

SERVICE

SOLUTIONS

SYNERGY

**2007 ANNUAL REPORT**  
North Carolina Reinsurance Facility

core  
**CORE VALUES**  
values

**COMMITMENT**

faithfully and diligently fulfill the obligations of our Organizations as set forth in the statutes.

**INTEGRITY**

perform each task as efficiently as possible with absolute honesty and integrity.

**RESPECT**

treat your fellow associates and those you serve on behalf of the Organizations with dignity and respect.

**TALENTS**

continually strive to improve the Organizations through the use of every associate's talents and creativity.

**OWNERSHIP**

encourage participation and a sense of ownership from the members of our Organizations.

**CONSISTENCY**

demonstrate fairness and consistency among all associates and encourage personal development.



n o r t h c a r o l i n a  
**NORTH CAROLINA REINSURANCE FACILITY**  
 r e i n s u r a n c e f a c i l i t y

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**GENERAL ORGANIZATIONAL INFORMATION**

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**ANNUAL MEETING**

The Annual Meeting for member companies of the North Carolina Reinsurance Facility will be held October 24, 2007 at the Grandover Resort and Conference Center, Greensboro, North Carolina.



message from

# MESSAGE FROM THE CHAIRMAN

the chairman

Serving on the Facility Board as an agent and a company representative, it is easy to understand that the Reinsurance Facility provides a great service to North Carolina insureds. Protecting the public from uninsured drivers at an affordable premium is a win-win proposition for all North Carolinians. Offering a reasonable cost alternative for risks that may not otherwise be insurable, it provides protection for our fellow citizens.

In 1984, when I served on the Board as an agent representative, the Facility had been in place for just over ten years, and it insured then, as now, about a quarter of the automobile liability insurance market. There is a still healthy competition among companies selling auto insurance; however, there have been some significant changes. The North Carolina auto liability market has grown from \$635 million to \$3.04 billion in annual premium. Internet access, electronic entry, and other technological innovations have kept automobile premiums affordable and competitive. Many more options are now available to insureds, including more local agents and direct access to many markets. There are now 291 insurance companies selling auto policies in North Carolina.

The Reinsurance Facility works well because of the efforts of so many. Industry representatives and agents serve on the Board, task forces, and committees that oversee the successful operation of the Facility. Various experts consult with these groups and offer important information and perspective. Last but certainly not least, dedicated staff manage the day-to-day activities and constantly look for ways to improve services and provide manageable data for more efficient operations. Many thanks to the professional staff of our Reinsurance Facility and to the former Board members and employees who laid the foundation for a precision operation.

Sincerely,

A handwritten signature in black ink that reads "Richard C. Yarbrough". The signature is written in a cursive, flowing style.

Richard C. Yarbrough CPCU, CIC  
Chair, NCRF Board of Governors

board of  
**BOARD OF GOVERNORS**  
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.

**COMPANY MEMBERS** **REPRESENTATIVE**

Allstate Insurance Co.....	Bob Blystone
Atlantic Casualty Insurance Co.....	Richard Yarbrough*
Integon Indemnity Corporation.....	Art Lyon
Nationwide Mutual Insurance Co.....	Amy Powell
New Hampshire Insurance Co.....	Gary T. Sanginario
Travelers Indemnity Co.....	Michael K. Fitzgerald
Universal Insurance Co.....	Greg Spray
	*chair

**AGENT MEMBERS**

Auto Insurance Agents of North Carolina, Inc.....	Jeffrey W. Butler
Independent Insurance Agents of NC, Inc.....	Steven D. Smith
Independent Insurance Agents of NC, Inc.....	Tim Ward
Apptd. by the Commissioner of Insurance ...	W. Hutson Wester, II
Apptd. by the Commissioner of Insurance .....	John E. Wooten, III

**PUBLIC MEMBERS** **LOCATION**

J. David Walker .....	Lumberton, NC
Steve J. Whitley .....	North Wilkesboro, NC

**EX-OFFICIO MEMBERS**

James E. Long .....	Commissioner of Insurance
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standing advisory  
**STANDING ADVISORY COMMITTEES**  
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 Accounting and Statistical Committee is a joint AIPSO and NCRF committee and is chaired by New Hampshire Insurance Company. In addition, there are several additional specialty advisory groups who perform similar tasks for the Facility throughout the year.

