STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER

FINANCIAL EXAMINATION

OF

Safeco Insurance Company of America
Seattle, Washington

NAIC CODE 24740
DECEMBER 31, 2005

Participating States:
Washington
Indiana
Illinois
Oregon
Texas
Missouri

SALUTATION

Seattle, Washington
June 8, 2007

The Honorable Alfred E. Gross
Insurance Commissioner
Chair, NAIC Financial Condition (E) Committee
Virginia Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, VA 23219

The Honorable Kent Michie
Commissioner, Utah Department of Insurance
NAIC Secretary, Western Zone
Department of Insurance
3110 State Office Building
Salt Lake City, UT 84114-1201

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building
312-14th Avenue SW
Olympia, WA 98504

Dear Commissioners:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

Safeco Insurance Company of America

of

Seattle, Washington

hereinafter referred to as "SICA" or the "Company," at the location of its home office, Safeco Plaza, 4333 Brooklyn Avenue Northeast, Seattle, Washington 98185. This report is respectfully submitted showing the condition of the Company as of December 31, 2005.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Safeco Insurance Company of America of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2005.

Patrick H. McNaughton

PATRICK H. MCNAUGHTON
Chief Examiner

June 8, 2007

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2001 through December 31, 2005 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was classified as an Association exam and was called through the NAIC's Examination Tracking System. This examination was also classified as a coordinated examination of all insurance companies that are members of the Safeco Holding Company Group, hereinafter referred to as the "Safeco Group". (This will also include non-insurer affiliates as indicated.) Washington State was also designated as the Lead State of the coordinated examination and examiners from the states of Washington, Indiana, Illinois, Missouri, Oregon, and Texas participated and assessed the financial condition and corporate affairs of the affiliated companies in the Safeco Group.

INSTRUCTIONS

The examiners reviewed the Company's filed 2005 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. **Reinsurance Recoverable from an Unauthorized Affiliate**
   Safeco Insurance Company of America (SICA), a Washington domiciled insurer, admitted $139,673,000 of reinsurance recoverable from Safeco National Insurance Company (SNL), a Missouri domiciled insurer and affiliate of SICA. SNL is not licensed to write insurance in Washington, and is therefore an unauthorized reinsurer. RCW 48.12.160 requires cash collateral or a clean, irrevocable letter of credit in order to admit reinsurance recoverable

from an unauthorized reinsurer. SICA admitted 100% of the reinsurance recoverable from SNL without obtaining cash collateral or a clean, irrevocable letter of credit as security.

In addition, SICA reported the recoverable from SNL as an "authorized" reinsurer on Schedule F - Part 3. This is not in accordance with RCW 48.05.250, which requires the Company to file a true statement of its financial condition, transactions, and affairs.

The Company is instructed to comply with RCW 48.12.160 by collateralizing the unauthorized reinsurance recoverable or non-admitting any un-collateralized reinsurance recoverable from SNL and RCW 48.05.250 by filing a true statement of its financial condition, transactions, and affairs. We have made an examination adjustment to recognize the penalty for this unauthorized reinsurance recoverable in the amount of $139,673,000.

2. **Investment Expense Allocation**

The Safeco Group has an Investment Expense Sharing Agreement dated March 12, 1999 that requires each company to pay their "allocable share" of the investment expenses. Safeco Insurance Company of America (SICA) incurs all investment expenses and then allocates these expenses to the other members of the Safeco Group. The examiners reviewed the 2005 investment expenses reported by each entity, and concluded that the expenses were not based on the individual company's percentage of invested assets. Several companies did not have any investment expense allocated to them. This result is not in compliance with RCW 48.31B.030(1)(a), which requires the terms of the agreement to be fair and reasonable, the charges or fees to be fair and reasonable, and expenses incurred and payment received to be allocated to the insurer in conformity with customary insurance accounting practices and consistently applied.

In addition, the agreement does not include the companies listed below as participants:

Safeco Surplus Lines Insurance Company
Safeco National Insurance Company
American States Insurance Company
Safeco Insurance Company of Indiana
American Economy Insurance Company
American States Preferred Insurance Company
Insurance Company of Illinois
Safeco Insurance Company of Illinois
American States Lloyds Insurance Company
Safeco Lloyds Insurance Company
American States Insurance Company of Texas
Safeco Insurance Company of Oregon

The Company is instructed to comply with RCW 48.31B.030(1)(a), which requires the terms of the Investment Expense Sharing Agreement to be fair and reasonable. Expenses incurred and payment received must be allocated to the affiliated companies in conformity with customary insurance accounting practices consistently applied. The

books, accounts, and records of each party to all such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties.

The Company is instructed to comply with RCW 48.31B.030(1)(b)(iv) which requires all insurers that are members of a holding company system to file, with the commissioner, all management agreements, service contracts, and cost sharing agreements prior to entering into them. All companies participating in the agreement need to be listed in the agreement. A revised agreement was submitted to the OIC in December 2006.

3. **Holding Company Act Compliance**

I. **Form D Filings- Notice of Intention to Enter into a Transaction**
The following intercompany agreements were subject to RCW 48.31B.030(1)(b) but were not properly filed with the commissioner:

a. **Expense Sharing Agreement dated June 12, 2002**
Between Safeco Insurance Company of America and Safeco Insurance Company of Oregon.

b. **Investment Expense Sharing Agreement dated March 12, 1999**
Between Safeco Insurance Company of America, General Insurance Company of America, First National Insurance Company of America and three non-Washington life companies.

c. **Reinsurance Agreement dated 10/15/2002**
Between Safeco Insurance Company of America and American States Insurance Company of Texas.

d. **Reinsurance Agreement dated 10/16/2002**
Between Safeco Insurance Company of America and American States Lloyds.

e. **Reinsurance Agreement dated 10/16/2002**
Between Safeco Insurance Company of America and Safeco Lloyds.

RCW 48.31B.030(1)(b) requires that certain transactions listed below involving a domestic insurer and a person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into the transaction and the commissioner declares the notice to be sufficient at least sixty days before, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period:

- Reinsurance agreements or modifications to them in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of the previous December.
- Management agreements, service contracts, and cost-sharing arrangements.

