STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER

FINANCIAL EXAMINATION

OF

Safeco Surplus Lines Insurance Company
Seattle, Washington

NAIC CODE 11100
DECEMBER 31, 2005

Participating States:
Washington
Indiana
Illinois
Oregon
Texas
Missouri

Safeco Surplus Lines Insurance Company
Order No. G07-184
Exhibit A

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 Surplus Lines Insurance Company

of

Seattle, Washington

hereinafter referred to as "SSLIC" 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 Surplus Lines Insurance Company 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 was 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 insurance 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. **Investment Expense Allocation**
   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.

2. **Holding Company Act Compliance- Form B Filings**

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 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).

3. <u>Right of Offset Clause</u>

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 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:

- Restated Intercompany Short Term Borrowing Agreement
- Reinsurance Agreement dated November 13, 1983
- Agreement of Allocation of Payment of Federal Income Taxes, February 28, 2000, and the Amendment dated July 21, 2006
- 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.

4. **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. **Inaccurate Notes to Financial Statements**
   - **Note 10B Disclosures Relating to Intercompany Loans and Dates of Transactions**
     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 prior year total admitted assets of the reporting entity.

- **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.

- **Note 26 Disclosures Relating to Pooling Agreement**
  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.

b. 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 engagements in securities lending of $71,776. 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.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

History and Capitalization

The Company was incorporated on August 26, 1983 under the laws of the state of Washington and began active operations on January 1, 1984. On April 8, 1999, the Company's Articles of Incorporation were amended to increase the par value of the Company's 12,000 shares of authorized common stock from $205 to $250 per share, and to increase the Company's Common Capital Stock account from $4,100,000 to $5,000,000. The $900,000 difference was transferred from the Company's Gross Paid In and Contributed Surplus account. At December 31, 2005 the Company's authorized capital was $5,000,000, 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 owned by SICA and ultimately 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. Beginning on November 30, 2006, Safeco Corporation was actively traded 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

SSLIC is admitted only in Washington and is qualified as a surplus lines carrier in all states except Washington, New Hampshire, and Guam. SSLIC is also a qualified carrier in the Virgin Islands and Puerto Rico. The Company writes fire, allied lines, commercial automobile, commercial multiple-peril, inland marine, medical malpractice, earthquake, worker's compensation, other liability, burglary and theft and boiler and machinery insurance. The direct business written by the Company is ceded 100% to SICA under an intercompany reinsurance agreement.

The Safeco Group markets its products through approximately 8,500 independent agents and brokers nationwide. The business enterprise has five regional offices (Redmond, Washington; Aliso Viejo, California; Richardson, Texas; Indianapolis, Indiana; and Atlanta, Georgia) while the personal enterprise has two regional offices (Redmond, Washington and Atlanta, Georgia). Claims offices are maintained throughout the United States to provide effective and efficient service to claimants.

Growth of Company

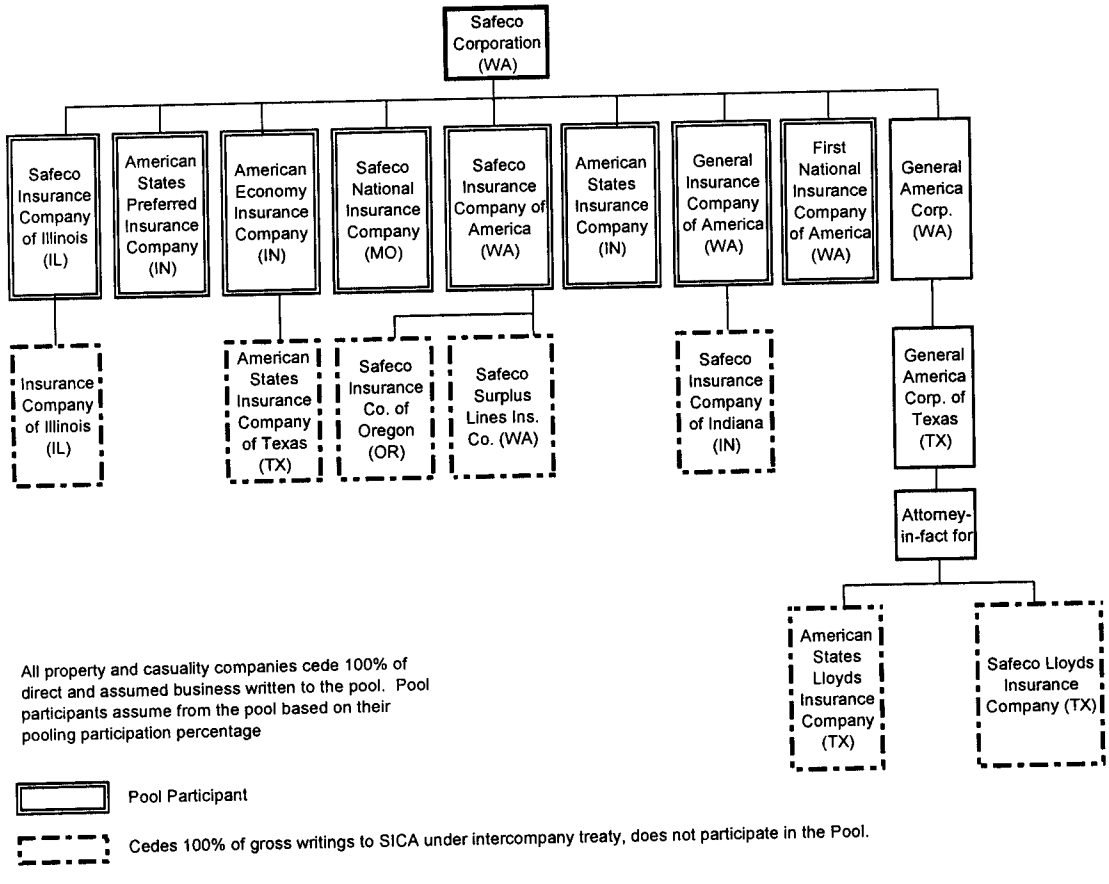
The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below (000's omitted):

