

STATE OF NORTH DAKOTA

BEFORE THE COMMISSIONER OF INSURANCE

IN RE THE MATTER OF)
)
THE PROPOSED ASSUMPTION AGREEMENT)
BETWEEN MIDWEST CASUALTY)
INSURANCE COMPANY AND GENERAL)
AGENTS INSURANCE COMPANY OF)
AMERICA, INC.,)

FINDINGS OF FACT, CONCLUSIONS OF LAW AND PROPOSED ORDER
APPROVING ASSUMPTION AGREEMENT WITH CONDITIONS

INTRODUCTION

Midwest Casualty Insurance Company of Bismarck, North Dakota, a North Dakota insurance company ("MCIC") formally petitioned the North Dakota Department of Insurance (the "Department") on December 6, 2002, for the approval of an Assumption Agreement (the "Assumption Agreement") by which General Agents Insurance Company of America, Inc.; Oklahoma City, Oklahoma, an Oklahoma insurance company ("General Agents") proposes to assume all of MCIC obligations under policies of insurance issued by MCIC as of the effective date of the Assumption Agreement, and to succeed to all obligations, liabilities, and rights of MCIC, all as more specifically reflected by the written provisions of the Assumption Agreement. Approval of the Assumption Agreement would release MCIC of any obligations under said policies. Approval of the Assumption Agreement would result in all assets and liabilities of MCIC, including all surplus, being transferred to General Agents. MCIC has petitioned for approval of the Assumption Agreement pursuant to the provisions of N.D.C.C. Ch. 26.1-07 (the "Petition"). Under provisions of

N.D.C.C. Ch. 26.1-07, the Commissioner of Insurance of the State of North Dakota (the "Commissioner") must hold a public hearing and then approve or disapprove the petition.

Under the law, the Commissioner's function is to determine if:

1. The proposed Assumption Agreement is inequitable to the policyholders of MCIC;
2. The proposed Assumption Agreement would materially reduce the financial security of the policyholders of MCIC in this state or elsewhere; and
3. The competence, experience, and integrity of the persons controlling General Agents are such that it would not be in the interest of the policyholders of MCIC to approve the Assumption Agreement.

FINDINGS OF FACT

1. MCIC is a North Dakota domestic insurance company organized on a stock plan basis.
2. MCIC's sole stockholder is GAINSCO, INC.
3. General Agents is an Oklahoma insurance company organized on a stock plan basis.
4. The Board of Directors of General Agents and MCIC have, by resolution, ratified and adopted the Assumption Agreement that is on file with the Commissioner.
5. MCIC purposes to transfer to General Agents all of MCIC's assets, liabilities and surplus. Following the effective date of the Assumption Agreement, MCIC intends to liquidate.
6. Pursuant to N.D.C.C. § 26.1-07-05.1, a public hearing was held on February 11, 2003, at 2:00 p.m. at the office of the Commissioner, Bismarck, North Dakota (the "Hearing") before Deputy Commissioner Doug Holloway who acted as Hearing Officer. Prior to the Hearing, the Order establishing the Hearing was published at least two weeks before the date of the hearing with the Bismarck Tribune, the Fargo Forum, the Minot Daily News, the Jamestown Sun, and the Grand Forks Herald. An Affidavit of Publication was submitted as Exhibits 6-10.

7. As of September 30, 2002, MCIC had no policyholders and accordingly no notice was required to be sent to any policyholders.

8. The persons who appeared at the Hearing on behalf of the Department, in addition to Deputy Commissioner Douglas Holloway, were Charles E. Johnson, Insurance Department General Counsel. MCIC and General Agents were represented by attorney Lyle W. Kirmis of Zuger Kirmis & Smith law firm.

9. At the Hearing, MCIC and General Agents presented witnesses who gave direct testimony in support of the approval of the Assumption Agreement, and who were available for questioning by the Department Special Counsel, and the Deputy Commissioner, as to matters deemed relevant to the Assumption Agreement or Petition. MCIC and General Agents witnesses were Glenn W. Anderson, President and Chief Executive Officer of both MCIC and General Agents; and Daniel J. Coots, Senior Vice President and Chief Financial Officer of both MCIC and General Agents. The MCIC witnesses appeared by telephone and also submitted written testimony received as Exhibits 11 and 12.

10. The Department participated in the Hearing through questioning of MCIC and General Agents' witnesses by the Deputy Commissioner Douglas Holloway and the Department Special Counsel, and through the presentation of testimony of Tim Hill, financial analyst for the Department.

11. The Department received no items of public input.

12. No other persons were present at the Hearing.

13. The Deputy Commissioner completed the Hearing at approximately 3:00 p.m.

14. With the agreement of MCIC and General Agents, it was agreed that the record would remain open until General Agents submitted to the Department its December 31, 2002, financial statement and Tim Hill had an opportunity to review said financial statement. It was noted that this

would not occur until sometime after March 1, 2003. It was agreed that if any further oral testimony was desired or required at that time, the Hearing would be reconvened.

