

NORTH CAROLINA REINSURANCE FACILITY

5401 Six Forks Road • Raleigh NC • 27609

(919) 783-9790 • www.ncrb.org

MINUTES OF THE THIRTY-FIRST ANNUAL MEETING OF THE NORTH CAROLINA
REINSURANCE FACILITY HELD AT THE GRANDOVER RESORT & CONFERENCE
CENTER, ONE THOUSAND CLUB ROAD, GREENSBORO, NORTH CAROLINA,
OCTOBER 27, 2004

MEMBERS PRESENT

Allstate Insurance Company
 Allstate Indemnity Company
 Northbrook Indemnity Company
Atlantic Casualty Insurance Company

Farmers Insurance Exchange
 Mid Century Insurance Company
 Truck Insurance Exchange
General Casualty Insurance Company of Wisconsin
 Regent Insurance Company
Government Employees Insurance Company
 GEICO General Insurance Company
 GEICO Indemnity Company

Hartford Accident & Indemnity Company
 Hartford Casualty Insurance Company
 Hartford Fire Insurance Company
 Hartford Insurance Company of 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
 Integon Preferred Insurance Company
 Integon Specialty Insurance Company
 New South Insurance Company
Liberty Mutual Insurance Company
 First Liberty Insurance Corporation
 Liberty Insurance Corporation
 Liberty Mutual Fire Insurance Company
 LM Insurance Corporation

REPRESENTED BY

Bob Blystone

Gail Cuddington
Richard Yarbrough
John Bond

Kenneth Anderson

Alicia Bowen
Tom McNicholas
Frankie Silva
Joe Thomas
Todd Martensen

Greg Carr

Art Lyon

Cheryl Watts

Nationwide Mutual Insurance Company	Dave Gettles
Farmland Mutual Insurance Company	Amy Powell
Nationwide Affinity Insurance Company	Mike Groseclose
Nationwide Agribusiness Insurance Company	
Nationwide Mutual Fire Insurance Company	
Nationwide Property & Casualty Insurance Company	
New Hampshire Insurance Company	Gary Sanginario
AIU Insurance Company	
American Home Assurance Company	
American International South Insurance 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 of North Carolina, Inc.	
Pennsylvania National Mutual Casualty Insurance Company	Alan Stowe
Penn National Security Insurance Company	
Progressive Casualty Insurance Company	Andrew Rose
National Continental Insurance Company	Patricia D'Ambrosia
Progressive American Insurance Company	
Progressive Northern Insurance Company	
Progressive Northwestern Insurance Company	
Progressive Preferred Insurance Company	
Progressive Southeastern Insurance Company	
United Financial Casualty Company	
Royal Insurance Company of America	Eric Schauer
American & Foreign Insurance Company	Vernon Willis
Connecticut Indemnity Company	
Fire & Casualty Insurance Company of Connecticut	
Globe Indemnity Company	
Grocers Insurance Company	
Peak Property & Casualty Insurance Corporation	
Royal Indemnity Company	
Safeguard Insurance Company	
Sea Insurance Company of America	
Security Insurance Company of Hartford	
Saint Paul Fire & Marine Insurance Company	Benjy Seagle
Athena Assurance Company	
Discover Property & Casualty Insurance Company	
Fidelity & Guaranty Insurance Underwriters	
Fidelity & Guaranty 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	
Southern General Insurance Company	Gerald Willis
	Angela Haithcock
	Wes Florence
State Automobile Mutual Insurance Company	

State Automobile National Insurance Company
State Automobile Property & Casualty Insurance Company
State Farm Mutual Automobile Insurance Company

Terry Pemberton
Jerry King
David Stoller
Benjy Seagle

Travelers Indemnity 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 Insurance Company of America
Travelers Casualty Company of Connecticut
Travelers Casualty & Surety Company
Travelers Commercial Casualty Company
Travelers Home & Marine Insurance Company
Travelers Indemnity Company of Connecticut
Travelers Indemnity Company of America
Travelers Property Casualty Company of America
Travelers Personal Security Insurance Company
Travelers Property Casualty Insurance Company

United Services Automobile Association
USAA Casualty Insurance Company
USAA General Indemnity Company

Joe Schmucker

Universal Insurance Company
Zurich American Insurance Company
American Guarantee & Liability Insurance Company
American Zurich Insurance Company

Greg Spray
Joseph Wells

OTHERS PRESENT

Able Auto Insurance Agency
Bagwell & Bagwell, Inc.
Evergreen Investment Management Company
Green & Wooten Insurance
Insurance Services Office
Jackson Sumner
North Carolina Department of Insurance

BB&T Insurance Services
Wester Realty & Insurance Agency, Inc.
Young, Moore & Henderson

Staff

REPRESENTED BY

Jeffrey Butler
Steve Smith
Rich Applebach
John Wooten
Patrick Woods
Kelly Ricketts
Fred Fuller
James Long*
David Walker
Hutson Wester
Mike Strickland
Mickey Spivey
Jim Auman
Jannet Barnes
Adrienne Bizzell
Edith Davis
Chuck Eckstein
Ray Evans

Delisa Fairley
Vicki Godbold
Linda Gould
Bob Greer
Wayne Hinton
Fred Hoerl
Betty Hurst
Tim Lucas
Kamala Massey
Lois Murphey
Mike Newton
Karen Ott
David Sink
Amy Tart
Sue Taylor

*Attended part of the meeting.

176 other companies were represented by proxy.

