



MINUTES OF THE THIRTY-SECOND ANNUAL MEETING OF THE NORTH CAROLINA REINSURANCE FACILITY HELD AT THE GRANDOVER RESORT AND CONFERENCE CENTER, ONE THOUSAND CLUB ROAD, GREENSBORO, NORTH CAROLINA
OCTOBER 26, 2005

MEMBERS PRESENT

REPRESENTED BY

Alliance Mutual Insurance Company

Mary Taylor
Robert White
Bob Blystone

Allstate Insurance Company
Allstate Indemnity Company
Northbrook Indemnity Company

American Southern Insurance Company

AMICA Mutual Insurance Company

Auto-Owners Insurance Company

Owners Insurance Company

Atlantic Casualty Insurance Company

Jim McCafferty
Lisa Melton
Alice Hamm
Mary Pierce
Paul Aycock
Greg Ricker
Richard Yarbrough
Ronnie Chamberlain

Erie Insurance Exchange

Erie Insurance Company

Government Employees Insurance Company

GEICO General Insurance Company

GEICO Indemnity Company

Hartford Fire Insurance Company

Hartford Accident & Indemnity Company

Hartford Casualty Insurance Company

Hartford Insurance Company of the Midwest

Hartford Underwriters Insurance Company

Property & Casualty Insurance Company of Hartford

Sentinel Insurance Company, Ltd.

Trumbull Insurance Company

Twin City Fire Insurance Company

Horace Mann Insurance Company

Horace Mann Property & Casualty Insurance Company

Teachers Insurance Company

Integon Indemnity Corporation

GMAC Direct Insurance Company

GMAC Insurance Company Online, Inc.

Integon Casualty Insurance Company

Integon General Insurance Corporation

Integon National Insurance Company

Tom McNicholas

Todd Martensen

Greg Carr

Art Lyon

Integon Preferred Insurance Company	
Integon Specialty Insurance Company	
New South Insurance Company	
Liberty Mutual Insurance Company	Greg Ciezadlo
First Liberty Insurance Corporation	
Liberty Insurance Corporation	
Liberty Mutual Fire Insurance Company	
LM Insurance Corporation	
Maryland Casualty Company	Paul Ziegler
American Guarantee & Liability Insurance Company	
American Zurich Insurance Company	
Assurance Company of America	
Northern Insurance Company of NY	
Valiant insurance Company	
Zurich American Insurance Company	
Nationwide Mutual Insurance Company	Amy Powell
Nationwide Affinity Insurance Company	Michael Groseclose
Nationwide Mutual Fire Insurance Company	
Nationwide Property & Casualty Insurance Company	
New Hampshire Insurance Company	Gary Sanginario
AIU Insurance Company	
American Home Assurance Company	
Birmingham Fire Insurance Company of Pennsylvania	
Commerce & Industry Insurance Company	
Granite State Insurance Company	
Insurance Company of the State of Pennsylvania	
National Union Fire Insurance Company	
North Carolina Farm Bureau Mutual Insurance Company	Roger Batdorff
Farm Bureau Insurance Company of North Carolina, Inc.	
Progressive Casualty Insurance Company	Patricia D'Ambrosia
National Continental Insurance Company	Andrew Rose
Progressive American Insurance Company	
Progressive Northern Insurance Company	
Progressive Northwestern Insurance Company	
Progressive Preferred Insurance Company	
Progressive Premier Insurance Company of Illinois	
Progressive Southeastern Insurance Company	
Progressive Universal Insurance Company	
United Financial Casualty Company	
Royal Indemnity Company	Tim Miller
Fire & Casualty Insurance Company of Connecticut	
Grocers Insurance Company	
Royal Insurance Company of America	
Sea Insurance Company of America	
Security Insurance Company of Hartford	
Southern General Insurance Company	Angela Haithcock
State Automobile Mutual Insurance Company	Wes Florence
State Automobile National Insurance Company	
State Automobile Property & Casualty Insurance Company	
Travelers Indemnity Company	Benjy Seagle
Athena Assurance Company	Michael Fitzgerald

Discover Property & Casualty Insurance Company
Fidelity & Guaranty Insurance Company
St. Paul Fire & Marine Insurance Company
St. Paul Guardian Insurance Company
St. Paul Medical Liability Insurance Company
St. Paul Mercury Insurance Company
St. Paul Protective Insurance Company
United States Fidelity & Guaranty Company
Automobile Insurance Company of Hartford
Charter Oak Fire Insurance Company
Farmington Casualty Company
Phoenix Insurance Company
Standard Fire Insurance Company
Travco Insurance Company
Travelers Casualty & Surety Company of America
Travelers Casualty & Surety Company of Illinois
Travelers Casualty Company of Connecticut
Travelers Casualty & Surety Company
Travelers Commercial Casualty Company
Travelers Commercial Insurance Company
Travelers Home & Marine Insurance Company
Travelers Indemnity Company of Connecticut
Travelers Indemnity Company of America
Travelers Indemnity Company of Illinois
Travelers Personal Security Insurance Company
Travelers Property Casualty Insurance Company
United Services Automobile Association
USAA Casualty Insurance Company
USAA General Indemnity Company
Universal Insurance Company

Joe Schmucker

Greg Spray

OTHERS PRESENT

Able Auto Insurance Agency
Bagwell & Bagwell, Inc.
Evergreen Investment Management Company

Green & Wooten Insurance
Independent Insurance Agents of North Carolina

Insurance Federation of North Carolina
Insurance Services Office
North Carolina Department of Insurance
Senn, Dunn, Marsh & Roland
Wester Realty & Insurance Agency, Inc.
Young, Moore & Henderson

Staff

REPRESENTED BY

Jeff Butler
Steve Smith
Rich Applebach
Paige Henderson
John Wooten
David Walker
Rick Pegram
Joe Stewart
Patrick Woods
Fred Fuller
Tim Ward
Hutson Wester
Mickey Spivey
Mike Strickland
Jannet Barnes
Adrienne Bizzell
Edith Davis
Chuck Eckstein

Ray Evans
Delisa Fairley
Vicki Godbold
Robert Greer
Fred Hoerl
Wayne Hinton
Tim Lucas
Kamala Massey
Lois Murphey
Mike Newton
Karen Ott
Liz Polley
David Sink
Sue Taylor

186 other companies voted by proxy.

The meeting was convened as scheduled, Mr. Blystone presiding. Mr. Evans announced that a quorum was participating by proxy.

Reference was made to the Facility's Antitrust Compliance Policy and Conflicts of Interest Statement, copies of which were made available.

1. Annual Report

Copies of the Thirty-Second Annual Report for the fiscal year ended September 30, 2005 were distributed. Mr. Evans and other members of Staff reviewed and commented on the Report, a copy of which is attached and forms a part of the record.

A motion was made, seconded, and unanimously passed to accept the Annual Report for fiscal year 2004-2005.

2. Plan of Operation Amendments

Ms. Davis reviewed proposed amendments to Articles IV, V, XII and XIII in the Facility's Plan of Operation, noting that Board of Governors recommended adoption of these amendments. It was also noted that the purpose of the amendments were to (1) update language regarding the membership of the Board of Governors as a result of recent statutory changes; (2) recognize the creation of the Compliance committee; and (3) clarify the duties of the Audit Committee and Compliance Committee.

A motion was made, seconded, and unanimously passed to adopt the amendments to Articles IV, V, XII and XIII in the Facility's Plan of Operation.

3. Board of Governors Selection

Ms. Davis reported that House Bill 1236 became law effective October 1, 2005, amending North Carolina General Statute 58-37-35 (d) to recognize the merger of the Alliance of American Insurers and the National Association of Independent Insurers

which became Property Casualty Insurance Association of America. This statutory change provides for one member company representative from Property Casualty Insurance Association of America and created one representative from the industry at large regardless of trade affiliation, to be selected by the insurer company members of the Board. She announced that Travelers Indemnity Company and Allstate Insurance Company had been selected respectively by the American Insurance Association and Property and Casualty Insurance Association of America as members of the Board of Governors for the ensuing three years. New Hampshire Insurance Company and Nationwide Mutual Insurance Company were elected for membership on the Board of Governors representing, respectively, the nonaffiliated stock and the non-affiliated non-stock members for three-year terms. Ms. Davis also announced that the Commissioner of Insurance had selected, as agent members of the Board of Governors for three year terms, Jeffrey W. Butler of Wilmington, Steven D. Smith of Raleigh, Tim Ward of Greensboro, W. Hutson Wester, II of Henderson and John E. Wooten, III of Wake Forest; and as domestic member insurers Integon Indemnity Corporation and Universal Insurance Company, also for three year terms. She further advised that public members appointed for three year terms by the Governor were J. David Walker of Lumberton and Steve Whitley of North Wilkesboro; and that Atlantic Casualty Insurance Company had been elected as the representative from the industry at large, for a three year term.

4. Chairman's Comments

Mr. Blystone commented about the level of activity in the Facility during the past year regarding recoupment changes and system improvements, and expressed gratitude on behalf of the Board of Governors to the staff, members of the Facility committees and Counsel for their efforts during the preceding year.

5. Adjournment

There being no further business, the meeting was adjourned.

Respectfully submitted,

Edith T. Davis

Director, Reinsurance Facility

ETD/lam
Enclosure
BG-05-09
11/23/05

NCRB-NCRF-NCIGA



north carolina

RATE BUREAU

REINSURANCE FACILITY

INSURANCE GUARANTY ASSOCIATION

North Carolina Reinsurance Facility 2005 ANNUAL REPORT

North Carolina Reinsurance Facility
5401 Six Forks Road • Raleigh, NC 27609
(919) 783-9790
www.ncrb.org

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THE BEGINNING

“There is created a nonprofit unincorporated legal entity to be known as the North Carolina Motor Vehicle Reinsurance Facility consisting of all insurers licensed to write and engaged in writing within this state motor vehicle insurance or any component thereof. Every such insurer, as a prerequisite to further engaging in writing such insurance in this state, shall be a member of the Facility and shall be bound by the rules of operation thereof as provided for in this Article and as promulgated by the Board of Governors. No company may withdraw membership in the Facility unless it ceases to write motor vehicle insurance in this state or ceases to be licensed to write such insurance.”

§58-37-5

MESSAGE FROM THE CHAIRMAN

This was my first year as Chairman and it certainly was a learning experience! One point stands out as I look back over the past 12 months ...we are very lucky to have the quality of people that we do running the NCRF. Whether it is the Staff who handle the multitude of daily issues, Legal Counsel, the members of the Board of Governors I am privileged to work with or the great number of experts who work on the Task Forces and Committees the NCRF relies so heavily upon...your efforts matter and on behalf of all Member Companies, I thank you for them.

The Facility has grown to over 1 million vehicles and is one of the largest Residual Market mechanisms in our country. With an organization this size, the year has certainly not lacked for activity as Operational issues, and Legislative actions arose. Throughout the year, the Board and Staff acted promptly and were able to maintain stability for all its constituents. As I look back, there are two items which I would like to comment upon:

First, as the financial impact of the 2004 refunds and past Clean Risk recoupments on the NCRF Balance sheet became clear, the Board responded in a measured fashion by implementing a graduated increase to the Clean Risk recoupment and installing a Loss recoupment as well. I am hopeful that as the Rate Bureau and Department of Insurance work together in the future that changes to rate levels and rating plans will enable us to reduce these charges to many NC drivers.

Second, the long term improvements in our Operating Systems which were outlined in last years Annual meeting are closer to reality.... and your input has been continually sought so that it is truly "User" friendly. The NCRF staff deserves much credit for their approach to this monumental task.

As we move forward, there are more challenges to tackle – the increase in MVR costs, the integration of the new "At Large" Board member, bringing the new Operating System on line, to mention a few - all of which will require the best efforts from all of us. Rest assured that we will work through these and all others to the best possible conclusion.

I thank you in advance for continuing to care and contribute in what I am sure will be a bright future for North Carolina and the drivers we insure.

Sincerely,



Bob Blystone, Chairman

THE YEAR IN REVIEW

It is no secret that business moves at a faster pace now than it has in years past. The statutes which govern us have not changed much over the Facility's thirty-two years but the marketplace sure has. Companies enter and leave the North Carolina marketplace with regularity, but the Facility remains a steady and stabilizing force on the market. That said, the way the Facility conducts its business is evolving at a faster pace than ever before.

Our goals are to be professional, efficient and effective while doing our best to ensure the Facility is receiving the right premiums and paying the right losses, and that we minimize the financial impact on the drivers of North Carolina. We strive to become a dynamic organization, proactive where appropriate, operate as other businesses do and to pay attention to the world outside our four walls for developments, trends, and great ideas.

During the past year, our attention was focused on two principle areas of activity. One was maintaining the Facility's strong financial position and the other is continuing to operate more effectively.

Because of inadequately priced "clean risks" the Facility's operating results continued at a loss. As a result, exceptional care was taken this year to monitor the Facility's financial position and to carefully plan and implement the appropriate "clean risk" recoupment surcharges. In addition, the Facility implemented a loss recoupment for the first time in many years. With no rate relief in sight for "clean risks", adjustments were even made during the year to ensure the Facility's financial stability and move us back toward "breakeven" as quickly as possible.

As a result of the settlement of the 2002 and 2003 rate cases, \$71 million in premium refunds and interest was paid out by the Facility. In addition to the impact on operating income, it generated six million of the 28.9 million transactions we processed this year with no increase in staff.

For the development of our new information system, EDGE, some processes have been eliminated and others refined but all have been documented. This system will take advantage of technology already standard in many companies and move us into a new age of web-based and electronic processing with increased data access, management, and control; and improve our day-to day operations. A Technical Committee has also been formed of member companies to leverage industry expertise during this development, and insure the greatest level of usability for the member companies when it is complete.

The Year in Review continued...

To prepare for this new system, all other related systems have been reviewed, a web security system put into place and contact management and EFT systems are under development. A reengineering of our compliance processes is nearing completion. Included in this is a risk assessment of our current environment modeled after recognized industry wide framework which yielded additional opportunities for more advanced controls to be built into EDGE.

To further ensure our ability to continue to operate, a business continuity plan is under development to supplement the business recovery plans currently in place. The Organization's security of the physical premises has been upgraded to safeguard our assets and staff.

Boiled down to this essence, the Board determined the Facility's goals for the past year were to "break even" operationally and reduce the overall cost of the direct operation to less than one half of one percent of operating income. Everything is in place to meet the break even goal with last quarter's operating loss of only \$800,000. We have met the second. Our current operating cost is approximately 0.45% of operating income.

For the future, maybe the most important attribute of the Facility is that our associates are engaged in what we do. During this very busy year filled with analysis, development, review, and planning, about seventy percent of the Facility staff was involved in some form of continuing professional education, and most served on one or more teams associated with these various projects. We believe that through education, challenge and teamwork opportunities they can provide better insights into maintaining effective operations.

Not least in adding to a successful year has been the guidance and oversight we receive from our Board, and its committees. In addition, the Facility's legal and advisory teams leverage industry knowledge and experience and ensure that our actions are careful, deliberate and appropriate.

We are grateful to all who participated in these efforts and look forward to your continued support as we continue down this road.