The Company is instructed to comply with RCW 48.31B.030(1)(b) by properly filing agreements subject to the Holding Company Act. Form D filings for the agreements listed above were sent to the OIC in December 2006.

II. Form B Filings- Notification

The agreements listed below were subject to RCW 48.31B.025(2)(c)(vi) or RCW 48.31B.025(2)(c)(v) but the Company failed to file or filed inaccurate information for the following agreements:

a. Reinsurance Agreement dated 11/3/1983

Between Safeco Insurance Company of America and Safeco Surplus Lines.

b. Short-Term Borrowing Agreement

The Restated Intercompany Short-Term Borrowing Agreement effective July 15, 2002 includes companies that are no longer affiliated with the Safeco Group companies and one entity that is no longer a party to the contract.

- Safeco Life Insurance Company is no longer affiliated with the Safeco Group and should be removed from the agreement.
- Safeco National Life Insurance Company is no longer affiliated with the Safeco Group and should be removed from the agreement.
- American States Life Insurance Company is no longer affiliated with the Safeco Group and should be removed from the agreement.
- Safeco Financial Products, Inc., is no longer a party to the agreement and should be removed from the agreement.

c. Expense Sharing Agreement

The Expense Sharing Agreement dated March 15, 2001 includes several insurance companies that are no longer affiliated with the Safeco Group and uses one incorrect name.

- Safeco Life Insurance Company is no longer affiliated with the Safeco Group and should be removed from the agreement.
- Safeco National Life Insurance Company is no longer affiliated with the Safeco Group and should be removed from the agreement.
- First Safeco National Life Insurance Company of New York is no longer affiliated with the Safeco Group and should be removed from the agreement.
- American States Life Insurance Company of Texas is no longer affiliated with the Safeco Group and should be removed from the agreement.

- Safeco Insurance Company of Pennsylvania is listed as a party to the agreement. This should be amended to read Safeco Insurance Company of Indiana.

RCW 48.31B.025(2)(c)(vi) and RCW 48.31B.025(2)(c)(v) require an insurer subject to registration to file the registration statement on a form prescribed by the commissioner, containing current information for reinsurance agreements currently outstanding and all management agreements, service contracts, and cost-sharing arrangements.

The Company is instructed to file accurate information for the above agreements so that they correctly identify the parties to the contracts in conformance with RCW 48.31B.025(2)(c)(vi) and RCW 48.31B.025(2)(c)(v).

4. **Right of Offset Clause**

The Safeco Group settles all intercompany payables and receivables for all the insurance companies in the group on a net basis. This methodology is acceptable as long as the intercompany agreements being settled provide for the right of offset. However, certain Safeco Group companies are parties to several agreements that do not include the right of offset clause.

NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (SSAP) 64 states: "Assets and liabilities shall be offset ...only when a valid right of setoff exists..." and "The right of setoff is enforceable by law". The companies are settling intercompany payables and receivables based upon the premise that a right of offset exists. However, since the agreements listed below do not contain the right of offset clause, this premise is not supported by the terms of these agreements. As a result, the Company is not in compliance with SSAP 64 as required by RCW 48.05.073.

Agreements that do not include a right of offset clause are:

- Investment Expense Sharing Agreement
  Restated Intercompany Short Term Borrowing Agreement
- Reinsurance Agreement dated November 3, 1983
- Agreement of Allocation of Payment of Federal Income Taxes, February 28, 2000, and the Amendment dated July 21, 2006
- Expense Sharing Agreement dated June 12, 2002
- Services Agreement (an amendment to the agreement dated 1/1/1984 and originally filed with Texas) dated March 17, 2003
- Investment Expense Sharing Agreement dated March 12, 1999
- Agreement for Maintenance of Services: Substitution and Discharge and Consent Thereto, dated December 29, 1998
- Expense Sharing Agreement dated March 15, 2001

The Company is instructed to comply with RCW 48.05.073 and SSAP 64 by either amending the agreements to include a right of offset clause, or by reporting and settling each agreement separately without a right of offset.

5. **First Cash Plus Plan Account Reconciliation**

The First Cash Plus Plan (FCP) is an option given to certain claimants for their settlement payment. Instead of the usual lump sum payment made via check, the FCP is offered to claimants that have settlement amounts above a certain threshold. The claimant receives a checkbook, and he or she has the right to withdrawal 100% of the funds at any time. The benefit to the claimant is that he or she still has 100% access to the settlement funds, but also has the option to leave funds in the account and earn interest.

The FCP reconciliation includes over $770,000 of uncleared differences at December 31, 2005 that date back to years 2000, 2001, and 2002. Over $680,000 still remained unresolved as of September 30, 2006. Since these reconciliation differences are not being cleared in a reasonable time frame, the Company is in violation of RCW 48.05.280, which requires the Company to keep full and adequate accounts and records.

The Company is instructed to comply with RCW 48.05.280, which requires the Company to keep full and adequate accounts and records of its assets, obligations, transactions, and affairs.

6. **NAIC 2005 Annual Statement Errors and Misclassifications**

The examination team discovered several instances in which the Company's NAIC 2005 Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC 2005 Annual Statement Instructions. While the Company needs to correct these practices, none of the following items in the instruction were material to the financial statements and no examination adjustments were made.

The Company is instructed to comply with RCW 48.05.073, RCW48.05.250, and WAC 284-07-050(2) in filing its NAIC 2005 Annual Statement in accordance with the NAIC Accounting Practices and Procedures Manual and the NAIC 2005 Annual Statement Instructions.

