FILED
AUG 03 2004

Department of Insurance
State of Idaho

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BEFORE THE DIRECTOR OF THE DEPARTMENT OF INSURANCE

STATE OF IDAHO

In The Matter of:	)	
	)	
ARGONAUT NORTHWEST INSURANCE COMPANY	)	ORDER ADOPTING REPORT OF EXAMINATION AS OF DECEMBER 31, 2002
	)	
Certificate of Authority PC647 NAIC Company Code: 19836	)	Docket No.18-2264-04
	)	

WHEREAS, the verified Report of Examination as of December 31, 2002 (Report) of Argonaut Northwest Insurance Company (Company) was completed by examiners of the Idaho Department of Insurance, verified and signed the 22nd day of June, 2004 by Lois Haley, CFE and filed with the Idaho Department of Insurance (Department) effective June 22nd, 2004; and

WHEREAS, said Report is attached hereto and incorporated herein as Exhibit A; and

WHEREAS, the Department's file indicates that said Report was mailed via certified mail to the Company on June 22, 2004, and while the Department's file does not contain the green return receipt, tracking information from the United States Post Office website shows that a copy of the verified Report was delivered on June 24, 2004; and as of the date of this order, the Department has not received a written response or rebuttal from the Company regarding the verified Report (the Department's file does reveal that the Company responded in writing to an un-verified draft of the examination report, prior to the June 22, 2004).

Now therefore, after carefully reviewing the above described Report, Exhibit A, and good cause appearing therefor, it is hereby ordered that the above described Report is adopted as filed. Further, the above described Report, Exhibit A, is deemed to include the findings and conclusions supporting this order; and

It is hereby further ordered that, in light of:

(1) the examiners' finding that the Company had not submitted an intercompany investment agreement as recommended by the previous Department exam (discussed at page 12 of the December 31, 1998 Report of Examination), and

(2) the December 31, 2002 Report reveals that the Company continued to have intercompany investment activity, with its parent company Argonaut Insurance Company, after the prior examination report. Further, the examiners found that in 2002 there was investment activity in amounts sufficient to require prior approval

of the Director (*see* Idaho Code § 41-3807(2)(a)). Pursuant to Idaho Code § 41-227(5)(a)

the Company is ordered to submit within 49 days of the date of this order, an inter-company investment agreement for approval by the Director; and

It is hereby further ordered that, within 30 days of the issuance of the adopted Report, which is the date of this order, the Company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and this order pursuant to Idaho Code § 41-227(6)(a).

NOTIFICATION OF RIGHTS

This is a final order of the agency. The company may file a motion for reconsideration of this final order within fourteen (14) days of the service date of this order. The agency will dispose of the petition for reconsideration within twenty-one (21) days of its receipt, or the petition will be considered denied by operation of law. *See* section 67-5246(4), Idaho Code.

Pursuant to §§ 41-227(6)(a), 67-5270 and 67-5272, Idaho Code, any party aggrieved by this final order may appeal this final order to district court by filing a petition for judicial review in the district court of the county in which:

i. A hearing was held,
ii. The final agency action was taken,
iii. The party seeking review of the order resides, or operates its principal place of business in Idaho, or
iv. The real property or personal property that was the subject of the agency action is located.

An appeal must be filed within twenty-eight (28) days of: (a) this final order, (b) an order denying any petition for reconsideration, or (c) the failure within twenty-one

(21) days to grant or deny a petition for reconsideration, whichever is later. *See* § 67-5273, Idaho Code. The filing of an appeal to district court does not itself stay the effectiveness or enforcement of the order under appeal.

IT IS HEREBY ORDERED that the examination report be adopted and filed as an official record of the Department.

Dated and Effective this 2nd day of August 2004.

Mary L. Hartung, Director
Idaho Department of Insurance

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of August 2004, I caused to be served the foregoing Order Adopting Examination Report on the following parties in the manner set forth below:

John Gattman Gantz, Jr., President Argonaut Northwest Insurance Company 10101 Reunion Pl., Suite 500 San Antonio, TX 78216	____ certified mail ✓ first class mail ____ hand delivery ____ telecopy
Mark William Huashill, Treasurer Argonaut Northwest Insurance Company 10101 Reunion Pl., Suite 500 San Antonio, TX 78216	____ certified mail ✓ first class mail ____ hand delivery ____ telecopy
Ms. Karen Meriweather, VP & CFO, Risk Management Argonaut Northwest Insurance Company 10101 Reunion Pl., Suite 500 San Antonio, TX 78216	✓ certified mail ✓ first class mail ____ hand delivery ____ telecopy

Georgia Hill, Bureau Chief/Chief Examiner
Idaho Department of Insurance
700 W. State St., 3rd Floor
Boise, Idaho 83720-0043

_____ certified mail
_____ first class mail
✓ hand delivery
_____ telecopy

Cheryl Karnowski

Cheryl Karnowski
Management Assistant

DEPARTMENT OF INSURANCE

STATE OF IDAHO

REPORT OF EXAMINATION

of

ARGONAUT NORTHWEST INSURANCE COMPANY
(a domestic stock insurer)

as of

December 31, 2002

FILED 6/2/04 Ca
date initial

ADOPTED 8/2/04 Ca
date initial

STATE OF IDAHO
Department of Insurance

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State of Idaho
DEPARTMENT OF INSURANCE
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DIRK KEMPTHORNE
Governor

MARY L. HARTUNG
Director

San Antonio, Texas
May 19, 2004

The Honorable Mary L. Hartung
Director of Insurance
700 West State Street
Boise, Idaho 83720

Madame:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Idaho, an examination has been made of the administrative affairs, books, records and financial condition of

Argonaut Northwest Insurance Company
10101 Reunion Place, Suite 500
San Antonio, Texas 78216

hereinafter referred to as the "Company," at its offices in San Antonio, Texas.

The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period January 1, 1999, through December 31, 2002, and included such prior transactions and any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The examination was conducted in conjunction with and concurrently with the examination of the parent company, Argonaut Insurance Company (AIC) by the California Department of Insurance and three subsidiaries that participate in the reinsurance pool: Argonaut Midwest Insurance Company, Argonaut Southwest Insurance Company, and Georgia Insurance Company by the States of Illinois, Louisiana, and Georgia, respectively. The intercompany reinsurance agreement and the reinsurance pool are described in detail under the caption, *REINSURANCE*.

Examiners from the States of Delaware and Louisiana representing Zone I – Northeastern and Zone II – Southeastern of the National Association of Insurance Commissioners, respectively, participated in the examination of AIC. The workpapers of the AIC examination are on file with the California Department of Insurance.

The examination was conducted in accordance with generally accepted examination procedures and accounting guidelines. Verification and valuation of assets, determination of liabilities, and an analysis and review of such other accounts and records appropriate to the examination were also performed.

The actuarial review of reserves and related liabilities for AIC was performed by PricewaterCoopers, LLP, consulting actuaries, for the California Department of Insurance. There was some reliance on the 2002 audit report and workplaces in this examination of the Company.

A letter of representation attesting to the Company's ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities was signed by and received from management.

PRIOR EXAMINATION

The prior financial examination was conducted by the Idaho Department of Insurance covering the period January 1, 1996 through December 31, 1998. Recommendations contained in the prior examination report and management's responses to those recommendations were as follows:

1. It is recommended that the Company hold the annual meeting in accordance with the Bylaws or change the Bylaws and that it hold the annual meeting of the Board of Directors in accordance with the by-laws or change the by-laws.