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

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

1. Annual Report

Mr. Evans presented the Thirty-First Annual Report for fiscal year ended September 30, 2004 and reported on highlights from the report. A copy of this report is attached.

A. Director's Report

Ms. Davis reported on Facility activities from the past year which included the increased number of meetings held by the Committees and the Board during the past twelve meeting; a summary of new staff positions added during the same period; and a recap of the operating results published in the Annual Report. She also gave an overview of the vision for the new Facility Information System currently under development and reported on its current status.

B. Finance & Administration Report

Mr. Sink briefly reported on the Financial Results of the North Carolina Reinsurance Facility for the Quarter Ending June 30, 2004 and the Operating Expenses for the fiscal years ending September 30, 2003 and September 30, 2004. Referring to page 19 through 21 and Appendix III and IV of the Annual Report, he noted that (1) the Facility's financial statements for the quarter ending June 30, 2004 reflected a net operating loss of \$112.4 million; (2) the aforementioned net operating loss was largely attributable to the provision for premium refunds of approximately \$91.5 million resulting from the settlement of the 2001 and 2002 automobile rate filings; (3) this provision for premium refunds was calculated

based on data and information developed for the purposes of escrowing Facility funds; and, (4) this provision will be appropriately adjusted based on the actual premium and interest refunds as reported by member companies in subsequent months. With respect to the operating expenses, Mr. Sink reported that the approximate 27% increase in expenses from the fiscal year ending September 30, 2003 to the fiscal year ending September 30, 2004 was mainly attributable to (1) an increase in Facility staff – particularly in the Compliance area – over the last twelve months; (2) an increase in Employee Benefits expenses which was also compounded by the increase in staff; and, (3) an increase in Outside Services expenses due to the change in the allocation of the Insurance Services Office (ISO) assessment between the Rate Bureau and the Reinsurance Facility effective in 2004. Mr. Sink further noted that the actual operating expenses of the Reinsurance Facility for the first nine months of 2004 approximated \$2.4 million, or 92% of the budget for the same period.

A motion was made, seconded, and unanimously passed to accept the Annual Report for fiscal year 2003-2004.

2. Commissioner of Insurance

Mr. Long briefly addressed the Board and the audience. He commented on recent and current issues and expressed appreciation to Mr. Evans, staff and industry representatives for maintaining ongoing communications with the Department of Insurance.

3. Chairman's Comments

Mr. Lyon commented on the past year, and remarked that the current net operating loss had generated a negative member's equity balance for the first time in many years and which was primarily attributable to the premium refunds generated by the settlement of the 2001 and 2002 auto rate cases. He expressed gratitude to the Staff, Counsel and Consultants for their efforts during the year and to member company representatives who participated in the numerous committee meetings held throughout the year.

4. Adjournment



There being no further business the meeting was adjourned.

Respectfully submitted,

Edith T. Davis

Director, Reinsurance Facility

ETD:lc
Enclosure
RF-04-16
11/16/04



2004
ANNUAL REPORT

North Carolina Reinsurance Facility

5401 Six Forks Road • Raleigh, NC 27609

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IN 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

During the past two years, it has been my privilege to serve as the Chairman of the Board of Governors of the North Carolina Reinsurance Facility. To be a part of something as important to the industry and to the consumers in North Carolina has been a truly interesting and rewarding experience for me personally.

In these uncertain times, the NCRF continues to provide a measure of stability to the private passenger auto market as it has over its thirty-year history. Although we are currently faced with unique financial challenges due to the impact of the 2001 and 2002 Escrow refunds, I am confident that this organization will take the appropriate actions to maintain our financial stability.

In the past two years, staff has demonstrated a passion to make a difference and has made significant progress in the areas of compliance, organizational structure, management development, performance, education and training. In addition, due to their diligent efforts we are well down the path to implementing a new information system for the NCRF that will serve our member companies well in the years to come.

The NCRF works well because of the folks who work with it and for it. The Board, Staff, Legal counsel, Committee members and employees work hard to keep this organization current, efficient and effective.

I want to thank everyone involved that makes the NCRF work so well. I appreciate your efforts and your support.

Sincerely,

Art Lyon,
Chairman

THE YEAR IN REVIEW

The remainder of this report goes into great detail about the work accomplished by the Reinsurance Facility in the past year. Before we provide this detail, however, it is important for us to discuss the strategies behind this work and what we see, as managers, on the horizon.

Broadly speaking, our primary goals are to continue to carry out the tasks prescribed by statute, to do these in the most efficient way possible, to be responsible custodians of the monies we receive and to perform all activities in a professional manner. These goals have been detailed to us by the Board of Governors and we believe the following pages will demonstrate that we are successfully complying with them.

This success has been fueled by significant changes in the way the Facility operates. As we look forward, we believe that the pace and scope of change this coming year will increase substantially.

Let's take a look at the major changes we see. First, for the first time in a number of years, the Facility operating results have generated a net operating loss. The bottom line is that the premiums charged for Facility risks are inadequate. Because of this, the Board has already begun to consider the need for a loss recoupment surcharge in addition to the clean risk recoupment surcharge already in place. While the precise amount and timing of an additional surcharge is unclear at this time, we are certain there will be one.

Second, we are at work on the development of a new information system which began last year. We expect to be ready to distribute requests for proposals later this year with an installation date late in 2005. With the size of the Facility staff, this is quite an undertaking but will significantly enhance our ability to manage the data we process and the ability of the member companies to interface with us.