The following exceptions were noted in our examination:

a. **Classification of Liabilities**

Several liability accounts containing employee wages and benefits and other expenses were not properly classified in the NAIC 2005 Annual Statement according to the NAIC 2005 Annual Statement Instructions and NAIC Accounting Practices and Procedures Manual. These accounts were incorrectly classified as "Amounts withheld or retained by the Company for account of others" or "Aggregate write–ins for liabilities" instead of "Loss adjustment expenses" or "Other expenses".

b. **Classification of Unpaid Expenses**

The unpaid expenses at December 31, 2005 in the Underwriting and Investment Exhibit (UIE) did not include bonuses and other miscellaneous liabilities recorded as Aggregate

write-ins for liabilities on the Liabilities, Surplus, and Other Funds page of the NAIC 2005 Annual Statement.

c. **Inaccurate Notes to Financial Statements**

- **Note 10B Disclosures Relating to Intercompany Loans and Dates of Transactions**
  The Note erroneously disclosed that SICA *issued* loans to its parent, Safeco Corporation and other affiliates. It should have disclosed that it *received* loans from its parent, Safeco Corporation, and other affiliates.

  The following disclosures were missing:
  The Company received a loan from American Economy Insurance Company.
  The Company received a loan from American States Insurance Company of Texas.

  In addition, the Company failed to report the date of the transactions in Note 10B, but rather disclosed that these amounts were in 2005. This disclosure does not meet the requirements of SSAP 25 Paragraph 17.b.i, which requires the Company to list the date of the transaction for non-reinsurance or non cost-allocation transactions equal to or greater than 1/2 of 1% of the total prior year admitted assets of the reporting entity. The Company is instructed to provide accurate and complete disclosures in the Notes to Financial Statements.

- **Note 12 Deferred Compensation Plan not Disclosed**
  The Company failed to disclose the Deferred Compensation and Supplemental Benefit Plan for Executives in Note 12 of the Financial Statements. This is not in accordance with SSAP 14. The Company is instructed to provide accurate and complete disclosures in the Notes to Financial Statements.

- **Note 26 Disclosures Relating to Intercompany Pooling Arrangements**
  Note 26 of the Notes to Financial Statements incorrectly listed all fifteen insurers as participants in an intercompany reinsurance agreement. This is incorrect, since there are eight intercompany reinsurance agreements. As noted in the reinsurance section of this report, there is a pooling agreement, which includes eight companies. The other seven companies in the group each have separate reinsurance agreements with SICA, which call for them to cede 100% of their business to SICA. The Company is instructed to comply with the NAIC 2005 Annual Statement Instructions by accurately describing the precise nature of all reinsurance transactions between affiliated companies. In this respect, the footnote disclosures should correctly: (a) name all participating parties of the pooling agreement, and (b) accurately describe the flow of business from other affiliates ceding business to the pool under separate reinsurance agreements.

d. **Inaccurate or Incomplete responses to General Interrogatories Note 21.1 and 21.2 Disclosures Relating to Securities Lending**
The Company incorrectly answered item 21.1 of the "General Interrogatories - Investment" by not revealing the Company's participation in securities lending in the amount of $182,881,492. As a result, the Company did not provide the amount of securities loaned to others required in item 21.21. In addition, the Company did not designate which securities were lent using the designation "LS" in column 3 of Schedule D as required by the NAIC 2005 Annual Statement Instructions.

7. **Reinsurance Cessions Not in Compliance with Treaties**

- At one time, American States Insurance Company (ASI) operated a full-scale reinsurance program, assuming business from a large number of companies. This reinsurance assumed program was discontinued and has been in run-off since 1993. ASI has various retrocessional programs in place providing some protection for the business assumed. These contracts are between ASI and third party reinsurers. Beginning in 2005, ASI incorrectly reported this business as ceded 100% to SICA (not directly to the third party reinsurers, as required by the treaties), which then incorrectly reported the retrocessional reinsurance as being ceded by SICA to the third party reinsurers.

- In addition, ASI's pre-1999 liability business is covered by reinsurance contracts between ASI and third party reinsurers but is being recorded incorrectly as ceded by ASI to SICA and then ceded by SICA to third party reinsurers.

- Safeco Insurance Company of Illinois (SIL) has an approved intercompany reinsurance agreement that provides for it to assume 100% of the business of its affiliate, Insurance Company of Illinois (ICI) effective and executed January 1, 1999. However, ICI recorded cessions directly to SICA (not SIL, as required by the treaty).

While this method of reporting simplifies the preparation of various statutory reports and has no net impact on surplus, the method does not comply with the terms of the underlying reinsurance treaties because SICA was not a party to the treaties.

The Company is instructed to comply with RCW 48.05.073, RCW48.05.250, and WAC 284-07-050(2) in filing its NAIC 2005 Annual Statement in accordance with the AP&P and the NAIC 2005 Annual Statement Instructions by properly reporting reinsurance cessions in compliance with the terms of reinsurance agreements or amending the agreements to include SICA.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

History and Capitalization

The Company was incorporated on September 2, 1953 under the laws of the state of Washington and began active operations on October 1, 1953. Operations were conducted under the name Selective Auto and Fire Insurance Company of America until November 2, 1953 at which time the present name was adopted. Authorized capital of the Company was $5,000,000 at December 31, 2005, which consisted of 20,000 shares of common stock with a $250 par value. All authorized shares were issued and outstanding at December 31, 2005. The Company is wholly-owned by Safeco Corporation (the "Parent"), a holding company incorporated under the laws of the state of Washington. Prior to November 30, 2006, Safeco Corporation was actively traded on the NASDAQ under the ticker symbol SAFC. On November 30, 2006, Safeco Corporation began active trading on the New York Stock Exchange (NYSE) under the ticker symbol SAF.

The last examination of the Company was as of December 31, 2000 and covered the period January 1, 1996 through December 31, 2000.

Territory and Plan of Operation

The Safeco Group operates as a property and casualty insurance company throughout the United States, through four segments: personal insurance, business insurance, surety, and property casualty other. The personal insurance segment offers auto, homeowners and other property, and specialty insurance products for individuals. The business insurance segment offers business owners' policies, commercial auto, commercial multi-peril packages, commercial property, general liability, and workers' compensation policies to small and medium-sized businesses. The surety segment offers bonds that provide payment and performance guarantees primarily for construction businesses and corporations. The property and casualty other segment includes those commercial business accounts currently in runoff. The Safeco Group markets its products primarily to drivers, homeowners, and small and medium sized businesses through approximately 8,500 independent agents and brokers nationwide. Claims offices are maintained throughout the United States to provide effective and efficient service to claimants.

