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Dept. of Commerce & Insurance
EXAMINATION SECTION

REPORT ON EXAMINATION

of the

TENNESSEE INSURANCE GUARANTY ASSOCIATION

Nashville, Tennessee

as of

December 31, 2001

THE DEPARTMENT OF COMMERCE AND INSURANCE
STATE OF TENNESSEE
Nashville, Tennessee

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Nashville, Tennessee
March 25, 2003

The Honorable Paula Flowers
Commissioner of Commerce and Insurance
State of Tennessee
500 James Robertson Parkway
Nashville, Tennessee 37243

Dear Commissioner Flowers:

Upon authority delegated by you, and in compliance with instructions, a financial examination has been made of the condition and affairs of the

TENNESSEE INSURANCE GUARANTY ASSOCIATION

NASHVILLE, TENNESSEE

hereinafter referred to as the "Association", and a report thereon is submitted as follows:

INTRODUCTION

This examination was arranged by the Department of Commerce and Insurance of the State of Tennessee under rules promulgated by the National Association of Insurance Commissioners and pursuant to the requirements of Chapter 56, Section 12-113 (a) of the Tennessee Code Annotated. It was conducted by duly authorized representatives of the Tennessee Department of Commerce and Insurance.

SCOPE OF EXAMINATION

The period covered hereunder is from December 31, 1996, the date of the last examination, to the close of business on December 31, 2001, the date of this examination. This examination included a review of material transactions and events occurring subsequent to the date of examination.

During the course of the examination, assets were verified and valued, and liabilities were determined or estimated as of December 31, 2001. The Association's financial condition was thus established. Test checks, covering selected periods, were made of income and disbursement items, and a general review was made of the Association's operations, practices, and compliance with applicable statutes and regulations. All asset and liability items contained in the financial statement of this report were examined and verified with relative emphasis according to their amount and potential impact on capital and surplus.

An examination was made into the following matters:

History and Organization
Management and Control
Corporate Records
Fidelity Bonds and Other Insurance
Plan of Operation
Accounts and Records
Claims
Litigation
Subsequent Events
Financial Statement

They are discussed in detail as follows:

HISTORY AND ORGANIZATION

The Association was organized pursuant to and operates in accordance with the Tennessee Guaranty Association Act, effective July 1, 1971. Under the provisions of this Act, the Commissioner of Insurance appointed five (5) members to the Board of Directors. These five members then submitted a "Plan of Operations" to the Commissioner of Insurance, which was approved effective November 22, 1971.

MANAGEMENT AND CONTROL

Regular meetings and special meetings of the Board of Directors may be held upon the request of any two (2) Board members. The Plan of Operation also states that the Board shall meet annually at the office of the Tennessee Insurance Commissioner on the second Tuesday in May, and also upon notice from the commissioner of any insolvency of a member insurer.

The majority of the Board shall constitute a quorum for the transaction of business and the acts of a majority of the Board members present at a meeting shall be the acts of the Board; except that the affirmative vote of four (4) members is required to:

(1) Approve a contract with a servicing facility.
(2) Levy an assessment or provide for a refund.
(3) Borrow money.

The following were the duly appointed Directors at December 31, 2001:

	Name	Company Affiliation
(1)	Jerry Mayo	Insurance Corporation of Hannover
(2)	Steven C. Williams	State Volunteer Mutual Insurance Company
(3)	Hulet M. Chaney	Tennessee Farmers Insurance Companies

(1) Chairman of the Board
(2) Vice Chairman of the Board
(3) Secretary of the Board

Andy J. Wind of Bituminous Insurance Company was a member of the Board of Directors until November 30, 2001, when his term expired. As of the date of this examination, he had not been reappointed by the Commissioner of Insurance. Dallas T. Reynolds of State Farm Insurance Companies was Chairman of the Board of Directors until his resignation on December 17, 2001. G. Ron Nichols, also of State Farm Insurance Companies, was appointed as his replacement on April 11, 2002.

In May of 1988, the Board appointed an Audit Committee. This Committee is responsible for selecting an accounting firm to perform the annual independent audit of the Association's financial statements and for reviewing the results of the audit. As of December 31, 2001, the Audit Committee consisted of Steven C. Williams, who acts as Chairman, and Jerry A. Mayo. In addition, Andy J. Wind was a member of this committee until November 30, 2001, when his term expired.