15. It was further agreed that a written report and recommendation of Tim Hill would be entered as part of the record after the close of the testimony on February 11. Said written report was submitted on March 21, 2003, and has been marked as Exhibit 13.

16. As of December 31, 2002, General Agents had a surplus of approximately \$38.8 million. MCIC had a surplus of approximately \$3.0 million. Neither MCIC nor General Agents were any longer writing insurance policies directly. Both MCIC and General Agents are part of a pooling arrangement whereby insurance being written by another company continues to be allocated to General Agents and MCIC. If the Assumption Agreement is approved, the pooling arrangement, as applied to MCIC, will, on the effective date, become moot; as General Agents will retain any portion of such business which was previously being ceded to MCIC.

17. MCIC has no active agents in the State of North Dakota and does not maintain an office in the State of North Dakota.

18. The proposed Assumption Agreement was approved by the Oklahoma Insurance Commissioner on October 15, 2002.

19. The persons who are in control of the operations of MCIC are the same persons who are in control of General Agents. No problems have been noted with the competence, experience, or integrity of the persons in control of General Agents.

20. General Agents did experience adverse business operations during the years 2001 and 2002. General Agents had a surplus of approximately \$72.4 million as of December 31, 2000. During 2001, continued adverse loss reserve development in commercial lines resulted in a loss to General Agents of \$17.2 million. At December 31, 2001, a large excess casualty loss was disputed by reinsurers which resulted in a further reduction of surplus of \$3.7 million. (This disputed loss

was resolved in the second quarter of 2002 resulting in the surplus increasing \$1.4 million at that time due to the decrease in provisions for reinsurance at that time.) In addition, during the year 2001, a change in accounting principles resulted in a reduction in surplus of \$2.1 million. (This change was related to ceding commissions on a certain reinsurance treaty being in excess of acquisition costs. Under SSAP's which became effective January 1, 2001, the excess amount could not be recognized on a written basis, but had to be recognized on an earned basis, thus, there was an adjustment to surplus.) These items resulted in the surplus of General Agents being reduced to, as of December 31, 2001, approximately \$47.7 million.

21. General Agents decided in the first quarter of 2002 to cease writing commercial lines of business. However, continued adverse experience with the commercial business during the first half of the year 2002 resulted in General Agents losing approximately another \$6.9 million for the first six months of 2002. However, General Agents posted income in the third quarter 2002 of approximately \$500,000 and additional fourth quarter income of approximately \$800,000.

22. In addition, beginning in the third quarter of 2002, General Agents used reserve analysis determinations of an outside actuary to establish its reserves, to-wit: Tillinghast-Towers Perrin ("TTP"). Accordingly, General Agents' reserves are within a reasonable range of TTP's estimates. At the end of 2001, General Agents had 1191 claims with a reserve of approximately \$84 million, or a reserve of \$70,455 per claim. At the end of 2002, General Agents' claims had dropped to 701 pending claims with a reserve of approximately \$72.4 million or a reserve of \$103,305 per claim. At the present time, there is no reason to believe that the reserve, as established by General Agents based on TTP's recommendation, are not adequate for the claims pending against General Agents.

23. MCIC's claims as of December 31, 2002, were 33 claims for which there was a reserve established of \$412,545. MCIC wrote only private automobile insurance as to which most of the limits were statutory limits.

24. General Agents did reflect a negative cash flow on its September 30, 2002, report of approximately \$70 million for the first nine months of 2002. However, of this amount approximately \$48 million represented a transfer of investments to a reinsurer after the surplus of General Agents dropped below \$53 million in December 2001. The reinsurer had previously allowed these assets to be retained by General Agents under the reinsurance agreement. The reinsurer continues to be responsible for the liabilities related to these assets. The remaining negative cash flow as of September 30, 2002, came from \$40.2 million in losses paid and \$8.7 million in underwriting expenses, as compared to only \$23.2 million in premiums received. This is consistent with a company being in run off and represents the use of investments to pay losses as claims and reserves go down, combined with operational losses in 2002 before General Agents ceased writing insurance policies.

25. All other operational areas of General Agents as to which any questions might be raised from the income statement were adequately addressed at the Hearing. The General Agents' agents' balance is reducing, and is appropriate for the business of General Agents. General Agents has no significant problems with any of its reinsurance carriers. General Agents anticipates that the cash flow to General Agents' parent, GAINSCO, Inc., will be adequate to allow GAINSCO to make all required loan payments. The authorized control level risk-based capital calculation for General Agents as of December 31, 2002, was \$12.6 million, which the Department finds to be an acceptable risk-based capital level.

26. In order to further assure the financial security of previous policyholders of MCIC, and claimants of MCIC, General Agents proposes depositing the amount of December 31, 2002, reserves, to-wit: \$412,545, in a trust account in the Bank of North Dakota established in the name of the Department, as trustee for General Agents.