The third area of major change is member compliance. During the past year we have added associates and increased the amount of work being done in this area. Ultimately our goal is to collect the correct premiums and pay the correct losses of ceded business exactly as statute and the plan of operation requires. This means creating a routine system to insure the accuracy of \$700 million in premium and \$600 million in claims payments processed through 22 million accounting transactions. This effort requires a focus on fair, comprehensive and systematic evaluations of all Facility transactions.

THE YEAR IN REVIEW

The fourth area is to embrace the spirit of accounting practice contained in the Sarbanes-Oxley legislation as it relates to internal controls and transparency of reporting. We are determined to be certain that every number we publish is the right number, the accurate number and a meaningful number.

The last area is to continue to build a strong management team. We have made a number of management changes throughout the organizations this past year. We believe we have the right team, including the shared resource managers, in place. Keeping our focus on the goals outlined above while making all of the changes just enumerated will be a significant challenge for the coming year.

We thank all of the folks that have helped us get to where we are. This includes our staff; shared resource managers; legal and advisory teams; and especially Committee members and Board members who have given us enormous amounts of time, input and guidance in helping us with our mission.

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, 2003 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	2002 PPNF LIABILITY PREMIUMS†
New York	846,080,000
North Carolina	579,009,000
Massachusetts	301,082,000
New Jersey	235,380,000

†Source: AIPSO FACTS 2003/2004

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. Seven meetings of the Board were held during the year, including two telephone conferences.

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	Robert Jones
Nationwide Mutual Insurance Company	Dave Gettles
New Hampshire Insurance Company	Gary Sanginario
Royal Insurance Company of America	Eric Schauer
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

BOARD OF GOVERNORS

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 Committee	State Farm Mutual Automobile Insurance Co
Compliance Committee	Universal Insurance Company
Investment	Nationwide Mutual Insurance Company
Legal Committee	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 September 30, 2004 there were 480 member companies.

The following companies were added during this report period:

NEW MEMBERS
American National Property & Casualty Company
American Sentinel Insurance Company
Encompass Indemnity Company
Hudson Insurance Company
Stonebridge Casualty Insurance Company
York Insurance Company

The following companies withdrew from membership or were merged with another member company during this report period:

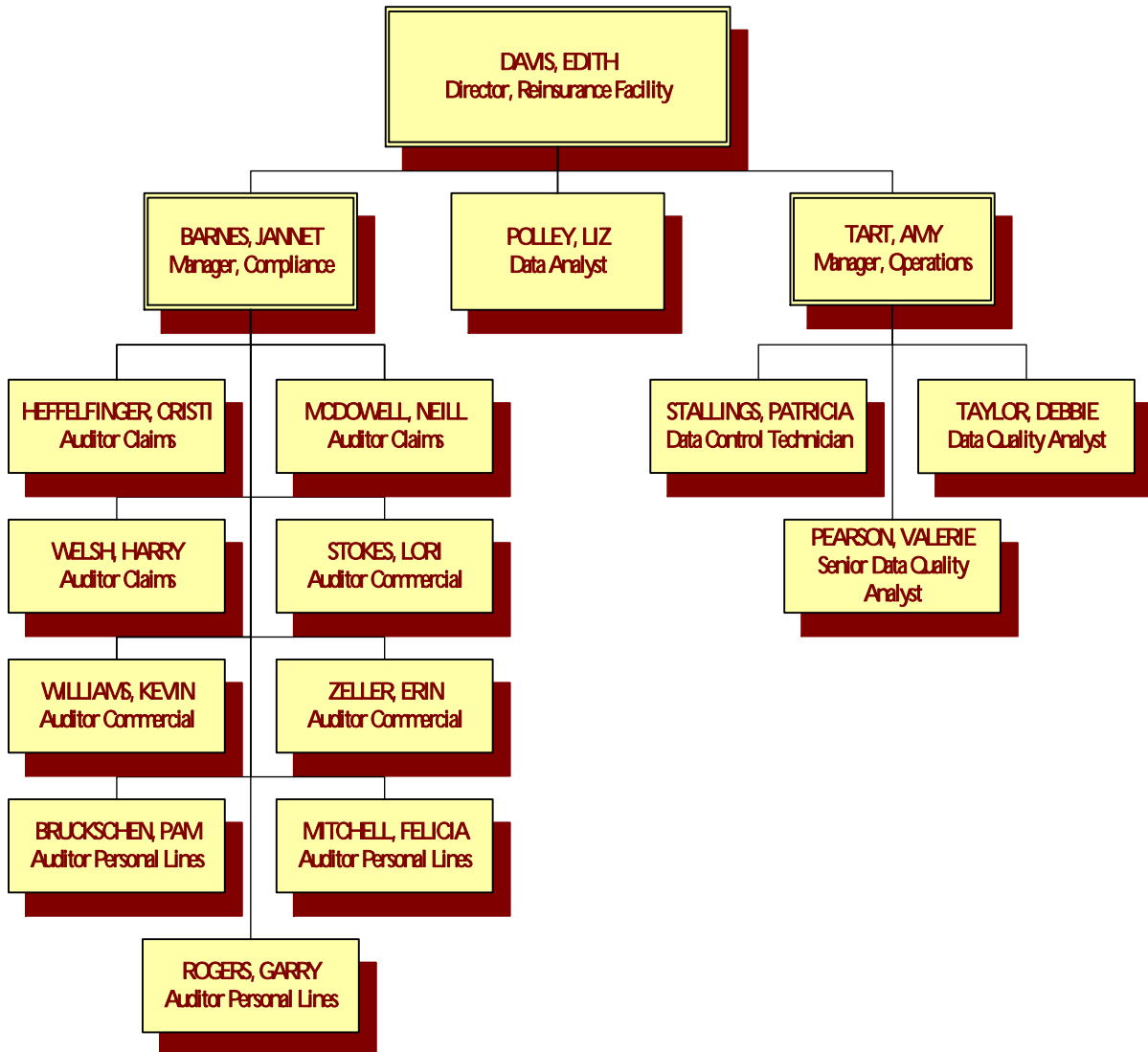
WITHDREW/MERGER
Chicago Insurance Company
Commercial Casualty Insurance Company of North Carolina
Casualty Reciprocal Exchange
New York Central Mutual Fire Insurance Company
Newark Insurance Company
Pennsylvania Casualty Company
State Capital Insurance Company