Raymond F. Evans
General Manager

Edith T. Davis
Director, Reinsurance Facility

HISTORY

The North Carolina Reinsurance Facility became operational on October 9, 1973 as the result of legislation that was enacted that year. The Facility replaced an automobile assigned risk plan, which had been in operation since 1947.

In 1958, the first year of compulsory automobile liability insurance in North Carolina, 9% of the non-fleet private passenger automobiles were insured through the Assigned Risk Plan, up from only 3% the previous year. The Plan's market share grew steadily to the point that 29% of the non-fleet private passenger automobiles were insured through the Plan during the year ended June 30, 1973. As of December 31, 2004 the Facility's market share is approximately 25%.

The Reinsurance Facility is a mechanism for pooling auto liability insurance risks that cannot obtain coverage by ordinary methods. The member companies share premiums, losses, and expenses in proportion to their respective North Carolina automobile liability insurance writings. Under the North Carolina law, licensed and writing carriers and agents must accept and insure any eligible applicant for coverages and limits that may be ceded to the Facility. The Facility accepts cession of bodily injury and property damage liability, medical payments, uninsured and combined uninsured/underinsured motorists coverages. Automobile physical damage coverages are not eligible for cession. Any eligible risk, which a company elects not to retain for its own account, may be ceded to the Facility. There is currently no cession limitation on the number of risks an insurance company may cede to the Facility.

As a measure of size, North Carolina is the second largest in terms of private passenger auto liability premiums of all state residual market mechanisms.

STATE	2003 PPNF LIABILITY PREMIUMS†
New York	800,428,000
North Carolina	648,668,000
Massachusetts	300,553,000
New Jersey	269,616,000

†Source: AIPSO FACTS 2004/2005

GOVERNANCE

BOARD OF GOVERNORS

Responsibility for management is vested in a fifteen-member Board of Governors. There are twelve voting members; seven member insurance companies; five agents appointed by the Insurance Commissioner; two nonvoting public members appointed by the Governor; and the Insurance Commissioner who is a member of the Board ex-officio without vote. Five meetings of the Board were held during the year, including one telephone conference.

During the year covered by this report the following seven member companies served as members of the Board of Governors:

MEMBER	REPRESENTATIVE
Allstate Insurance Company†	Bob Blystone
Integon Indemnity Corporation	Art Lyon
Liberty Mutual Insurance Company	Greg Ciezadlo
Nationwide Mutual Insurance Company	John Thrasher
New Hampshire Insurance Company	Gary Sanginario
Royal Insurance Company of America	Tim Miller
Universal Insurance Company	Greg Spray

†Chairman

The following five agents served as members of the Board of Governors during the year covered by this report:

AGENTS	
Independent Insurance Agents of North Carolina, Inc.	Steven D. Smith Bagwell & Bagwell, Inc.
Appointed by the Commissioner of Insurance	W. Hutson Wester, II Wester Realty & Insurance Agency, Inc.
Appointed by the Commissioner of Insurance	John E. Wooten, III Green & Wooten Insurance
Auto Insurance Agents of North Carolina, Inc.	Jeffrey W. Butler Able Auto Insurance Agency
Independent Insurance Agents of North Carolina	J. David Walker BB&T Insurance Services

Governance continued...

The following served as public and ex-officio members of the Board of Governors during this report period:

PUBLIC MEMBERS	EX-OFFICIO MEMBER
Frederick M. Tate Elizabethtown, NC	James E. Long Commissioner of Insurance
Steve J. Whitley North Wilkesboro, NC	

STANDING ADVISORY COMMITTEES

The Plan of Operation establishes a number of advisory committees. These committees oversee the activities of the Facility and formulate recommendations for presentation to the Board of Governors.

The standing committees and respective chairing companies for the report period were:

COMMITTEE	CHAIR COMPANY
Accounting & Statistical †	Eagle Insurance Company
Audit	Liberty Mutual Insurance Company
Claims	State Farm Mutual Automobile Insurance Co
Claims Quality Control	State Farm Mutual Automobile Insurance Co
Compliance	Universal Insurance Company
Investment	Nationwide Mutual Insurance Company
Legal	Liberty Mutual Insurance Company
Market	Travelers Indemnity Company
Rating	Liberty Mutual Insurance Company

†Joint AIPSO/NCRF committee

MEMBERSHIP

All companies licensed to write and are writing automobile liability insurance in the State are required to become members of the Reinsurance Facility. As of August 31, 2005 there were 474 member companies.

The following companies were added during this report period:

NEW MEMBERS	
Allied Property & Casualty Insurance Company	
AMCO Insurance Company	
Depositors Insurance Company	
G.U.I.C. Insurance Company	
IDS Property Casualty Insurance Company	
Nipponkoa Insurance Company, Ltd. (US Branch)	
Progressive Premier Insurance Company of Illinois	
Progressive Universal Insurance Company	
Sentry Casualty Company	
Western General Insurance Company	

The following companies withdrew from membership or were merged with another member company during the year:

WITHDREW/MERGER	
American & Foreign Insurance Company	Frontier Insurance Company
American Professionals Insurance Company	Globe Indemnity Company
American Protection Insurance Company	Gulf Insurance Company
Atlantic Indemnity Company	Royal Insurance Company of America
Atlantic Security Insurance Company	Safeguard Insurance Company
Connecticut Indemnity Company	South Carolina Insurance Company
Consolidated American Insurance Company	Specialty National Insurance Company
Fire & Casualty Insurance Company of Connecticut	Unisun Insurance Company

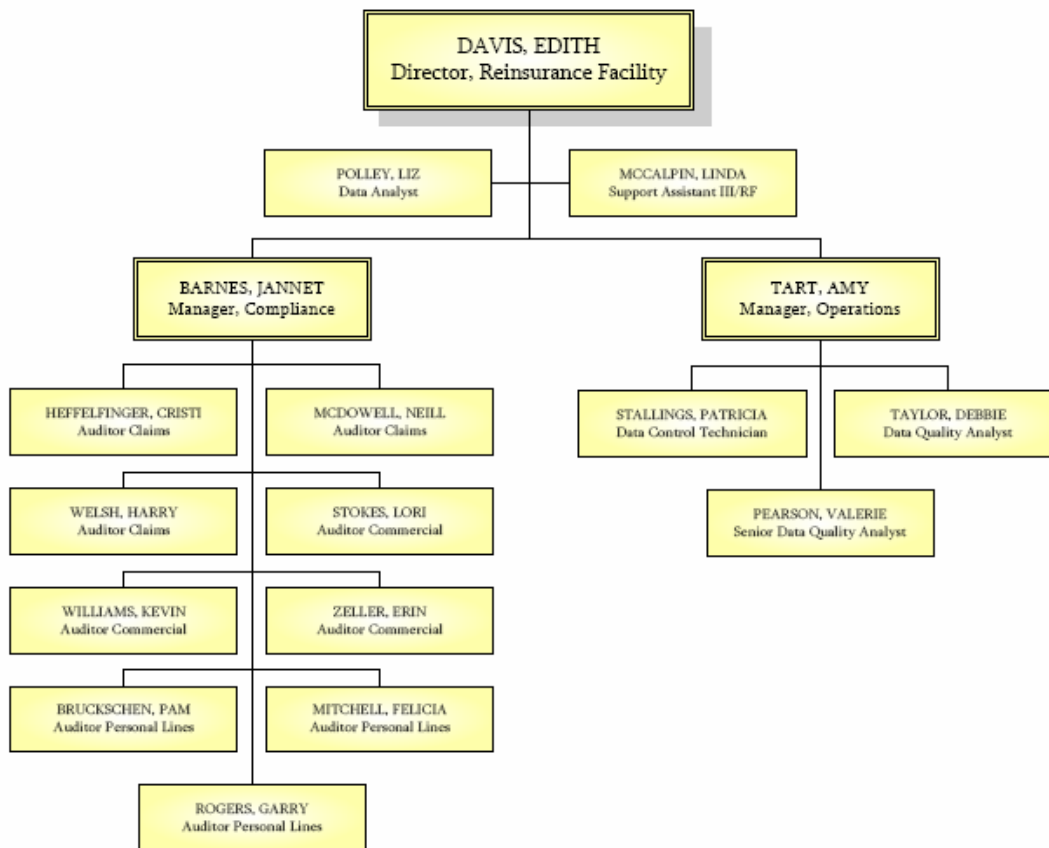
NCRF TEAM



North Carolina Reinsurance Facility
2005 Annual Report

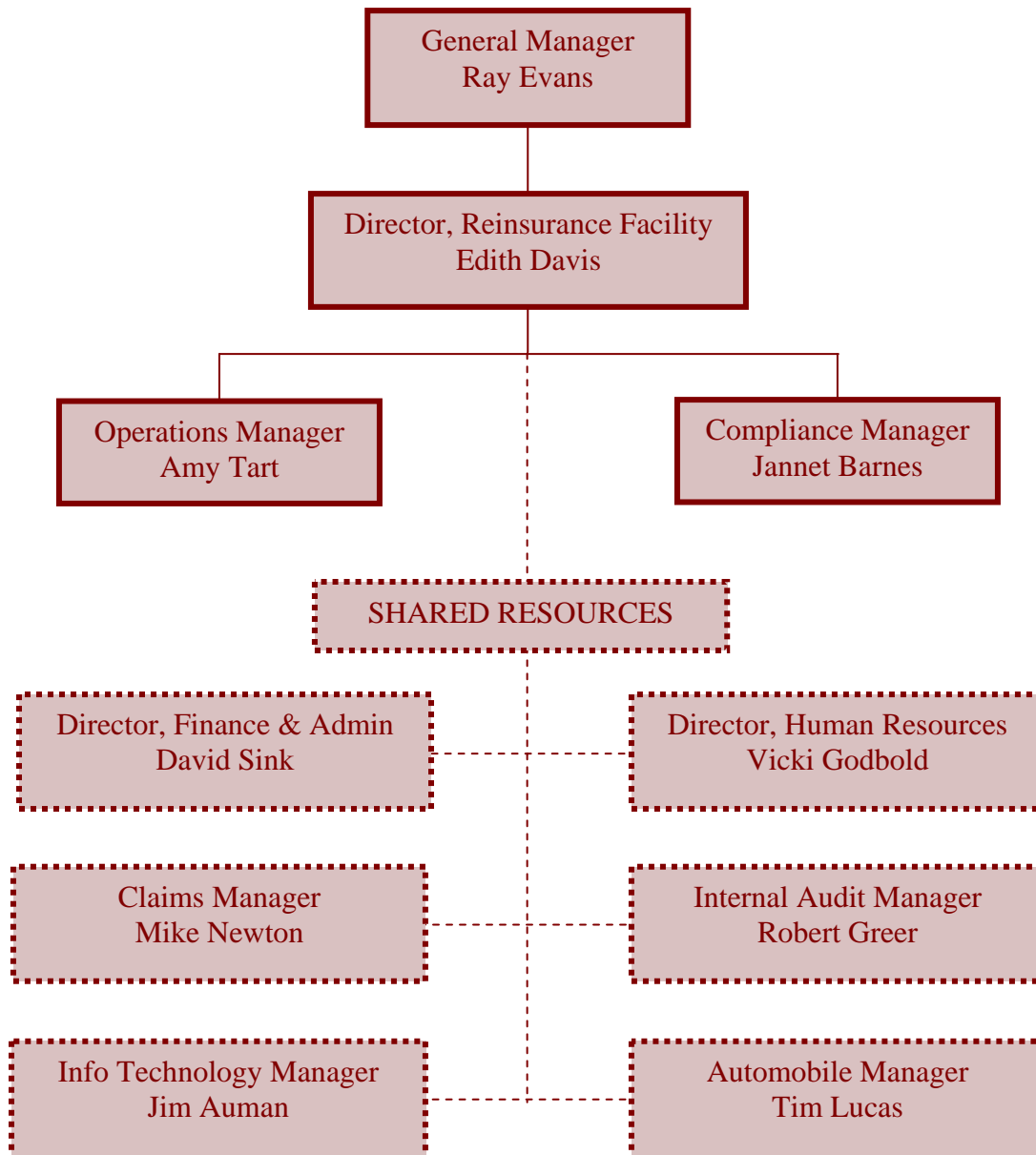
NCRF Team continued...

The North Carolina Reinsurance Facility is located in leased offices at 5401 Six Forks Road, Raleigh, North Carolina. At the end of this report period there were seventeen full-time associates.



NCRF Team continued...

Responsibility for day-to-day Facility operations is by the following management staff, some of whom also perform duties for the North Carolina Rate Bureau and the North Carolina Insurance Guaranty Association:



FACILITY OPERATIONS

The Staff of the NCRF is charged with annually overseeing over \$735 million in reinsurance premiums, 2.7 million cession transactions, more than twenty-eight million accounting transactions, over \$130 million of recoupment surcharges, over \$600 million in loss reimbursements to members, and maintaining over \$500 million in reserves for losses. This is all done effectively with a budget of approximately \$4.5 million or approximately ½ percent of income from premiums and recoupment.

Efforts to review and update all processes and procedures continued during the year. Requirements for a new information system named EDGE designed to assist the Facility to interface with the member companies in a web-based electronic environment were completed and proposals for the development of the new system were solicited during this report period. Development of this system is expected to begin by year end 2005.

Great effort continues to be devoted to the evaluation and documentation of internal controls and processes for both operations and the system design.

The Facility staff conducted numerous training sessions throughout the year with member companies to facilitate Facility reporting and error correction.

OPERATING RESULTS

Each ceding company must submit to the Facility a monthly detailed report of premiums and paid losses for policies ceded to the Facility, a Monthly Recoupment Report summarizing Facility surcharges on both ceded and non-ceded policies, and a Monthly Summary Report from which the company receives credit for its predetermined expense allowances to cover acquisition, underwriting and claim adjustment expenses. Each ceding company also submits a quarterly report of losses on ceded policies that have been reported but have not yet been settled. These detail reports are also entered into the computer masterfile.

After the monthly accounting reports are received from the ceding companies and balanced, there is a monthly cash settlement with the ceding companies. Companies whose written premiums and recoupment surcharges due the Facility exceeded the total of their paid losses plus expense allowances and other credits must pay the balances to

the Facility. Companies whose written premiums and recoupment surcharges due the Facility were less than the total of their paid losses and other credits collect the deficit from the Facility.

PROCESSING

As part of the Facility staff, the Operations department is responsible for cession transactions, accounting transactions and reports, and error correction issues. If a company wants to cede a policy to the Facility it must file a cession notice identifying the case individually by name, policy number, effective and expiration dates. Cession notices are submitted in the form of individual pieces of paper, printed lists, magnetic media or by telecommunication. The resulting cession notice data are then entered into a computerized masterfile.

AIPSO, as the central processor, processed over 2.7 million cession transactions and almost 298 million accounting transactions last year. In addition to maintaining the computerized masterfile which includes all Facility transactions, AIPSO is responsible for producing or furnishing data for the production of most of the Facility's accounting and statistical reports, furnishing lists of apparent reporting errors as well as other types of reports utilized in the Facility's audit activities, furnishing claim reports used in the Facility's claim quality control work, and printing and distributing the Facility's Standard Practice Manual and its Commercial Automobile Manual of Rules and Rates.