27. General Agents will provide to the Department a listing of all pending claims against

MCIC as of December 31, 2002, as well as the reserves established for such claims. At the end of each quarter, beginning March 31, 2003, MCIC will submit to the Department an updated list of claims and reserves. MCIC agreed to provide to the North Dakota Department of Insurance a listing of the existing MCIC claims, existing as of December 31, 2002, together with the reserve for said claims, and then deposit the reserved amount with the Bank of North Dakota. Such amount is to be held in an interest bearing account of the North Dakota Insurance Department, in trust for General Agents. After the end of each quarter, beginning with the quarter ending March 31, 2003, General Agents shall be entitled to submit to the North Dakota Insurance Department an updated list of all claims still pending against MCIC, together with the amount of the current cumulative reserves on such claims. If the North Dakota Insurance Department does not object to the reserves or the completeness or accuracy of the list, it will notify the Bank of North Dakota, within 30 days after the submission of the updated list, to return excess funds in the trust account to General Agents. If the Department questions the accuracy or completeness of the list, or the amount of reserves, General Agents may request, pursuant to the provisions of N.D.C.C. Ch. 28-32, a hearing before the North Dakota Insurance Department on the North Dakota Insurance Department's objections. MCIC agreed that in the event General Agents is unable to satisfy any of the MCIC claims as listed with the North Dakota Department of Insurance, the North Dakota Department of Insurance shall be authorized to use the funds on deposit with the Bank of North Dakota to satisfy any such claims, and expenses related thereto.

28. GA and MCIC requested at the hearing that the effective date of the Assumption Agreement be changed to March 31, 2003, for accounting purposes.

CONCLUSIONS OF LAW

1. The Commissioner concludes that the Assumption Agreement is not inequitable to the policyholders of MCIC.

2. The Commissioner concludes that the explanations provided by General Agents regarding financial operations, and the method by which General Agents is presently setting reserves, combined with the increased surplus of GA as compared with MCIC, combined with the deposit with the Bank of North Dakota of the amount of reserve for existing claims of MCIC, are such that the Assumption Agreement will not materially reduce the financial security of any claimants of MCIC; and that there are no policyholders of MCIC so that the Assumption Agreements cannot reduce the financial security of policyholders.

3. The Commissioner concludes that the persons in control of the operations of General Agents are the same persons who are in control of the operations of MCIC and that there is nothing to show that the competence, experience, and integrity of such persons are such that it would not be in the interest of the policyholders of MCIC to approve the Assumption Agreement.

4. The Commissioner concludes that General Agents and MCIC have met all statutory requirements for the approval of the Assumption Agreement.

NOW, THEREFORE, based upon the Findings of Fact and Conclusions of Law cited above, Douglas L. Holloway hereby recommends to the Commissioner of Insurance that he enter an Order as follows:

PROPOSED ORDER

1. That the Petition of MCIC and General Agents for the approval of the Assumption Agreement, by which General Agents will assume all assets, liabilities and surplus of MCIC, is approved subject to the amendments hereinafter set forth.

2. That the effective date of the Assumption Agreement shall be March 31, 2003.

3. That the approval of the Assumption Agreement is conditioned upon General Agents and MCIC providing to the North Dakota Department of Insurance a listing of the existing MCIC claims, existing as of December 31, 2002, together with the reserve for said claims, and then

depositing \$412,545 with the Bank of North Dakota. Such amount is to be held in an interest bearing account of the North Dakota Insurance Department, in trust for General Agents. After the end of each quarter, beginning with the quarter ending March 31,2003, General Agents shall be entitled to submit to the North Dakota Insurance Department an updated list of all claims still pending against MCIC, together with the amount of the current cumulative reserves on such claims. If the North Dakota Insurance Department does not object to the reserves or the completeness or accuracy of the list, it will notify the Bank of North Dakota, within 30 days after the submission of the updated list, to return excess funds in the trust account to General Agents. If the Department questions the accuracy or completeness of the list, or the amount of reserves, General Agents may request, pursuant to the provisions of N.D.C.C. Ch. 28-32, a hearing before the North Dakota Insurance Department on the North Dakota Insurance Department's objections. In the event General Agents is unable to satisfy any of the MCIC claims as listed with the North Dakota Department of Insurance, the North Dakota Department of Insurance shall be authorized to use the funds on deposit with the Bank of North Dakota to satisfy any such claims, and expenses related thereto.

4. Any finding of fact, designated as such, which is more appropriately a conclusion of law, and any conclusion of law, designated as such, which is more appropriately a finding of fact, shall be accorded the proper character and construed so as to give effect to all of the provisions herein.

DATED this 26th day of March, 2003.

Douglas L. Holloway (ID #5111)
Deputy Commissioner
N.D. Insurance Department
600 East Boulevard Avenue, Dept. 401
Bismarck, ND 58505
(701) 328-2440