The following committees met during the report period:

audit  
**AUDIT COMMITTEE**  
committee

**MEMBERS** **REPRESENTATIVE**

Liberty Mutual Insurance Co.....	Ronald H. Robertson, Jr., CPA*
NC Farm Bureau Mutual Insurance Co.....	Brian Top
Nationwide Mutual Insurance Co.....	Kathy Southern
Pennsylvania Nat. Mut. Casualty Ins Co.....	Charles J. Uckele
State Farm Mutual Automobile Insurance Co.....	Alan Bentley
Travelers Indemnity Co.....	B.F. Seagle
Agent .....	Steven D. Smith
	*chair

claims  
**CLAIMS COMMITTEE**  
committee

**MEMBERS** **REPRESENTATIVE**

Allstate Insurance Co.....	Todd Lonker
Hartford Accident & Indemnity Co.....	Lorraine Karas
Nationwide Mutual Automobile Insurance Co.....	Bob Kistner
State Farm Mutual Automobile Insurance Co.....	Tom Huels*
Travelers Indemnity Co.....	B.F. Seagle
United Services Automobile Association.....	Michael Cox
Agent .....	W. Hutson Wester, II
Agent .....	John E. Wooten, III
	*chair

compliance  
**COMPLIANCE COMMITTEE**  
committee

**MEMBERS** **REPRESENTATIVE**

Integon Indemnity Corp.....	Seth Kernodle
Nationwide Mutual Insurance Co.....	Kathy Southern
Universal Insurance Co.....	Gregory L. Spray *
Agent .....	W. Hutson Wester, II
	*chair

investment  
**INVESTMENT COMMITTEE**  
committee

**MEMBERS** **REPRESENTATIVE**

Allstate Insurance Co.....	Douglas Dupont
Nationwide Mutual Insurance Co.....	J. Kevin King*
State Farm Mutual Automobile Ins. Co.....	Alan Bentley
	*chair

rating  
**RATING COMMITTEE**  
 committee

<b>MEMBERS</b>	<b>REPRESENTATIVE</b>
Atlantic Casualty Insurance Co. ....	Mark Caughron*
Liberty Mutual Insurance Co. ....	Cheryl B. Watts
Nationwide Mutual Insurance Co. ....	Mike Barnes
NC Farm Bureau Mutual Insurance Co. ....	Roger N. Batdorff
Travelers Indemnity Co. ....	Todd Hoivik
Agent.....	Tim Ward
	*chair

task force on  
**TASK FORCE ON EXPENSE ALLOWANCES**  
 expense allowances

<b>MEMBERS</b>	<b>REPRESENTATIVE</b>
Allstate Insurance Co. ....	Bob Blystone
American International South Insurance Co. ....	Gary T. Sanginario
Nationwide Mutual Insurance Co. ....	Isaac Adams*
Sentry Insurance Co. ....	Tim Miller
State Farm Mutual Automobile Insurance Co. ....	Alan Bentley
Agent.....	Tim Ward
	*chair

task force on  
**TASK FORCE ON RECOURPMENT**  
 recoupment

<b>MEMBERS</b>	<b>REPRESENTATIVE</b>
General Casualty Insurance Co. ....	Stephen H. Cone
Nationwide Mutual Insurance Co. ....	Isaac Adams
NC Farm Bureau Mutual Insurance Co. ....	Roger N. Batdorff
Progressive Casualty Insurance Co. ....	Chris Skorcz
Southern Guaranty Insurance Co. ....	Stephen H. Cone
State Farm Mutual Automobile Insurance Co. ....	Alan Bentley*
Travelers Indemnity Co. ....	B.F. Seagle
Agent.....	Steven D. Smith
	*chair

technical advisory  
**TECHNICAL ADVISORY GROUP**  
 group

<b>MEMBERS</b>	<b>REPRESENTATIVE</b>
Allstate Insurance Co. ....	Essie Williams
Atlantic Casualty Insurance Group .....	Greg Ricker
Discovery Insurance Co. ....	Denise Jefferson
Guaranty National Insurance Co. ....	Diane Wirkus
Integon Indemnity Corporation.....	Mary Anne Peele
Nationwide Mutual Insurance Group .....	Larry Donaldson
New Hampshire Insurance Co. ....	Pete Cotton
NC Farm Bureau Mutual Insurance Co. ....	Brian Top
Safeco Insurance Co. ....	Jeff Castle
Southern General Insurance Co. ....	Marguerite Clark
State Farm Mutual Insurance Co. ....	Paula Harlow
Travelers Indemnity Co. ....	Annette Whitaker
Universal Insurance Co.....	Lisa Stafford