NCRF TEAM



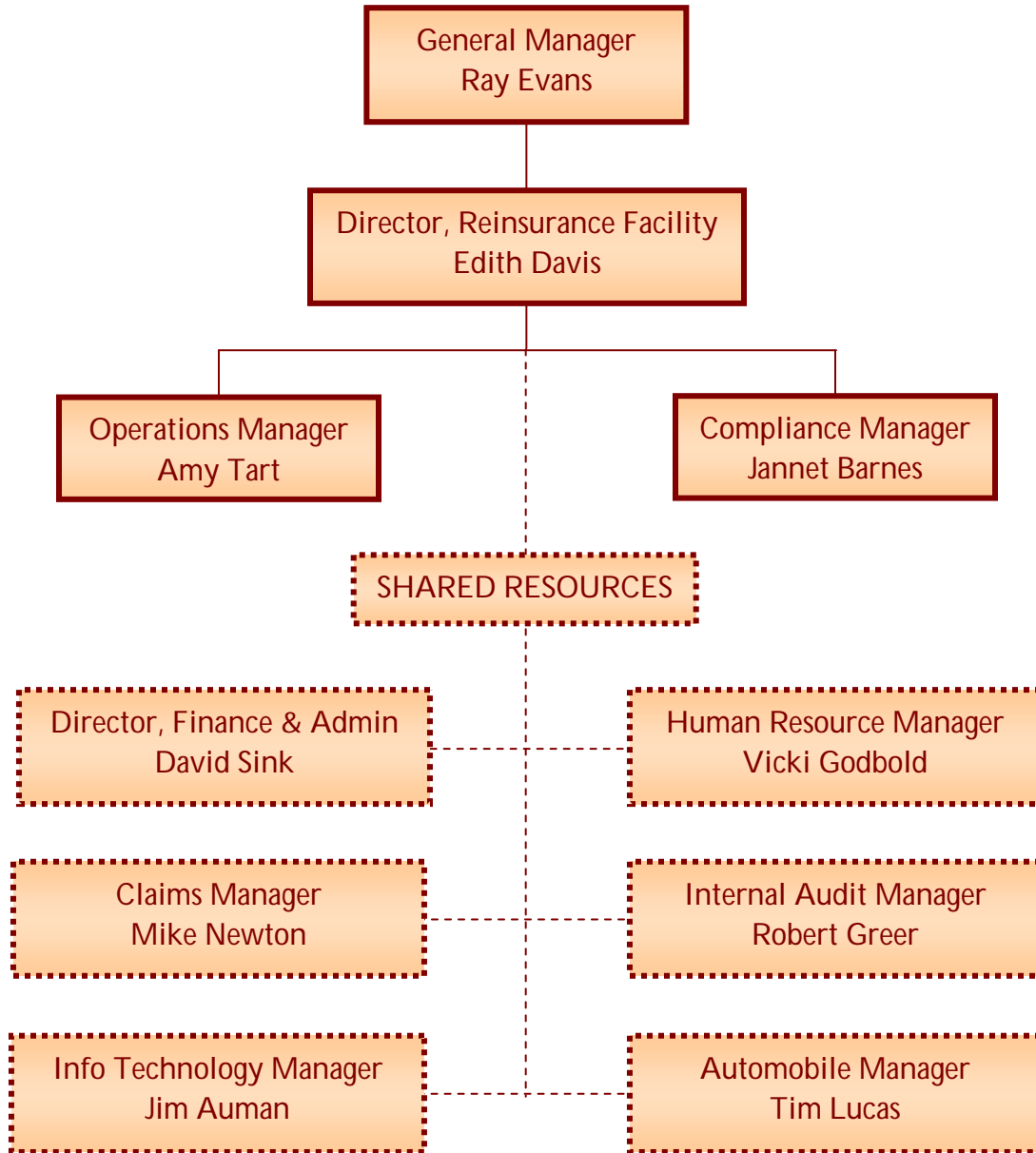
ORGANIZATIONAL CHART

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 sixteen full-time associates.



MANAGEMENT STAFF

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 \$700 million in reinsurance premiums, two and a half million cession transactions, more than twenty-two million accounting transactions, over \$100 million of recoupment surcharges, almost \$600 million in loss reimbursements to members, and maintaining over \$400 million in reserves for losses. This is all done effectively with a budget of approximately \$3 million or less than ½ percent of premium.

Efforts to review and update all processes and procedures continued during the year. Great effort has been committed to the development for specifications for a new information system design to assist the Facility to interface with the member companies. Significant strides have been made in the evaluation and documentation of internal controls and processes.

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 approximately 22.4 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.