In a letter to the Department of Insurance dated February 13, 2002, management stated the following:

We have undertaken a comprehensive review of the by-laws of all of the companies held (directly or indirectly) by Argonaut Group, Inc. and we will change the by-laws in accordance with this recommendation.

2. It is recommended that the Company adhere to the terms of the pooling agreement and completely settle its intercompany balances on a quarterly basis.

Previously, the company waited until intercompany balances reached at least $1 million prior to settling the balance to avoid the purchase or sale of odd lots of securities. Going forward, the company will comply with this recommendation and settle intercompany balances on a quarterly basis, regardless of the amount, in compliance with the pooling agreement and this recommendation.

3. It was recommended that the Company formalize its investment practices through the formation of an intercompany investment agreement with its subsidiaries. The agreement should specify the parties involved, the duties to be performed, and should have a provision for at least quarterly settlement.

The company concurs with this recommendation and will be drafting such an agreement for the subsidiaries of the Argonaut Group, Inc.

4. The prior examination resulted in a net (decrease) to surplus of $1,159,219, which is summarized below:

Accrued retrospective premiums	$ 235,488
Miscellaneous balances receivable	4,723
Losses	642,408
Loss adjustment expenses	276,600
Total:	$1,159,219

The recommendations contained in the prior examination report were addressed by the Company, except those related to annual meetings and the investment agreement.

Additional comments in this regard are included under the captions, *CORPORATE RECORDS* and *MANAGEMENT AND CONTROL.*

HISTORY AND DESCRIPTION

General

The Company was incorporated as a stock insurance company under the name of Argonaut Northwest Insurance Company on June 14, 1963. The Company commenced operations on March 12, 1964 conducting multiple-line insurance business.

The Company operated under the provisions of Title 41 of the Idaho Code, and provided coverages for disability, excluding managed care – property; marine & transportation; – surety; and casualty, including workers' compensation lines of business.

The Company is currently licensed and authorized to transact multiple property and liability insurance in seven states and the District of Columbia. Additional comments in this regard are included under the caption, *TERRITORY AND PLAN OF OPERATION.*

Capital Stock and Paid in Surplus

The Articles of Incorporation, as amended July 6, 1994, provided for authorized capital of $2,500,000, consisting of 2,500,000 shares of common stock each with a par value of $1. The shares are of one class of common stock with uniform rights and are not subject to assessment.

As of the examination date, the Company had 2,500,000 shares of capital stock authorized, issued and outstanding with a par value of $1 per share for total capital of $2,500,000. The number of issued and outstanding shares was reconciled to Company's capital stock records without exception. The Company's paid in and contributed surplus at December 31, 2002 was $720,000.

Pursuant to Section 41-2835(3), Idaho Code, a director of a stock insurance company shall be a stockholder thereof. A review of the Company's capital stock records indicated that stock certificates were issued to former directors, not to those serving on the Board at December 31, 2002. Therefore, the Company was not in compliance with Section 41-2835(3) at the balance sheet date.

However, effective July 1, 2003, Section 41-2835(3), Idaho Code was repealed. Consequently, directors of stock insurers are no longer required to be stockholders; therefore, corrective action is not necessary. Since the Company asserts that it is wholly owned by AIC, it is recommended that the stock certificates issued to the former directors be cancelled and that a certificate representing one hundred percent ownership be issued to AIC.

Dividends to Stockholders

During the period January 1, 1999 through December 31, 2002, the Board of Directors declared and the following dividends were paid to the stockholders of the Company:

Date Declared	Date Approved/Notified	Date Paid	Cash Distribution	Non-Cash Distribution
2/6/02	2/28/02	3/22/02	$1,100,000	Not Applicable

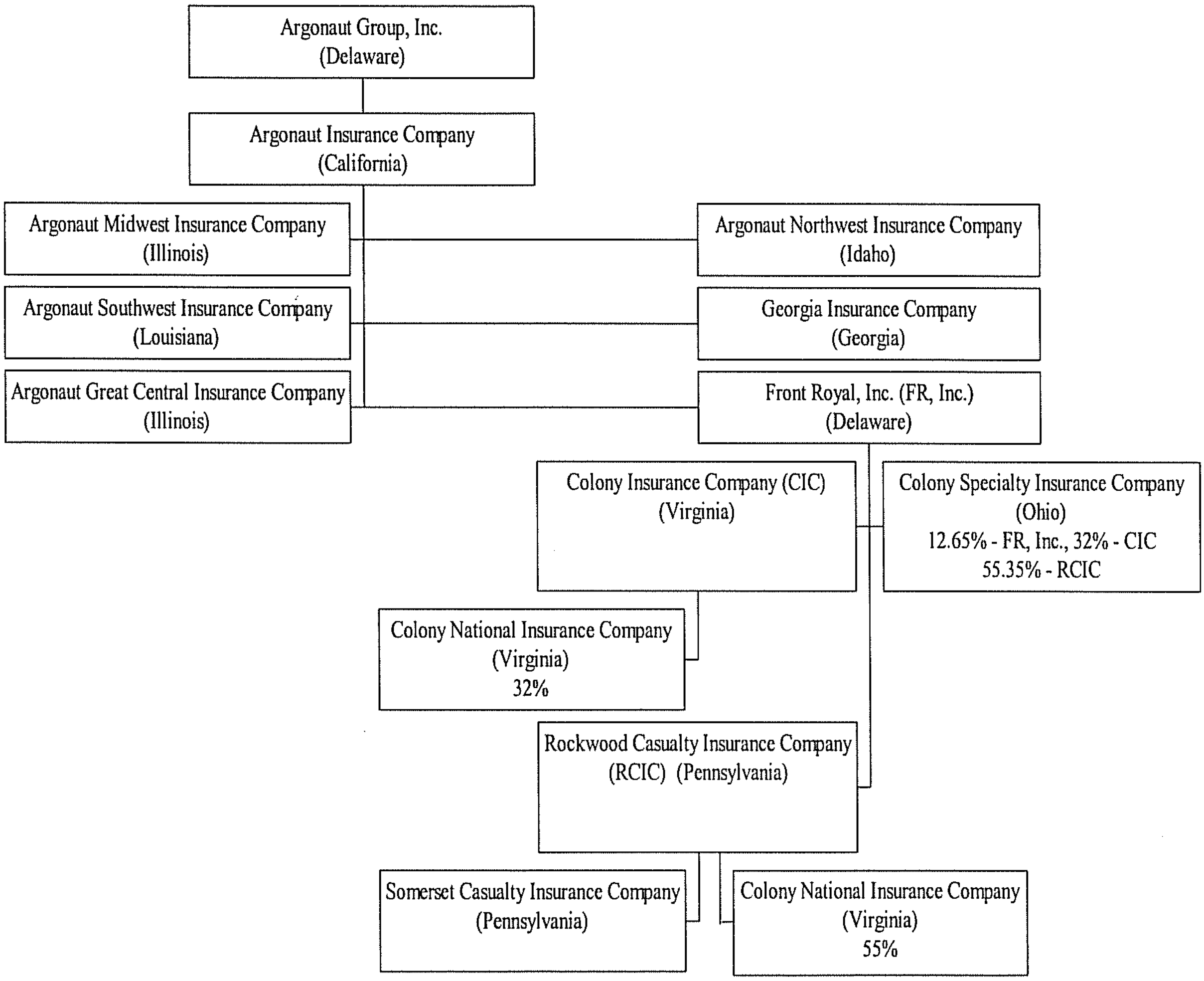
The dividend, as permitted under Section 41-2843, Idaho Code, was properly authorized by the Board of Directors and was acknowledged by the Department of Insurance.

