER, THIS
25TH DAY OF OCTOBER 2007.*

Matthew Denn

Insurance Commissioner

REPORT ON EXAMINATION
OF THE
MONTICELLO INSURANCE COMPANY
(nka Max Specialty Insurance Company)
AS OF
December 31, 2005

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.

A handwritten signature in black ink, appearing to read "Matthew Denn", written in a cursive style.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 25TH Day of OCTOBER 2007.

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SALUTATION

September 17, 2007

Honorable Alfred W. Gross
Chairman
Financial Condition (E) Committee, NAIC
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
P. O. Box 1157
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Honorable Thomas E. Hampton
Secretary, Northeastern Zone (I), NAIC
Department of Insurance, Securities and
Banking
Government of the District of Columbia
810 First Street N.E., Suite 701
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State of Utah
State of Office Building, Room 3110
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Honorable Matthew Denn
Insurance Commissioner
Department of Insurance
State of Delaware
841 Silver Lake Boulevard
Dover, Delaware 19904-2465

Dear Commissioners:

In accordance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06-009, dated March 10, 2006, an examination has been made of the affairs, financial condition and management of the

MONTICELLO INSURANCE COMPANY

hereinafter referred to as "Company", incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 1209 Orange Street, Wilmington, Delaware. The examination was conducted at the current main

administrative office of the Company, located at 777 San Marin Drive, Novato, California. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005, and consisted of and concentrated on 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 when deemed necessary.

This report is presented on the exception basis. It is designed to set forth the facts with regard to any material 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 procedure of the examination followed the guidelines established by the National Association of Insurance Commissioners' (NAIC) Committee on Financial Condition Examiners Handbook, and generally accepted statutory insurance examination standards.

In addition to items hereinafter incorporated as part of the report, the following were checked and made part of the working papers of this examination.

Employees' Welfare
Fidelity Bond and Other Insurance
NAIC IRIS Ratios
Statutory Deposits

This examination was conducted by the Delaware Department of Insurance in accordance with the Association Plan of Examination guidelines established by the National Association of Insurance Commissioners. There was no other state that participated in the examination. This examination was performed concurrently with the Examination of Jefferson Insurance Company, the parent, conducted by the New York Insurance Department.

HISTORY

The Company was incorporated on May 30, 1973 under the laws of the State of Delaware as a stock, multiple-line insurer having perpetual existence.

The Certificate of Incorporation and the Certificates of Amendment were filed with the Office of Secretary of State and the Insurance Commissioner of the State of Delaware. The Certified Charter Documents of the Company on file with the Delaware Department of Insurance consisted of the Certificate of Incorporation filed with the Delaware Secretary of State on May 30, 1973, the Certificate of Amendment Before Payment of Capital filed on March 15, 1974, and the Certificates of Amendment filed on May 3, 1978, February 16, 1982 and March 22, 1990.

Pursuant to the provisions of *Section 242 of the General Corporation Law of the State of Delaware*, and in accordance with the Certificate of Amendment of the Certificate of Incorporation of the Company dated March 21, 1990, the latest amendment and the most updated changes which apply to the Company's current operations are:

- The Company is to engage in the transaction of the following kinds of insurance business: (a) health insurance, (b) property insurance, (c) surety insurance, (d) casualty insurance, (e) marine and transportation insurance, and (f) reinsurance.
- The total number of shares of stock which the corporation shall have authority to issue is 1,600 and the par value of such shares is \$2,562.50 amounting in the aggregate to \$4,100,000.

There had been no change to the Certificate of Incorporation during the three-year examination period from January 1, 2003 through December 31, 2005.

The Company's registered statutory home office in the State of Delaware is located at 1209 Orange Street, Wilmington, Delaware 19801. The main administrative office is located at 777 San Marin Drive, Novato, California 94998.

CORPORATE RECORDS

Certificate of Incorporation

The Company's Certificate of Incorporation and the Certificates of Amendment in effect at the examination date as of December 31, 2005 were properly filed with the Office of Secretary of State and the Insurance Commissioner of the State of Delaware.

In accordance with the Certified Charter Documents approved by the Delaware Insurance Department, on August 17, 2000, the corporate charter documents of the Company are true and correct copies of the documents on file with Delaware Department of Insurance. These documents consisted of the following:

- A Certificate of Incorporation filed with the Delaware Secretary of State on May 30, 1973,

- A Certificate of Amendment Before Payment of Capital filed on March 15, 1974, and
- Certificates of Amendment filed on May 3, 1978, February 16, 1982 and March 22, 1990.

There had been no change to the certificate of incorporation during the three-year examination period from January 1, 2003 through December 31, 2005.

Bylaws

The Company's By-Laws in effect at the examination date as of December 31, 2005 was the Amended and Restated Bylaws dated January 1, 2002. There had been no change to the bylaws during the three-year examination period from January 1, 2003 through December 31, 2005.