Raymond F. Evans, Jr., CPCU  
General Manager

g e n e r a l m a n a g e r s  
**GENERAL MANAGER'S REPORT**  
r e p o r t

Another year, another set of challenges. With the North Carolina Legislature in its long session, I believe we spent more time in 2007 educating and explaining the operations of the Facility – participating in dozens of interviews, meetings and bill analysis sessions – than we did dealing with our usual concerns.

We don't know if this is the good news or the bad news, but the end result was that virtually nothing changed. On the decidedly positive side, we heard from many sources that the process enhanced the Facility's reputation for honesty, integrity, accessibility and helpfulness.

In spite of the legislatively induced distraction, we made considerable progress in improving our routine functions of complying with the statute, getting the right premium and paying the right amount for claims.

Insuring that premium and loss transactions are accurate falls to the Compliance folks and they steadily increased their effectiveness this past year. We believe we are doing a more comprehensive job of reviewing premium and loss data, being less intrusive to member companies in the process, and becoming more confident in the accuracy of our numbers.

Work on the replacement operating system is continuing with an anticipated go-live date in early 2008; developers here and offshore are working nearly around the clock to help the Facility and our IT department bring it all together.

One thing that has struck me this year is the important role the Facility plays in our state's auto insurance market. Because of that, our job here continues to be to do the best we can in the most efficient way possible. I think the work of our associates, with the support of counsel and help from the Board and Committees, is a big part of why the whole market works. Thanks to everyone.



edith T. DAVIS, CPA  
director, reinsurance facility

*Edith T. Davis*

management discussion  
**MANAGEMENT DISCUSSION & ANALYSIS**  
& analysis

**Mission:**

- Ensure availability of auto liability insurance to all eligible risks
- Collect the right premiums
- Pay the right losses
- Minimize the impact on policyholders and companies in North Carolina

**so·lu·tion:**

Pronunciation: sə-ˈlū-shən

Function: noun

Definition: a: an action or process of solving a problem; b : an answer to a problem

The Facility was created in 1973 by legislators in the General Assembly as their solution to ensure that all eligible risks could purchase auto liability insurance. We still serve that purpose today.

The following pages of financial information reflect a very stable and financially sound Reinsurance Facility. The Facility operations have generated notable net operating gains and, as a result, the Clean Risk recoupment surcharge will be reduced from 8.82% to 2.48% effective October, 2007. This is very different from two years ago when the Facility's equity position was negative \$112 million. Several factors contributed to this turnaround, as follows.

Financial  
**FINANCIAL POSITION**  
position

**RATE CHANGES**

The Facility experienced the effect of rate increases for private passenger non-fleet vehicles.

Ceded "clean risks" comprised approximately 69% of the total ceded exposures. Two voluntary liability rate increases—5.1% overall effective May 2006 and 4.0% overall effective November 2006 – were applied. (By law, this group may only be charged the voluntary manual rate; however, this is not a self supporting rate for these risks.)

Ceded private passenger "other-than-clean" risks comprised about 27% of total ceded exposures; the overall rate increase of 2.9% for this group took effect in October 2006.

There was no rate change for the remaining 4% of exposures in the commercial line of business for the report period.

In 2007, no changes were filed for the voluntary private passenger rates, and the Facility filed a base rate change to the "other-than-clean risks" ceded to the Facility. The filed rates decreased 4.6%, split among a decrease of 9.3% for bodily injury, an increase of 2.4% for property damage, and a decrease of 3.3% for medical payments coverage. The revision also included a decrease of 5.2% for motorcycle liability insurance. This filing was effective on or after October 1, 2007.

**CLEAN RISK RECOUPMENT**

North Carolina law requires carriers to "take all comers" and the risks for whom the voluntary rates are inadequate are often ceded to the Facility. Even in the Facility the rates for "clean risks" are capped at the voluntary rate level. The difference between what this group pays and what they should pay is made up through the statutorily authorized "clean risk" recoupment surcharge applied to the liability premiums of private passenger non-fleet policies. Effective October 2006, this surcharge was 8.82% (before agent compensation); through June 2007, it generated approximately \$188.8 million.