MANAGEMENT AND CONTROL

Insurance Holding Company System

The Company is a member of an insurance holding company system. The ultimate controlling person is Argonaut Group, Inc. (AGII) as depicted in the following abridged organizational chart. The chart is limited to the Company's parent along with its subsidiary insurance companies.

Argonaut Group, Inc.



AGII is a holding company primarily engaged, through its subsidiaries, in the selling, underwriting, and servicing of workers' compensation and other lines of property and casualty insurance.

Singleton Group LLC owns approximately 21.4 percent of all outstanding voting securities of AGII. The Singleton Group holds the shares previously held by Henry E. Singleton, who passed away on August 31, 1999. AIC owns all of the Company's outstanding stock, except for directors' shares.

Affiliated Transactions

As previously noted, the Company is party to an intercompany pooling agreement with AIC and its subsidiaries, Argonaut Midwest Insurance Company, Argonaut Southwest Insurance Company, and Georgia Insurance Company.

AIC is the lead company for the pool and retains 92 percent of the pool business. The Company's participation is 0.6 percent. Under the terms of this agreement, the companies share facilities, certain property and equipment, and accounting and administrative services. The intercompany pooling agreement was filed with the Idaho Department of Insurance. Additional comments relating to the pooling agreement are made under the caption *REINSURANCE.*

AIC and each of the subsidiaries in the pooled group have a consolidated federal income tax allocation agreement with AGII. This agreement is discussed in detail under the caption, *MANAGEMENT AND CONTROL.*

A review of the latest Form B Registration Statement filed by AGII showed that it had been submitted to the Idaho Department of Insurance, and appeared to be current and valid.

Directors

The following persons were the duly elected members of the Board of Directors at December 31, 2002:

Name and Business Address	Principal Occupation
Mark Edmund Watson, III	Chairman of the Board
Mark William Haushill	Senior Vice President, Treasurer & Chief Financial Officer
Bryon Louis LeFlore, Jr.	Secretary
John Gattman Gantz, Jr.	Chief Executive Officer & President
John William Polak	President, Argonaut Great Central

Officers:

The following persons were serving as officers at December 31, 2002:

Mark Edmund Watson, III	Chairman of the Board
John Gattman Gantz, Jr.	Chief Executive Officer & President
Thomas John Matson	Executive Vice President
Mark William Haushill	Senior Vice President & Treasurer
Bryon Louis LeFlore, Jr.	Secretary
Ellen Margaret Gardiner	Vice-President & Actuary
Daniel Gerald Platt	Vice President & Controller
Mark T. Torok	Assistant Secretary
Mark J. Samuels	Assistant Secretary
Stanley H. Davis	Assistant Controller

Subsequent to the examination date, Ms. Gardiner resigned as Vice-President and Actuary of the Company.

Committees

The following persons were elected and/or appointed to special or standing committees at December 31, 2002:

Executive Committee	Investment Committee
Mark Edmund Watson, III	Mark Edmund Watson, III
Mark William Haushill	Mark William Haushill
John Gattman Gantz, Jr.	John Gattman Gantz, Jr.

Reinsurance Committee	
Mark Edmund Watson, III	John William Polak
Marilyn Anne Brands	John Gattman Gantz, Jr.
Rhonda Kelly Ijams	

Conflict of Interest

The Company has a conflict of interest policy in place that requires the directors, officers, and employees to disclosure annually, on a prescribed written form, any affiliation with or material interest in any operation or activity that conflicts or may potentially conflict with their official duties with the Company.

Conflict of interest certifications that were completed for the years 1999 through 2002 appeared to appropriately disclose any possible conflicts of interest.

Contracts and Agreements

The following intercompany agreements and/or arrangements were in effect at December 31, 2002:

Intercompany Pooling Agreement

The Company, along with its parent and three affiliates, participated in an intercompany reinsurance pooling agreement whereby premiums, losses and underwriting expenses were pooled in the percentages specified in the agreement. This agreement is discussed in detail under the caption, *REINSURANCE.*

Federal Income Tax Allocation Agreement

A federal income tax allocation agreement was executed by and between AGII and its subsidiaries, including the Company. The agreement was effective the taxable year ending December 31, 2001, and will terminate for any subsidiary when it ceases to be a subsidiary, when agreed upon, or in the event AGII fails to file a consolidated return for any taxable year. The agreement shall continue in effect with respect to payment/refund due for taxable periods prior to termination.

Allocation under the agreement is based upon a separate return calculation for each company at the consolidated return tax rate. In the event the Company has a tax liability on a separate company basis, its taxes will be paid by AGII. In the event the Company has a refund of taxes on a separate company basis, the amount will be received from AGII. Estimated income tax payments by the Company are to be made on the normal due dates as prescribed by the Internal Revenue Service with a settlement made within thirty days after the date of filing the consolidated federal income tax return. All settlements for income tax payments to AGII or refunds to a subsidiary shall be made within 30 days after the date the consolidated income tax return is filed.

The federal income tax allocation agreement was filed with the Department of Insurance on March 16, 2000.

Intercompany Investment Transactions

As previously noted, the Company's reinsurance pooling agreement specifically excludes investment activities. Yet, it was noted during the prior and the current examination that AIC buys and sells securities for its subsidiaries, including the Company. A review of the investment activity during 2002 has indicated that certain investment transactions between the Company and AIC were not in compliance with Idaho law. Under Section 41-3807(2)(a), Idaho Code, an insurer engaging in transactions involving investments among affiliates exceeding the lesser of 3 percent of admitted assets or 25 percent of surplus must notify the director of their intention to enter into such transactions at least thirty days prior thereto.

The prior examination report recommended that the Company pursue formalizing this investment practice through the formation of an intercompany investment agreement with AIC. In a letter to the Department of Insurance dated February 13, 2002, the Company indicated that it concurred with the recommendation and would draft an intercompany investment agreement for the subsidiaries of AGII. At the date of this report, this has not been done. Therefore, it is again recommended that the investment activity be formalized and the agreement be filed with the Department to comply with Section 41-3807(2)(a), Idaho Code. The agreement should, at a minimum, identify the types of investment transactions covered, address transfer of title, set forth the obligations of the entities, specify the fees or interest (if any) and include settlement terms.

CORPORATE RECORDS

Articles of Incorporation and Bylaws

The Company's records indicated that the Articles of Incorporation and the Bylaws were not amended during the period under examination.

Minutes of Meetings

A review of the minutes of the meetings of the Shareholders, the Board of Directors, and the various committees for the period January 1, 1999 through December 31, 2002 indicated compliance with the Articles of Incorporation and Bylaws with respect to the election of the Board of Directors and Officers, and the election or appointment of Committee members.

This review of the minutes also indicated that a quorum was present at all Board of Directors' meetings held during the examination period and that significant Company transactions and events were properly authorized. Specifically, investment transactions were approved by the Board of Directors, as required by Section 41-704, Idaho Code.