Minutes

The minutes of meetings of the sole shareholder, the board of directors and the executive committee of the board for the three-year examination period as of December 31, 2005 consisted of the minutes of regular meetings and special meetings and the written consents in lieu of meetings.

The review and test of such corporate records were focused on the corporate activities with respect to the resolutions pertain to the election or resign or removal of members of the board of directors, the election or appointment or removal of officers, the authorization and approval of amendments of the articles of incorporation and the by-laws, the approval of investments, the review of the previous examination report by the board members, the attendance of meetings of the board of directors and its committees, and the written notice to the Commissioner of Insurance of change of directors and

officers, among others, and to ascertain that the exercise of the meetings and the written consents in lieu of meetings was consistent with the Company's articles of incorporation and by-laws.

On numerous occasions, the actions and resolutions by the sole shareholder or the board of directors for changes of directors and senior officers were not notified to the Commissioner in writing. Such lack of action resulted in that the Company is not consistently and fully in compliance with *Section 4919 of the Delaware Insurance Laws*.

It is recommended that the Company comply with *Section 4919 of the Delaware Insurance Laws* and promptly notify the Commissioner in writing of any change of personnel among its directors or principal officers.

A review of the minutes for the three-year examination period as of December 31, 2005 indicated that the last report of examination as of December 31, 2002 was not distributed to members of the board of directors of the Company.

It is recommended that the Company, a wholly-owned subsidiary of Jefferson Insurance Company of New York, distribute the prior report on examination to members of the board of directors.

CAPITALIZATION

The total number of shares, which the Company is authorized to issue, is 1,600 shares of common stock at a par value of \$2,562.50 each. As of December 31, 2005, Jefferson Insurance Company of New York was the sole shareholder of the 1,600 issued and outstanding shares of the capital common stock of the Company in the amount of \$4,100,000.

The information stated is consistent with what was indicated in the Certificate of Amendment of Certificate of Incorporation of the Company dated March 21, 1990. The Company's handling of its certificates of stock is in compliance with the provisions of Articles VI of the By-Laws of the Company, and its capital common stock is properly recorded and maintained and is consistent with what was reported in the 2005 annual statement of the Company and Jefferson Insurance Company, the parent.

Dividends

During the three-year examination period as of December 31, 2005, there was no dividend authorized, declared or paid to the sole shareholder. The gross paid in and contributed surplus in the amount of \$9,700,000 remained unchanged during the examination period.

MANAGEMENT AND CONTROL

Meetings of Stockholders

Article II of the Amended and Restated By-Laws of the Company provides that the annual meetings of the stockholders shall elect a board of directors and transact such other business as may properly be brought before the meeting.

Board of Directors

Article III of the Amended and Restated By-Laws of the Company provides that the business of the Company shall be managed by its board of directors. The board may exercise all the powers of the Company and do the lawful acts and things as are not by statute or by the certificate of incorporation or by the by-laws directed or required to be

exercised or done by the stockholders. The numbers of directors, which shall constitute the whole board, shall be no less than seven (7) and no more than nine (9).

The seven (7) elected members serving on the board of directors as of December 31, 2005, according to the Action by the Sole Shareholder in Lieu of a Meeting dated March 8, 2005 and the Action by the Sole Shareholder in Lieu of a Special Meeting dated August 24, 2005, are listed in the following:

<u>Name and Residence City</u>	<u>Principal Business Affiliation</u>
Joseph John Beneducci Novato, California	President and Chief Operating Officer Fireman's Fund Insurance Company
Bruce Farrell Friedberg Novato, California	Senior Vice President and Chief Actuary Fireman's Fund Insurance Company
Peter Huehne Novato, California	Chief Financial Officer Allianz of America Corporation
Louise Jordan Novato, California	Senior Vice President and Controller Fireman's Fund Insurance Company
Janet Sharon Kloenhamer Novato, California	Senior Vice President, General Counsel and Corporate Secretary Fireman's Fund Insurance Company
Jill Elaine Paterson Novato, California	Executive Vice President and Chief Financial Officer Fireman's Fund Insurance Company
Linda Eastes Wright Novato, California	Senior Vice President and Treasurer Fireman's Fund Insurance Company

Officers

The activities of election and appointment of officers of the Company were reflected entirely in the minutes during the three-year examination period as of December 31, 2005.