Mr. David Broemel was named Executive Secretary of the Association on February 14, 1986, and was serving in said position as of the date of this examination. Mr. Broemel acts as the business manager for the Association and is responsible for the general administration of its day-to-day operations.

CORPORATE RECORDS

The minutes of the meetings of the Board of Directors were reviewed for the period under examination. They were found to be well written, complete as to necessary detail, and appear to reflect properly the acts of the Board.

FIDELITY BOND AND OTHER INSURANCE

The Association had blanket employee dishonesty coverage (fidelity bond) during the period under review. The policy limit is one million dollars ($1,000,000.00) with a ten thousand dollar ($10,000.00) deductible.

The Association does not possess Directors and Officers or Errors and Omissions Coverage. T.C.A. §56-12-116 provides:

> There shall be no liability on the part of and no cause of action of any nature shall arise against any member insurer, the association or its agents or employees, the board of directors, or the commissioner or his representatives for any action taken by them in the performance of their powers and duties under this part.

As of the date of this examination the Association also had in force a commercial business owners policy and workers' compensation coverage.

PLAN OF OPERATION

The Association was organized pursuant to, and operates in accordance with, Tennessee Code Annotated §56-12-101. The purpose of the Association is to provide a mechanism for the payment of covered claims under certain insurance policies, to avoid excessive delay in payment, and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, and to provide a process for the Association to assess the cost of such protection among insurers.

The Association has the responsibility to settle covered claims of insurers as of the date the insurer is declared insolvent and any claims arising 30 days after the determination of insolvency. Covered claims are unpaid claims and, prior to July 1 1989, excluded unearned premium claims, which arise out of and are within the coverage and not in excess of the applicable limits of certain insurance policies issued by a member insurer which becomes insolvent. The Association shall pay the full amount of any covered claim arising from a worker's compensation policy. Claim settlement amounts for other coverages are subject to statutory limits or the policy limits, whichever is lower. There is a statutory deductible per claim for all claims except worker's compensation claims.

In 1989, legislation was enacted in the State of Tennessee which provided that, for companies declared insolvent on or after July 1, 1989, unearned premium claims, subject to certain limits, shall be considered covered claims as defined under the Tennessee Insurance Code. These claims also have a statutory deductible. Accordingly, the settlement of such claims is the responsibility of the Association.

In 1995, legislation was enacted in the State of Tennessee which allows the Association to authorize the Tennessee Local Development Authority to issue tax exempt bonds and/or notes to expedite the handling and payment of natural disaster covered claims if funds needed to pay these claims are in excess of assessment capacity. The act also bars claims which have been filed with the Association, domiciliary or ancillary receiver after the final date set by a court order for the filing of claims against the domiciliary or ancillary receiver of an insolvent insurer.

In 1999, legislation was enacted in the State of Tennessee which amended the definition of a covered claim to exclude any first party claim by an insured whose net worth exceeds ten million dollars ($10,000,000) or who is an affiliate of the insolvent insurer. This amendment also gave the Association the right to recover the amount of any liability (third party) claim paid on behalf of an insured whose net worth exceeds twenty-five million dollars ($25,000,000) or on behalf of any insured who is an affiliate of the insolvent insurance company.

As of December 31, 2001, there were 31 open insolvencies being administered by the Association. The following insolvencies occurred between December 31, 1996, the date of the last Report of Examination, and the date of this report:

1997
American Eagle Insurance Company
Grangers Mutual Insurance Company
United Southern Assurance Company

1998
None

1999
None

2000
Commercial Compensation Insurance Company

2001
Acceleration National Insurance Company
Credit General Insurance Company
International Indemnity Company
Reliance Insurance Company

ACCOUNTS AND RECORDS

During the course of the examination, such tests and audit procedures were made as were considered necessary. Accounting records conform to generally accepted accounting practices and appear to properly reflect the operations during the period under examination and the status of the Association at the date of examination. The Association converted from a cash basis of accounting to the accrual method in 1987.

For each year under examination, the Association has had an independent audit of its financial statements. From 1997 through 2000, this audit was done by KPMG Peat Marwick. In 2001, the audit was performed by Crosslin Vaden and Associates.