The mix of business is about 66% personal lines, 30% commercial, and 4% surety, based on net written premiums. Personal automobile is the dominant line, followed by homeowners, commercial multi-peril, and commercial automobile liability coverage. Approximately 47% of the Safeco Group's premiums are written in the states of California, Washington, Texas, Florida and Oregon.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases and Sales

In 2004, Safeco Corporation, the parent company, completed the sale of its life and investments businesses. On May 1, 2006, the parent sold Safeco Financial Institution Solutions, Inc., an affiliate of the Company.

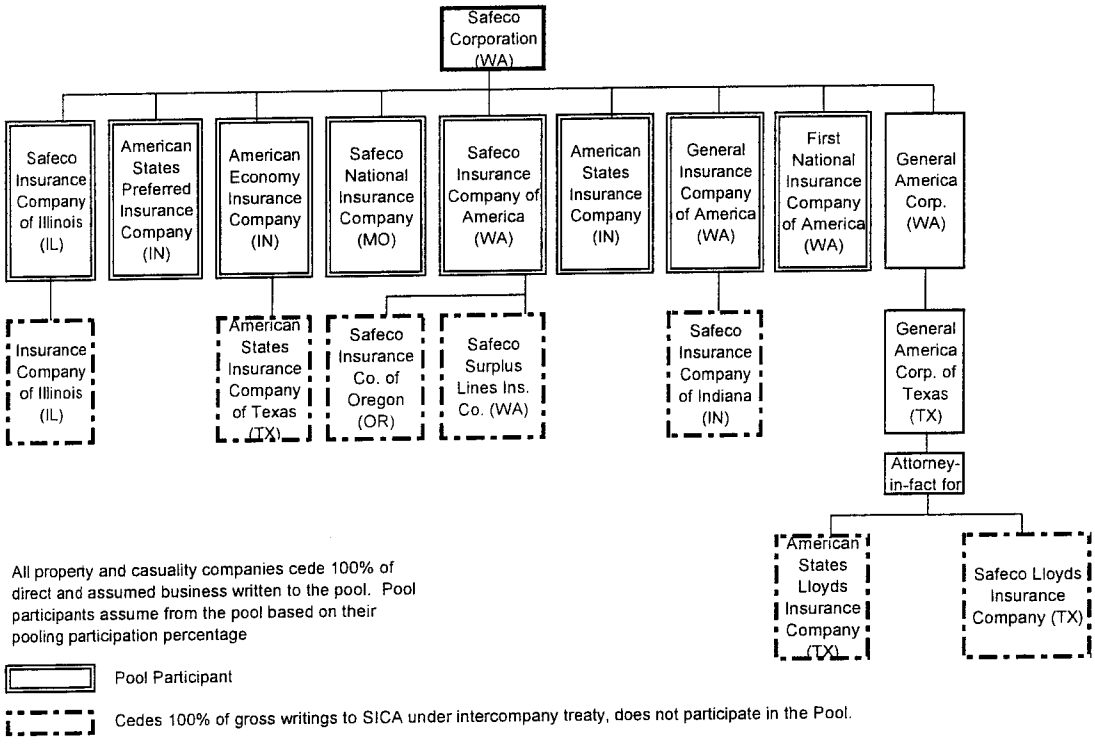
Growth of Company
The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below (000's omitted):

Year	Admitted Assets	Liabilities	Capital & Surplus
2005	$4,468,952	$3,271,077	$1,197,874
2004	3,785,602	2,742,204	1,043,397
2003	3,418,944	2,600,468	818,476
2002	3,384,999	2,558,928	826,071
2001	3,394,839	2,637,915	756,924

Year	Premiums Earned	Net Underwriting Gain (Loss)	Net Investment Gains (Losses)	Net Income
2005	$1,918,546	$175,088	$169,257	$255,964
2004	1,824,586	150,493	210,700	232,067
2003	1,617,578	(14,251)	180,536	114,821
2002	1,492,023	(78,748)	315,460	146,358
2001	1,476,010	(292,538)	197,923	(22,135)

Affiliated Companies
The Company is a wholly-owned subsidiary of Safeco Corporation. As a member of an insurance holding company system, the Company is required to file registration statements in accordance with RCW 48.31B.025 and WAC 284-18-300. Safeco Corporation filed the registration statements for each year under examination on behalf of the Company and its affiliates within the Safeco Group

The following organization chart shows the affiliated insurance companies:



Intercompany Contracts

The following intercompany contracts were in-force as of December 31, 2005:

- **Reinsurance Pooling Agreement** dated January 1, 1998 and amended April 11, 2002 between Safeco Insurance Company of America, First National Insurance Company of America, General Insurance Company of America, Safeco National Insurance Company, American States Insurance Company, American Economy Insurance Company, American States Preferred Insurance Company, and Safeco Insurance Company of Illinois.

- **Expense Sharing Agreement** dated March 15, 2001 between Safeco Insurance Company of America, First National Insurance Company of America, General Insurance Company of America, Safeco National Insurance Company, American States Insurance Company, American Economy Insurance Company, American States Preferred Insurance Company, Safeco Insurance Company of Illinois, Safeco Surplus Lines Insurance Company, Safeco Insurance Company of Indiana (formerly of Pennsylvania), Insurance Company of Illinois, American States Insurance Company of Texas, and, as mentioned earlier in Instruction 2.II.c, four entities that are no longer affiliated with the Safeco Group.

- **Expense Sharing Agreement** dated June 12, 2002 between Safeco Insurance Company of America and Safeco Insurance Company of Oregon.

- **Agreement for Maintenance of Services: Substitution and Discharge and Consent Thereto**, effective December 29, 1998, between Safeco Insurance Company of America and American States Lloyds Insurance Company.

- **Services Agreement** dated August 1, 2002 (an amendment to the agreement dated January 1, 1984 and originally filed with Texas) between Safeco Insurance Company of America and Safeco Lloyds Insurance Company.