The elected and appointed officers serving as of December 31, 2005 are listed in the following:

<u>Name</u>	<u>Title</u>
Peter Huehne	Chairman of the Board
Joseph J. Beneducci	President and CEO
Jill E. Paterson	Executive Vice President and CFO
Janet S. Kloenhamer	Senior Vice President, General Counsel and Corporate Secretary
Linda E. Wright	Senior Vice President and Treasurer
Louise Jordan	Senior Vice President and Controller
William S. Paukovitz	Vice President
Christopher P. Roe	Vice President
John C. Mancini	Vice President
Steven B. Resnick	Vice President
Julie A. Garrison	Assistant Secretary
Emily Glidden	Assistant Treasurer
Thomas Hanzel	Assistant Vice President

Conflict of Interest Disclosure Procedure

During the course of the examination, this examination reviewed and tested the Company's Statement of Policy on Conflict of Interest and Declaration of Conflict of Interest, as completed by members of the board of directors, officers and key employees, for the three-year examination period as of December 31, 2005. The result of such review and test did not reveal any conflict of interest declared by these individuals, in accordance with the Company's Statement of Policy on Conflict of Interest.

However, it is noted that all appointed officers were not included in the process of the conflict of interest disclosure and were not required to execute a declaration of

conflict of interest. As provided in the corporate records, the Company's officers are either elected or appointed.

It is recommended to safeguard the properties of the Company and to protect the interests and benefits of the policyholders, all officers, both elected and appointed, among other key employees of the Company, be included in the process of the conflict of interest disclosure, and complete a declaration of conflict of interest annually.

It is also noted that, during the Company's December 2003, August 2004 and November 2005 distributions of the declaration of conflict of interest, several declarations were signed and dated but there were no response made to the required information. These declarations, except for signatures and dates, were left blank.

It is further recommended that all declarations of conflict of interest be properly completed to include necessary response to the requested information according to the Company's Statement of Policy on Conflict of Interest.

Intercompany Management and Service Agreements

During the course of the examination, this examination obtained and reviewed all management, service and tax sharing agreements (other than reinsurance) between the Company and any other member of the insurance holding company system in effect during the three-year examination as of December 31, 2005 and its subsequent period. Appropriate regulatory approval documents were included as a part of such review. The Company's intercompany agreements in effect were summarized in the following.

1. Service Agreement between Monticello Insurance Company ("MIC") and Fireman's Fund Insurance Company ("FFIC") effective January 1, 2003:

Pursuant to *Section 5005(a)(2)d of the Delaware Insurance Laws*, this agreement was approved by the Delaware Department of Insurance, according to its letter to FFIC dated November 27, 2002.

The transaction to enter into the service agreement was also authorized to proceed by the California Department of Insurance, according to its letter to FFIC on January 17, 2003, pursuant to *Section 1215.5(b)(4) of the California Insurance Code*. FFIC is domiciled in the State of California, and the California Department of Insurance is the licensing authority of FFIC.

The New York Insurance Department (“NYID”), according to its letter to Jefferson Insurance Company (“JIC”) dated December 3, 2002, indicated that the Service Agreement between JIC and FFIC meets the criteria of *Section 1505(a) and (d) of the New York Insurance Laws*, and the NYID has no objections to the implementation of such agreement, contingent upon the NYID’s approval of the JIC’s 325(b) plan. MIC is a wholly-owned subsidiary of JIC; and, the business of these two companies is pooled, according to a pooling arrangement.

2. Tax Reimbursement Agreement between Monticello Insurance Company (“MIC”) and Allianz of America, Inc. (“AZOA”) effective August 1, 1992:

The Company implemented and executed the agreement but did not make available for examination the filing and approval documents with the Delaware Department of Insurance. This condition resulted in that the Company is not consistently and fully in compliance with *Section 5005(a)(2)d of the Delaware Insurance Laws* which provides that all management agreements, service contracts and all cost-sharing arrangements may not be entered into unless the domestic insurer in its holding company system has notified the Delaware Insurance Department in writing of its intention to enter into such transaction at

least 30 days prior thereto, or such shorter period as the Commissioner may permit, and the Commissioner has not disapprove it within such period.

It is recommended that the Company comply with *Section 5005(a)(2)d of the Delaware Insurance Laws.*

In addition to the above-mentioned two (2) agreements, during the three-year examination period as of December 31, 2005 and its subsequent period, the Company received certain investment services from a member of the insurance holding company system without an existing agreement to define the terms and conditions of the business and to justify the accounting for intercompany transactions including service fees.

During the course of the examination, the Company did not provide evidence that such agreement is physically in existence and is properly filed with and approved by the Delaware Department of Insurance. This existing adverse condition resulted in that the Company is not consistently and fully in compliance with *Section 5005(a)(2)d of the Delaware Insurance Laws.*

It is further recommended that the Company comply with *Section 5005(a)(2)d of the Delaware Insurance Laws.*

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system and is a wholly-owned subsidiary of Jefferson Insurance Company of New York (“JIC”). JIC is 100% owned by Alliance Global Risks US Insurance Company, formally known as Allianz Insurance Company, of Burbank, California, which is owned by Allianz of America, Inc. (“AZOA”) of Wilmington, Delaware. AZOA, in turn, is 100% owned by

Allianz A. G. Holding of Munich, Germany, the ultimate controlling person of the insurance holding company system.