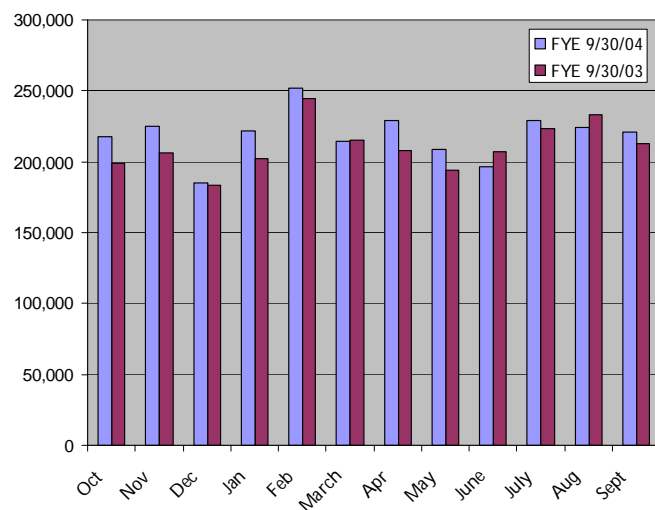
CESSION VOLUME

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, 2004, and 2003.

CESSION NOTICES PROCESSED MONTHLY

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

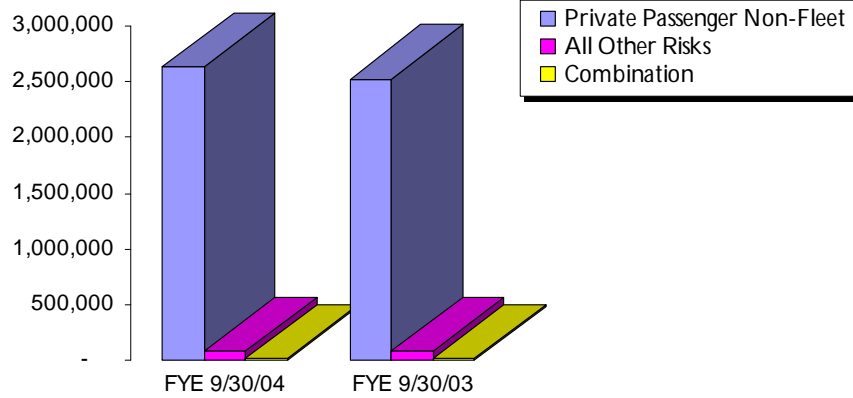
MONTH	FYE 9/30/04	FYE 9/30/03
October	217,404	198,802
November	225,128	205,896
December	184,916	183,621
January	222,057	202,069
February	251,795	244,896
March	214,466	214,969
April	229,154	208,189
May	208,652	194,274
June	196,839	206,930
July	229,269	223,237
August	223,987	232,902
September	220,829	212,623
TOTAL	2,624,496	2,528,408



Percentage Change Over Prior Year: 3.08%

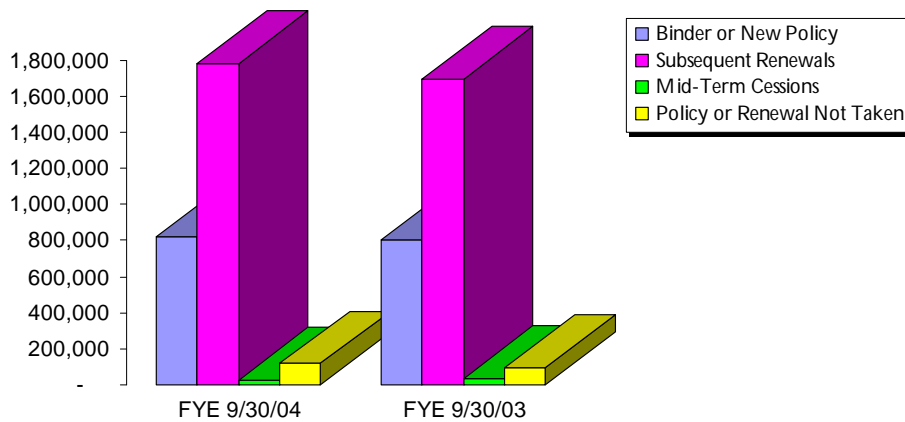
CESSION VOLUME

CESSIONS BY CLASS



	FYE 9/30/04	FYE 9/30/03
Private Passenger Non-Fleet	2,641,445	2,528,650
All Other Risks	83,075	78,674
Combination	15,846	13,233
TOTAL	2,740,366	2,620,557