**OPERATING RESULTS**

Last year, we noted that positive equity had been restored and the loss recoupment surcharge had expired for policies effective after March 31, 2006, as planned.

The North Carolina automobile market saw improvement in loss experience, and coupled with the liability rate increases and clean risk recoupment, the Facility began to see operating gains without any increase in market share.

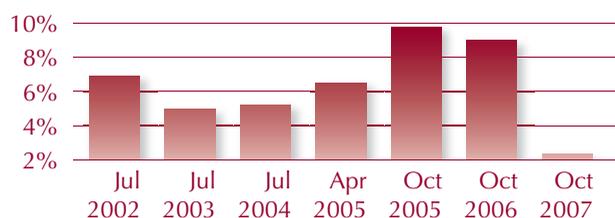
**INVESTMENT INCOME**

Investment income contributed \$31 million due in part to higher returns on the portfolio from the operating gains and some improvement on investment yields. There were also some minor revisions during this fiscal year to the portfolio's Investment Policy to improve performance with continued low risk.

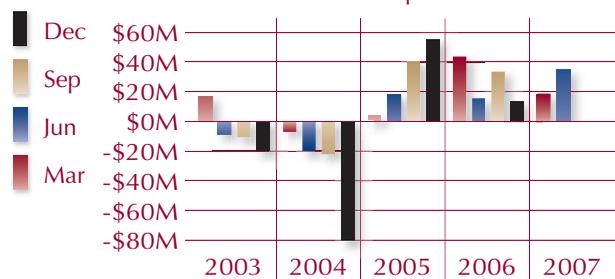
**MEMBER'S EQUITY**

The Facility is required to operate at neither a profit nor loss. As part of this balancing act, the recoupment surcharges are reviewed at least annually and adjusted as appropriate. In July 2007, the Board of Governors, as authorized by statute, approved that the otherwise applicable clean risk recoupment be reduced to reflect credit for the entire balance of Member's Equity surplus generated by the Private Passenger line of business as of March 31, 2007, the most recent period available. The Clean Risk Recoupment surcharge will be reduced from 8.82% (before inclusion of agent compensation) to 2.48% (before inclusion of agent compensation) effective October 2007.

Clean Risk Recoupment Surcharges



Net Results of Operations



operations  
**OPERATIONS ACTIVITY**  
activity

During this report period, we were the largest residual market mechanism by total written premium volume in the United States. There were 1.04 million policies in force as of June 2007, consisting of 96% Private Passenger non-fleet policies and 4% All Other policies, generating more than 27 million transactions. Cession notice volume was flat over the prior year and written premium for the fiscal year ending September 2007 was estimated to exceed \$760 million – a slight increase over the prior fiscal year attributable to liability rate increases in both voluntary and ceded base rates which became effective in 2006.

compliance  
**COMPLIANCE ACTIVITY**  
activity

As part of our responsibility to ensure that the Facility collects the right premium and pays the right losses, regular and special audits are performed on all member companies. This is no small effort as there are over 100 member company groups reporting to the Facility. We continue to emphasize compliance with statutes, rules and regulations, and eligibility for ceded coverage and reimbursement. During this report period almost 6000 premium and claim files were reviewed and approximately \$4.5 million in rating or reporting errors were identified. These audits often identify system problems which enable a company to correct them sooner and minimize the impact.

legislative  
**LEGISLATIVE CHANGES**  
changes

The Facility was created by the Legislature in 1973 with N.C.G.S. §58-37 and replaced an Assigned Risk Auto Plan. At that time there was a perceived stigma of being in a bad risk pool, and this new mechanism enabled drivers to select the company of their choice. Since then the legislature has made alterations to address changing conditions in the marketplace.

One such change was House Bill 729, which became law in North Carolina on August 23, 2007. A portion of this legislation was effective on ratification; however, most of the bill's provisions become effective on January 1, 2008. This legislation amends several statutes dealing with the eligibility of risks that can be ceded to the Facility. One of the major changes was in the eligibility for cession of nonfleet private passenger motor vehicles owned by nonresidents.