- **Investment Expense Sharing Agreement** dated March 12, 1999, effective October 1, 1998 between Safeco Insurance Company of America, First National Insurance Company of America, and General Insurance Company of America.

- **Restated Intercompany Short-Term Borrowing Agreement** effective July 15, 2002 for Washington companies and October 25, 2002 for all others, between Safeco Insurance Company of America, First National Insurance Company of America, General Insurance Company of America, Safeco National Insurance Company, American States Insurance Company, American Economy Insurance Company, American States Preferred Insurance Company, Safeco Insurance Company of Illinois, Safeco Surplus Lines Insurance Company, Safeco Insurance Company of Indiana, Insurance Company of Illinois, American States Insurance Company of Texas, Safeco Insurance Company of Oregon, and, as mentioned earlier in Instruction 2.II.b, three entities that are no longer affiliated with the Safeco Group and one entity no longer a party to the agreement.

- **Agreement of Allocation of Payment of Federal Income Taxes** dated February 28, 2000 between Safeco Insurance Company of America, First National Insurance Company of America, General Insurance Company of America, Safeco National Insurance Company, American States Insurance Company, American Economy Insurance Company, American States Preferred Insurance Company, Safeco Insurance Company of Illinois, Safeco Surplus Lines Insurance Company, Safeco Insurance Company of Indiana, Insurance Company of Illinois, American States Insurance Company of Texas, Safeco Lloyds Insurance Company, American States Lloyds Insurance Company, and Safeco Insurance Company of Oregon.

- **Reinsurance Agreement** dated April 11, 2002 between Safeco Insurance Company of America and Safeco Insurance Company of Oregon.

- **Reinsurance Agreement** dated November 3, 1983 between Safeco Insurance Company of America and Safeco Surplus Lines Insurance Company.

- **Reinsurance Agreement** dated March 12, 1999 between Safeco Insurance Company of America and Safeco Insurance Company of Indiana.

- **Reinsurance Agreement** dated October 15, 2002 between Safeco Insurance Company of America and American States Insurance Company of Texas.

- **Reinsurance Agreement** dated October 16, 2002 between Safeco Insurance Company of America and American States Lloyds Insurance Company.

MANAGEMENT AND CONTROL

Ownership
The Company's stock is 100% owned by Safeco Corporation, a publicly traded corporation.

Directors
Directors of the Company as of December 31, 2005 were as follows:

Board Member	Principal Occupation
Michael Sean McGavick	President - Chairman of the Board
Michael Edward LaRocco	Co-President - Chief Operating Officer
Dale Ellis Lauer	Executive Vice President Claims and Service
Christine Barbara Mead	Co-President
Allie Mysliwy	Executive Vice President - Chief Business Services Officer, Safeco Corporation
Jeffrey Edward Roe	Co-President
Yom Senegor	Executive Vice President - Chief Information Officer, Safeco Corporation
Kasey Sweet	Assistant Vice President, Safeco Corporation
Richard Brendan Kelly	Sr. Vice President
Arthur Chong	Executive Vice President - Chief Legal Officer, Safeco Corporation

Officers
Officers of the Company as of December 31, 2005 were as follows:

Name	
Michael Sean McGavick	President
Neal Andrew Fuller	Treasurer
Stephanie Gayle Daley-Watson	Secretary
Michael Edward LaRocco	Co-President
Christine Barbara Mead	Co-President
Jeffrey Edward Roe	Co-President
Dale Ellis Lauer	Executive Vice President
Gregory Allan Tacchetti	Senior Vice President
Robert Clark Taylor	Senior Vice President
Richard Brendan Kelly	Senior Vice President
Michael Henry Hughes	Senior Vice President
John Ammendola	Senior Vice President
Charles Francis Horne Jr.	Senior Vice President
Teresa Jean Dalenta	Senior Vice President
Eleanor Susan Barnard	Senior Vice President
Willard Myron Hendry	Senior Vice President
Michael Clay Peters	President, Safeco Surety

Conflict of Interest
The Company has a policy that requires all employees, directors, and officers to complete a conflict of interest statement annually. The purpose of the statement is to detect any activities or participation on the part of an employee or director that could possibly be interpreted as having the appearance of a conflict of interest. Our review did not reveal any exceptions.

Fidelity Bond and Other Insurance
The Company is a named insured under a financial institution bond that provides $15,000,000 of directors' and officers' (D&O) liability insurance. The policy was issued to Safeco Corporation and covers all subsidiaries and affiliates. The fidelity coverage carried by the Company exceeds the NAIC minimum recommended amount.

The Company was also a named insured on various insurance policies issued to Safeco Corporation that provided property coverage for buildings and contents and comprehensive commercial general liability. These policies were in effect during the period covered by this examination and provided coverage for the Company.

Officers', Employees', and Agents' Welfare and Pension Plans

- **Cash Balance Defined Benefit Pension Plan**
  Safeco Corporation sponsors a cash balance defined benefit pension plan covering a wide range of Company employees. The plan provides benefits for each year of service after 1988, based on each eligible participant's compensation plus a stipulated rate of return on their benefit balance. The Parent's funding policy is to contribute amounts at least sufficient to meet the minimum funding requirements of the Employee Retirement Income Security Act (ERISA) that can be deducted for federal income tax purposes. Pension costs amounted to $2,946,000 and $4,307,505 in 2005 and 2004, respectively. The Company has no legal obligation for benefits under this plan.

- **Defined Contribution Plan**
  Safeco Corporation sponsors a defined contribution plan covering a wide range of Company employees. The plan includes a minimum contribution of 3% of each eligible participant's compensation, and a profit sharing component based on the Parent's income. The Parent makes contributions to the plan semi-monthly. Expenses for this plan amounted to $14,808,000 and $13,196,905 in 2005 and 2004, respectively. The Company has no legal obligation for benefits under this plan.