Year	Assets	Liabilities	Capital	Surplus	Premiums Earned
2005	$31,713	$4,829	$5,000	$21,884	$0
2004	26,152	189	5,000	20,962	0
2003	28,055	631	5,000	22,425	0
2002	29,828	918	5,000	23,910	0
2001	27,717	463	5,000	22,254	0

Affiliated Companies

The Company is a wholly-owned subsidiary of SICA. Safeco Corporation is the ultimate parent. 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, its parent 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 at December 31, 2005:

- **Restated Intercompany Short-Term Borrowing Agreement** effective July 15, 2002 for the 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..

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

- **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, and 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.

- **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.

MANAGEMENT AND CONTROL

Shareholder
The Company's outstanding shares are 100% owned by SICA, an insurance company incorporated under the laws of the state of Washington. SICA is a wholly-owned subsidiary of Safeco Corporation, an insurance holding company incorporated under the laws of the state of Washington.

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
Christine Barbara Mead	Co-President - Chief Financial Officer - Safeco Corporation
Jeffrey Edward Roe	Co-President - Distribution, Sales and Marketing – Safeco Corporation
Dale Ellis Lauer	Executive Vice President Claims and Service
Allie Mysliwy	Executive Vice President - Chief Business Services Officer, Safeco Corporation
Yom Senegor	Executive Vice President - Chief Information Officer, Safeco Corporation
Arthur Chong	Executive Vice President and Chief Legal Officer, Safeco Corporation
Richard Brendan Kelly	Chief Investment Officer - Safeco Corporation
Kasey Sweet	Assistant Vice President

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

Name	Title
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

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.

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 Company is a member of the Safeco Group and cedes 100% of its business to SICA pursuant to an intercompany reinsurance agreement. The reserves carried by the Company for Unpaid Losses and Loss Adjustment Expense reserves were $0 and $0, respectively, as of December 31, 2005.

The OIC's 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 Company is a member of the Safeco Group and cedes 100% of its business to SICA pursuant to an intercompany reinsurance agreement. The Company reported no net premiums or losses in its 2005 NAIC Annual Statement.

As of December 31, 2005, the Company had $22,458,000 in aggregate unsecured amounts recoverable from SICA.

STATUTORY DEPOSITS

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

Location	Description of Assets	Book Value	Market Value
Arkansas	Bonds	$254,775	$256,094
Connecticut	Bonds	101,259	99,094
Louisiana	Bonds	152,169	153,984
Massachusetts	Bonds	824,263	911,531
New Hampshire	Bonds	590,381	692,969
New Mexico	Bonds	136,087	149,258
New York	Bonds	3,202,790	3,443,822
Oklahoma	Bonds	150,000	166,703
South Carolina	Bonds	301,105	308,719
Washington	Bonds	2,968,462	3,269,980
Total		$8,681,291	$9,452,154

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 SAP basis for NAIC Annual Statement reporting. The certified public accounting firm of Ernst & Young audits the Company annually. 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 significant 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 data security. 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, disaster recovery plan.