Insurance Holding Company Annual Registration Statement

The Delaware Department of Insurance, in accordance with the letter dated April 10, 1987, granted the Company's request for exemption from filing the insurance holding company registration statement.

The insurance holding company annual registration statements filed with the New York Insurance Department for the three-year examination period as of December 31, 2005 were specified in *Part 80 of the New York Department Regulation No. 52* and filed pursuant to *Section 1503 of the New York Insurance Laws*.

Organizational Chart

The insurance holding company system of Allianz consists of more than one hundred affiliated companies. This examination identified those companies having ownership and/or management and service relations with the Company, and created an organizational chart for the purpose of the report of examination, which depicts the Company's identities of and interrelationships within the insurance holding company system as of December 31, 2005.

The following organizational chart sets forth as at the date of this examination the identities of and interrelationships among affiliated companies within the insurance holding company system. The controlling party of each affiliate is maintained by ownership of 100% of the voting stocks of each subsidiary. The state of domicile of each entity is indicated on the organizational chart.

Organizational Chart



Note: The ownership of each of the above entity is 100%.

TERRITORY AND PLAN OF OPERATION

Certificate of Authority, Line of Business and Territory

Pursuant to the Delaware Certificate of Authority Number 1364P, dated October 27, 1976, the Company is authorized to transact the business, within the State of Delaware, of Property, Casualty, including Vehicle, Liability, Burglary and Theft, Personal Property Floater, Leakage and Fire Extinguisher Equipment. As amended on September 28, 1990, the Company is further authorized to transact the business of Health, Surety, Marine and Transportation, Glass, Boiler and Machinery, Credit, Malpractice, Elevator, Congenital Defects, Livestock, Entertainments and Miscellaneous. The Company is an approved surplus lines carrier in all states and commonwealths and the District of Columbia with the exception effective January 13, 2005, the Company withdrew from the State of New York.

Underwriting Practice

The Jefferson Companies (Jefferson Insurance Company and Monticello Insurance Company) were placed in run-off status in 2001. Effective July 1, 2001, the Companies substantially ceased writing new and renewal business. As of December 31, 2005, Monticello Insurance Company reported \$12,932 in direct premiums written.

Agency System and Agency Contract

There were no contracted agents of the Company as of December 31, 2005. The Company discontinued its underwriting activity and canceled all agency and broker agreements. All personal and commercial agency agreements were either terminated or converted to Interstate Insurance Group agency contracts. As of December 31, 2005, the

Company did not have an agency plan in effect, and there was no employed managing general agent (MGA) or third party administrator (TPA).

Claims Handling

As of December 31, 2005, the Company's claims processing functions are handled at the offices in St. Louis, Missouri and Novato, California.

Business Plan

In mid-year 2000, the operations of Jefferson Companies (Jefferson Insurance Company and Monticello Insurance Company) were merged into Interstate Companies and other affiliated companies that engaged in insurance underwriting programs, risks and insurance products substantially similar to those underwritten by Jefferson Companies. As of December 31, 2005 and its subsequent period, all corporate books and records are maintained at the Home Office of Fireman's Fund Insurance Company ("FFIC") in Novato, California.

REINSURANCE

Assumed Reinsurance

With the exception of the pooling arrangement with Jefferson Insurance Company of New York, the parent, the Company had no other assumed reinsurance business as of December 31, 2005. The pooling arrangement with Jefferson is discussed below in further detail under the caption of "Reciprocal Quota-Share Agreement."

Ceded Reinsurance

With the exception of the pooling arrangement with Jefferson, the only ceded reinsurance treaty in effect as of December 31, 2005 was the Interests and Liabilities Agreement between Jefferson Insurance Company and Monticello Insurance Company of

the one part (the reinsured or the ceding company) and Allianz Aktiengesellschaft of the other part (the reinsurer or the assuming company), effective January 1, 1998, in accordance with the Property Capacity Variable Quota Share Reinsurance Treaty between Jefferson Insurance Company (the reinsurer or the assuming company) and Monticello Insurance Company (the reinsured or the ceding company), effective January 1, 1998. Allianz Aktiengesellschaft (Germany) is the ultimate controlling person within the insurance holding company system.

Reciprocal Quota-Share Agreement

A reciprocal quota-share reinsurance agreement is currently in effect between Jefferson Insurance Company (“Jefferson”) and Monticello Insurance Company (“Monticello”) whereby the net underwriting, reinsurance, and claim operations of the companies are pooled.

Effective January 1, 1977, the agreement was placed to consolidate and pool the underwriting operation of Jefferson and Monticello in the interest of economical operation, equitable division of underwriting expenses, increasing the underwriting capacity, and broadening the scope and spread of business of Jefferson and Monticello.