Independent reviews of reserve adequacy and claims adjusting practices were performed by Willis Corroon Administrative Services Corporation as of September 30, 1998 and September 30, 2001.

FINANCIAL STATEMENT

There follows a comparative financial statement covering the years 1997 – 2001 as developed by this examination.

ASSETS	1997	1998	1999	2000	2001
Cash and cash equivalents	185,895	174,015	392,795	236,490	3,323,040
Short-term investments	14,797,103	15,725,790	16,404,721	16,942,508	69,086,935
Claim reimbursements receivable	144,597	91,797	169,764	252,688	604,629
Assessments from members	-	-	-	9,855,000	3,032,152
Furniture, fixtures and equipment	36,164	27,192	12,458	25,949	37,842
Prepaid expenses	12,500	5,079		-	-
Total Assets	15,176,259	16,023,873	16,979,738	27,312,635	76,084,598
LIABILITIES & FUND BALANCE					
Reserve for unpaid losses	10,956,253	9,530,852	8,629,355	12,623,185	37,239,861
Other liabilities	17,839	26,942	35,462	30,424	82,837
Total Liabilities	10,974,092	9,557,794	8,664,817	12,653,609	37,322,698
Fund balance	4,202,167	6,466,079	8,314,921	14,659,026	38,761,900
Total Liabilities and Fund Balance	15,176,259	16,023,873	16,979,738	27,312,635	76,084,598
SUMMARY OF OPERATIONS					
REVENUES					
Assessments declared	-	-	-	9,855,000	54,966,481
Investment income	772,134	811,562	742,879	1,162,275	2,449,688
Liquidation distributions	672,660	1,087,099	1,122,818	874,143	-
Reimbursement of claims	92,615	47,371	70,244	50,300	122,582
Total revenue	1,537,409	1,946,032	1,935,941	11,941,718	57,538,751
EXPENSES					
Net claims paid	545,038	378,906	358,824	971,998	6,323,814
Adjustment expenses	211,900	317,789	235,690	264,536	1,098,844
Increase (decrease) in claim reserve	1,192,038	(1,425,401)	(901,497)	3,993,830	24,616,676
Administrative expenses	375,408	410,826	394,082	367,249	582,259
Other expenses	-	-	-	-	814,285
Total expenses	2,324,384	(317,880)	87,099	5,597,613	33,435,878
Net income	(786,975)	2,263,912	1,848,842	6,344,105	24,102,873
Fund balance - beginning of year	4,989,142	4,202,167	6,466,079	8,314,921	14,659,026
Fund balance - end of year	4,202,167	6,466,079	8,314,921	14,659,026	38,761,899

COMMENTS

Although minor differences were noted during the course of this examination, none materially affected the operations of the Association or the fund balance as December 31, 2001.

Based on the results of this examination, it appears that the Association is in compliance with the Tennessee Insurance Guaranty Association Act (Tennessee Code Annotated, Section 56-12-101, et seq.).

CONCLUSION

Insurance examination practices and procedures, as promulgated by the National Association of Insurance commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of the Tennessee Insurance Guaranty Association, Nashville, Tennessee.

In such manner, it was determined that, as of December 31, 2001, the Association had assets of $76,084,598, liabilities of $37,322,698, and a fund balance of $38,761,899.

The courteous cooperation extended by the Association during the course of the examination is hereby acknowledged.

Respectfully submitted,

Rhonda Bowling-Black

Rhonda Bowling-Black, CFE
Examiner-in Charge
State of Tennessee

Amy J. Maggard

Amy J. Maggard
Insurance Examiner
State of Tennessee

AFFIDAVIT

The undersigned deposes and says that she has duly executed the attached examination report of the Tennessee Insurance Guaranty Association dated March 25, 2003, and made as of December 31, 2002, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says that she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of her knowledge, information and belief.

Rhonda Bowling-Black

Rhonda Bowling-Black, CFE
Examiner-in-Charge
State of Tennessee

Subscribed and sworn to before me

this 27th day of

March, 2003

Notary Kristen L. Scott

County Hamilton

State Tennessee

Commission expires Nov 9, 2005

Kristen L. Scott