CESSION VOLUME

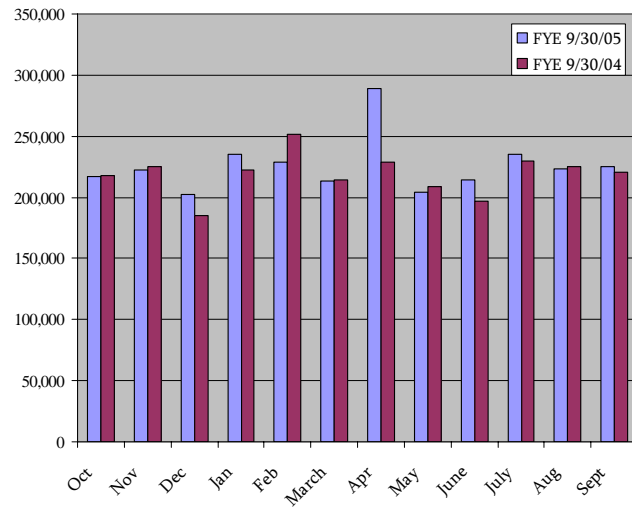
The information below represents the number of cession notices processed by the Facility monthly along with the number of processed cession notices by class and transaction code for the fiscal years ended September 30, 2005, and 2004.

Facility Operations continued...

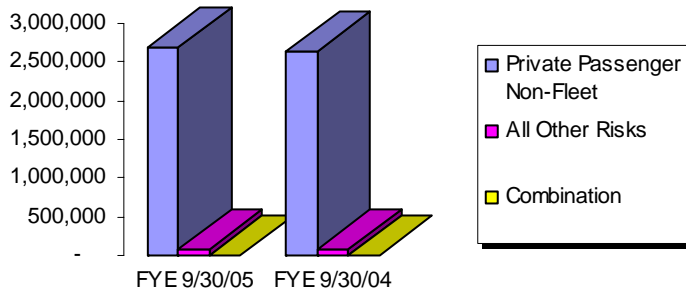
CESSION NOTICES PROCESSED MONTHLY

(Excluding Transaction Code 4 -- Policy or Renewal Not Taken)

MONTH	FYE 9/30/05	FYE 9/30/04
Oct	216,939	217,404
Nov	222,413	225,128
Dec	202,197	184,916
Jan	234,845	222,057
Feb	228,752	251,795
March	212,884	214,466
Apr	288,906	229,154
May	204,407	208,652
June	214,365	196,839
July	235,007	229,269
Aug	223,455	224,987
Sept	224,742	220,829
TOTAL	2,708,912	2,625,496



CESSIONS BY CLASS

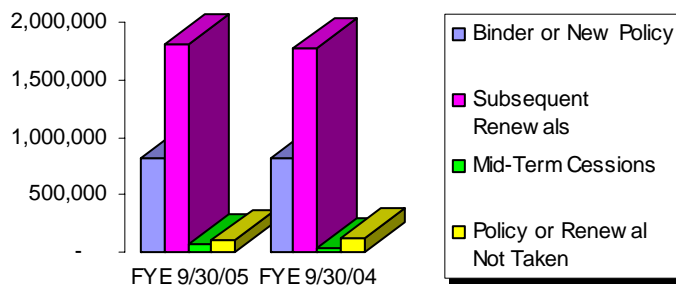


	FYE 9/30/05	FYE 9/30/04
Private Passenger Non-Fleet	2,673,596	2,641,445
All Other Risks	78,039	83,075
Combination	16,551	15,846
TOTAL	2,768,186	2,740,366

Percent Change over prior year: 1.02%

Facility Operations continued...

CESSIONS BY TYPE



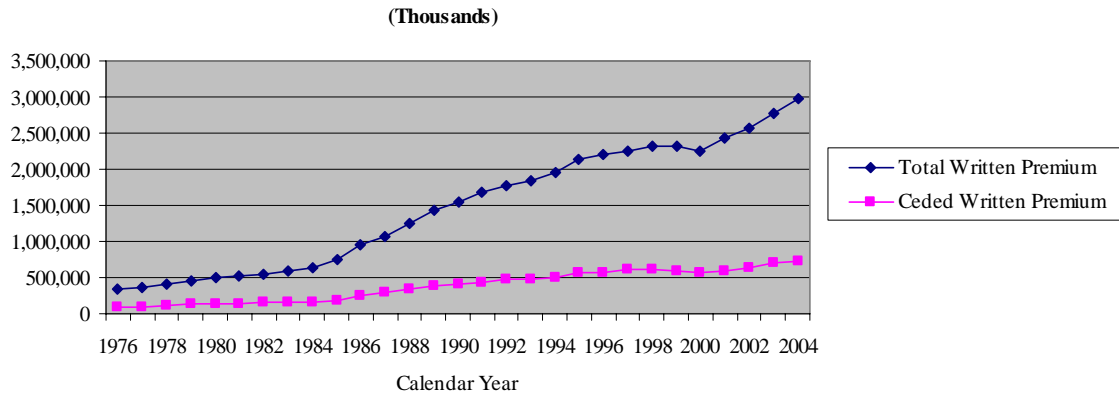
	FYE 9/30/05	FYE 9/30/04
Binder or New Policy	819,251	818,124
Subsequent Renewals	1,816,683	1,781,019
Mid-Term Cessions	72,978	26,353
Policy or Renewal Not Taken	106,374	114,870
TOTAL	2,815,286	2,740,366

PREMIUMS

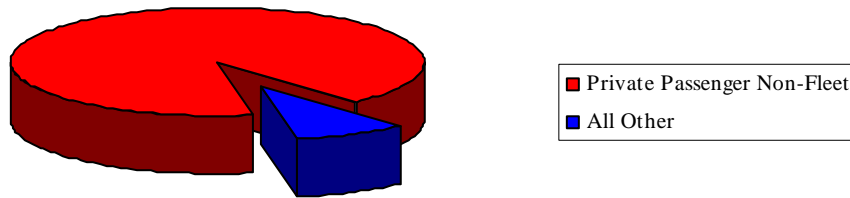
During this report period the NCRF was the second largest residual market mechanism by total written premium volume in the United States. Almost one quarter of automobile liability premiums written in North Carolina were in the Facility. The Facility's share of the market increased about one percent in calendar year 2004 over 2003. Currently, the premiums consist of approximately 91% Private Passenger Non-Fleet business and 9% All Other business.

Facility Operations continued...

NC AUTO LIABILITY WRITTEN PREMIUMS



COMPOSITION OF CEDED PREMIUM CYE 12/31/04



RECOUPMENT SURCHARGE

CLEAN RISK

One of the key components of the NCRF that differentiates it from other residual markets is “clean risks.” By statute, any ceded risk with no Safe Driver Insurance Plan points and no inexperienced operators in the household qualifies for the voluntary rate.

Unfortunately there is a difference between the voluntary rate and the ceded “clean risk” actuarially sound rate. This difference is recouped through surcharges to all drivers in North Carolina.

During a meeting held on December 20, 2004, the Board of Governors voted with respect to private passenger non-fleet policies written to become effective on or after April 1, 2005 to implement a “clean risks” recoupment surcharge of 6.43% (before agent compensation). At a meeting held on July 13, 2005, the Board voted to adjust the “clean risks” recoupment surcharge to 9.71% (before agent compensation) for private passenger non-fleet policies written to become effective on or after October 1, 2005. No recoveries from this new surcharge were received during this report period.

A summary of all “clean risks” recoupments since the inception of the “clean risks” recoupment through July 2005 is located in the Appendix.

CLEAN RISK RECOUPMENT SURCHARGE ACTIVITY BY RECOUPMENT PERIOD

(Thousands of Dollars)

Surcharge Period	Surcharge Percentage	Surcharge Written
4/1/05 to 9/30/05	6.43%	\$56,946†
7/1/04 to 3/31/05	5.35%	\$100,199†
7/1/03 to 6/30/04	5.05%	\$122,040
7/1/02 to 6/30/03	6.79%	\$156,909
7/1/01 to 6/30/02	7.22%	\$154,088
7/1/00 to 6/30/01	5.15%	\$107,588

†Through 7/31/05

LOSS RECOUPMENT

The law requires the Facility to operate at neither a profit nor a loss. Because of increased losses in the Facility and the effect of refunding premiums and interest following the resolution of the North Carolina Rate Bureau 2002 and 2003 voluntary private passenger rate cases, the Facility is now in a significant loss position for the first time in many years.

The law requires that this loss be recouped by surcharges which, like the “clean risks” surcharge, are applied only to the liability coverages of motor vehicle policies.

During a meeting held on December 20, 2004, the Board of Governors voted (1) with respect to private passenger non-fleet policies to implement a loss recoupment surcharge of 4.17% (before agent compensation) to be applied to policies written to become effective on or after April 1, 2005; and (2) with respect to other than private passenger non-fleet risks, that no loss recoupment surcharge be applied.

A summary of all loss recoupments since the inception of the loss recoupment through April 2005 is located in the Appendix.

LOSS RECOUPMENT SURCHARGE ACTIVITY BY PERIOD

Surcharge Period	Surcharge Percentage	Surcharge Written
4/1/05 to 3/31/06	4.17%	\$36,474†

†Through 7/31/05

FINANCIAL RESULTS

Facility financial reports are prepared and distributed quarterly to member companies. The Facility operates on a fiscal year from October 1 to September 30.

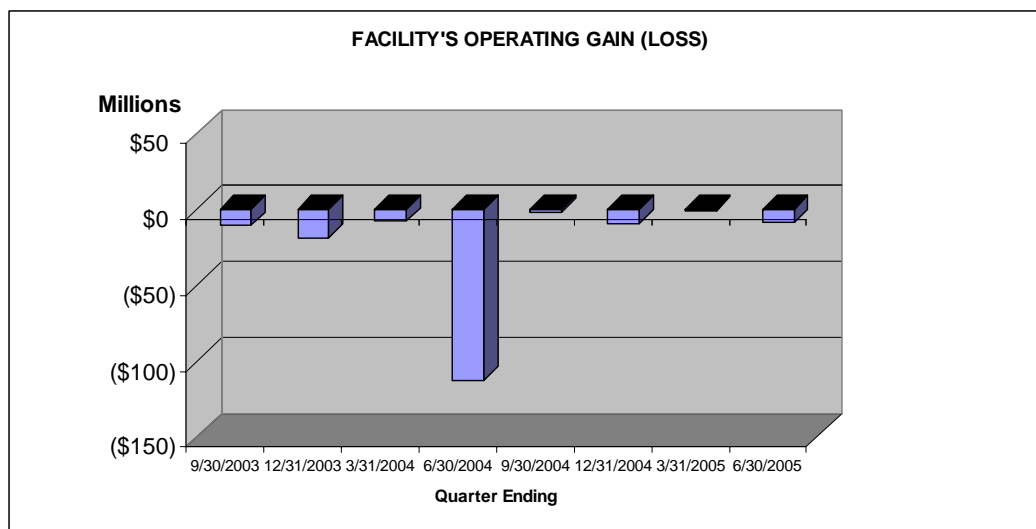
Results from the most recent period are detailed in the Income Statement, Balance Sheet and Comparative Statements of Income for the last five years located in the Appendix.

SUMMARY

The Facility sustained a loss from operations for the three months ending June 30, 2005; however, members' equity actually increased as a result of loss recoupments reported by member companies. The loss from operations for the quarter was \$8.96 million, bringing the fiscal year-to-date loss to \$19.2 million. As noted later in this narrative, this increase is mostly attributable to an increase in incurred losses of \$24.4 million from the prior quarter. Earned premiums and clean risk recoupments also increased over the most recent quarter, but at a more moderate pace, partially offsetting some of the increase in incurred losses.

This quarter is somewhat unusual in that the other than private passenger business lost \$7.6 million and the private passenger business sustained a loss of approximately \$1.3 million. While the reasons are unclear as to this occurrence, this is disproportionate to recent periods and staff is currently reviewing the data in detail.

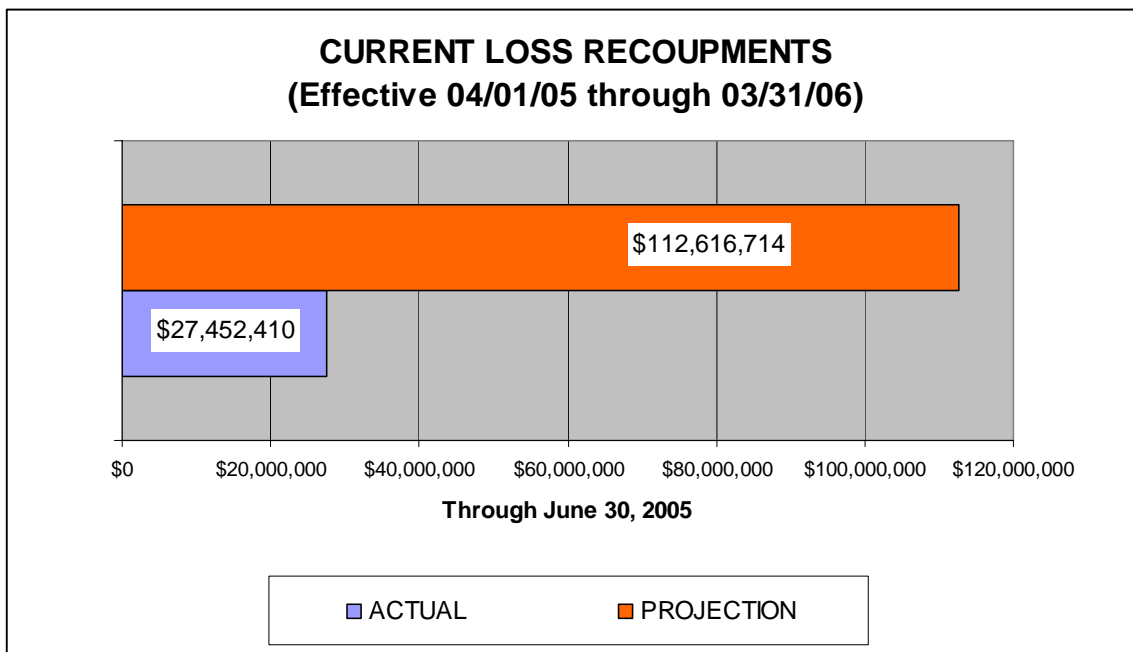
The following chart reflects the Facility's quarterly results from operations over the last eight quarters.



Facility Operations continued...

These results for the quarter exclude loss recoupments reported to the Facility by member companies – consistent with the Facility’s accounting practice for recording loss recoupments. Loss recoupments reported during the most recent quarter approximated \$25.8 million. These offset the loss from operations for the current quarter to bring the Facility’s members’ deficit to approximately \$104.3 million as of June 30, 2005 – an improvement of almost \$17 million during the quarter.