- **Postretirement Healthcare and Life Insurance Program**
  Safeco Corporation sponsors a postretirement healthcare and life insurance program covering retired and certain active employees, their beneficiaries and eligible dependents. During 2003, the program was amended to eliminate the future benefit for a significant number of employees, resulting in recognition of curtailment gains. The Parent makes contributions to this program as claims are incurred. Expense amounted to $451,000 and $1,217,649 in 2005 and 2004, respectively. The Company has no legal obligation for benefits under this plan.

- **Deferred Compensation and Supplemental Benefit for Executives**
  Safeco Corporation sponsors a deferred compensation and supplemental benefit plan for executives, which allows a select group of management and highly compensated employees to accumulate a portion of their earnings in a tax-deferred account. Once these employees become eligible for the 401(k), the plan permits Safeco Corporation to credit their account with deferrals of "excess savings" contributions and an employer match. Contributions are in excess of IRS limitations for the 401(k). It is an unfunded, unsecured, nonqualified program. Participants are unsecured general creditors of Safeco Corporation.

CORPORATE RECORDS

The Company's Board of Directors (BOD) managed the property and business of the Company and was actively involved in the Company's affairs. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes. Appointments and elections of officers, reinsurance contracts, bank agreements, and other contracts were also noted in the BOD's minutes.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The reserves carried by the Company for "Losses" and "Loss adjustment expenses" were $1,300,451,324 and $319,816,429, respectively, as of December 31, 2005. These amounts represent the Company's 33% participation in the intercompany pooling reinsurance agreement.

The OIC's property and casualty actuarial staff reviewed the Unpaid Losses and Loss Adjustment Expense reserves of the Safeco Group and concluded that the Safeco Group's reserves, on a net basis, are within a range of reasonable estimates. Therefore, the Company's loss and loss adjustment expense reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2005 NAIC Annual Statement.

REINSURANCE

Intercompany Reinsurance
The direct and assumed business of the Safeco Group is ceded 100% to SICA, the lead pool reinsurer, pursuant to either the pooling agreement for those eight affiliates which assume a retrocessional share of the pooled business (the Pool) or via individual 100% intercompany reinsurance agreements for the other seven affiliated companies.

The eight companies of the Safeco Group that participated in the intercompany reinsurance pooling agreement and their respective percentages of participation as of December 31, 2005 are:

Company Name	Pooling Percentage
Safeco Insurance Company of America	33%
General Insurance Company of America	23%
American States Insurance Company	19%
American Economy Insurance Company	14%
Safeco Insurance Company of Illinois	5%
First National Insurance Company of America	2%
Safeco National Insurance Company	2%
American States Preferred Insurance Company	2%
Combined Group Total	100%

The pooling process is accomplished in three steps. First, each affiliate identified above cedes 100% of its direct and assumed business to SICA pursuant to the terms of an intercompany pooling agreement. In addition, the other seven affiliated companies also cede 100% of direct and assumed business to SICA via individual 100% intercompany reinsurance agreements but do not assume any share of the Pool. Those companies are:

Company Name
Safeco Surplus Lines Insurance Company
Safeco Lloyds Insurance Company
Safeco Insurance Company of Indiana
Safeco Insurance Company of Oregon
Insurance Company of Illinois
American States Insurance Company of Texas
American States Lloyds Insurance Company

Second, SICA combines the business assumed from its affiliates with its own direct and external assumed business and then cedes excess of loss and catastrophe reinsurance to various unrelated reinsurers and various state-operated residual market reinsurance facilities (external reinsurance). Any uncollected external reinsurance balances are ultimately shared in proportion to designated pooling percentages.

Third, in its capacity as lead Pool insurer, SICA then cedes (or retrocedes) back to each participant its applicable pooling percentage, as shown above. The respective shares of each participant of the Pool have not changed throughout the current examination period.

ASSUMED REINSURANCE

Other than transactions pertaining to intercompany Pool SICA had an immaterial amount of assumed reinsurance, which generally consisted of minor amounts resulting from state-mandated participation in pools or underwriting associations and loss reserves on assumed business in runoff.

CEDED REINSURANCE

As discussed above, SICA, in its capacity as lead Pool reinsurer, cedes reinsurance to a group of unrelated reinsurers (external reinsurance) and various state-operated residual reinsurance facilities. Coverage consists primarily of a combination of excess of loss and catastrophe coverage designed to limit net retention to desired levels. The following table reflects the significant external reinsurance contracts that were in effect at December 31, 2005:

Type of Coverage	Layers	Reinsurance Limits	Retention
Commercial Property Excess of Loss	2	$15 million	$5 million
Umbrella Excess of Loss	2	16 million	4 million
Workers' Compensation Excess of Loss (per person per occurrence)	2	15 million	5 million
Workers' Compensation Clash (Catastrophe) Excess of Loss	1	90% of 30 million	20 million
Large Contractor Surety:	3	90% of 80 million	20 million
Property Catastrophe Excess of Loss	5	90% of 660 million	100 million

Most of the Company's external reinsurance is placed with reinsurers rated A- or better by A. M. Best and entities licensed or authorized in Washington. The recoverable balances for the one reinsurer not rated by A. M. Best were collateralized by a letter of credit. All contracts contain an appropriate insolvency clause. Except as described below, SICA obtains letters of credit (LOC) or other acceptable collateral for all material amounts due from reinsurers not authorized by the state of Washington.

One of the Safeco Pool participants, Safeco National Insurance Company, is not licensed in the state of Washington. As SICA did not hold either an LOC or other acceptable collateral covering balances ceded to Safeco National Insurance Company at December 31, 2005, an examination adjustment in the amount of $139,673,000 has been posted to cover the net reserves ceded to this unauthorized reinsurer. (See Instruction No. 1).

STATUTORY DEPOSITS

The Company maintained the following statutory deposits as of December 31, 2005:

State	Description of Assets	Book Value	Fair Value
Arizona	Bonds	$5,957,029	$6,041,609
California	Bonds	111,807,442	119,845,399
Delaware	Bonds	99,504	99,094
Georgia	Bonds	125,011	124,023
Idaho	Bonds	150,491	147,653
Louisiana	Bonds	214,089	240,719
Massachusetts	Bonds	499,928	500,938
Nevada	Bonds	100,215	100,906
New Mexico	Bonds	300,646	302,719
North Carolina	Bonds	313,133	320,411
Oregon	Bonds	14,364,262	14,344,020
Washington	Bonds	3,920,641	3,996,520
Total		$137,852,391	$146,064,011

Securities held by the state of Washington and other states were confirmed directly with the Company's authorized custodians.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain the confidentiality, integrity and availability of data. Sufficient internal controls are in place and monitored by the Company. The Company's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, business continuity and disaster recovery plan.