CESSIONS BY TYPE

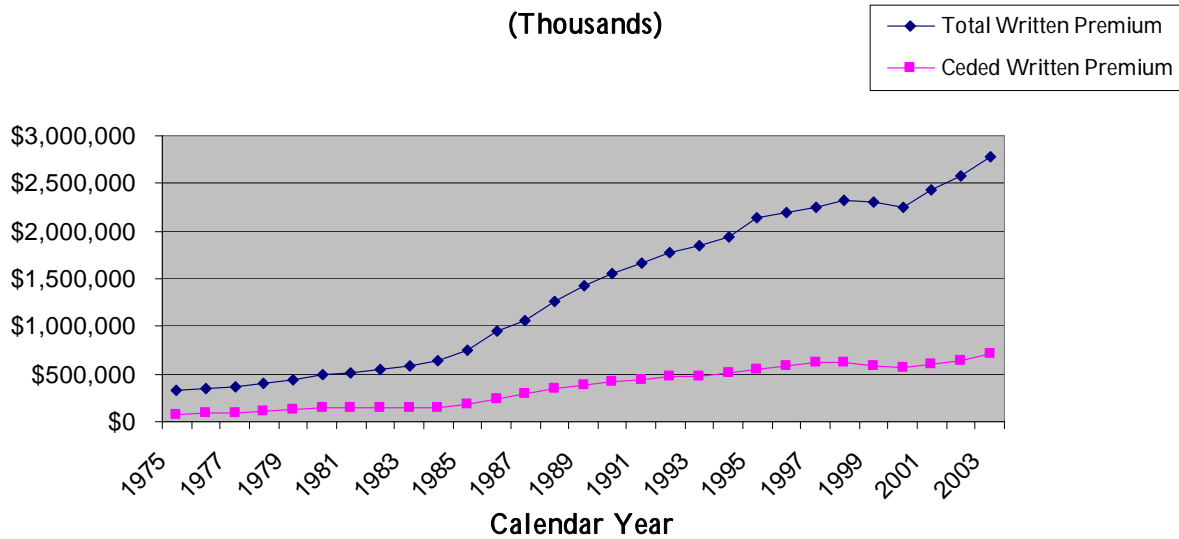


	FYE 9/30/04	FYE 9/30/03
Private Passenger Non-Fleet	2,641,445	2,528,650
All Other Risks	83,075	78,674
Combination	15,846	13,233
TOTAL	2,740,366	2,620,557

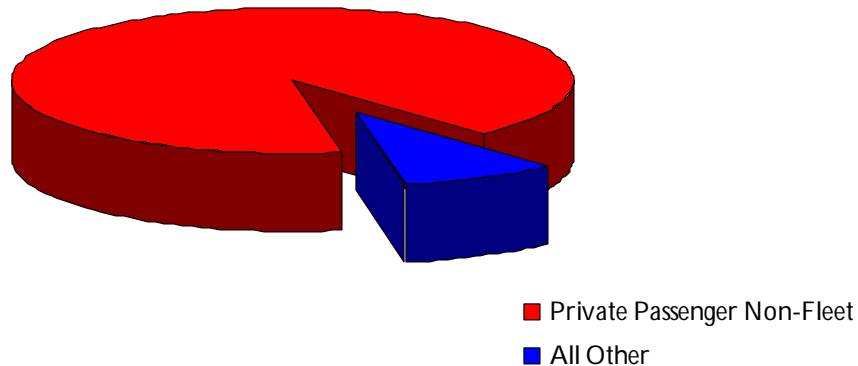
PREMIUMS

During this report period the NCRF was the third 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 2003 over 2002. Currently, the premiums consist of approximately 90% Private Passenger Non-Fleet business and 10% All Other business.

NC AUTO LIABILITY WRITTEN PREMIUMS



COMPOSITION OF CEDED PREMIUM CYE 12/31/03



RECOUPMENT SURCHARGE

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 April 7, 2004, the Board of Governors voted (1) with respect to private passenger non-fleet vehicles to implement a “clean risks” recoupment surcharge of 5.35% (before agent compensation) and no loss recoupment surcharge; and (2) with respect to other than private passenger non-fleet risks, that no loss recoupment surcharge be applied to policies written to become effective during the twelve months beginning July 1, 2004.

A summary of all “clean risks” recoupments since the inception of the “clean risks” recoupment through July 2004 is located in the Appendix.

CLEAN RISK RECOUPMENT SURCHARGE ACTIVITY BY RECOUPMENT PERIOD

(Thousands of Dollars)

Surcharge Period	Surcharge Percentage	Surcharge Written
7/1/04 to 6/30/05	5.35%	\$11,427†
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 7/31/04

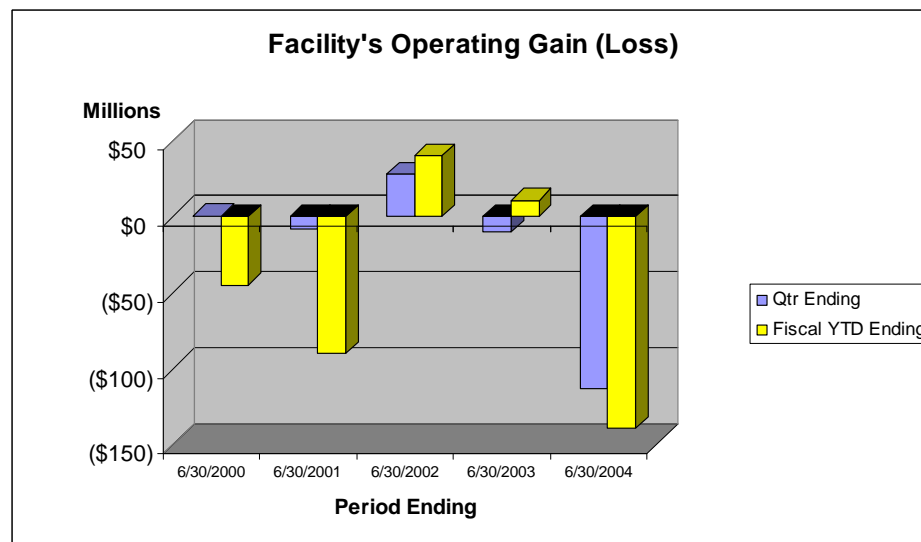
FINANCIAL RESULTS

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

For the quarter ending June 30, 2004, the Facility's net operating loss was \$112.4 million. This compares to a net operating loss of \$9.9 million for the quarter ending June 30, 2003. For the fiscal year to date from October 1, 2003 through June 30, 2004, the Facility's net operating loss was \$139.1 million, compared to a gain of \$10.6 million for the nine months ending June 30, 2003. As explained below, the Facility's income statements for the current quarter and fiscal year to date have been significantly impacted by an extraordinary item recorded as a result of orders issued pertaining to the 2001 and 2002 private passenger automobile rate filings.