Each company participates in the net fortunes of the combined underwriting, reinsurance, and claim operations of the companies in proportion to each company’s respective participation. According to the amendment effective January 1, 1986, which was signed by both companies on December 19, 1985, the participations are 80% for Jefferson and 20% for Monticello.

The agreement shall automatically be renewed from year to year in accordance with its terms. This agreement may be terminated on December 31 of any year provided

either company shall give written notice to the other company of its intention to terminate not less than 90 days preceding the termination date.

GROWTH OF COMPANY

The Company's business operation is currently in run-off mode. During the three-year examination period from January 1, 2003 through December 31, 2005, according to the Company's annual statements, as examined, the statutory admitted assets had decreased from \$61,211,472 as of December 31, 2002 to \$45,708,246 as of December 31, 2005, a decrease of 25.33% for the three-year examination period. The liabilities had decreased from \$36,871,468 to \$9,157,635, a decrease of 75.16% for the period. And, the surplus as regards policyholders had increased from \$24,340,004 to \$36,550,611, an increase of 50.17% for the same period. The following exhibit shows the dollar amounts of each category by year:

Year End	Admitted Assets	Liabilities	Capital	Gross Paid In and Contributed Surplus	Unassigned Funds (Surplus)	Surplus as Regards Policyholders
2002 *	\$61,211,472	\$36,871,468	\$4,100,000	\$9,700,000	\$10,540,004	\$24,340,004
2003	54,775,405	18,225,743	4,100,000	9,700,000	22,749,662	36,549,662
2004	47,807,904	10,530,679	4,100,000	9,700,000	23,477,225	37,277,225
2005 *	45,708,246	9,157,635	4,100,000	9,700,000	22,750,611	36,550,611

* Per examination

[Source of Information: Annual Statements, Pages 2 and 3]

During the three-year examination period ended December 31, 2005, the written premiums had significantly decreased. Since the last examination as of December 31, 2002 and during the three-year examination period ended December 31, 2005, there had

been no contracted agents of Monticello. As of June 30, 2001, no further new or renewal personal or commercial lines of business were written, and all personal and commercial agency agreements were either terminated or converted to Interstate Insurance Group agency contracts. The remaining insurance business of the Company is continuously in run-off mode. The following exhibit shows the amounts of direct, assumed, ceded and net premiums written since the last examination as of December 31, 2002 and during the three-year examination period as of December 31, 2005:

Year	Premiums Written			
	Direct	Assumed	Ceded	Net
2002 *	1,625,045	3,728,197	1,625,045	3,728,197
2003	913,661	516,297	913,661	516,297
2004	245,020	69,436	245,020	69,436
2005 *	12,932	37,319	12,932	37,319

* Per examination

[Source of Information: Annual Statements, U/I Exhibit, Part 1B – Premiums Written]

ACCOUNTS AND RECORDS

As of December 31, 2005 and its subsequent period, the Company's books and records are substantially maintained at the Home Office of Fireman's Fund Insurance Company ("FFIC") in Novato, California. FFIC provides management services to the Company, according to a service agreement as discussed previously in this report under the caption of MANAGEMENT AND CONTROL – Intercompany Management and Service Agreements. Both FFIC and Monticello are member insurance companies to Allianz Group.

The general ledger accounts in the trial balance support the financial data in the annual statement. The balance sheet items in the 2005 annual statement were traced to the 2005 trial balance and brought forward from the 2004 trial balance and further agreed to the Company's 2005 detailed general ledger data and the GAAP general ledger adjustments which were necessary for the reconciliation process. The Company's 2005 detailed general ledger data consisted of all transactions posted in the entire year of 2005.

During the course of the examination, this examination reviewed the Company's accounting processes for proper management controls. These accounting processes included the statutory reporting, the general ledger maintenance, the investment accounting, the cash accounting, the underwriting, the expenditures and the tax accounting.

Expenses Allocation

Due to the pooling arrangement between Jefferson and Monticello, certain financial records were commingled into one data source; however, each company's business activities and accounting transactions are identified by company code.

During the course of the examination, the expense exhibits in the annual statements were reviewed and tested by examiners from both the New York Insurance Department ("NYID") and the Delaware Department of Insurance on the combined 100% pooled basis.

One exception was noted that the Jefferson Companies did not provide necessary support of the basis for the intercompany expenses allocation.

It is recommended that the Company, a wholly-owned subsidiary of Jefferson Insurance Company of New York and a member participating in the pooling arrangement with Jefferson, provide necessary documentation to

support the intercompany expenses allocation basis, as required by the NAIC Accounting Procedures and Practices Manual, SSAP No. 94(1) (2005)

Complaint Records

During the course of the examination, the examiner obtained and reviewed the Company's procedures for handling complaints and the complaint log for the three-year examination period as of December 31, 2005; and, further verified the Company's compliance with provisions of *Section 2304(17) of the Delaware Insurance Laws*.