SUBSEQUENT EVENTS

There were no material events adversely impacting the Company between the examination date and the last day of our fieldwork.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The Company remedied all prior examination instructions and implemented the recommendations.

FINANCIAL STATEMENTS

Statement of Assets, Liabilities, Surplus and Other Funds
Statement of Income and Capital and Surplus Account
Reconciliation of Capital and Surplus since the last Examination
Analysis of Changes in Financial Statements Resulting from the Examination

SAFECO INSURANCE COMPANY OF AMERICA
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2005

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	NOTES
Assets				
Bonds	$2,925,096,556	$0	$2,925,096,556	
Stocks:				
Preferred stocks	20,183,879		20,183,879	
Common stocks	408,440,358		408,440,358	
Real estate:				
Properties occupied by the company	465,975		465,975	
Properties held for production of income	273,383		273,383	
Properties held for sale	8,551,981		8,551,981	
Cash and short-term investments	84,906,669		84,906,669	
Other invested assets	6,998,182		6,998,182	
Receivable for securities	386,712		386,712	
Subtotal, cash and invested assets	3,455,303,695	0	3,455,303,695	
Investment income due and accrued	40,360,895	$0	40,360,895	
Premiums and considerations				
Uncollected premiums and agents' balances in course of collection	312,906,713		312,906,713	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	315,936,238		315,936,238	
Accrued retrospective premium	791,482		791,482	
Amount recoverable from reinsurers	221,793,224		221,793,224	
Net deferred tax asset	99,803,268		99,803,268	
Guaranty funds receivable or on deposit	1,946,600		1,946,600	
Electronic data processing equipment and software	10,603,283		10,603,283	
Receivable from parent, subsidiaries and affiliates	6,719,429		6,719,429	
Aggregate write-ins for other than invested assets	2,787,006		2,787,006	
Total Assets	**$4,468,951,833**	**$0**	**$4,468,951,833**	
Liabilities, Surplus and other Funds				
Losses	$1,300,451,324		$1,300,451,324	
Reinsurance payable on paid losses and loss adjustment expenses	203,811,430		203,811,430	
Loss adjustment expenses	319,816,429		319,816,429	
Commissions payable, contingent commissions	46,850,038		46,850,038	
Other expenses	15,159,749		15,159,749	
Taxes, licenses and fees (excluding federal and foreign income taxes)	15,006,390		15,006,390	
Current federal and foreign income taxes	20,509,143		20,509,143	
Unearned premiums	711,109,819		711,109,819	
Advance premiums	17,710,381		17,710,381	
Dividends declared and unpaid - policyholders	854,045		854,045	
Ceded reinsurance premiums payable	259,767,146		259,767,146	
Funds held by company under reinsurance treaties	78,827		78,827	
Amounts withheld or retained by company for account of others	15,358,711		15,358,711	
Provision for reinsurance	26,031,858	139,673,000	165,704,858	A1
Payable to parent, subsidiaries and affiliates	169,161,967		169,161,967	
Payable for securities	5,591,258		5,591,258	
Aggregate write-ins for liabilities	143,808,832		143,808,832	
Total Liabilities	**3,271,077,347**	**139,673,000**	**3,410,750,347**	
Common capital stock	5,000,000		5,000,000	
Gross paid in and contributed surplus	240,451,979		240,451,979	
Unassigned funds (surplus)	952,422,507	(139,673,000)	812,749,507	A1
Surplus as regards policyholders	**1,197,874,486**	**(139,673,000)**	**1,058,201,486**	
Total Liabilities, Surplus and other Funds	**$4,468,951,833**	**$0**	**$4,468,951,833**	

SAFECO INSURANCE COMPANY OF AMERICA
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2005

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENT	BALANCE PER EXAMINATION	NOTES
STATEMENT OF INCOME				
Underwriting Income				
Premiums earned	$1,918,546,173	$0	$1,918,546,173	
Deductions				
Losses incurred	952,612,210		952,612,210	
Loss expenses incurred	242,984,462		242,984,462	
Other underwriting expenses incurred	547,861,707		547,861,707	
Total underwriting deductions	1,743,458,379		1,743,458,379	
Net underwriting gain or (loss)	$175,087,794	0	$175,087,794	
Investment Income				
Net investment income earned	151,540,218		151,540,218	
Net realized capital gains or (losses)	17,716,498		17,716,498	
Net investment gain or (loss)	169,256,716	0	169,256,716	
Other Income				
Net (loss) from agents' or premiums balances charged off	(7,433,899)		(7,433,899)	
Finance and service charges not included in premiums	10,279,726		10,279,726	
Total other income	2,845,827	0	2,845,827	
Net income before dividends to policyholders but before federal and foreign income taxes	347,190,337		347,190,337	
Dividends to policyholders	940,368		940,368	
Net income, after dividends to policyholders but before federal and foreign income taxes	346,249,969		346,249,969	
Federal and foreign income taxes incurred	90,285,774	0	90,285,774	
Net income	**$255,964,195**	**$0**	**$255,964,195**	
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	**$1,043,397,228**	**$0**	**$1,043,397,228**	
Gains and (Losses) in Surplus				
Net income	255,964,195		255,964,195	
Change in net unrealized capital gain/losses	(19,784,599)		(19,784,599)	
Change in net unrealized foreign exchange capital gain	266,183		266,183	
Change in net deferred income tax	(5,995,235)		(5,995,235)	
Change in nonadmitted assets	30,820,284		30,820,284	
Change in provision for reinsurance	(4,057,591)	(139,673,000)	(143,730,591)	A1
Surplus adjustment - paid in	7,264,021		7,264,021	
Dividends to stockholders	(110,000,000)		(110,000,000)	
Change in surplus as regards policyholders	154,477,258	(139,673,000)	14,804,258	
Surplus as regards policyholders, December 31 current year	**$1,197,874,486**	**($139,673,000)**	**$1,058,201,486**	