The Board of Directors certified that they had received a copy of the Company's December 31, 1998 Report of Examination and February 19, 2002 Order Adopting the Report of Examination on March 12, 2002.

The Company's Bylaws require an annual meeting of the shareholders to be held on the last Friday in April, to be followed immediately by a Board of Directors' meeting. The prior examination reports as of December 31, 1995 and December 31, 1998, recommended that the Company hold the annual meetings of the shareholders and the Board of Directors in accordance with the Bylaws or change the Bylaws.

For the years 1999, 2000, and 2001, the annual shareholders and subsequent directors' meetings were not held on the last Friday in April pursuant to the Bylaws. In 2002, the annual meeting of the shareholders was held in compliance with the Bylaws; however, a director's meeting did not immediately follow. Therefore, it is again recommended that the Board of Directors' meetings be held in compliance with the Company's Bylaws.

FIDELITY BOND AND OTHER INSURANCE

The Company was a named insured under various insurance policies issued to AGII. Coverages in effect as of December 31, 2002 included automobile liability and business travel accident coverage; directors' and officers' liability; employment practices liability; fiduciary liability; general liability; umbrella and excess umbrella liability; errors and omissions coverage; property coverage; workers' compensation and employers' liability; and financial institution bond insurance.

The protection of the financial institution bond met the suggested minimum limits recommended by the NAIC *Financial Condition Examiners Handbook* for AGII and the Company.

The insurance companies providing coverage to the Company and to AGII were licensed or otherwise authorized in the State of Idaho, except for the writer of the automobile and general liability policies. Property coverage was written on a surplus lines basis.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company does not have any employees. However, employee benefit costs are allocated under the provisions of the intercompany pooling agreement for the plans and benefits offered by an affiliate, AGII. The various plans and benefits are summarized below.

AGII sponsored a qualified, noncontributory defined benefit pension plan covering substantially all employees of the Companies. The Companies have no legal obligation for benefits under this plan. The benefits are based on years of service and the employees' highest five consecutive years of compensation during the last ten years of employment. AGII's funding policy is to contribute annually not less than the minimum required and not greater than the maximum amount that can be deducted for federal income tax purposes. Each subsidiary is charged for its separately determined contribution based on its normal cost, actuarial liabilities, and share of plan assets. The Company's recorded pension expense for 2002 was $7,119.

Substantially all employees of the Companies are eligible to participate in employee savings plans sponsored by AGII. Under these plans, a percentage of the employee's pay may be contributed to various savings alternatives including, under one plan, investment in AGII common stock. The plans provide for the Companies to match the employee's contribution under various formulas. The Companies' employees may participate in a contributory deferred compensation 401(k) plan sponsored by AGII, an affiliate. The Company recognized costs of $1,808 during 2002 for these plans.

Employees of the Companies are provided comprehensive medical benefits, including dental, flexible spending accounts, and workers' compensation insurance. Employees are also eligible for numerous other benefits including life insurance, long-term disability, business travel accident coverage, vacation, and supplemental plans, among other things.

The Company does not participate in any multi-employer defined benefit pension plans other than the qualified noncontributory defined benefit pension plan. Furthermore, the Company does not participate in postemployment benefits and compensated absences programs.

TERRITORY AND PLAN OF OPERATION

The Company is currently licensed and authorized to transact multiple line property and liability insurance in the following states and the District of Columbia:

Arizona	District of Columbia	Hawaii	Idaho
Montana	New Jersey	Oregon	Washington

As previously reported, the Company participates in an intercompany reinsurance pooling agreement, which governs the basic insurance operations of the Company and those parties to the agreement. The provisions and details of this agreement are summarized in a subsequent section of this report under the caption, *REINSURANCE.*

During the period under examination, the Company wrote primarily workers' compensation insurance. In addition, the Company wrote several complementary lines of commercial insurance, consisting mainly of general and automobile liability. In general, direct written premiums increased between 1999 and 2002. However, with the exception of 2001, Idaho premiums decreased during the same period.

In mid 2002, the Company initiated a plan to return to its historical focus of providing primary casualty risk management solutions and services to the upper middle market and to expand its lines of business to include general and automobile liability insurance.

Subsequent to the examination date, it was announced that AIC would discontinue small programs and small, individually written guaranteed cost, retrospectively rated accounts, and wrap-up programs. Wrap up programs provide casualty coverage for all contractors and subcontractors working on a particular construction project, and are especially used for public projects such as freeways, pipeline, utility, or transportation systems.

The principle source of business is through national brokerage firms and large regional brokers.

STATUTORY AND SPECIAL DEPOSITS

As of December 31, 2002, the Company had provided the following deposits in trust for the protection of all its policyholders and/or creditors:

Description	Par Value	Statement Value	Market Value
Idaho:			
U. S. Treasury Notes, 5.875%, Due 11/15/04	$1,165,000	$1,199,605	$1,258,200
U. S. Treasury Notes, 4.625%, Due 05/15/06	475,000	483,048	512,258
U. S. Treasury Notes, 3.250%, Due 08/15/07	800,000	796,257	819,750
New Jersey:			
U. S. Treasury Notes, 5.875%, Due 11/15/04	70,000	72,079	75,600
Totals	$2,510,000	$2,550,989	$2,665,808

Securities on deposit with the State of Idaho were held through the office of the Director of Insurance, in compliance with Section 41-316A, Idaho Code.

The Company also maintained special deposits that were not for the benefit of all policyholders. Securities on deposit with the respective states are scheduled below:

Description	Par Value	Statement Value	Market Value
Arizona:			
U. S. Treasury Notes, 4.625%, Due 05/15/06	$1,150,000	$1,169,484	$1,240,203
U. S. Treasury Notes, 3.000%, Due 11/15/07	560,000	559,914	566,825
Idaho:			
U. S. Treasury Notes, 5.875%, Due 11/15/04	1,100,000	1,132,675	1,188,000
U. S. Treasury Notes, 4.625%, Due 05/15/06	155,000	157,626	167,158
U. S. Treasury Notes, 3.500%, Due 11/15/06	1,000,000	1,017,209	1,040,625
Oregon:			
U. S. Treasury Notes, 5.875%, Due 11/15/04	115,000	118,416	124,200
U. S. Treasury Notes, 4.625%, Due 05/15/06	400,000	406,777	431,375
U. S. Treasury Notes, 5.875%, Due 11/15/04	50,000	51,485	54,000
U. S. Treasury Notes, 5.000%, Due 08/15/11	200,000	204,721	219,313
Totals	$4,730,000	$4,818,307	$5,031,699

GROWTH OF THE COMPANY

The Company's growth for the years indicated, as taken from the prior examination report and its Annual Statements, is shown in the following schedule:

Year	Admitted Assets	Liabilities	Capital & Surplus	Net Income(Loss)
1998*	$15,225,404	$5,481,404	$ 9,744,000	$(320,154)
1999	15,506,758	4,404,474	11,102,284	229,746
2000	15,743,172	4,933,492	10,809,680	(251,487)
2001	15,944,861	4,886,274	11,058,587	398,071
2002*	17,773,506	7,584,563	10,188,943	(39,232)

*As determined by Examination.