The FFIC's Corporate Consumer Affairs oversees all the complaints and maintains the complaint registers since taking over the Company's complaints in July 2002. It appears that the corporate complaint handling guidelines and procedures are in place. The complaints received from the regulators, the policyholders and the third parties are registered in the complaint log. All complaints recorded in the complaint log for the period under examination were handled and closed within reasonable time periods.

Records of Legal Actions

To assess the Company's contingent liability arising from legal actions, this examination requested certain legal files for review and test. The Company's legal docket requested for examination covers a summary list of court cases pending at the examination date, a summary letter of opinion from the general counsel or handling attorney on each of the pending court cases, and a description of any legal actions taken by any state during the period of this examination, including supporting documentation.

Such information was not provided for examination due to that the Company's General Counsel's Office is in the process of reviewing the confidentiality issues and determining the confidentiality on certain files. Accurate and meaningful examination conclusions may not be made based on partial, incomplete or no sufficient information provided for examination.

Under the circumstance, the Company is not in compliance with *Section 320(c) of the Delaware Insurance Laws* which provides in part that, among others, every person being examined should make freely available to the Commissioner, or the Commissioner's examiners, the accounts, records, documents, files, information, assets and matters of such person, in the person's possession or control, relating to the subject of the examination and should facilitate the examination.

It is recommended that the Company comply with *Section 320(c) of the Delaware Insurance Laws*.

FINANCIAL STATEMENTS

The following financial statements and exhibits present the Company's financial condition as of December 31, 2005 and operating results for the year ended December 31, 2005, as determined by this examination:

- Statement of Financial Condition as of December 31, 2005
- Underwriting and Investment Income for the Period Ended December 31, 2005
- Analysis of Examination Changes as of December 31, 2005

Assets
December 31, 2005

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$44,113,252		\$44,113,252	1
Cash	(2,375,966)		(2,375,966)	
Other invested assets	1,798,513		1,798,513	
Interest income due and accrued	573,380		573,380	
Uncollected premiums and agent's balances in course of collection	4,193	\$2,649	1,544	
Amounts recoverable from reinsurers	917,641		917,641	
Net deferred tax asset	1,033,156	897,031	136,125	
Guaranty funds receivable or on deposit	3,513		3,513	
Receivables from parent, subsidiaries and affiliates	92,957		92,957	
Aggregate write-ins for other than invested assets	447,287		447,287	
TOTALS	<u>\$46,607,926</u>	<u>\$899,680</u>	<u>\$45,708,246</u>	

Liabilities, Surplus and Other Funds
December 31, 2005

		<u>Notes</u>
Losses	\$6,682,124	2
Reinsurance payable on paid losses and loss adjustment expenses	660,859	
Loss adjustment expenses	1,681,757	
Taxes, licenses and fees (excluding federal and foreign income taxes)	(35,756)	
Ceded reinsurance premiums payable (net of ceding commissions)	7,721	
Aggregate write-ins for liabilities	<u>160,930</u>	
Total liabilities	<u>\$9,157,635</u>	
Common capital stock	4,100,000	
Gross paid in and contributed surplus	9,700,000	
Unassigned funds (surplus)	<u>22,750,611</u>	
Surplus as regards policyholders	<u>\$36,550,611</u>	
TOTAL	<u><u>\$45,708,246</u></u>	

Underwriting and Investment Income
for the Period Ended
December 31, 2005

		Notes
UNDERWRITING INCOME		
Premiums earned	\$37,951	
DEDUCTIONS:		
Losses incurred	(450,000)	
Loss expenses incurred	551,955	
Other underwriting expenses incurred	555,378	
Total underwriting deductions	\$657,333	
Net underwriting gains or (losses)	(\$619,382)	
INVESTMENT INCOME		
Net investment income earned	\$1,992,695	
Net realized capital gains (losses) less capital gains tax of \$0	(97,404)	
Net investment gains or (losses)	\$1,895,291	
Net income after capital gains tax but before dividends to policyholders and federal and foreign income taxes	\$1,275,909	
Dividends to policyholders	0	
Net income after capital gains tax and dividends to policyholders but before federal and foreign income taxes	\$1,275,909	
Federal and foreign income taxes incurred	0	
Net income	\$1,275,909	
CAPITAL AND SURPLUS ACCOUNT		
Surplus as regards policyholders, December 31, 2004	\$37,277,225	
Net income	\$1,275,909	
Change in net deferred income taxes	(477,700)	
Change in nonadmitted assets	611,177	
Change in loss reserves	(2,136,000)	2
Change in surplus as regards policyholders	(\$726,614)	
Surplus as regards policyholders, December 31, 2005	\$36,550,611	

Analysis of Examination Changes
December 31, 2005

				<u>Notes</u>
Capital and Surplus, per Company			\$38,686,611	
	<u>Amount Reported by Company</u>	<u>Amount Determined by Examination</u>	<u>Surplus Increase (Decrease)</u>	
Assets:				
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Liabilities:				
Losses	(\$4,546,124)	(\$6,682,124)	(\$2,136,000)	2
Net Examination Change			<u>(\$2,136,000)</u>	
Capital and Surplus, per Examination			<u>\$36,550,611</u>	

NOTES TO FINANCIAL STATEMENTS

1. Bonds\$44,113,252

Bonds owned by the Company are stated at amortized value. As of December 31, 2005, the fair market value of bonds owned by the Company amounted to \$44,196,968, which is greater than its statement value, in the amount of \$44,113,252.