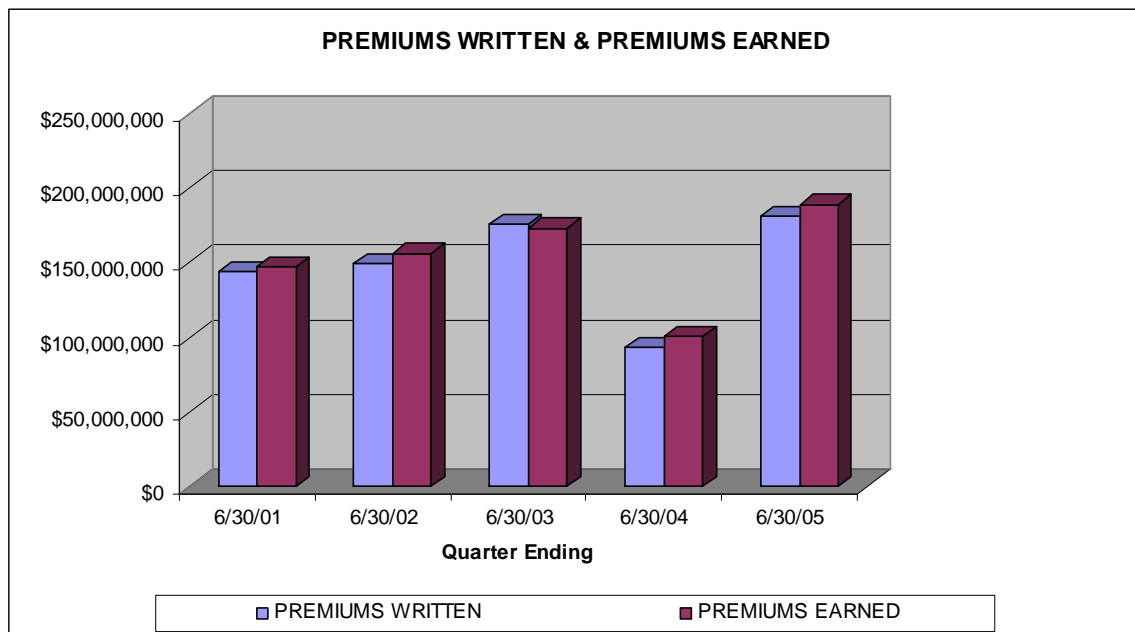
As noted previously, the Facility’s Board of Governors approved the implementation of a loss recoupment surcharge in an effort to recover approximately \$112.7 million – the amount of members’ deficit that existed at September 30, 2004. The chart below compares the actual recoupments to the targeted projection at June 30, 2005.



UNDERWRITING INCOME

Premiums

Premiums written for the quarter ending June 30, 2005 were approximately \$181.2 million and earned premiums totaled \$189.2 million. Reviewing the quarters ending June 30, written premiums were up 3.77%, 3.05% and 21.64% over comparable periods the last three years, respectively – after eliminating the affect of the premium refunds recorded in the quarter ending June 30, 2004.



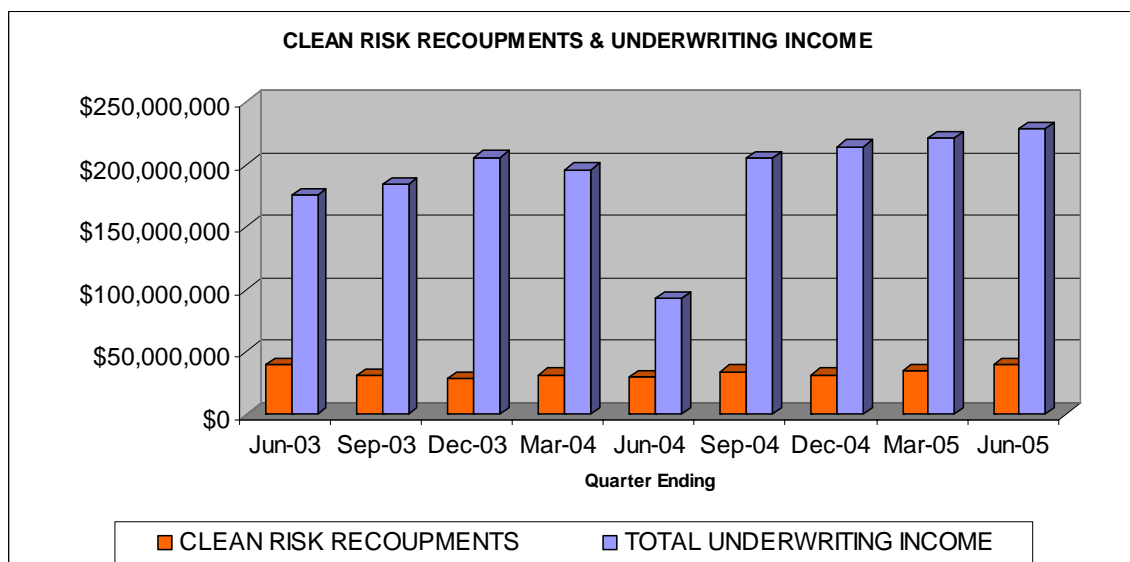
Facility Operations continued...

Recoupment

The general statutes provide that clean risk recoupments may be implemented to offset the inadequate premium charged to clean risks ceded to the Facility that must be written at the voluntary rates. The income derived from these recoupments is significant in the overall operating results of the Facility as it lessens the loss sustained in part due to the inadequate premium rate levels.

Clean risk recoupment income totaled \$39.6 million for the quarter ending June 30, 2005, up approximately 13.1% from the prior quarter and 33.6% from the same period a year ago. The increase from a year ago is mainly attributable to the higher surcharge implemented on policies becoming effective between April 1, 2005 and September 30, 2005. The current clean risk recoupment surcharge is 6.43% compared to 5.05% that was in effect a year ago. During the most recent quarter, clean risk recoupment income comprised approximately 17.3% of total underwriting income – slightly higher than the 14% for the same quarter last year – after adjusting for the affect of the premium refunds.

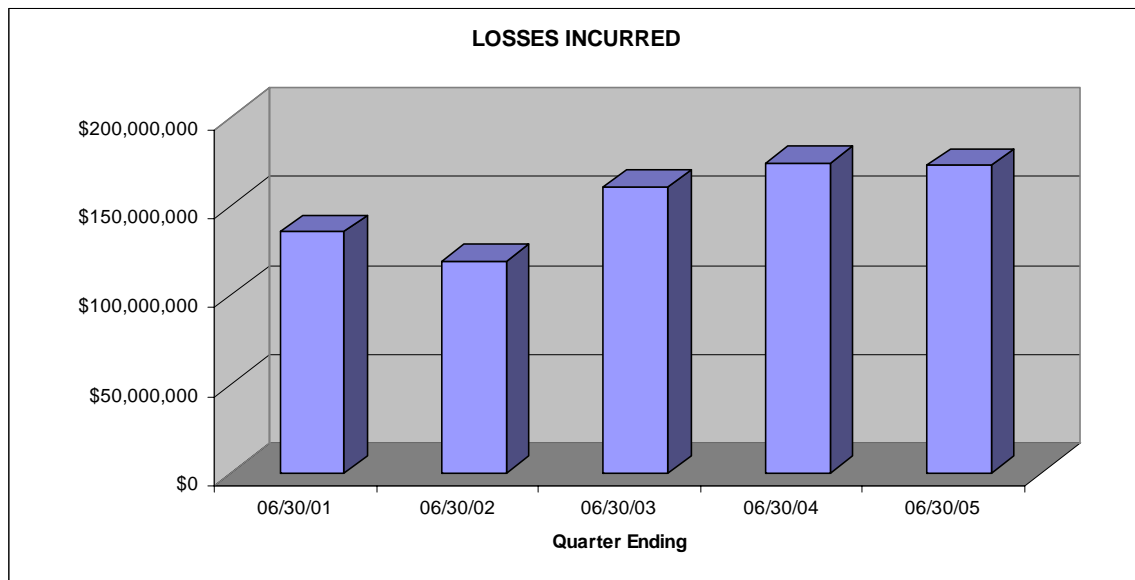
The chart below reflects the quarterly clean risk recoupments in relation to the Facility's total underwriting income since June 2003. (Please note that the premium refunds as required by the orders relating to the 2001 and 2002 rate cases are reflected in total underwriting income in the June 2004 quarter; however, they did not affect clean risk recoupment income.)



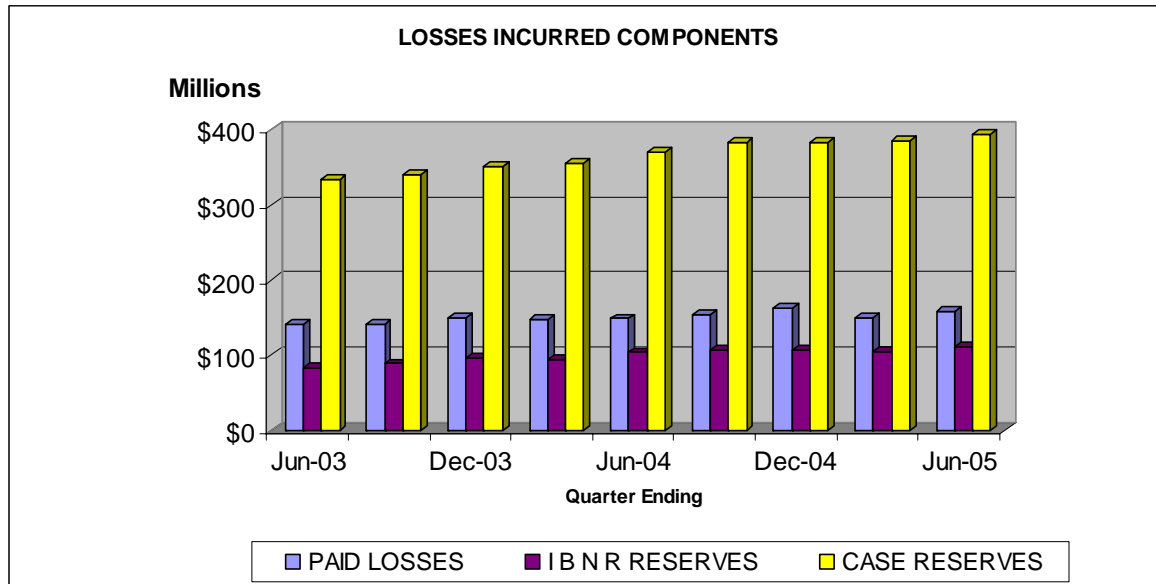
UNDERWRITING DEDUCTIONS

Losses Incurred

Losses incurred totaled \$172.7 million for the quarter ending June 30, 2005 – an increase of approximately 16.4% from the prior quarter and slightly under the \$174.2 million incurred during the same period a year ago. The Facility's loss ratio – as a percentage of earned premiums – was approximately 91.3% for the most recent quarter which is slightly over the average of 89.3% for the last three years. The following exhibits reflect the comparison of incurred losses over comparable periods and the individual components – by quarter – since June 2003.



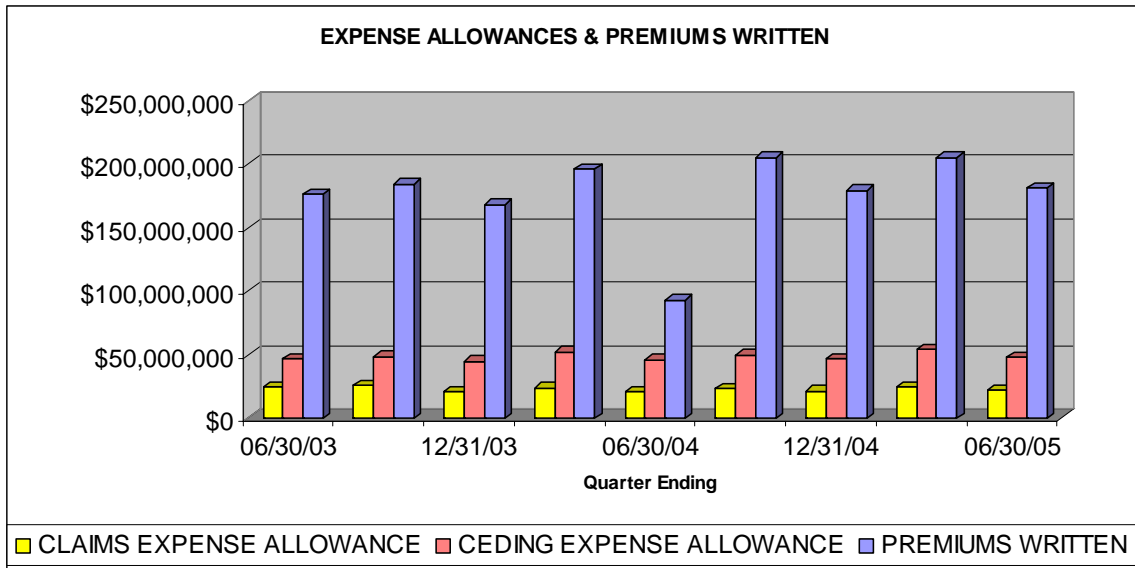
Facility Operations continued...



Expense Allowances

Ceding and Claims Expense Allowances approximate 38% of premiums written for the current quarter and remain consistent with our projections. The following chart reflects the claims and ceding expense allowances and their relation to premiums written over the last two years. (Please note that the premium refunds as required by the orders relating to the 2001 and 2002 rate cases are reflected in premiums written in the June 2004 quarter; however, they did not affect the expense allowances.)

Facility Operations continued...



INVESTMENTS

The Facility's formal investment program was implemented in 1978 in response to needs created when the Facility law was changed materially in 1977. Allstate Insurance Company, Nationwide Mutual Insurance Company (Chairman) and Royal Insurance Company of America constituted the Investment Committee at the close of the period covered by this report. That Committee continued during the year overseeing the Facility's investment program managed by Evergreen Investments, an institutional investment division of Wachovia Bank. A separate report is provided by the Investment Committee.

The following chart summarizes investment activity for the past five years:

INVESTMENT ACTIVITY BY FISCAL PERIOD

Fiscal Period	Total Investment Income	Ending Investment Balance	Total Return on Investment
FYE 9/30/05†	\$25,355,017	\$631,133,842	2.21%
FYE 9/30/04	\$29,988,513	\$670,338,084	2.20%
FYE 9/30/03	\$39,297,653	\$666,676,755	2.84%
FYE 9/30/02	\$34,942,510	\$616,342,242	4.12%
FYE 9/30/01	\$43,224,647	\$579,014,754	5.74%

† Un-audited

OPERATING EXPENSES

The operating expenses of the Facility increased substantially from the prior fiscal period. Some of the increase is the result of strategic operational decisions implemented within the past year that did not fully impact the operational expenses until the most recent report year. Those activities include (1) the additional Facility staff necessitated by the increased emphasis on compliance activity; (2) the change in the allocation of expenses billed by the Insurance Services Office, Inc. for actuarial and other rate related services billed to the Facility and the Rate Bureau; (3) expenses related to the analysis and development of a new information system for the processing of Facility transactions.

The operating expenses were also significantly impacted by an increased allocation of IT resources to primarily assist with the system development. System development expenses and other IT expenses represented approximately 21% of the increase from last year. Consulting services – including the expenses related to services provided by the Insurance Services Office, Inc. – accounted for an additional 18% of the increase in operating expenses over the prior year.

During the past year, the Facility has also experienced an increase in activities requiring the assistance of legal counsel. The Facility automobile rate filing, revisions in the methodology for determining clean risk and loss recoupment surcharges, development of internal controls and other matters have resulted in an increase of almost 70% in our legal expenses compared to the prior fiscal year.