LOSS EXPERIENCE

The ratios of benefits and expenses to written premium shown in the following schedule were derived from amounts reported in the Company's Annual Statements:

Year	Net Premiums Written	Net Losses Paid	Underwriting Expenses	Ratio of Benefits and Expenses to Written Premium
1998	$679,424	$865,378	$627,027	219.66%
1999	546,075	678,787	437,478	204.42%
2000	782,561	809,893	322,997	144.76%
2001	707,980	752,573	345,179	155.05%
2002	810,777	616,253	342,446	118.25%

REINSURANCE

As previously reported, the Company, along with its parent and three of its affiliates participated in an intercompany reinsurance pooling agreement whereby premium, losses, and underwriting expenses were pooled in the following percentages:

Argonaut Insurance Company	92.0%
Argonaut Midwest Insurance Company	6.6%
Argonaut Southwest Insurance Company	0.7%
Argonaut Northwest Insurance Company	0.6%
Georgia Insurance Company	0.1%
Total:	100.0%

The intercompany pooling agreement has been in existence since 1977, and was last amended in 1984. Substantially all of the Company's insurance operations were governed by the provisions of this agreement. Specifically, all premiums and losses of the subsidiaries in the pool are to be ceded to AIC, then retroceded to the subsidiaries in the respective percentages. The agreement also provides for AIC to pay for all losses and underwriting expenses, collect all premiums, and secure reinsurance for the pool. Federal income taxes and investment expenses are specifically excluded from the pooling agreement, however. The agreement also requires that intercompany balances between pool members be settled on at least a quarterly basis.

Assumed

The Company did not assume reinsurance during the examination period, other than from its intercompany pool or from mandatory pools and associations. AIC assumed California workers compensation 2002 business underwritten by Kemper Employers Insurance Company, Commercial Compensation Specialty Operation.

Ceded:

As previously described, all business written by the subsidiaries is ceded to AIC. AIC, then combines the business with its own writings to create the *pooled* business. AIC, as the lead insurer in the pool, retains its percentage (92 percent) and then retrocedes the balance of the pooled business to its subsidiaries.

AIC had the following reinsurance agreements, other than intercompany, in effect at December 31, 2002:

Line of Business and Type of Contract	Reinsurer's Name	AIC's Retention	Reinsurer's Limit
Workers Compensation, Employers' Liability including US Long shore & Harbor WC Act:			
Underlying Layer Excess of Loss	American Re-Insurance Company (75%) AIC retains 25%	$500,000 minimum attachment point	The difference between $1 million and the greater of $500,000 and the insured's' self insured retention (SIR)
Workers Compensation, Employers' Liability, including US Long shore & Harbor WC Act and Third Party Liability			
Underlying Excess of Loss	American Re-Insurance Company (100%)	$1 million per occurrence and $5 million in retained losses each underwriting year	$4 million per occurrence with a $4 million annual limit on California Construction Defect losses
Casualty Clash XOL First Layer	XL Reins of America (50%); Folksamerica Reins Co. (50%)	$2 million per occurrence	$3 million in excess of $2 million with a $12 million annual aggregate limit
Casualty Clash XOL Second Layer	Arch Re (30%); XL Reins of America (24%); Folksamerica Reins Co (15%); Lloyd's London (11%); PMA Re (10%); Partners Re (10%)	$5 million per occurrence	$5 million in excess of $5 million with a $15 million annual aggregate limit
Casualty Clash XOL Third Layer	XL Reins of America (30%); Folksamerica Reins Co. (8%); Arch Re (15%); Lloyd's London (29%); PMA Re (8%); Partners Re (10%)	$10 million per occurrence	$10 million in excess of $10 million with a $20 million annual aggregate limit

Workers Compensation Employers' Liability including US Long shore & Harbor WC Act:			
Per Person Excess of Loss (XOL)	American Health Care Indemnity Company (20%); AIC retains 80%	$5 million per person, per occurrence	$5 million per occurrence with a $15 million annual aggregate limit
First Catastrophe Excess of Loss	Arch Re (6%); Lloyd's London (16%); Ace American (30%); American Re-Insurance Co. (33%); AXA Corporate Solutions (15%);	$20 million per occurrence	$30 million in excess of $20 million with a $60 million annual aggregate limit
Second Catastrophe Excess of Loss	National Union Fire of Pittsburgh (85%); AXA Corporate Solutions (15%)	$50 million per occurrence	$25 million in excess of $50 million with annual aggregate limit of $50 million; sunset provision require company to report losses within 84 months of the agreement expiration.
Workers' Compensation & Employers Liability policies underwritten by American Management Corporation (AMC) Conway Arkansas			
AMC 90% Quota Share	Berkley Insurance 65% AMC Re, Inc. 25%	10% share	90% share up to $250,000 per occurrence
First Excess of Loss	AMC Re, Inc. 100%	$250,000	$750,000 in excess of $250,000 per occurrence
Second Excess of Loss	AMC Re, Inc. 100%	$1 million	$4 million per occurrence with a $12 million annual aggregate

Workers Compensation & Employers Liability policies underwritten by Trans City Automobile Dealers Workers Compensation Insurance Program			
WC Quota Share	Trans City Casualty Ins. Co. Scottsdale, AZ 65%	35% share	65% share of first $250,000 per occurrence and 350% of reinsurance premium ceded each Agreement Year
Automobile Liability policies written by Esurance Insurance Services, Ins.			
Quota Share	Folksamerica Reinsurance Co 100%	none	100% quota share
Commercial General Liability with respect to Construction Wrap-Up, Owner Controlled Insurance Program (OCIP), and Contractors Controlled Insurance Program (CCIP)			
Excess of Loss	General Reinsurance Corp. (100%)		
Insured deductible less than $500,000		$500,000	$500,000 in excess of $500,000
Insured deductible $500,000		10% of $500,000 in excess of $500,000	90% of $500,000 in excess of $500,000

AIC ceded $1,141,685 in 2002 premiums through the facultative market. In addition, AIC fronted and ceded $4,284,000 in 2002 premiums to its subsidiary, Argonaut Great Central Insurance Company.

AIC is liable for reinsurance ceded in the event its reinsurers do not meet their contractual obligations.

In 2002, the largest net aggregate amount insured in any one risk (excluding workers' compensation) by the Company was $120,000.

INSURANCE PRODUCTS AND RELATED PRACTICES

A limited scope Market Conduct Examination was conducted in conjunction with the examination of the administrative affairs, books, records, and financial condition of the Company. Underlying data was also validated during the limited scope Market Conduct Examination.

Policy Forms and Underwriting Practices

The Company utilized National Council on Compensation Insurance (NCCI) policy forms for its workers' compensation line of business. Insurance Service Office (ISO) policies were utilized for general liability and other lines of business written by the Company. The policy forms and various endorsements have been filed with the Idaho Department of Insurance. Since 1996, the Company has filed applications for a negative 25 percent deviation from the workers' compensation rates filed by the NCCI. During the current examination period, the Company filed an application for continuation of the rate deviation for the year 2000. The Idaho Department of Insurance granted the request on January 7, 2000. Subsequent rate deviations were not requested by the Company.

Underwriting for the States of Idaho, Montana, Utah, Northern California, Oregon, Washington, and Hawaii is performed in the Menlo Park, California office. The underwriting function for Southern California, Arizona, Nevada, and Colorado is carried out in the Los Angeles office.

A limited review of selected policies indicated compliance with underwriting guidelines, policy forms, and rates.

Treatment of Policyholders

Claims

Samples of open, paid, and released claims incurred during the examination period were reviewed. This review indicated that sampled claims were settled properly and payments were made in a timely manner.