During the course of the examination, the examiner reviewed the Custodian Agreement between the Company and Mellon Bank to determine its compliance with the provisions as set forth in *Part 1, Section IV.J of the NAIC Financial Condition Examiners Handbook*. The Amended and Restated Custodian Agreement with Mellon Bank, N.A. entered into as of November 1, 1998 were found to be lacking safeguards and provisions as set forth in the NAIC Financial Condition Examiners Handbook, Part 1 – General, Section IV – Conducting Examinations, Subsection J – Custodial or Safekeeping Agreements.

It is recommended that the Company comply with the provisions as set forth in *Part 1, Section IV.J of the NAIC Financial Condition Examiners Handbook*.

2. Losses.....\$6,682,124

The actuarial evaluation and the actuarial certification of the Company’s loss and loss adjustment expense reserves as of December 31, 2005 were performed by the actuarial staff of New York Insurance Department on the consolidated 100% pooled basis. In accordance with the Reciprocal Quota Share Agreement in effect between the Company and Jefferson Insurance Company (“Jefferson”), the parent, the Company participates 20% of the pooled business and Jefferson participates the remaining 80%.

Based on the result of such statutory actuarial reserve analyses, it is concluded that the Company's loss reserves as of December 31, 2005 were deficient by \$2,136,000. In response to such actuarial judgmental decision, this examination made an accounting adjustment to increase the Company's loss reserves by the same amount. Consequently, the balance of the liability item "Losses" was increased from \$4,546,124 to \$6,682,124 as of December 31, 2005.

This action was taken concurrently in conjunction with what was warranted by New York Insurance Department for the examination of Jefferson Insurance Company as of December 31, 2005. Subsequent adjustments were made to increase the loss reserves for both Monticello and Jefferson, the adjusted balances of loss reserves as of December 31, 2005 remain proportioned at 20% and 80%, respectively.

It is recommended that the Company maintain adequate loss and loss adjustment expense reserves to meet its contractual obligations.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company's compliance with prior examination recommendations was reviewed for each account in the current examination. All prior examination recommendations were either directly or indirectly addressed in the current examination. In the instances where the Company was not in compliance with the prior examination recommendation, a repeat recommendation was made in this report.

There were fifteen (15) recommendations made in the prior examination report. It has been determined in the current examination that four (4) of these have not been

complied with. See Numbers “1”, “3” and “5” of the current examination recommendations under the caption of “RECOMMENDATIONS” for further discussion.

RECOMMENDATIONS

1. Corporate Records (Page 6)

It is recommended that the Company comply with *Section 4919 of the Delaware Insurance Laws* and promptly notify the Commissioner in writing of any change of personnel among its directors or principal officers.

2. Corporate Records (Page 6)

It is recommended that the Company, a wholly-owned subsidiary of Jefferson Insurance Company of New York, distribute the prior report on examination to members of the board of directors.

3. Conflict of Interest Disclosure Procedure (Page 10)

It is recommended that all officers, both elected and appointed, among other key employees of the Company, be included in the process of the conflict of interest disclosure, and complete a declaration of conflict of interest annually.

4. Conflict of Interest Disclosure Procedure (Page 10)

It is recommended that all declarations of conflict of interest be properly completed to include necessary response to the requested information according to the Company’s Statement of Policy on Conflict of Interest.

5. Intercompany Management and Service Agreements (Page 12)

It is recommended that the Company comply with *Section 5005(a)(2)d of the Delaware Insurance Laws* which provides that all management agreements, service contracts and all cost-sharing arrangements may not be entered into unless the domestic insurer in its holding company system has notified the Commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the Commissioner may permit, and the Commissioner has not disapprove it within such period.

6. Expenses Allocation (Page 20)

It is recommended that the Company, a wholly-owned subsidiary of Jefferson Insurance Company of New York and a member participating in the pooling arrangement with Jefferson, provide necessary documentation to support the intercompany expenses allocation basis as required by the NAIC Accounting Procedures and Practices, SSAP No.94(1).