SAFECO INSURANCE COMPANY OF AMERICA
RECONCILIATION OF SURPLUS
FOR YEARS ENDED DECEMBER 31,

	2005	2004	2003	2002	2001
Capital and surplus, December 31, previous year	$1,043,397,228	$818,475,958	$826,070,655	$756,924,150	$706,320,466
Net income	255,964,195	232,066,903	114,820,682	146,357,751	(22,135,395)
Change in net unrealized capital gains or (losses)	(19,784,599)	(8,208,358)	(11,672,857)	(220,079,412)	(112,435,936)
Change in net unrealized foreign exchange capital gains or (loss)	266,183	1,703,959	595,066	3,683,254	(1,916,332)
Change in net deferred income tax	(5,995,235)	17,282,911	5,087,017	114,138,275	5,670,889
Change in nonadmitted assets	30,820,284	31,083,650	30,331,611	27,810,107	(16,074,169)
Change in provision for reinsurance	(4,057,591)	(4,546,411)	(1,756,216)	(2,263,470)	(3,172,878)
Cumulative effects of changes in accounting principles					57,827,019
Surplus adjustments:					
Paid in	7,264,021	5,881,474		75,000,000	141,166,543
Dividends to stockholders	(110,000,000)	(76,704,134)	(145,000,000)	(75,500,000)	
Aggregate write-ins for gains and losses in surplus		26,361,275			1,673,943
Examination Adjustment	(139,673,000)				
Change in surplus as regards policyholders for the year	14,804,258	224,921,270	(7,594,696)	69,146,505	50,603,684
Surplus as regards policyholders, December 31, current year	$1,058,201,486	$1,043,397,228	$818,475,958	$826,070,655	$756,924,150

SAFECO INSURANCE COMPANY OF AMERICA
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS
RESULTING FROM THE EXAMINATION
AS OF DECEMBER 31, 2005

	PER COMPANY	PER EXAMINATION	EXAMINATION ADJUSTMENT REFERENCE	INCREASE (DECREASE) IN SURPLUS	TOTAL
Capital and Surplus, December 31, 2005 - Per Annual Statement					**$1,197,874,486**
Provision for Reinsurance	26,031,858	165,704,858	A1	(139,673,000)	
Change in surplus					(139,673,000)
Capital and Surplus, December 31, 2005 - Per Examination					**$1,058,201,486**

NOTES TO THE FINANCIAL STATEMENTS

A1. Provision for Reinsurance

Safeco Insurance Company of America admitted $139,673,000 of reinsurance recoverables from an unauthorized affiliated reinsurer without obtaining cash collateral or a clean, irrevocable letter of credit as required by RCW 48.12.160. This amount should have been non-admitted.

This adjustment was posted as an increase to the "Provision for Reinsurance" account in order to mirror the entry booked by the Company on the second quarter 2006 statutory statement. (See Instruction No. 1).

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Safeco Insurance Company of America during the course of this examination.

In addition to the undersigned, the following individuals participated in the examination and the preparation of this report. Representing the Washington State Office of the Insurance Commissioner: Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timoteo L. Navaja, CFE, CIE, Property and Casualty Field Supervisor, Tarik M. Subbagh, CPA, CFE, Insurance Examiner; John J. Gaynard, CPA, CFE, CPCU, Reinsurance Specialist; Adrienne C. DeBella, CPA, CFE, Insurance Examiner; Kathy L.W. Hicks, CPA, Insurance Examiner; Randy E. Fong, Insurance Examiner; D. Lee Barclay, FCAS, MAAA, Senior Actuary; Eric Slavich, Actuarial Analyst; and James Antush, Actuarial Analyst. Representing the Indiana Department of Insurance: Michael P. Dinius, CPA, CFE, Insurance Examiner in Charge; Peter A. Warfel, CPA, Senior Examiner; Phet Pannhanouvoung, ACL Specialist; Brad E. Meyers, CISA, ISQ Specialist; and James H. Ryan, CFE, Senior Consultant and Reinsurance Specialist. Representing the Illinois Department of Financial and Professional Regulation, Division of Insurance: Patrick A. Hyde, CFE, CPA, Assistant Chief Examiner, James G. Hatzis, CFE, Insurance Examiner in Charge; Jorge C. Arana, Jr., CFE, Insurance Examiner; Tera F. Mickel, Staff Examiner; Sherry A. Pablo, Staff Examiner; and Michael A. Manwaring, Staff Examiner. Representing the Oregon Department of Consumer and Business Services, Insurance Division: Greg A. Lathrop, CFE, Supervising Insurance Examiner. Representing the Texas Department of Insurance, Financial Analysis and Examinations: Sylvia L. Thomson, CPA, CPCU, CFE, Financial Examiner. Representing the Missouri Department of Insurance, Financial Institutions, and Professional Registration: Vicki L. Denton, CFE, Financial Examiner-In-Charge.

Respectfully submitted,

Jerry Epler

Jerry Epler, CPA/ABV, CFE
Examiner in Charge
State of Washington

AFFIDAVIT

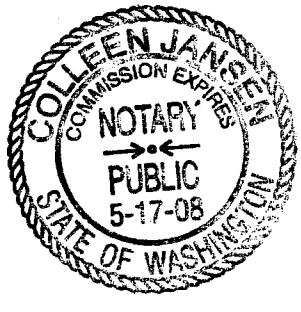
STATE OF WASHINGTON }
} ss
COUNTY OF KING }

Jerry Epler, CPA/ABV, CFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Safeco Insurance Company of America was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Jerry Epler

Jerry Epler, CPA/ABV, CFE
Examiner in Charge
State of Washington

Subscribed and sworn to before me this 8th day of June 2007.

Notary Public in and for the
State of Washington