RATE FILINGS – ESTIMATE OF PREMIUM REFUNDS

On July 22, 2004, the North Carolina Commissioner of Insurance signed an Order for Refunds and a Settlement Agreement and Consent Order, thereby concluding the outstanding 2001 and 2002 private passenger automobile rate filings. The aforementioned

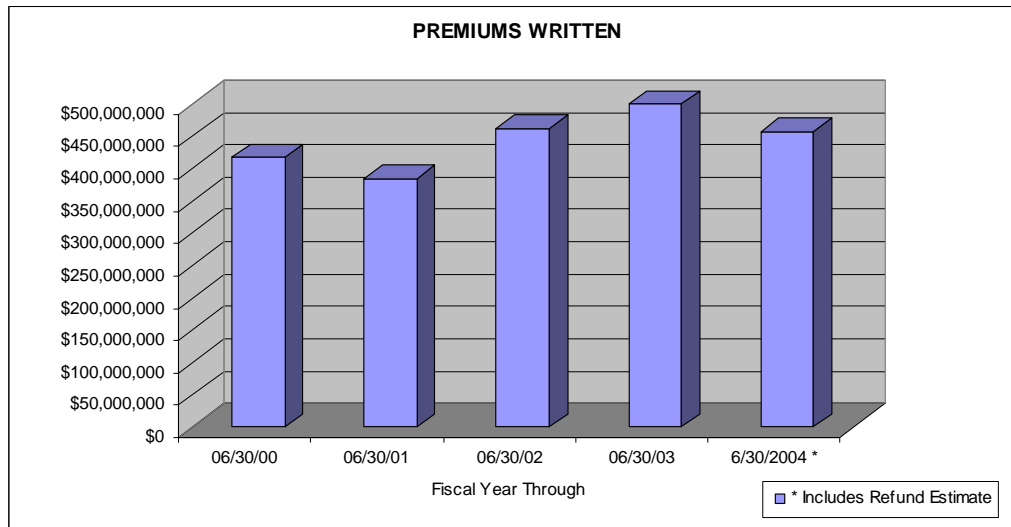
FINANCIAL RESULTS

actions will require the Facility to refund – with interest – a portion of the premiums collected from rates implemented that have been determined to be in excess of the ordered and approved rates. The Facility has estimated the amount of premium refunds and interest to be \$81,626,311 and \$9,828,888, respectively. These amounts have been appropriately included in the Facility's financial statements as of June 30, 2004.

UNDERWRITING INCOME

Premiums

As a result of the adjustment for the estimated refund, written premiums are down 47% and 11% from the same quarter and fiscal year to date a year ago, respectively. Without regards to the affect of the estimated refunds, written premiums are down .7% and up 4.4% from the same quarter and fiscal year to date a year ago, respectively.



Recoupment

Clean risk recoupment income amounted to \$29.7 million and \$89.4 million for the quarter ending June 30, 2004 and the fiscal year to date ending June 30, 2004, respectively. Recoupment income comprised 16% of total underwriting income during the fiscal year to date compared to 19% for the similar period during the prior year. The clean risk recoupment surcharge implemented for policies effective July 1, 2002 to June 30, 2003 was 6.76% compared to the surcharge of 5.05% implemented on policies effective during the twelve months beginning July 1, 2003. As of June 30, 2004, the clean

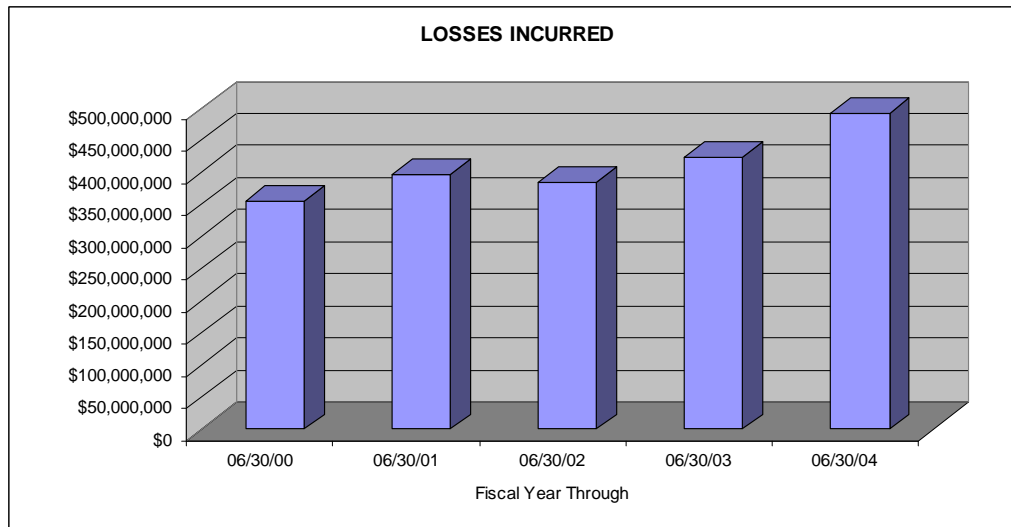
FINANCIAL RESULTS

risk surcharge of 5.05% has recovered approximately \$122.5 million – slightly over the projected shortfall.