During the examination period, the Company reported suspected fraudulent claims to the Department of Insurance as required by Section 41-290, Idaho Code.

Complaints

The Company maintained a complaint register as required by Section 41-1330, Idaho Code. No complaints were filed against the Company during the period under examination.

Advertising and Sales Material

Information about the Company and its products is available to the general public on AGII's website at www.ArgonautGroup.com. Underwriters may also distribute this information to new agents. In addition, Argonaut publishes a safety newsletter that is also accessible on the Internet. The information available on AGII's website was reviewed and nothing deceptive or misleading was noted.

According to management, the Company may on occasion print advertisements in the trade press or advertise at client industry conventions. Advertisements of this nature were not reviewed.

ACCOUNTS AND RECORDS

General Accounting

During the examination of AIC, it was noted that various detail reports were not reconciled to the general ledger and/or the annual statement on a regular basis. This was noted primarily in *Other expenses*, *Taxes, licenses and fees*, and *Amounts receivable under high deductible policies*. Additional information is contained in Note 3 to the Financial Statements.

Information Systems Review

A review of AIC's general controls over its information systems was made during the course of the examination. As a result of the review, some weaknesses in controls were noted in the following areas: reinsurance, user access, e-commerce controls, program change controls, business continuity planning, and data retention policies. The weaknesses noted were presented to AIC along with recommendations to strengthen its controls. AIC concurred with the findings and recommendations, and has made or will make appropriate changes.

Independent Accountants

The Company's annual independent audits for the years 1999 through 2001 were performed by Arthur Andersen, LLP, San Francisco, California. The San Francisco office of Arthur Andersen was closed in 2002.

For the year 2002, the annual independent audit was performed by Ernst & Young LLP, San Antonio, Texas.

The statutory financial statements were presented on a consolidated basis for all years under examination. There was some reliance on the 2002 audit report and workpapers in this examination of the Company.

Actuarial Opinion

The policy reserves and related actuarial items were calculated by the Company and reviewed by Ellen M. Gardiner, FCAS, MAAA, Vice President and Chief Actuary of the Company. The December 31, 2002 statement of opinion issued stated that the amounts carried in the balance sheet: (a) meet the requirements of the insurance laws of the State of Idaho; (b) are computed in accordance with accepted loss reserving standards and principles; and (c) make a reasonable provision for all unpaid loss and loss expense obligations combined of the Company under the terms of its policies and agreements.

The identified actuarial items in the Annual Statement were as follows:

Reserve for unpaid losses (Page 3, Line 1)	$3,457,662
Reserve for unpaid loss adjustment expenses (Page, 3 Line 3)	738,920
Reserve for unpaid losses - direct and assumed (Schedule P, Part 1, totals from Columns 13 and 15)	4,577,000
Reserve for unpaid loss adjustment expenses – direct and assumed (Schedule P, Part 1, totals from Columns 17, 19, and 21)	959,000

As reported in Note 4 to the Financial Statements, analysis of the reserve items identified above were performed by the consulting actuary for all pool companies combined.

Anticipated net salvage and subrogation are included as a reduction to loss reserves shown above. As of December 31, 2002, the amount of the reduction was $51,000.

A tabular discount of $206,000 was included as a reduction to loss reserves and loss expense reserves as reported in Schedule P and under losses and loss adjustment expenses reported in Page 3, Lines 1 and 2. The non-tabular discount was zero.

The Company participated in various voluntary and involuntary underwriting pools and associations. The Company's share of the net reserves held for such pools was $2,000, and is reflected in the reserves for unpaid losses and unpaid loss adjustment expenses noted above. For involuntary pool business, the Company relied on actuarial opinions prepared by actuaries on behalf of the pool. The Company supplemented the involuntary pool reserves by accruals for any reporting lag that may exist. The involuntary pool reserves were not independently evaluated; therefore the scope of the opinion did not include these reserves.

The net reserves for losses and loss adjustment expenses that the Company carried for asbestos liabilities and environmental liabilities were $898,000 and $171,000, respectively. These reserves are included in the table above and are disclosed in the Notes to Financial Statements. According to the consulting actuary, the Company's exposure to asbestos and environmental claims is material.

The total reserves for losses and loss adjustment expenses that the Company carried for the extended loss and expense reserve and which were reported in the Schedule P Interrogatories were zero.

SUBSEQUENT EVENTS

Affiliated Transactions

On March 31, 2003, AGII sold 2,453,310 shares of Series A. Mandatory Convertible Preferred Stock to four (4) subsidiaries of HCC Insurance Holdings, Inc. (HCC). The purchase price was $12 per share, for a total of $29,439,720. These shares were issued with voting rights. The shares acquired by HCC's subsidiaries gave them 9.9 percent of the outstanding voting shares of AGII.

On March 31, 2003, AGII borrowed $18 million from HCC. AGII gave HCC a promissory note with an interest rate of twelve percent, and a maturity date of March 31, 2006.

Of the total $47,439,720 proceeds from the HCC transactions, $41,439,720 was contributed to the surplus of AIC on March 31, 2003; $5 million was placed in an escrow account for servicing the preferred stock and $1 million stayed with AGII.

On April 15, 2003, AGII sold 500,000 shares of Series A Mandatory Convertible Preferred Stock to Century Capital Partners III (CCP III), a limited partnership, located in Boston, Massachusetts. The purchase price was $12 per share, for a total of $6 million. These shares were issued with voting rights. The funds from this sale were used to pay off $6 million of the $18 million previously mentioned promissory note issued to HCC. On October 1, 2002, AIC acquired a partnership interest in CCP III. The book value of the investment was $602,767 at December 31, 2002. Under the terms of the partnership agreement, AIC may be called upon for capital contributions to the partnership up to $5 million. As reported in AIC's 2003 Annual Statement, the book value of CCP III was $1,432,621 at December 31, 2003. The President and Director of the management company affiliated with CCP III is a member of the Board of Directors of HCC.

On May 15, 2003, Argonaut Group Statutory Trust (AGST) issued $15 million in Capital Securities to I-Preferred Term Securities II, LTD, (I-Preferred) of George Town, Grand Cayman, Cayman Island. I-Preferred paid $15 million for the Capital Securities of AGST, and AGST used the proceeds to acquire $15 million in floating rate junior subordinated deferred interest debentures from AGII. On June 24, 2003, AIC received $12 million in contributed surplus from this transaction.

In December 2003, AGII closed on a public offering of 5,368,000 shares of its own common stock. The net proceeds to AGII were $79.9 million. Concurrent with the closing of the offering, HCC converted $8.9 million of its remaining $12 million promissory note into 596,474 common shares of AGII. By doing so, HCC maintained its undiluted ownership in AGII at 9.9 percent. Also in December 2003, AGH paid off the remaining $3.1 million of its promissory note to HCC. In February 2004, HCC acquired additional shares of AGII through open market purchases that increased their percentage of ownership in AGII to 10.338 percent.

In connection with the above transactions, a Form A – Acquisition of Control of Argonaut Northwest by HCC Insurance Holdings, Inc. was filed with the Idaho Department of Insurance. HCC also submitted Form A filings to the domiciliary states of other companies in the group. The Form A filing was approved by the Idaho Department of Insurance effective July 15, 2003. The disclaimer of affiliation filed concurrently with the Form A by Ariel Capital Management, Inc., pursuant to Idaho Code Section 41-3806(1) was also approved.

FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

Balance Sheet as of December 31, 2002

Underwriting and Investment Exhibit, Year 2002

Capital and Surplus Account, Year 2002

Reconciliation of Capital and Surplus Account, December 31, 1998, to December 31, 2002.

Balance Sheet
As of December 31, 2002

ASSETS

	Assets	Nonadmitted Assets	Net Admitted
Bonds (Note 1)	$13,822,272	$ 0	$13,822,272
Cash and short-term investments	50,000	0	50,000
Receivable for securities (Note 2)	3,031,609	0	3,031,609
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	119,116	49,479	69,637
Premiums, agents' balances and installments booked but deferred and not yet due	335,903	0	335,903
Accrued retrospective premiums	164,973	16,497	148,476
Amounts receivable under high deductible policies (Note 3)	92,974	19,194	73,780
Federal and foreign income tax recoverable and interest thereon	238,000	157,000	81,000
Guaranty funds receivable or on deposit	5,668	0	5,668
Electronic data processing equipment and software	39,591	0	39,591
Interest, dividends and real estate income due and accrued (Note 2)	106,636	0	106,636
Equities and deposits in pools and associations	67	0	67
Other assets nonadmitted	23,794	23,794	0
Aggregate write-ins for other than invested assets	16,147	7,280	8,867
Totals	$18,046,750	$273,244	$17,773,506

Balance Sheet
As of December 31, 2002 (Continued)

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses (Note 4)	$ 3,457,662
Loss adjustment expenses (Note 4)	738,920
Commissions payable, contingent commissions and other similar charges	15,289
Other expenses (Note 3)	53,786
Taxes, licenses and fees (Note 3)	84,581
Federal and foreign income taxes	16,000
Unearned premiums	461,025
Dividends declared and unpaid: Policyholders	7,735
Amounts withheld or retained by company for account of others	227,986
Payable to parent, subsidiaries and affiliates	2,521,579
Total liabilities	$ 7,584,563
Common capital stock	$ 2,500,000
Gross paid in and contributed surplus	720,000
Unassigned funds (surplus)	6,968,943
Surplus as regards policyholders	$10,188,943
Totals	$17,773,506

UNDERWRITING AND INVESTMENT EXHIBIT

For the Year Ending December 31, 2002

STATEMENT OF INCOME

UNDERWRITING INCOME	Per Company and Examination
Premiums earned	$ 659,493
Deductions:	
Losses incurred	$ 657,773
Loss expenses incurred	273,111
Other underwriting expenses incurred	389,305
Total underwriting deductions	$ 1,320,189
Net underwriting loss	$ (660,696)
INVESTMENT INCOME	
Net investment income earned (Note 2)	$ 641,596
Net realized capital losses	(1,827)
Net investment gain	$ 639,769
OTHER INCOME	
Net loss from agents' or premium balances charged off	$(83)
Aggregate write-ins for miscellaneous income	513
Total other income	$ 430
Net income before dividends to policyholders and before Federal and foreign income taxes	$(20,497)
Dividends to policyholders	$ 2,735
Net income after dividends to policyholders and before Federal and foreign income taxes	$ (23,232)
Federal and foreign income taxes incurred	$ 16,000
Net income	$ (39,232)

CAPITAL AND SURPLUS ACCOUNT

For the Year Ending December 31, 2002

	Per Company	Examination Changes	Per Examination
Surplus as regards policyholders, December 31, 2001	$11,058,587	$ 0	$11,058,587
GAINS AND (LOSSES) IN SURPLUS			
Net income	$ (39,232)	$ 0	$ (39,232)
Change in net deferred income tax	(37,000)	0	(37,000)
Change in nonadmitted assets	306,588	0	306,588
Dividends to stockholders	(1,100,000)	0	(1,100,000)
Change in surplus as regards policyholders for the year	$ (869,644)	$ 0	$ (869,644)
Surplus as regards policyholders, December 31, 2002	$10,188,943	$ 0	$10,188,943

RECONCILIATION OF RESERVES AND UNASSIGNED FUNDS

December 31, 1998 Through December 31, 2002

	1999	2000	2001	2002
Surplus as regards policyholders, December 31, previous year	*$10,903,219	$11,102,285	$10,809,680	$11,058,587
Net income	229,746	(251,487)	398,071	$ (39,232)
Net unrealized capital gains or (losses)	0	(48,125)	0	
Change in net deferred income tax	0	0	5,000	(37,000)
Change in nonadmitted assets	(30,680)	7,007	(240,164)	306,588
Cumulative effect of changes in accounting principles	0	0	86,000	
Dividends to stockholders	0	0	0	(1,100,000)
Change in surplus as regards policyholders for the year	$ 199,066	$ (292,605)	$ 248,907	$ (869,644)
Surplus as regards policyholders, December 31, current year	$11,102,285	$10,809,680	$11,058,587	$10,188,943

Reconciliation of 1998 Surplus from Annual Statement to Examination:

*Surplus as regards policyholders at December 31, 1998 per Annual Statement	$10,903,219
1998 Examination Adjustments	(1,159,219)
Surplus as regards policyholders at December 31, 1998, per Examination	$9,744,000

NOTES TO THE FINANCIAL STATEMENTS

Note (1) – Bonds $13,822,272

Investments of the Company are maintained under custodial agreements with various financial institutions. Deficiencies were noted in the depository agreement with the State of Oregon and U.S. Bank, and in the investment/custody agreement with U.S. Bank for investments not held as special/statutory deposits. Specifically, these agreements did not contain the following safeguards and controls set forth in the NAIC's *Financial Condition Examiners Handbook:*

That in the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

That the national bank, state bank or trust company as custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.

In addition, the investment/custody agreement with U.S. Bank for investments not held as special/statutory deposits did not contain the following NAIC safeguard and control:

That during regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company.

Custody agreements for the special/statutory deposits with the States of Arizona (BNY Western Trust Company) and Idaho State Industrial Commission (Wells Fargo Bank) were not on file at the Company. Therefore, these agreements were not reviewed for NAIC safeguards.

Based on the foregoing, it is recommended that the depository agreement with the State of Oregon and U.S. Bank and the investment/custody agreement for the non-special/statutory investments with U.S. Bank be amended to include the above safeguards recommended by the NAIC. It is also recommended that the Company either obtain or execute custody agreements with BNY Western Trust Company and Wells Fargo Bank. These custodial agreements should also contain the aforementioned safeguards and controls.

When investments of the Company mature, are called, or are sold, the proceeds, along with interest income earned are transferred from the Company's custody accounts to its cash account. If funds in the Company's cash account exceed $50,000, the excess is transferred to AIC's cash concentration account. According to management, the Company's funds stay on deposit in AIC's cash concentration account indefinitely. Furthermore, the Company does not receive a fee or earn interest for the use of its funds on deposit with AIC. The Company does not pay investment fees to AIC either.

Under Section 41-703(1), Idaho Code, no security or investment other than real and personal property shall be eligible for acquisition unless it is interest bearing or interest accruing. Therefore, the Company's funds on deposit with AIC were not in compliance with Section 41-703(1), Idaho Code. It is recommended that future investments of the Company comply with Section 41-703, Idaho Code.