Prior to this change, N.C.G.S. §58-37-1 provided that nonfleet private passenger motor vehicles owned by nonresidents were eligible risks if they were registered or principally garaged in North Carolina. As amended by House Bill 729, N.C.G.S. §58-37-1 now will provide that such vehicles are eligible risks only if they are registered and principally garaged in North Carolina and supplies a definition of "principally garaged." The

legislation also contains a new section, N.C.G.S. §58-2-164, to address rate evasion fraud and prevention programs that will require consideration by the companies.

edge system  
**EDGE SYSTEM DEVELOPMENT**  
development

The development of our new Electronic Data Gathering Enterprise (EDGE) system is nearing completion and we are entering the testing phase. This web-based system will allow companies to interface with the Facility like never before, providing them access to the nearly 300 million records of their own reported data.

As some functionality is being phased in, benefits are already being realized. The deadline for reporting accounting data was shortened in early 2007 from 45 days to 25 days – and 100% of member companies achieved the target implementation date! The result is that member companies now receive monthly settlements approximately one month earlier.

File Transfer Protocol (FTP) submission of data will be a requirement for EDGE and companies have already begun the transition from reporting to AIPSO via magnetic media to reporting directly to the Facility via FTP. A number of major carriers are already in full production. Special thanks to the migration coordinators at the member companies who are facilitating this progress.

This is the largest development project this organization has ever taken on. The efforts of many dedicated project team members and subject matter experts at the Facility, AIPSO and member companies will be realized when this system goes live. A heartfelt thanks goes out to the project team and especially to the member companies and our Board of Governors who have been so supportive during this effort. It will change the way companies do business with the Facility and offer features such as single sign-on access to the NCRF, NCRB, and NCIGA; real-time ceding of risks; online edits; email alerts; and new online consolidated billing with EFT payment options among others.

conclusion  
**CONCLUSION**

It has been a whirlwind of a year. We have managed a lot of ceded business and audited a lot of files all the while attending endless meetings for the EDGE project and supplying lots of information to outside parties about the Facility and how it works. That's our job. And we will continue to try to improve our processes and do it even better. So next year the Facility will still be here, stable as ever, to ensure the availability of auto insurance for all eligible risks

*Edith T. Davis*

Edith T. Davis, CPA  
Director, NCRF

n o r t h c a r o l i n a  
**NORTH CAROLINA REINSURANCE FACILITY**  
 r e i n s u r a n c e f a c i l i t y

**BALANCE SHEET**

<b>ASSETS</b>	<b>June 30, 2006</b>	<b>June 30, 2007</b>
Cash (Checking Account)	\$(80,582)	\$488,997
Investments	757,547,666	848,658,137
Accounts Receivable	42,508,789	38,199,344
Accrued Interest Receivable	7,241,560	7,944,782
Other Assets	61,275	22,784
<b>Total Assets</b>	<b>\$807,278,708</b>	<b>\$895,314,044</b>
<b>LIABILITIES &amp; MEMBERS' EQUITY</b>		
Accounts Payable	\$34,526,221	\$27,360,085
Loss Reserves	501,638,712	493,915,306
Unearned Premium Reserves	223,886,672	229,556,308
Other Liabilities	279,069	236,024
<b>Total Liabilities</b>	<b>\$760,330,674</b>	<b>\$751,067,723</b>
Members' Equity	46,948,034	144,246,321
<b>Total Liabilities &amp; Members' Equity</b>	<b>\$807,278,708</b>	<b>\$895,314,044</b>

**INCOME STATEMENT**

<b>INCOME</b>	<b>Fiscal Year Thru June 30, 2006</b>	<b>Fiscal Year Thru June 30, 2007</b>
Earned Premiums	\$554,758,981	\$583,740,330
Clean Risk Recoupment	182,867,644	186,848,060
Investment Income	18,661,479	30,899,452
Membership Fee Income	46,950	48,800
Other Income	555,341	411,368
<b>Total Income</b>	<b>\$756,890,395</b>	<b>\$801,948,010</b>
<b>EXPENSES</b>		
Losses Incurred	\$478,293,182	\$495,961,374
Ceding & Claims Expenses	215,247,671	228,940,917
Salaries & Administration Expenses	1,029,784	1,112,401
Outside Services Expenses	1,723,403	2,600,834
Other Operating Expenses	780,105	1,272,469
<b>Total Expenses</b>	<b>\$697,074,145</b>	<b>\$729,887,995</b>
Net Income Before Loss Recoupments	\$59,816,250	\$72,060,015
Loss Recoupments	51,825,962	(1,560,779)
<b>Net Income After Loss Recoupments</b>	<b>\$111,642,212</b>	<b>\$70,499,236</b>