SUBSEQUENT EVENTS

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

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

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

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

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

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	NOTES
Assets				
Bonds	$25,982,957	$0	$25,982,957	
Preferred stocks	168,354		168,354	
Subtotal, cash and invested assets	26,151,311	0	26,151,311	
Investment income due and accrued	396,569		396,569	
Amount recoverable from reinsurers	4,752,106		4,752,106	
Net deferred tax asset	15,113		15,113	
Receivable from parent, subsidiaries and affiliates	397,961		397,961	
Total Assets	**$31,713,060**	**$0**	**$31,713,060**	
Liabilities, Surplus and other Funds				
Losses	$0		$0	
Current federal and foreign income taxes	77,120		77,120	
Ceded reinsurance premiums payable	2,733,811		2,733,811	
Payable to parent, subsidiaries and affiliates	2,018,295		2,018,295	
Total Liabilities	**4,829,226**	**0**	**4,829,226**	
Common capital stock	5,000,000		5,000,000	
Gross paid in and contributed surplus	5,650,000		5,650,000	
Unassigned funds (surplus)	16,233,834		16,233,834	
Surplus as regards policyholders	**26,883,834**	**0**	**26,883,834**	
Total Liabilities, Surplus and other Funds	**$31,713,060**	**$0**	**$31,713,060**	

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

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	NOTES
STATEMENT OF INCOME				
Underwriting Income				
Premiums earned	$0	$0	$0	
Deductions				
Losses incurred	0		0	
Loss expenses incurred	0		0	
Other underwriting expenses incurred	0		0	
Total underwriting deductions	0		0	
Net underwriting gain or (loss)	$0	0	$0	
Investment Income				
Net investment income earned	1,396,592		1,396,592	
Net realized capital gains or (losses)	(36,918)		(36,918)	
Net investment gain or (loss)	1,359,674	0	1,359,674	
Other Income				
Net (loss) from agents' or premiums balances charged off	0		0	
Finance and service charges not included in premiums	0		0	
Total other income	0	0	0	
Net income before dividends to policyholders but before federal and foreign income taxes	1,359,674		1,359,674	
Dividends to policyholders	0		0	
Net income, after dividends to policyholders but before federal and foreign income taxes	1,359,674		1,359,674	
Federal and foreign income taxes incurred	322,685		322,685	
Net income	**$1,036,989**	**$0**	**$1,036,989**	
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	**$25,962,388**	**$0**	**$25,962,388**	
Gains and (Losses) in Surplus				
Net income	1,036,989		1,036,989	
Change in net deferred income tax	25,524		25,524	
Change in nonadmitted assets	(141,067)		(141,067)	
Change in surplus as regards policyholders	921,446	0	921,446	
Surplus as regards policyholders, December 31 current year	**$26,883,834**	**$0**	**$26,883,834**	

SAFECO SURPLUS LINES INSURANCE COMPANY
RECONCILIATION OF SURPLUS
FOR THE PERIOD ENDING DECEMBER 31,

	2005	2004	2003	2002	2001
Capital and surplus, December 31, previous year	$25,962,388	$27,424,903	$28,910,195	$27,253,756	$25,959,254
Net income	1,036,989	1,223,062	1,332,120	1,572,391	1,394,905
Change in net unrealized capital gains or (losses)			136	(253)	
Change in net deferred income tax	25,524	23,326	(21,454)	(2,605)	84,121
Change in nonadmitted assets	(141,067)	(8,933)	3,906	86,906	(90,812)
Cumulative effects of changes in accounting principles					(93,712)
Dividends to stockholders		(2,700,000)	(2,800,000)		
Aggregate write-ins for gains and losses in surplus		30			
Change in surplus as regards policyholders for the year	921,446	(1,462,515)	(1,485,292)	1,656,439	1,294,502
Surplus as regards policyholders, December 31,current year	$26,883,834	$25,962,388	$27,424,903	$28,910,195	$27,253,756

NOTES TO THE FINANCIAL STATEMENTS

No adjustments were made to the financial statements as a result of this examination.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Safeco Surplus Lines Insurance Company 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 L. Epler, CPA/ABV, CFE
Examiner in Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
} ss
COUNTY OF KING }

Jerry L. 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 Surplus Lines Insurance Company 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 L. Epler, CPA/ABV, CFE
Examiner in Charge
State of Washington

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

Colleen Jansen

Notary Public in and for the
State of Washington

COLLEEN JANSEN
COMMISSION EXPIRES
NOTARY
PUBLIC
5-17-08
STATE OF WASHINGTON