Note (2) – Receivable for securities	$3,031,609
Investment income earned	641,596

At December 31, 2002, the Company reported a *receivable for securities* comprised of the following:

Receivable for securities	$3,000,000
Interest income earned but not received	145,241
Securities payable	(113,632)
Receivable for securities	$3,031,609

A review of this asset indicated that the *receivable for securities* and *interest income earned but not received* items were actually collected prior to the balance sheet date, and were, therefore improperly classified at December 31, 2002. The review further indicated that the *securities payable* item was in fact, investment income earned and collected.

In late December 2002, two bonds with par values totaling $3,000,000 were called. The proceeds of the called bonds, along with interest earned, were deposited in the Company's custody account at US Bank. The proceeds were then used to purchase an AIM Treasury Portfolio Institutional Class money market fund within the same account. Bank records indicated that the AIM money market fund was on deposit at December 31, 2002, and balances in the custody account, which included the AIM money market fund, were independently confirmed by US Bank for the examination. Other amounts within the $145,241*interest income earned but not received* item relating to interest on investments in other custody accounts, were also collected prior to the balance sheet date. Based on the foregoing, the AIM money market fund and *interest income earned but not received* should have been reported as either a short-term investment or common stock and investment income earned.

Pursuant to the NAIC's Securities Valuation Office (SVO), money market funds may be reported as short-term investments if the fund is filed with the SVO. Otherwise, common stock treatment is appropriate. The AIM Treasury Portfolio Institution Class money market fund was not included in the list of money market funds filed with the SVO. Therefore, the balance should have been reported as common stock in accordance with instructions set forth in the SVO manual.

Since the money market fund was deemed common stock by the examination, the investment was subject to Section 41-706, Idaho Code. Under this section, an insurer shall not, except with the consent of the director, have at any one time any combination of investments in any one person exceeding 10 percent of the insurer's assets. The balance in the AIM Treasury Portfolio Institutional Class money market fund at December 31, 2002 exceeded the limits set forth in Section 41-706, Idaho Code. However, the bank records indicated that the fund was liquidated subsequent to the examination date and the proceeds transferred to the Company's cash account. Therefore, the entire balance was admitted as an asset in the examination report.

According to management, the AIM money market fund was reported as a *receivable for securities* because the bond proceeds were not paid to the Company's checking account by the month-end cut-off date. For accounting purposes, the month end cut-off for reporting cash transactions is the last Friday of the month (December 27, 2002) and the month end cut-off for investments is the last day of the month (December 31, 2002). Since the AIM money market fund was not in the checking account on the cash cut-off date, management did not report such as a short-term investment (deemed common stock by this examination).

The *securities payable* of $113,632 represented funds that were wired to the Company's cash account on December 27, 2002. A detail of the items within the wire was not available; therefore management recorded the funds as unknown *securities payable.* However, the bank statements for the cash account indicated that the subject funds were actually investment income earned and collected in 2002. Therefore, the *securities payable* should have been reported as investment income earned.

Based on the foregoing, it is recommended that, in the future, investments of the Company comply with Section 41-706, Idaho Code, and assets and investment income earned be properly classified in the financial statements.

Note (3) - Amounts receivable under high deductible policies	$73,780
Other expenses	53,786
Taxes, licenses and fees	84,581

It was noted that various detail reports were not reconciled to the general ledger and/or the annual statement on a regular basis. This was noted primarily in *Amounts receivable under high deductible policies, Other expenses,* and *Taxes, licenses and fees.* The change in Company personnel, relating to the home office relocation in 2001, was a contributing factor to this situation.

The major problems that arise with failing to reconcile detail subsidiary reports regularly are that entries made in prior periods may lack sufficient documentation. Better documentation results in a more accurate picture of financial condition, and will reduce the time required to review an account. It is recommended that AIC analyze its general ledger accounts on a regular basis and reconcile the subsidiary reports to the general ledger accounts. Company management has stated that an account analysis will be made on all accounts during 2004, and maintained on a regular basis thereafter.

Note (4) – Losses	$3,457,662
Loss Adjustment Expenses	738,920

Losses and loss adjustment expenses as of December 31, 2002 for AIC were examined by PricewaterCoopers, LLP, consulting actuaries, for the California Department of Insurance. The consulting actuaries determined that AIC's reserves were understated by $22,815,000. The Company's share (0.6 percent) was $136,890. As this amount was not material to the financial statements as a whole, balance sheet changes were not made in the examination report.

SUMMARY, COMMENTS AND RECOMMENDATIONS

Summary

The results of this examination disclosed that as of December 31, 2002, the Company had admitted assets of $17,773,506, liabilities of $7,584,563, and unassigned funds of $6,968,943. Therefore, the Company's total capital and surplus exceeded the $2,000,000 minimum prescribed by Section 41-313, Idaho Code.

Comments and Recommendations

Page

10 It is again recommended that the Company's investment activity with AIC be formalized and the agreement be filed with the Department to comply with Section 41-3807(2)(a), Idaho Code.

11 It is again recommended that the Board of Directors' meetings be held in compliance with the Company's Bylaws.

29 It is recommended that the depository agreement with the State of Oregon and U.S. Bank and the investment/custody agreement for the non-special/statutory investments with U.S. Bank be amended to include safeguards recommended by the NAIC. It is also recommended that the Company either obtain or execute custody agreements with BNY Western Trust Company and Wells Fargo Bank. These custodial agreements should also contain safeguards and controls recommended by the NAIC.

30 It is recommended that future investments of the Company comply with Section 41-703, Idaho Code.

31 It is recommended that, in the future, investments of the Company comply with Section 41-706, Idaho Code, and assets and investment income earned be properly classified in the financial statements.

32 Various detail reports, noted primarily in *Amounts receivable under high deductible policies, Other expenses,* and *Taxes, licenses and fees* were not reconciled to the general ledger and/or the annual statement on a regular basis. It is recommended that AIC analyze its general ledger accounts on a regular basis and reconcile the subsidiary reports to the general ledger accounts. Company management has stated that an account analysis will be made on all accounts during 2004, and maintained on a regular basis thereafter.

Items not considered material to the examination as a whole are reported in the Management Letter dated May 19, 2004. The Management Letter is incorporated as part of the Report of Examination by reference for all purposes.

CONCLUSION

The undersigned acknowledges the assistance and cooperation of the Company's officers and employees, in conducting the examination.

Respectfully submitted,

Lois Haley

Lois Haley, CFE
Senior Insurance Examiner
State of Idaho
Department of Insurance

AFFIDAVIT OF EXAMINER

State of Idaho: Idaho
County of : Ada

Lois Haley being duly sworn, deposes and says that she is a duly appointed Examiner for the Department of Insurance of the State of Idaho, that she has made an examination of the affairs and financial condition of **Argonaut Northwest Insurance Company** for the period from January 1, 1999, through December 31, 2002, that the information contained in the report consisting of the foregoing pages is true and correct to the best of her knowledge and belief; and that any conclusions and recommendations contained in this report are based on the facts disclosed in the examination.

Lois Haley
Lois Haley, CFE
Senior Insurance Examiner
Department of Insurance
State of Idaho

Subscribed and sworn to before me the 22nd day of June, 2004, at Boise, Idaho.

ROBERT E. MEUNIER JR.
NOTARY PUBLIC
STATE OF IDAHO

Robert E. Meunier
Notary Public

My Commission Expires: 11/10/2004