The Facility has also realized increases in employee benefit expenses as a result of an increased staff level over the last two years and the increase premiums related to the medical and dental plans.

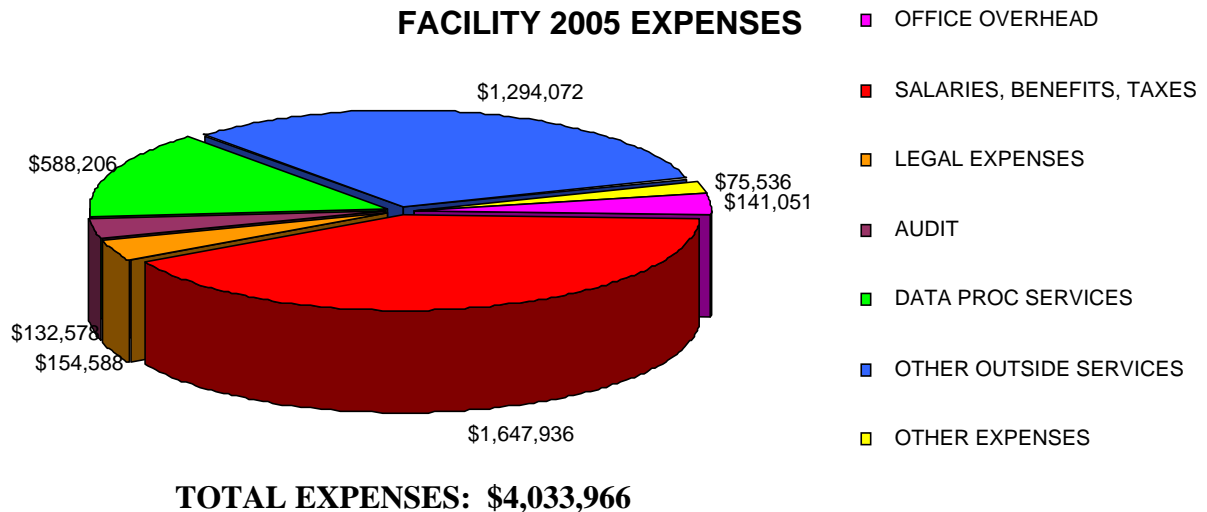
While expenses are much higher than last year, the projections are the Facility will remain within its 2005 budget as many of the aforementioned expenses were anticipated. Again, we believe these increases reflect strategic decisions to improve our operations and provide effective and efficient services to our constituents.

The exhibit and chart on the following page reflect a more detailed overview of the Facility's operating expenses.

Facility Operations continued...

Operating Expenses

CATEGORY	2005 EXPENSES	2004 EXPENSES
SALARIES & ADMINISTRATION	\$1,212,155	\$914,337
PAYROLL TAXES	\$59,428	\$51,681
RENT & ALTERATIONS	\$74,299	\$51,965
SOFTWARE & SYSTEMS	\$128,106	\$15,517
POSTAGE	\$4,974	\$5,133
PRINTING & SUPPLIES	\$14,863	\$14,850
FURNITURE & EQUIPMENT	\$20,890	\$17,921
TELEPHONE	\$26,025	\$12,270
EMPLOYEE BENEFITS	\$376,352	\$298,698
LEGAL EXPENSES	\$154,588	\$91,131
AUDIT	\$132,578	\$118,459
DATA PROCESSING SERVICES	\$460,100	\$353,569
OTHER OUTSIDE SERVICES	\$1,294,072	\$1,008,530
OTHER EXPENSES	\$75,536	\$54,154
TOTAL OPERATING EXPENSES	\$4,033,966	\$3,008,217



COMPLIANCE ACTIVITY

At the direction of the Board, the Facility has significantly increased its focus on member compliance in recent years. Ongoing activities in Compliance included the development of new process documentation; and a review and refinement of all audit procedures. The Audit and Compliance committees share oversight responsibilities and provide general direction for staff audit activities. These audit activities included review of over 5,000 files and more than 100 reporting companies or groups in three principal areas.

PREMIUMS

A sample review of ceded policy files was conducted to assure that transactions reported to the Facility was supported by proper documentation and that the Facility Rules of Operation were being followed. Policies were tested for various attributes including eligibility, promptness and accuracy of reported premium transactions, accuracy of premium computations, and applicability of ceded limits.

These audits detected non-compliance situations such as failure to correctly implement new rate changes, failure to report premium, and policies ceded for ineligible risks. In each case, the member company was informed, and staff worked with the company to correct or reverse the transactions.

In connection with the rating of "all other" risks ceded to the Facility which qualified for experience rating, the staff provided assistance in obtaining the necessary experience rating data and in the calculation of experience modifications. Staff conducted several training sessions for member company personnel at the Facility Office, as well as compiled a list of Frequently Asked Questions about ceded commercial coverages to be posted on our web site. Staff continues to collaborate with the North Carolina Rate Bureau automobile staff on the revision of the NCRF Commercial Automobile Rating Manual.

Audits were conducted of each designated carrier's processing activities and the activities of designated agents as required by Section 6 of the Standard Practice Manual in connection with designated business.

RECOUPMENTS

Continued emphasis was placed on checking the accuracy of recoupment surcharge totals reported by member companies and verifying that recoupment surcharges on both ceded and non-ceded policies were properly applied. This year has been a year of clarification on issues such as the application of recoupment surcharges to private passenger vehicles written on commercial policies, and recoupment audit methods used by staff.

CLAIMS

The Claims Staff receives additional general guidance from the Claims Committee and Claims Quality Control Committee. During this report period a sample review of ceded policy files was conducted to assure that paid loss transactions reported to the Facility were eligible for cession, accurate, supported by proper documentation and that the Facility Rules of Operation were being followed.

Each of the files reviewed was evaluated as provided in the NCRF Claim Quality Review Program as to promptness of contact, application of coverage, promptness and adequacy of investigation, verification of damages, recognition of recovery potential, adequacy of reporting to file, adequacy of supervision, correctness of analysis and evaluation, and negotiation and settlement performance.

Correction of any dollar accounting errors were required to be made immediately, and any systematic deviations or questionable trends noted as a result of these audits were brought to the carriers' attention for remedial action and to the attention of the appropriate Facility Advisory Committee for review.

Audits were conducted of each designated carrier's processing activities and the activities of designated agents as required by Section 6 of the Standard Practice Manual in connection with designated business.

Special claim audits were conducted in the following areas: bodily injury and property damage claims in excess of minimum limits; eligibility of losses reported with accident dates within the first 30 days of the policy term; claim adjustment expense payments miscoded as loss payments or included in claim payments; proper effort being made concerning salvage and subrogation recovery and credit to the Facility; review and

Facility Operations continued...

analysis of monthly losses paid reports and quarterly losses outstanding reports from all ceding member companies; and that claims reported under uninsured motorist property damage did not have collision coverage available.

Any areas of claim performance considered sub-standard were brought to the attention of the ceding company. No intentional deviation from the Rules of Operation was noted. Any problem areas or discrepancies noted as a result of these audits were brought also to the carriers' attention for corrective action.

In connection with the annual audit of the Facility financial statements by independent auditors, the Staff provided assistance wherever possible, including review of documentation and evaluation of controls at member companies.

The Staff continues to review monthly reports and correspondence on a day-to-day basis for any indication for non-compliance with the Rules of Operation. Any discrepancies are noted and followed up with member companies to insure that corrective action is taken.

INTERNAL AUDIT

As defined by the Institute of Internal Auditors, internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Adopting this definition to focus the roles and responsibilities of the internal audit staff, the Organizations made substantial progress during the year toward establishing a comprehensive internal control structure following the concepts of the COSO Internal Control Integrated Framework. Concentrating on internal controls over financial reporting, processes were analyzed and documented, risks were assessed and appropriate controls were developed to mitigate those risks. This involved identification of significant accounts impacting the financial statements, identification of relevant assertions, detailing processes that influence each significant account and formulating appropriate controls.

The risk assessment and control matrix with respect to financial reporting was substantially completed by year end, although further refinements will be made as assessment and review will be ongoing. While priority was given to financial reporting, similar efforts were also in progress regarding controls relating to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. Plans were made to begin evaluation and testing of control effectiveness as soon as feasible.

Further advances were evident in the control environment, as governing bodies and advisory committees became more active in addressing audit and control issues and providing direction to staff and counsel regarding control activities, monitoring, information gathering and communication. This included an evaluation of the various components of the internal control structure using the Audit Committee Toolkit published by the AICPA.

Staff endeavored to remain current as to prevailing best practices through research, training and education, involvement in professional associations, and communication with counterparts in industry. Continuing efforts were made to promote Organization-

Facility Operations continued...

Internal Audit

wide awareness of the internal control environment. Periodic reports were made by staff regarding the Associates Accounting Complaints Policy, with no complaints submitted to date.

In accordance with the COSO framework, internal control is a process requiring the involvement of Board and Committee members, managers and associates at all levels within the Organizations. The continuing efforts of these individuals will help the Organizations achieve the objectives of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations.

RATES, FORMS AND RULES CHANGES

RATE REVISIONS

1) 2005 Private Passenger Automobile Insurance Rate Filing

On February 1, 2005, the Rate Bureau filed with the Commissioner of Insurance revised rates for private passenger automobiles and motorcycles. The filing proposed an overall rate level increase of 11.5% for private passenger automobile liability and physical damage and an increase of 0.2% for motorcycle liability. It was proposed to become effective October 1, 2005.

On March 31, 2005, the Commissioner of Insurance issued a Notice of Public Hearing in connection with this filing and scheduled a public hearing to convene on September 26, 2005.

On July 29, 2005, the Rate Bureau filed revisions to the filing as a result of two errors, one by Insurance Services Office (ISO) in aggregating the paid loss data for automobile liability coverages for one quarter and one by PCI in reporting the automobile liability excess paid losses for calendar year 2003. A simple correction of these two errors would have resulted in only slight adjustments to the filed liability rate level changes. However, it was determined that, since the loss trends that were selected were based on erroneous data and since more recent trend data was available, the liability trends should be revisited. It was also determined that since the liability trends were being revisited, the physical damage trend selections should also be revisited. As a result, the overall filed automobile rate level changed from 11.5% to a revised 9.6% and the motorcycle liability filed indications changed from 0.2% to -1.5%.

The matter remained pending before the Commissioner of Insurance at the close of the period covered by this Report.

2) 2005 Commercial Automobile Liability Rate Filing

On February 3, 2005, the Reinsurance Facility filed with the Commissioner of Insurance (1) revised basic limits commercial automobile rates for commercial cars, garages and private passenger types not eligible for rating under the North Carolina Personal Automobile Policy; and (2) bodily injury and property damage liability increased limits tables for such coverages rated under the Facility's Commercial Automobile Insurance Manual.

Rates, Forms and Rules Changes continued...

Rate Revisions

This rate level change resulted in an overall average rate level decrease of -0.1%. This change became effective with respect to policies effective on or after July 1, 2005.

3) 2005 Private Passenger Automobile Insurance Rate Filing for “Other That Clean Risks”

On July 1, 2005, the Reinsurance Facility filed with the Commissioner of Insurance base rate changes for bodily injury and property damage liability and medical payments insurance for non-fleet private passenger automobiles ceded to the Reinsurance Facility and bodily injury and property damage liability insurance for motorcycles ceded to the Reinsurance Facility. The filed rates applied only to risks other than “clean risks” as defined in G.S. 58-37-35(1). This rate level revision resulted in an overall average rate level decrease of -3.3% for automobiles and -14.5% for motorcycles. This revision became effective with respect to policies effective on or after October 1, 2005.

FILING ACTIVITIES

The following automobile insurance filings submitted by the Reinsurance Facility were approved or deemed approved by the Commissioner of Insurance during the year ended August 31, 2005:

FILING DATE	SUBJECT
September 21, 2004	Endorsement NC 03 50 09 04 – Amendment of Policy Provisions
October 4, 2004	Commercial Auto Forms and Rules Terrorism Risk Act of 2002 – Conditional & Post-TRIA Endorsements
June 2, 2005	Revision to Safe Driver Insurance Plan Aggressive Driver
July 13, 2005	Private Passenger Automobile Manual Revision

OTHER FACILITY ACTIVITY

INFORMATION TECHNOLOGY REVIEW

The IT Department is a shared department that serves the IT service delivery and support requirements of the three Organizations (NCRF, NCIGA and NCRB). The department is divided into two units, Infrastructure and Projects, which report to the IT Manager. The Infrastructure Staff consists of a Database Administrator, Network Administrator, and two Help Desk Technicians, while Projects consists of two Project Managers who handle the full IT Project Portfolio for the Organizations.

The mission of our department is to be accountable for managing the planning, acquisition, maintenance and support of technology solutions that align with the Organizations business strategies, objectives and processes. To assist the business units with better understanding their technology needs, IT has worked with the business units to plan the staffing and development of Business Application Analysts (BAA) in each unit. These new positions help translate business requirements into technology needs and act as a resource for projects handling key service delivery tasks such as QA, training and documentation. As of this report, the Finance department has hired a full time BAA, and a second is being recruited for NCRF, with plans for additional areas being assessed for 2006.

For tasks that do not require full-time staffing, IT relies on its third-party vendors for supplemental efforts. These vendors assist with technical, project, consulting, coaching, and legal matters.

IT is governed by a technology and architecture framework that complements the three separate but co-existing Organizations. This framework guides us to choose solutions that are mature, have industry-wide acceptance, follow a service-oriented architecture and can easily integrate within our current IT infrastructure.

Senior Management continues to act as the Organizations' "project steering committee". Over the last year, IT delivered the following services: 1) additional Document Management capability for the Organizations to archive important documents for business continuity purposes; 2) a new Corporate Identity for each Organization; 3) a Member Company Assessment application; 4) improvements to the existing Industry Data collection web-based applications; 5) enhancements to the insolvency processing system of the IGA; 6) access to internet-based conferencing via Microsoft Live Meeting;

Other Facility Activity continued...

Information Technology Review

7) Organization-wide Microsoft Office upgrade; 8) additional fax-from-desktop capability; 9) remote access from home via a secure VPN; 10) a full scale infrastructure security assessment; 11) audit and control software; 12) contributions to the Organizations Business Continuity effort (of which IT Disaster Recovery is a major factor); and 13) major infrastructure upgrades to accommodate upcoming project deliverables (including redundant web farms and test systems).

Effort continues on the following projects initiated in 2004: 1) EDGE (the NCRF's Information System project); 2) a membership-based Contact Management System for the Organizations to track their customers, 3) a secure Web-Portal for customer access to the Organizations website; 4) Interfaces from business unit applications into the Accounting system for EFT and Billing purposes; and 5) a web-based workers compensation Assigned Risk application.

HUMAN RESOURCES REVIEW

This year we have continued our responsibilities of administering HR policies, programs and practices for the 99 associates comprising the three organizations (NCRF, NCRB, NCIGA).

New for 2005, we introduced the first initiative of our Wellness Strategy in February & April with a voluntary weight loss program. Fifty-five associates participated with a total of 256.2 pounds lost. We are currently in our third session.