SHARED RESOURCES



**R. MIKE NEWTON**  
manager, claims

**JIM AUMAN**  
director,  
information technology

**TAMMY CHOBOY**  
manager,  
quality assurance

**VICKI GOBOLD**  
director,  
human resources

**TIM LUCAS**  
manager,  
automobile

**AMY TART**  
manager,  
administrative services

**DAVID SINK**  
director,  
finance

NCRF MANAGEMENT STAFF



**JANNET BARNES**  
manager,  
compliance

**VALERIE PEARSON**  
supervisor,  
operations

**SPECIAL-PURPOSE STATEMENTS OF OPERATIONS**

UNDERWRITING INCOME & EXPENSES	Years Ended September 30, 2006	September 30, 2005
Premiums Earned	\$743,119,401	\$742,061,858
Clean Risk Recoupment	249,253,969	150,582,254
<b>Total Underwriting Income</b>	<b>\$992,373,370</b>	<b>\$892,644,112</b>
Losses Incurred	\$635,769,818	\$637,647,285
Ceding Expense Allowances	199,881,841	199,256,687
Claims Expense Allowances	93,051,730	91,005,200
<b>Total Underwriting Expenses</b>	<b>\$928,703,389</b>	<b>\$927,909,172</b>
<b>Net Underwriting (Loss) or Gain</b>	<b>\$63,669,981</b>	<b>\$(35,265,060)</b>
<b>OTHER INCOME (Expense)</b>		
Net Investment Income	\$31,920,109	\$24,694,189
Net Realized Capital Gains (Losses)	(4,672,275)	528,290
Late Premium Charges and Penalties	465,872	523,989
Membership Fees	47,350	50,550
Cession Notice Charges	21,690	26,159
General and Administrative Expense	(4,880,691)	(3,668,034)
Provision for Premium Refunds, Including Interest	-	5,705,552
Other Miscellaneous Income	(4,653)	216,674
<b>Total Other Income (Expense) - Net</b>	<b>\$22,897,402</b>	<b>\$28,077,369</b>
<b>Net Operating (Loss) or Gain</b>	<b>\$86,567,383</b>	<b>\$(7,187,691)</b>

**SPECIAL-PURPOSE BALANCE SHEETS**

<b>ASSETS</b>	<b>Years Ended September 30, 2006</b>	<b>September 30, 2005</b>
Cash and short-term investments	\$83,466,602	\$28,259,744
Long-term investments, at amortized cost	690,122,248	603,487,957
Accrued interest receivable	6,640,099	5,241,584
Receivables from member companies:		
Settlements	53,434,675	59,064,984
Late premium charges and penalties	31,578	43,241
	<u>\$53,466,253</u>	<u>\$59,108,225</u>
Earned but unbilled premiums	–	\$35,357
Total assets	<u>\$833,695,202</u>	<u>\$696,132,867</u>
<b>LIABILITIES &amp; MEMBERS' (DEFICIT) EQUITY</b>		
Loss and loss adjustment expense reserves:		
In course of settlement	\$390,158,556	\$393,371,809
Incurred but not reported	112,335,543	110,999,151
Total loss and loss adjustment expense reserves	\$502,494,099	\$504,370,960
Unearned premium reserves	\$232,696,618	\$232,617,782
Settlements payable to member companies	24,465,895	23,432,045
Other liabilities	291,505	406,258
Total liabilities	\$759,948,117	\$760,827,045
Commitments and contingencies		
Members' equity (deficit)	<u>\$73,747,085</u>	<u>\$(64,694,178)</u>
Total liabilities and members' equity (deficit)	<u>\$833,695,202</u>	<u>\$696,132,867</u>

## Report of Independent Auditors

The 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, 2006 and 2005, and the related special-purpose statements of operations, members' equity (deficit) 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 audits 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, 2006 and 2005, 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*

February 9, 2007

A Member Practice of Ernst & Young Global