7. Records of Legal Actions (Page 22)

It is recommended that the Company comply with *Section 320(c) of the Delaware Insurance Laws* which provides that, among others, every person being examined should make freely available to the Commissioner, or the Commissioner's examiners, the accounts, records, documents, files, information, assets and matters of such person, in the person's possession or control, relating to the subject of the examination and should facilitate the examination.

8. Bonds (*Page 27*)

It is recommended that the Company's custodial or safekeeping agreements provide safeguards and provisions as set forth in *Part 1, Section IV.J of the NAIC Financial Condition Examiners Handbook*.

9. Losses (*Page 28*)

It is recommended that the Company maintain adequate loss and loss adjustment expense reserves to meet its contractual obligations.

SUMMARY COMMENTS

The following significant events occurred during the period under examination:

History (*Page 3*)

In 2002, the Company moved its main administrative office from Newport Tower, 525 Washington Boulevard, Jersey City, New Jersey, as reported in the Company's 2002 annual statement, to 777 San Marin Drive, Novato, California. The Company's registered statutory home office in the State of Delaware remains the same at 1209 Orange Street, Wilmington, Delaware 19801.

Underwriting Practice (*Page 15*)

The Jefferson Companies (Jefferson Insurance Company and Monticello Insurance Company) were placed in run-off status in 2001. Effective July 1, 2001, the Companies substantially ceased writing new and renewal business. As of December 31, 2005, Monticello Insurance Company reported \$12,932 in direct premiums written.

In summary, the examination made one (1) adjustment to the Company's financial statements as of December 31, 2005. The net decrease to surplus in the amount of

\$2,136,000 represents 5.52% of the Company's total capital and surplus at that date. The examination made nine (9) recommendations.

CONCLUSION

As a result of this examination, the financial condition of the Monticello Insurance Company as of December 31, 2005 was determined to be as follows:

Admitted Assets		<u>\$45,708,246</u>
Liabilities		\$9,157,635
Common capital stock	\$4,100,000	
Gross paid in and contributed surplus	9,700,000	
Unassigned funds (surplus)	22,750,611	
Capital and Surplus		<u>36,550,611</u>
Total		<u>\$45,708,246</u>

Since the last examination as of December 31, 2002, the Company's net admitted assets have decreased \$15,503,226; liabilities have decreased \$27,713,833; and, capital and surplus have increased \$12,210,607.

In addition to the undersigned, Messrs. Adebola Awofeso, Senior Insurance Examiner, Lamin Jammeh, Senior Insurance Examiner, Leon Tambue, Senior Insurance Examiner, Leroy Kaalund, Principal Insurance Examiner, and the actuarial staff of New York Insurance Department concurrently participated in the examination.

Respectfully submitted,



Paul Wu, CFE, CIE
Examiner In-Charge
Department of Insurance
State of Delaware

SUBSEQUENT EVENTS

Sale of Company

Effective April 2, 2007, Max USA Holdings Ltd. (“Max USA”), a Delaware corporation and a wholly-owned subsidiary of Max Re Capital Ltd. (“Max Re Capital”), a Bermuda company, acquired Monticello Insurance Company (“Monticello”), in accordance with the Commissioner’s Final Order and Decision dated March 23, 2007. In the same Final Order and Decision, the Commissioner also approved Monticello’s entry into a Whole Account Quota Share Reinsurance Agreement with Max Re Ltd. (“Max Re”), a Bermuda company, subsequent to the acquisition.

Max USA acquired Monticello by the acquisition of all of the issued and outstanding capital stock of Monticello pursuant to the terms of the Stock Purchase Agreement dated August 18, 2006, as amended November 2, 2006, by and among Vaccaro Insurance Holdings, Inc. (“VIH”), Allianz Global Risks US Insurance Company (“AGR US”), a California insurance company, and Jefferson Insurance Company, a New York insurance company and a wholly-owned subsidiary of AGR US, as assigned by VIH to Max USA on December 8, 2006. Upon the completion of the acquisition, Monticello became an indirect wholly-owned subsidiary of Max Re Capital.

Activities Subsequent to the Sale

Effective April 3, 2007, the name of Monticello Insurance Company was changed to Max Specialty Insurance Company (“Max Specialty”); and, its main administrative office was changed to 9020 Stony Point Parkway, Suite 325, Richmond, VA 23235.

Max Specialty intends to function primarily as a property and casualty surplus lines insurer, and to write excess and surplus lines insurance in the states where the

Company is currently authorized to operate as an excess and surplus lines insurer. The Company also intends to be authorized in the remaining states of the United States as an eligible excess and surplus lines insurer.

On June 6, 2007, the Commissioner approved an intercompany service agreement between the Company and Max Specialty Insurance Services, Ltd., an affiliate, effective June 1, 2007.

Max Re Capital, Ltd., the ultimate parent, changed its name to Max Capital Group, Ltd., and Max Re Ltd., an affiliate, changed its name to Max Bermuda Ltd., effective May 4, 2007.