In May, we introduced our second initiative by offering membership with Gold's Gym at discount prices, we have 16 associates participating.

In July, we held our first annual Wellness Week. During the week our benefit vendors were on-site for Q&A's, a Lunch-n-Learn session on Stress Management was offered, associates participated in cholesterol and blood pressure screenings, and a seminar on the major components of wellness including proper nutrition, regular exercise, heart health, balanced lifestyle and stress management was held.

Our wellness strategy is two fold, the first being a healthy associate and the second a decrease in health care costs.

Educating our associates is an on-going initiative which consisted of the following this year:

- Year-to-date training coordination included 31 associates during the 1st quarter, 98 associates during the 2nd quarter and 92 associates in the 3rd quarter.
- We coordinated Diversity Training for all associates during August and September.
- We coordinated Management training in September and will be conducting associate training in November.

Performance of our associates is essential in providing service to our member companies. Written performance feedback is provided by management in January with the Annual Performance Evaluation and in June with a goals review.

Other Facility Activity continued...

Human Resources Review

HR's strategic mission is to support the goals and challenges of the Organizations by providing services which promote a work environment that is characterized by fair treatment of associates, open communications, personal accountability, trust and mutual respect.

FACILITY MANUAL AMENDMENTS

Section 3 of the North Carolina Reinsurance Facility Standard Practice Manual was modified to reflect cession telecommunication procedures currently in use and make certain related editorial changes to the file formats. Editorial revisions were undertaken to Sections 2 and 6 to reflect the division of responsibilities between the Audit Committee and the Compliance Committee as provided in their respective charters. Section 4 of the Manual was amended to reflect annual updates and additions to the clean risk and loss recoupment surcharges percentages effective April 1, 2005; and to remove obsolete language.

COMPANY EXEMPTIONS

Under the provisions of G.S. 58-37-55, the Board of Governors may exempt a company from selling and servicing a particular category of business if the company is not qualified to service the business. During the period covered by this report there were no new requests for exemptions.

Since inception of the Facility, the Board has approved five exemption requests. The two approved exemptions, which remained in effect on September 30, 2005, were for American Reinsurance Company to write only excess insurance and for Midwest Mutual Insurance Company to insure only motorcycles and certain types of four-wheel all terrain vehicles.

APPEALS

G.S. 58-37-65 and Article XV of the Plan of Operation provide for appeals to the Board of Governors by an affected insured, agent or company member of the Facility on any alleged improper ruling of the Facility. During the period covered by this report there were no appeals requested by any member companies.

LEGISLATION

The North Carolina General Assembly met in 2005 and passed House Bill 1236 with an effective date of October 1, 2005, and amended North Carolina Governing Statute 58-37-35 (d) which defines the composition of the Board of Governors. The purpose of the change was to recognize the merger of the Alliance of American Insurers and the National Association of Independent Insurers which became Property Casualty Insurance Association of America. This statute change will provide for one member company representative from Property Casualty Insurance Association of America and create one representative from the industry at large regardless of trade affiliation, to be selected by the insurer company members of the Board. It is anticipated that a corresponding change to the Plan of Operation will be approved by member companies at the 2005 Annual Meeting.

Also passed during this session was Senate Bill 622 which increased the fee that the North Carolina Division of Motor Vehicles charges insurers for records of convictions for moving traffic offenses from \$5 to \$8.

DESIGNATED AGENT PROGRAM

The annual volume of business in the designated agent program has continued to decrease to approximately \$1.8 million, as market availability is generally not a problem. There were 20 designated agents and two designated carriers at the beginning of the fiscal year. No agent applications for designated carrier assignment were received from the Department of Insurance during the year. Two agents were eliminated from the program during the year through termination of appointment by the agent. There were 18 designated agents assigned to three designated carriers as of September 30, 2005. There were no agent applications pending assignment on that date.

Other Facility Activity continued...

With respect to the Facility's annual review of designated business, the Board of Governors directed that the Task force on NCRF Expense Allowances review the designated carriers' expense indications for ceding and claims expense allowances for designated business. The Board reviewed the procedures and findings of the audits of designated carriers. The Task Force on NCRF Expense Allowances reviewed this issue on July 12, 2004.

The Board of Governors, upon the recommendations of the Task Force on NCRF Expense Allowances, established designated carrier expense allowances for the fiscal year beginning October 1, 2005. The Board of Governors accepted the Report of Audit of Designated Carriers prepared by Facility staff and reviewed the eligibility status of each designated carrier. The Board determined that Atlantic Casualty Insurance Company, Integon General Insurance Corporation and Integon National Insurance Corporation were eligible to be appointed to serve as designated carriers for the Facility.

Subsequently, the Facility executed new contracts with three companies to serve as designated carriers to become effective October 1, 2005.

APPENDIX

- I. North Carolina Automobile Liability Insurance Written Premiums
by Calendar Year
- II. NCRF Recoupments and Allocations
- III. NCRF Balance Sheet
- IV. NCRF Income Statement
- V. NCRF Comparative Statements of Income (Quarter ending June 30)
- VI. NCRF Comparative Income Statement (Fiscal Year-to-Date June 30)
- VII. Audited Special-Purpose Financial Statements

**NORTH CAROLINA AUTOMOBILE LIABILITY INSURANCE
WRITTEN PREMIUMS BY CALENDAR YEAR**

(Thousands of Dollars)

(1) Calendar <u>Year</u>	(2) Total N.C. Direct <u>Written Premium</u>	(3) NCRF Ceded <u>Written Premium</u>	(4) <u>(3)÷(2)</u>
1975	\$320,161	\$ 74,053	.231
1976	340,110	89,147	.262
1977	362,035	99,642	.275
1978	398,550	118,227	.297
1979	443,581	133,645	.301
1980	488,983	141,754	.290
1981	515,649	140,465	.272
1982	544,376	150,129	.276
1983	593,253	152,077	.256
1984	634,560	155,434	.245
1985	758,232	186,310	.246
1986	951,085	239,900	.252
1987	1,067,169	287,809	.270
1988	1,258,719	341,431	.271
1989	1,421,243	386,390	.272
1990	1,547,832	414,208	.268
1991	1,671,347	438,631	.262
1992	1,771,361	466,693	.263
1993	1,843,534	473,768	.257
1994	1,944,289	510,487	.263
1995	2,144,433	557,126	.260
1996	2,200,938	577,528	.262
1997	2,253,254	616,497	.274
1998	2,329,153	619,752	.266
1999	2,313,278	584,055	.252
2000	2,249,850	570,561*	.254
2001	2,431,964	594,902	.245
2002	2,571,791	634,106	.247
2003	2,782,357	712,260	.256
2004	2,981,517	735,572**	.247

*Excludes premium refunds totaling \$54.3 million.

**Excludes premium refunds totaling \$61.7 million.

NCRF RECOUPMENTS AND ALLOCATIONS

Type	Applicable to Policies Effective	Which Policies?	Percent Surcharge	Recovered Thru 7/31/05 (Thousands)
φ Clean Risk Recoupment	3/1/80- 2/28/81	All Subj. to SDIP	1.1%	4,549
φ Clean Risk Recoupment	3/1/81- 9/30/81	All Subj. to SDIP	1.4%	3,147
φ Clean Risk Recoupment	10/1/81- 3/31/82	All Pointed SDIP	1.8% *	1,511
φ Clean Risk Recoupment	4/1/82- 3/31/83	All Pointed SDIP	4.0% *	6,558
φ Clean Risk Recoupment	4/1/83- 3/31/84	All Pointed SDIP	4.2% *	6,975
φ Clean Risk Recoupment	4/1/84- 3/31/85	All Pointed SDIP	4.3% *	7,151
φ Clean Risk Recoupment	4/1/85- 3/31/86	All Pointed SDIP	5.7% *	10,643
φ Clean Risk Recoupment	4/1/86- 3/31/87	All Pointed SDIP	8.1% *	16,495
φ Clean Risk Recoupment	4/1/87- 3/31/88	All Pointed SDIP	8.8% *	22,028
φ Clean Risk Recoupment	4/1/88- 6/30/88	All Pointed SDIP	10.8% *	7,697
φ Clean Risk Allocation	7/1/88- 6/30/89	All PPNF	0.6% *	6,505
φ Clean Risk Recoupment	7/1/88- 6/30/89	All Pointed SDIP	8.6% *	27,573
φ Clean Risk Allocation	7/1/89- 6/30/90	All PPNF	2.8% *	32,242
φ Clean Risk Recoupment	7/1/89- 6/30/90	As Per SDIP	14.6% *	46,012
φ Clean Risk Allocation	7/1/90- 6/30/91	All PPNF	3.65% *	46,518
φ Clean Risk Recoupment	7/1/90- 6/30/91	As Per SDIP	12.60% *	43,509
φ Clean Risk Allocation	7/1/91- 6/30/92	All PPNF	3.85% *	53,835
φ Clean Risk Recoupment	7/1/91- 6/30/92	As Per SDIP	8.60% *	32,076
φ Clean Risk Allocation	7/1/92- 6/30/93	All PPNF	6.79% *	103,103
φ Clean Risk Recoupment	7/1/92- 6/30/93	As Per SDIP	10.23% *	38,778
φ Clean Risk Allocation	7/1/93- 6/30/94	All PPNF	5.68% *	88,755
φ Clean Risk Recoupment	7/1/93- 6/30/94	As Per SDIP	5.00% *	20,302
φ Clean Risk Allocation	7/1/95- 6/30/96	All PPNF	2.98% *	57,818
φ Clean Risk Allocation	7/1/96- 6/30/97	All PPNF	3.71% *	73,055
φ Clean Risk Allocation	7/1/97- 6/30/98	All PPNF	4.11% *	83,142
φ Clean Risk Recoupment	7/1/98- 6/30/99	All PPNF	3.63% *	74,728
φ Clean Risk Recoupment	7/1/99- 6/30/00	All PPNF	1.07% *	23,070
φ Clean Risk Recoupment	7/1/00- 6/30/01	All PPNF	5.15% *	107,588
φ Clean Risk Recoupment	7/1/01- 6/30/02	All PPNF	7.22% *	154,088
† Clean Risk Recoupment	7/1/02- 6/30/03	All PPNF	6.79% *	156,909
Clean Risk Recoupment	7/1/03- 6/30/04	All PPNF	5.05% *	121,275
Clean Risk Recoupment	7/1/04- 3/31/05	All PPNF	5.35% *	100,199
Clean Risk Recoupment	4/1/05- 9/30/05	All PPNF	6.43% *	56,946
Clean Risk Recoupment	10/1/05- 9/30/06	All PPNF	9.71% *	-

φ These surcharges closed in prior years.
 * Excluding agent compensation or commission.
 † This surcharge closed February 29, 2004.

NCRF RECOUPMENTS AND ALLOCATIONS

<u>Type</u>	<u>Loss Period</u>	<u>Applicable to Policies Effective</u>	<u>Which Policies?</u>	<u>Percent Surcharge</u>	<u>Amount of Loss (Millions)</u>	<u>Recovered Thru 7/31/05 (Thousands)</u>
φ Prior Loss-Direct	10/1/77- 9/30/78	3/1/80- 2/28/81	All Facility #	18.6%	\$31.4	\$25,494
φ Prior Loss-Direct	10/1/78- 6/30/79	3/1/81- 9/30/81	All Facility #	16.4%	15.8	11,661
φ Prior Loss-Assmt.	10/1/78- 6/30/79	10/1/81- 2/28/82	All Pointed SDIP	13.3% *	14.3	8,314
φ Qtrly. Assessment	7/1/79- 9/30/79	4/1/80- 6/30/80	All	5.3%	6.6	6,071
φ Qtrly. Assessment	10/1/79-12/31/79	7/1/80- 9/30/80	All	5.3%	6.8	6,453
φ Qtrly. Assessment	1/1/80- 3/31/80	10/1/80-12/31/80	All	4.9%	7.2	5,540
φ Qtrly. Assessment	4/1/80- 6/30/80	1/1/81- 3/31/81	All	8.3%	13.4	10,887
φ Qtrly. Assessment	7/1/80- 9/30/80	4/1/81- 6/30/81	All	5.7%	9.4	6,507
φ Qtrly. Assessment	10/1/80-12/31/80	7/1/81- 9/30/81	All	0.4%	0.6	643
φ Qtrly. Assessment	1/1/81- 3/31/81	10/1/81-12/31/81	All Pointed SDIP	9.7% *	6.1	3,682
φ Qtrly. Assessment	4/1/81- 6/30/81	1/1/82- 3/31/82	All Pointed SDIP	9.7% *	6.6	4,141
φ Qtrly. Assessment**	7/1/81- 9/30/81	4/1/82- 3/31/83	All Pointed SDIP	5.5% *	15.7	9,337
φ Loss Assessment	10/1/81- 9/30/82	4/1/83- 3/31/84	All Pointed SDIP	12.6% *	32.8	21,399
φ Loss Assessment**	10/1/82- 9/30/83	4/1/84- 3/31/85	All Pointed SDIP	20.2% *	47.3	32,954
φ Loss Assessment**	10/1/83- 9/30/84	4/1/85- 3/31/86	All Pointed SDIP	18.6% *	45.2	35,956
φ Loss Assessment**	10/1/77- 9/30/84	4/1/85- 3/31/86	All Except PPNF	2.8% *	4.7	5,542
φ Loss Assessment**	10/1/84- 9/30/85	4/1/86- 3/31/87	All Pointed SDIP	26.9% *	69.7	56,131
φ Loss Assessment	10/1/84- 9/30/85	4/1/86- 3/31/87	All Except PPNF	5.6% *	8.6	12,984
φ Loss Assessment**	10/1/85- 9/30/86	4/1/87- 3/31/88	All Pointed SDIP	31.4% *	80.0	80,772
φ Loss Assessment**	10/1/85- 9/30/86	4/1/87- 3/31/88	All Except PPNF	1.8% *	4.6	4,872
φ Loss Assessment**	10/1/86- 9/30/87	4/1/88- 6/30/88	All Pointed SDIP	35.6% *	23.4	25,100
φ Loss Assessment**	10/1/86- 9/30/87	4/1/88- 6/30/88	All Except PPNF	1.3% *	1.2	732
φ Loss Allocation**	10/1/86-12/31/87	7/1/88- 6/30/89	All PPNF	1.9% *	18.3	19,722
φ Loss Assessment**	10/1/86-12/31/87	7/1/88- 6/30/89	All Pointed SDIP	25.5% *	73.3	81,415
φ Loss Assessment**	10/1/86-12/31/87	7/1/88- 6/30/89	All Except PPNF	1.5% *	6.2	4,766
φ Loss Allocation**	1/1/88-12/31/88	7/1/89- 6/30/90	All PPNF	1.8% *	20.3	20,722
φ Loss Assessment**	1/1/88-12/31/88	7/1/89- 6/30/90	As Per SDIP	9.4% *	30.5	29,013
φ Loss Allocation**	1/1/89-12/31/89	7/1/90- 6/30/91	All PPNF	0.19% *	2.5	2,358
φ Loss Assessment**	1/1/89-12/31/89	7/1/90- 6/30/91	As Per SDIP	0.67% *	2.5	2,292
Loss Assessment	4/1/05-3/31/06	4/1/05- 3/31/06	All PPNF	4.17% *	112.7	36,474

φ These surcharges closed in prior years.
 # Except certain policies produced by designated agents.
 * Excluding agent compensation or commission.
 ** Includes shortfalls from prior recoupments.

NORTH CAROLINA REINSURANCE FACILITY

BALANCE SHEET

June 30, 2005

ASSETS

Cash Unrestricted	\$109,014.27
Cash Restricted (Including Escrow)	0.00
Investments	605,790,815.84
Accrued Interest Receivable	6,368,659.07
Accounts Receivable - Member Company Balances	47,366,617.10
Miscellaneous Charges Receivable (Net)	58,779.16
Membership Fees Receivable	0.00
Assessments Receivable	92.02
Computer Equipment (Net)	0.00
Other Assets	0.00
Total Assets	\$659,693,977.46

LIABILITIES TO MEMBER COMPANIES

Miscellaneous Accounts Payable - Rounding	\$0.00
Reserve - Unearned Premiums	228,450,521.00
Earned But Unbilled Premium Reserve	(38,168.00)
Premium Deficiency Reserve	0.00
Reserve - Outstanding Losses - Case	393,263,166.58
Reserve - Outstanding Losses - IBNR	110,922,457.00
Advanced Premium Liability	256,137.00
Deferred Revenue - Recoupment	0.00
Provision for Premium Refunds	0.00
Accounts Payable - Member Company Balances	31,164,382.57
Accounts Payable - Miscellaneous	(490.84)
Total Liabilities	\$764,018,005.31
Participating Members' Equity	(104,324,027.85)
Total Liabilities and Members' Equity	\$659,693,977.46

NORTH CAROLINA REINSURANCE FACILITY
Statement of Income - All Policy Years Combined
Fiscal Year Commencing October 1, 2004
Quarter Ending June 30, 2005

	<u>Current Quarter</u>	<u>Fiscal Year-to-Date</u>	<u>Inception to Date</u>
Underwriting Income			
Premiums Written	\$181,220,420.63	\$565,437,006.16	\$11,547,347,325.33
Unearned Premiums (Prior)	236,398,037.00	221,227,798.00	0.00
Unearned Premiums (Current)	(228,450,521.00)	(228,450,521.00)	(228,450,521.00)
Earned but Unbilled Premium (Prior)	(28,114.00)	(47,092.00)	0.00
Earned but Unbilled Premium (Current)	38,168.00	38,168.00	38,168.00
<hr/>			
Premiums Earned	\$189,177,990.63	\$558,205,359.16	\$11,318,934,972.33
Clean Risk Subsidy	39,640,679.59	106,455,270.68	1,620,933,165.06
<hr/>			
Total Underwriting Income	\$228,818,670.22	\$664,660,629.84	\$12,939,868,137.39
<hr/>			
Underwriting Deductions			
Losses Incurred	\$172,697,530.53	\$484,147,802.11	\$10,188,450,951.74
Change in Premium Deficiency Reserve	0.00	0.00	0.00
Claims Expense Allowance	21,826,913.08	67,711,077.42	1,344,030,990.23
Ceding Expense Allowance	47,765,957.20	149,194,535.48	2,894,647,545.22
<hr/>			
Total Deductions	(\$242,290,400.81)	(\$701,053,415.01)	(\$14,427,129,487.19)
<hr/>			
Net Underwriting Gain (Loss)	(\$13,471,730.59)	(\$36,392,785.17)	(\$1,487,261,349.80)
<hr/>			
Miscellaneous Income & Expenses			
Membership Fees	\$700.00	\$49,200.00	\$1,091,400.00
Interest Earned	5,410,433.51	19,362,497.12	825,180,444.94
Other Income	134,536.90	297,611.98	4,315,334.72
Miscellaneous Charges	89,592.85	297,107.50	8,902,852.74
Other Expenses Incurred	(1,121,487.07)	(2,773,355.28)	(97,163,886.76)
<hr/>			
Total Miscellaneous Income & Expenses	\$4,513,776.19	\$17,233,061.32	\$742,326,145.64
<hr/>			
Net Operating Gain (Loss)	(\$8,957,954.40)	(\$19,159,723.85)	(\$744,935,204.16)

MEMBERS EQUITY ACCOUNT

Members' Equity - Beginning of Period	(\$121,184,246.76)	(\$112,616,713.99)	\$0.00
Net Operating Loss Distributed to Member Companies	0.00	0.00	77,699,060.55
Net Operating Gain (Loss)	(8,957,954.40)	(19,159,723.85)	(744,935,204.16)
Loss Recoupment/Allocation	25,818,173.31	27,452,409.99	562,912,115.76
<hr/>			
Members' Equity - End of Period	(\$104,324,027.85)	(\$104,324,027.85)	(\$104,324,027.85)

NORTH CAROLINA REINSURANCE FACILITY
Comparative Statements of Income - All Policy Years Combined
Quarter Ending June 30

	<u>Quarter Ending</u> <u>June 30, 2005</u>	Quarter Ending <u>June 30, 2004</u>	Quarter Ending <u>June 30, 2003</u>	Quarter Ending <u>June 30, 2002</u>	Quarter Ending <u>June 30, 2001</u>
Underwriting Income					
Premiums Written	\$181,220,420.63	\$93,009,906.19	\$175,851,927.86	\$149,019,477.51	\$144,102,098.76
Unearned Premiums (Prior)	236,398,037.00	223,895,648.00	207,807,743.00	188,782,770.00	176,450,701.00
Unearned Premiums (Current)	(228,450,521.00)	(216,496,710.00)	(210,332,289.00)	(181,402,421.00)	(173,211,824.00)
Earned but Unbilled Premium (Prior)	(28,114.00)	(42,034.00)	(77,683.00)	(72,182.00)	(134,580.00)
Earned but Unbilled Premium (Current)	38,168.00	50,680.00	94,890.00	89,184.00	119,615.00
	\$189,177,990.63	\$100,417,490.19	\$173,344,588.86	\$156,416,828.51	\$147,326,010.76
Premiums Earned	39,640,679.59	29,667,732.41	39,588,833.52	38,204,935.72	26,322,312.77
Clean Risk Subsidy					
Total Underwriting Income	\$228,818,670.22	\$130,085,222.60	\$212,933,422.38	\$194,621,764.23	\$173,648,323.53
Underwriting Deductions					
Losses Incurred	\$172,697,530.53	\$174,189,682.48	\$160,774,955.34	\$119,331,144.83	\$135,639,142.26
Change in Premium Deficiency Reserve	0.00	0.00	0.00	0.00	0.00
Claims Expense Allowance	21,826,913.08	20,798,270.10	24,591,149.11	18,953,940.86	19,933,437.46
Ceding Expense Allowance	47,765,957.20	46,131,518.31	46,415,918.19	38,182,049.20	37,695,051.73
Total Deductions	(\$242,290,400.81)	(\$241,119,470.89)	(\$231,782,022.64)	(\$176,467,134.89)	(\$193,267,631.45)
Net Underwriting Gain (Loss)	(\$13,471,730.59)	(\$111,034,248.29)	(\$18,848,600.26)	\$18,154,629.34	(\$19,619,307.92)
Miscellaneous Income & Expenses					
Membership Fees	\$700.00	\$0.00	\$0.00	\$200.00	\$700.00
Interest Earned	5,410,433.51	9,079,638.07	9,295,602.87	10,156,044.10	11,821,310.32
Other Income	134,536.90	158,104.00	26,948.32	89,755.34	84,772.27
Miscellaneous Charges	89,592.85	104,381.03	112,268.99	163,743.70	204,521.29
Other Expenses Incurred	(1,121,487.07)	(10,679,101.79)	(527,838.95)	(447,728.22)	(696,854.20)
Total Miscellaneous Income & Expenses	\$4,513,776.19	(\$1,336,978.69)	\$8,906,981.23	\$9,962,014.92	\$11,414,449.68
Net Operating Gain (Loss)	(\$8,957,954.40)	(\$112,371,226.98)	(\$9,941,619.03)	\$28,116,644.26	(\$8,204,858.24)

NORTH CAROLINA REINSURANCE FACILITY
Comparative Statements of Income - All Policy Years Combined
Fiscal Year-to-Date Through June 30

	Fiscal YTD Through June 30, 2005	Fiscal YTD Through June 30, 2004	Fiscal YTD Through June 30, 2003	Fiscal YTD Through June 30, 2002	Fiscal YTD Through June 30, 2001
Underwriting Income					
Premiums Written	\$565,437,006.16	\$457,568,775.08	\$516,727,053.31	\$461,777,485.01	\$383,918,177.43
Unearned Premiums (Prior)	221,227,798.00	216,568,136.00	190,605,628.00	177,315,375.00	176,102,003.00
Unearned Premiums (Current)	(228,450,521.00)	(216,496,710.00)	(210,332,289.00)	(181,402,421.00)	(173,211,824.00)
Earned but Unbilled Premium (Prior)	(47,092.00)	(110,855.00)	(102,964.00)	(93,260.00)	0.00
Earned but Unbilled Premium (Current)	38,168.00	50,680.00	94,890.00	89,184.00	119,615.00
Premiums Earned	\$558,205,359.16	\$457,580,026.08	\$496,992,318.31	\$457,686,363.01	\$386,927,971.43
Clean Risk Subsidy	106,455,270.68	89,397,798.15	117,844,307.76	115,341,363.68	79,844,497.27
Total Underwriting Income	\$664,660,629.84	\$546,977,824.23	\$614,836,626.07	\$573,027,726.69	\$466,772,468.70
Underwriting Deductions					
Losses Incurred	\$484,147,802.11	\$491,037,313.18	\$423,803,406.73	\$383,468,003.98	\$395,735,109.54
Change in Premium Deficiency Reserve	0.00	0.00	0.00	0.00	0.00
Claims Expense Allowance	67,711,077.42	65,365,503.95	72,047,433.86	58,423,749.40	59,640,677.15
Ceding Expense Allowance	149,194,535.48	142,942,663.00	136,584,724.58	117,626,462.09	112,973,738.13
Total Deductions	(\$701,053,415.01)	(\$699,345,480.13)	(\$632,435,565.17)	(\$559,518,215.47)	(\$568,349,524.82)
Net Underwriting Gain (Loss)	(\$36,392,785.17)	(\$152,367,655.90)	(\$17,598,939.10)	\$13,509,511.22	(\$101,577,056.12)
Miscellaneous Income & Expenses					
Membership Fees	\$49,200.00	\$48,300.00	\$48,600.00	\$47,900.00	\$46,900.00
Interest Earned	19,362,497.12	24,658,299.81	29,582,039.31	27,146,821.91	33,905,851.74
Other Income	297,611.98	226,989.36	63,840.93	359,800.16	216,591.19
Miscellaneous Charges	297,107.50	330,937.54	350,520.07	514,908.95	708,993.22
Other Expenses Incurred	(2,773,355.28)	(11,955,929.60)	(1,888,765.53)	(1,641,671.12)	(23,229,003.90)
Total Miscellaneous Income & Expenses	\$17,233,061.32	\$13,308,597.11	\$28,156,234.78	\$26,427,759.90	\$11,649,332.25
Net Operating Gain (Loss)	(\$19,159,723.85)	(\$139,059,058.79)	\$10,557,295.68	\$39,937,271.12	(\$89,927,723.87)

SPECIAL-PURPOSE FINANCIAL STATEMENTS

North Carolina Reinsurance Facility
(A Partnership)

Years ended September 30, 2004 and 2003 with Report of Independent Auditors

North Carolina Reinsurance Facility (A Partnership)

Audited Special-Purpose Financial Statements

Years ended September 30, 2004 and 2003

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Report of Independent Auditors

Board of Governors
North Carolina Reinsurance Facility

We have audited the accompanying special-purpose balance sheets of the North Carolina Reinsurance Facility (the “Facility”, a partnership) as of September 30, 2004 and 2003 and the related special-purpose statements of operations, members' (deficit) equity and cash flows for the years then ended. These financial statements are the responsibility of the Facility's management. Our responsibility is to express an opinion on these special-purpose financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Facility's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, the “Standard Practice Manual,” which were approved for use by and within the authority of the Chair of the Facility's Board of Governors and are not intended to be a presentation in conformity with accounting principles generally accepted in the United States.

In our opinion, the special-purpose financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Reinsurance Facility at September 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed by the Facility's Standard Practice Manual.

This report is intended solely for the information and use of the Board of Governors, the member companies and the North Carolina Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

January 7, 2005

North Carolina Reinsurance Facility (A Partnership)

Special-Purpose Balance Sheets

	September 30	
	2004	2003
Assets		
Cash and short-term investments	\$ 108,820,022	\$ 13,704,911
Long-term investments, at amortized cost	561,894,492	653,949,661
Accrued interest receivable	6,028,826	7,483,784
Receivables from member companies:		
Settlements	26,789,402	26,994,885
Late premium charges and penalties	23,902	33,773
	<u>26,813,304</u>	<u>27,028,658</u>
Earned but unbilled premiums	47,092	110,855
Total assets	<u>\$ 703,603,736</u>	<u>\$ 702,277,869</u>
Liabilities and members' equity		
Loss and loss adjustment expense reserves		
In course of settlement	\$ 383,017,494	\$ 340,886,672
Incurred but not reported	107,661,364	88,513,340
Total loss and loss adjustment expense reserves	<u>490,678,858</u>	<u>429,400,012</u>
Unearned premium reserves	221,227,798	216,568,136
Provision for premium refunds	67,881,099	-
Settlements payable to member companies	36,301,406	27,885,500
Other liabilities	131,289	60,363
Total liabilities	<u>816,220,450</u>	<u>673,914,011</u>
Commitments and contingencies		
Members' (deficit) equity	<u>(112,616,714)</u>	28,363,858
Total liabilities and members' (deficit) equity	<u>\$ 703,603,736</u>	<u>\$ 702,277,869</u>

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)

Special-Purpose Statements of Operations

	Year ended September 30	
	2004	2003
Premiums earned	\$ 722,046,336	\$ 675,038,074
Clean risk subsidies	123,630,900	148,975,070
Total underwriting income	845,677,236	824,013,144
Losses incurred	661,504,233	578,602,857
Ceding expense allowances	192,784,211	185,013,506
Claims expense allowances	88,271,151	98,065,040
Total underwriting expenses	942,559,595	861,681,403
Net underwriting loss	(96,882,359)	(37,668,259)
Other income (expense):		
Net investment income	23,486,201	28,594,682
Net realized capital gains	6,189,610	10,341,071
Late premium charges and penalties	639,736	537,945
Membership fees	48,400	48,900
Cession notice charges	24,992	24,970
General and administrative expense	(2,632,030)	(2,126,267)
Provision for premium refunds, including interest	(71,936,000)	-
Other miscellaneous income (expenses)	80,878	(3,410)
Total other (expense) income – net	(44,098,213)	37,417,891
Net operating loss	\$(140,980,572)	\$ (250,368)

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)

Special-Purpose Statements of Changes in Members' (Deficit) Equity

	Year ended September 30	
	2004	2003
Members' equity at beginning of year	\$ 28,363,858	\$ 28,614,226
Net operating loss	(140,980,572)	(250,368)
Members' (deficit) equity at end of year	<u>\$ (112,616,714)</u>	<u>\$ 28,363,858</u>

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)

Special-Purpose Statements of Cash Flows

	Year ended September 30	
	2004	2003
Operating activities		
Net operating loss	\$(140,980,572)	\$ (250,368)
Change in operating assets and liabilities:		
Net realized capital gains on investments	(6,189,610)	(10,341,071)
Amortization of bond premiums	5,821,160	3,855,713
Loss and loss adjustment expense reserves	61,278,846	25,975,009
Unearned premium reserves	4,659,662	25,962,508
Receivables/payables from member companies	8,631,260	(1,693,190)
Premium refunds	67,881,099	-
Accrued interest receivable	1,454,958	(327,015)
Earned but unbilled premiums	63,763	(7,891)
Other assets and liabilities	70,926	(8,917)
Net cash provided by operating activities	<u>2,691,492</u>	<u>43,164,778</u>
Investing activities		
Proceeds from sale or maturity of invested assets	368,113,022	409,639,016
Purchase of invested assets	(275,689,403)	(456,619,155)
Net cash provided by (used in) investing activities	<u>92,423,619</u>	<u>(46,980,139)</u>
Net increase (decrease) in cash and short-term investments	95,115,111	(3,815,361)
Cash and short-term investments:		
Beginning of year	13,704,911	17,520,272
End of year	<u>\$ 108,820,022</u>	<u>\$ 13,704,911</u>

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements

September 30, 2004

1. Basis of Presentation and Accounting Policies

The Facility

During its 1973 session, the General Assembly of North Carolina created the North Carolina Reinsurance Facility (the "Facility"), a nonprofit, unincorporated legal entity (a partnership) consisting of all insurers licensed to write and engaged in writing motor vehicle insurance, or any component thereof, within North Carolina. The Facility began operations on October 9, 1973, replacing the operations of the North Carolina Automobile Insurance Plan.

In connection with its function as manager of the reinsurance pool, the Facility assures the availability of motor vehicle insurance to any eligible risk in North Carolina. All of the profit or loss on the business ceded to the Facility is allocated to the members based on the member companies' business in North Carolina and utilization of the Facility.

Use of Estimates and Assumptions

The preparation of special-purpose financial statements of insurance companies requires management to make estimates and assumptions that affect assets and liabilities reported in the special-purpose financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

Operations and Basis of Accounting

It is the policy of the Facility to recognize written premiums, subsidies, paid losses and case-basis loss reserves when reported by the member companies. The member companies prepare monthly reports (a "bordereaux") of the insurance ceded to the Facility. The bordereaux includes written premiums, subsidies and losses paid, which are the basis for the Facility's initial accounting entries. Quarterly, the member companies submit reports detailing case-basis loss reserves for inclusion in the Facility's special-purpose financial statements. Records supporting the bordereaux are maintained by the member companies. Member companies are allowed a ceding expense allowance and a claims expense allowance based generally upon written premiums.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

1. Basis of Presentation and Accounting Policies (continued)

The Facility's special-purpose financial statements represent accounting practices prescribed or permitted by its "Standard Practice Manual." The significant variances between such practices for the Facility and accounting principles generally accepted in the United States ("GAAP") are as follows:

- Generally, claims expense allowances for other than designated carriers and ceding expense allowances are recorded as the corresponding premiums are reported to the Facility, rather than as the corresponding premiums are earned by the Facility. Under GAAP, such costs, to the extent recoverable, would be deferred and amortized over the effective period of the related insurance policies.
- Operating losses sustained by the Facility may be recouped by way of a surcharge on motor vehicle policies issued by its member companies. In advance of the recoupment, the Facility may assess its member companies for the losses, which the member companies then recoup from their policyholders. The Facility records all amounts recouped by the member companies as a credit to members' equity; no income is recognized from the assessments or recoupments.
- Fixed asset purchases, except for data processing equipment, are expensed when purchased. Under GAAP, these purchases would be depreciated over the estimated useful life.

The effect on the special-purpose financial statements of these variances are not reasonably determinable but are presumed to be material.

Descriptions of the more significant accounting practices follow.

Investments

Bonds and U.S. Treasury Bills are stated at amortized cost using the straight-line method to amortize discounts or premiums. Invested cash and other investments are stated at principal balance or cost. Gains or losses on disposals of investments are determined on a specific identification basis and included in operations.

Single class and multi-class mortgage-backed are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from internal estimates and are based on the current interest rate and economic environment. The retrospective adjustment method is used to value all such securities.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

1. Basis of Presentation and Accounting Policies (continued)

Cash and Short-Term Investments

Cash and short-term investments are highly liquid investments with original maturities of three months or less and are principally stated at amortized cost.

Unearned Premiums

Unearned premiums computed on the monthly pro rata method represent the amount of premiums written related to the unexpired terms of the policies in force.

Assessments and Loss Recoupments Surcharges

Loss recoupment surcharges for operating losses will be credited directly to member's equity as they are written by member companies and passed on to the Facility. There were no loss recoupment surcharges authorized by the Facility's Board of Governors for the periods July 1, 2002 to June 30, 2003 or July 1, 2003 to June 30, 2004.

Settlement of Balances

For ceded business having policy effective dates of October 1977 and subsequent, the ultimate profit or loss will be determined after the close of each policy year and final settlement will be made with the member companies at that time. This will take place following the expiration of the time period required for development of loss data as established by the National Association of Insurance Commissioners.

Clean Risk Subsidies

Clean risk subsidies are designed to replace the premium income lost by the Facility as the result of changes in the rate structure for "clean risk" drivers. These subsidies are recognized as underwriting income as they are written and reported to the Facility by the member companies. For the twelve months beginning July 1, 2003, the clean risk recoupment was 5.05%. For the twelve months beginning July 1, 2004, the clean risk recoupment was 5.35%.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

1. Basis of Presentation and Accounting Policies (continued)

Reserve for Losses and Loss Adjustment Expenses

The liabilities for losses and loss adjustment expenses (“LAE”) are determined using case-basis evaluations and analyses and represent estimates of the ultimate cost of all losses and LAE incurred through September 30 of each year. Reserves for losses and LAE are estimated using individual case-basis valuations as reported by the member companies and statistical analyses. These liabilities are necessarily subject to the impact of future changes in claim severity and other factors. Management believes that the liabilities for losses and LAE are reasonable; however, such liabilities are necessarily based on estimates, and the ultimate net cost of claims incurred but unpaid as of September 30 of each year may vary from such estimates. The estimates are continually reviewed and, as adjustments to these liabilities become necessary, such adjustments are included in current operations. LAE expenses represent outside legal expenses of designated carriers.

Loss reserves are recorded net of approximately \$7,935,841 and \$7,157,261 of anticipated salvage and subrogation at September 30, 2004 and 2003, respectively.

Unreported Premiums

Written premiums are recorded when reported by the member companies. In some cases, premiums may be reported in an accounting month other than the month of cession.

Pending Transactions

When reported by member companies, written premiums and paid losses are subjected to various validity tests. Entries questioned by these tests are isolated in a pending file and reported back to the submitting companies for correction, reversal or validation. The amounts of such pending transactions at September 30 that are included in the accompanying special purpose financial statements of the Facility pending action by the member companies are as follows:

	<u>2004</u>	<u>2003</u>
Written premiums	\$1,636,653	\$ 739,608
Paid losses	1,937,865	2,344,596
Case basis loss reserves	2,527,448	4,826,078

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

1. Basis of Presentation and Accounting Policies (continued)

The above paid losses at September 30, 2004 and 2003 include paid losses of \$1,061,683 and \$1,031,835, respectively, which have been pending for over eight months and, according to Facility policy, have been charged back to member companies.

Fixed Assets

The cost of furniture and fixtures is charged to operations, rather than being capitalized.

2. Long-Term Investments

The amortized cost and the market value of long-term investments are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
At September 30, 2004:				
United States Government and governmental agencies and authorities	\$ 255,804,117	\$ 3,405,962	\$ 865,464	\$ 258,344,615
Corporate bonds	156,977,172	4,421,082	553,173	160,845,081
Mortgage-backed securities	149,113,203	982,692	659,212	149,439,683
Total investments	<u>\$ 561,894,492</u>	<u>\$ 8,812,736</u>	<u>\$ 2,077,849</u>	<u>\$ 568,629,379</u>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
At September 30, 2003:				
United States Government and governmental agencies and authorities	\$ 289,270,860	\$ 5,600,027	\$ 551,890	\$ 294,378,997
Corporate bonds	154,659,112	9,580,524	12,429	164,227,207
Mortgage-backed securities	210,019,689	8,582,932	197,365	218,405,256
Total investments	<u>\$ 653,949,661</u>	<u>\$ 23,823,483</u>	<u>\$ 761,684</u>	<u>\$ 677,011,460</u>

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

2. Long-Term Investments (continued)

The amortized cost and market value of long-term investments at September 30, 2004, by contractual maturity, are as follows. Actual maturities may differ from contractual maturities as certain borrowers may have the right to call or prepay obligations without penalty.

	Amortized Cost	Market Value
Years to maturity:		
One or less	\$ 120,555,764	\$ 120,779,000
After one through five	171,211,290	172,906,023
After five through ten	121,014,235	125,504,673
After ten years	—	—
Mortgage-back securities	149,113,203	149,439,683
Total	<u>\$ 561,894,492</u>	<u>\$ 568,629,379</u>

Proceeds from the sale of investments in bonds during 2004 and 2003 were \$368,113,022 and \$409,639,016; gross gains of \$8,869,311 and \$12,299,782 and gross losses of \$2,679,701 and \$1,958,711 were realized on those sales, respectively.

Major categories of net investment income are summarized as follows:

	Year ended September 30	
	2004	2003
Income:		
Bonds and short-term investments	\$ 23,856,432	\$ 28,932,355
Cash	5,956	24,226
Total investment income	<u>23,862,388</u>	28,956,581
Less investment expenses	<u>(376,187)</u>	(361,899)
Net investment income	<u>\$ 23,486,201</u>	<u>\$ 28,594,682</u>

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

3. Members' (Deficit) Equity

Members' (deficit) equity represents the amount by which assets held by the Facility on the behalf of its member companies (are less than) or exceed liabilities. Any deficiency in members' equity may be recovered through additional loss recoupment surcharges from member companies, or increases in future underwriting income.

4. Related Party Transactions

The employees of the Facility share management and other services with the North Carolina Insurance Guaranty Association and the North Carolina Rate Bureau. Salary expense, office rent and other overhead expenses are allocated based on labor-hours. These expenses were approximately \$1,018,000 and \$860,000 in 2004 and 2003, respectively.

5. Losses and Loss Adjustment Expenses ("LAE")

The following table provides reconciliations of the beginning and ending reserve balances, for the years ended September 30:

	2004	2003
	<i>(In Thousands)</i>	
Reserve for losses and LAE, at beginning of year	\$ 429,400	\$ 403,425
Add provision for claims occurring in:		
Current year	641,492	572,584
Prior years	20,012	6,019
Incurring losses and LAE during the current year	661,504	578,603
Deduct payments for claims occurring in:		
Current year	323,277	298,149
Prior years	276,948	254,479
Claim payments during the current year	600,225	552,628
Reserve for losses and LAE, at end of year	\$ 490,679	\$ 429,400

The \$20,012,000 and \$6,019,000 of unfavorable development on prior accident years experienced in the years ended September 30, 2004 and 2003, respectively, are attributable to changes in the loss emergence patterns that were not anticipated in the estimates of losses and loss adjustment expenses based on projections of historical experience. These differences resulted principally in the private passenger bodily injury line of business.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

6. Income Taxes

The Facility is a partnership for federal and state income tax purposes. No federal or state income taxes have been provided, as these taxes are the responsibility of the member companies.

7. Fair Value of Financial Instruments

The following methods and assumptions were used by the Facility to estimate the "fair value" disclosures for "financial instruments":

Cash: The carrying amounts reported in the accompanying special-purpose balance sheets for these financial instruments approximate fair value.

Investments: The fair value of investments is based on quoted market values as of the close of business on September 30, 2004 and 2003 (see Note 2).

Other: The carrying amounts of accrued interest receivable, receivables from member companies, and settlements payable to member companies approximate their fair value at September 30, 2004 and 2003.

8. Provision for Premium Refunds

When the North Carolina Rate Bureau ("Bureau") appeals a rate case and implements a rate increase over the disapproval of the Commissioner of Insurance, the Bureau instructs member companies to establish premium escrow accounts as provided by law. This procedure was utilized with respect to the voluntary market rates for private passenger automobile insurance effective April 1, 2002. Since the rates for "clean risks" ceded to the Facility are capped at the voluntary level, the rates used by the Facility for "clean risks" were subject to judicial review and escrow requirements. As a result, the Facility established escrow accounts, covering the disputed portion of the premiums charged "clean risks" for Facility policies becoming effective during the period covered by these outstanding 2001 and 2002 rate cases. It was finally determined that such rates were excessive and member companies that ceded policies to the Facility covered by these cases are required to make refunds in the amount and manner provided by law and the Facility will reimburse those member companies for those refunds. Premiums associated with the rate increases were recorded when written. Premium refunds are being recorded in the Statement of Operations in the current year since the cases are settled. As of September 30, 2004, the balance in the escrow accounts was \$91,551,378, related to the settled 2001 and 2002 rates cases described below and are included in cash and short term investments on the accompanying balance sheet.

North Carolina Reinsurance Facility (A Partnership)
Notes to Special-Purpose Financial Statements (continued)

8. Provision for Premium Refunds (continued)

On July 22, 2004, orders were signed by the Commissioner whereby the 2001 and 2002 implemented rate increases were settled. Member companies that ceded policies to the Facility covered by these cases are required to make refunds in the amount and manner provided by the settlement agreement, including interest. The Facility estimated a provision of \$71,936,000 for the year ended September 30, 2004 related to this settlement. The outstanding balance at September 30 of this provision was as follows:

Provision for premium refunds payable	\$60,343,691
Provision for interest on premium refunds as agreed to in settlement	<u>7,537,408</u>
	<u>\$67,881,099</u>

9. Subsequent Event

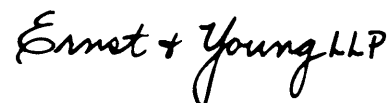
On November 5, 2004, member companies were advised that with respect to the Facility's recoupment surcharges on Non-Fleet Private Passenger automobile business only that (1) the current clean risk recoupment would be revised and implemented in the amount of 6.43% (before agent compensation) on April 1, 2005 for new and renewal policies effective on or after April 1, 2005 through March 31, 2006; and (2) a loss recoupment would be implemented in the amount of 4.17% (before agent compensation) on April 1, 2005 for new and renewal policies effective on or after April 1, 2005 through March 31, 2006.

The clean risk recoupment is adjusted annually, previously with a July 1 effective date.

Board of Governors
North Carolina Reinsurance Facility

In planning and performing our audit of the special-purpose financial statements of North Carolina Reinsurance Facility (the "Company") for the year ended September 30, 2004, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the Company's financial statements and not to provide assurance on internal control. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the Company's internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the Board of Governors and management of the Company and state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.



January 7, 2005