UNDERWRITING DEDUCTIONS

Losses Incurred

Losses incurred amounted to \$174.2 million and \$491.0 million for the quarter ending June 30, 2004 and the fiscal year to date ending June 30, 2004, respectively. This represents 8.3% and 15.9% increases over comparable periods in the prior year. Much of the increase in losses incurred is attributable to the change in reserves. Comparing the fiscal years to date ending June 30, 2003 and 2004, the actual paid losses increased from \$410.8 million to \$446.2 million, or approximately 8.6%, while the combined case base and IBNR reserves increased from \$13.0 million to \$44.8 million, or approximately 245%. Staff closely monitors the changes in reserves each quarter as the reserves continue to comprise a significant portion of incurred losses.



Loss ratios – as a percentage of earned premiums – are approximately 173% and 107% for the current quarter and fiscal year to date, respectively. Disregarding the impact of the premium refunds, the loss ratios approximate 96% and 91% during the respective periods – which are slightly above the average of 89% over the last three years.

FINANCIAL RESULTS

Expense Allowances

Ceding and Claims Expense Allowance approximate 38% of written premium after eliminating the impact of the adjustment for premium refunds. The current allowances are within the consistent range of 38% – 40% and are congruent with our projections.

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 9/30/04†	\$29,988,513	\$670,338,084	2.20%
FYE 9/30/03	\$40,493,032	\$667,872,111	3.99%
FYE 9/30/02	\$34,942,510	\$616,342,242	8.19%
FYE 9/30/01	\$43,224,647	\$579,014,754	12.45%
FYE 9/30/00	\$40,858,163	\$684,346,275	6.21%

† Un-audited

OPERATING EXPENSES

Expenses for this report period were up significantly – 21% over the previous report period. This is a result of two decisions by the Board to expand and change the operational direction of the Facility.

The first was to enhance the level of compliance activity. Approximately \$200,000 of the increase in Salaries and Administration is primarily attributable to the additional staff positions authorized by the Board to support the increased level of compliance activity. These included two new claims auditors, one new commercial auto auditor, and a newly created position of data analyst in addition to the allocated portions from the shared resource departments, most notably the IT department staff increases. The result is that the Facility is more secure in its effort to collect the “right” premium and pay the “right” losses, which will be discussed more in the next section.

Employee benefits increased as a result of both the increase in staff and significant increases in health insurance premiums last year.

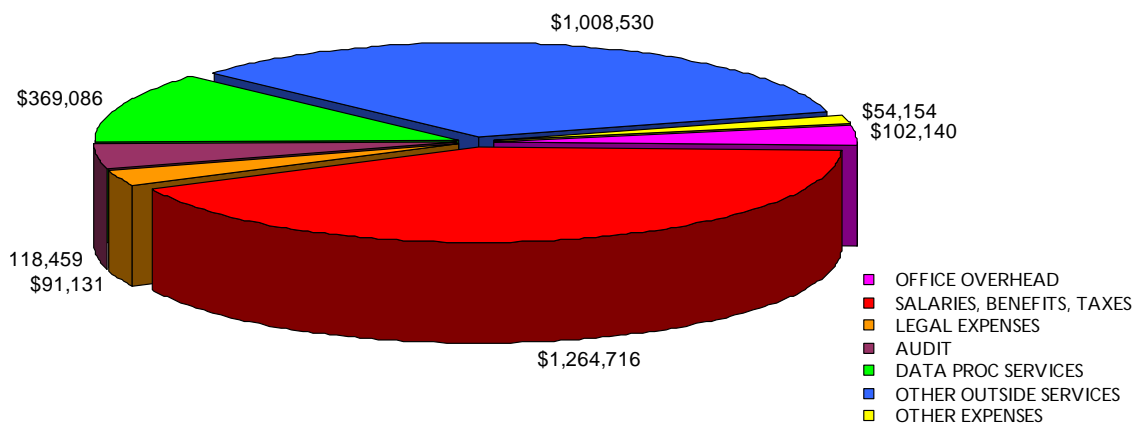
The second, and most substantial in its impact, was the decision to approve a proposed change in the methodology used by the Insurance Services Office, Inc. to bill the Reinsurance Facility for actuarial and related rate and manual work, previously paid by the Rate Bureau. The increase in Other Outside Services reflects \$532,000 of additional charges paid to ISO as a result of this change.

Without the impact of these important changes, the operating expenses would have decreased approximately 7% from the previous year.

It is important to note that while expenses were higher, the amounts continue to be within the budget approved by the Board.

OPERATING EXPENSES

CATEGORY	2004 EXPENSES	2003 EXPENSES
SALARIES & ADMINISTRATION	\$914,337	\$701,621
PAYROLL TAXES	\$51,681	\$44,018
RENT & ALTERATIONS	\$51,965	\$63,970
SOFTWARE & SYSTEMS	\$15,517	\$18,695
POSTAGE	\$5,133	\$11,375
PRINTING & SUPPLIES	\$14,850	\$12,821
FURNITURE & EQUIPMENT	\$17,921	\$99,100
TELEPHONE	\$12,270	\$13,682
EMPLOYEE BENEFITS	\$298,698	\$205,021
LEGAL EXPENSES	\$91,131	\$68,242
AUDIT	\$118,459	\$106,473
DATA PROCESSING SERVICES	\$353,569	\$445,884
OTHER OUTSIDE SERVICES	\$1,008,530	\$532,501
OTHER EXPENSES	54,154	\$42,449
TOTAL OPERATING EXPENSES	\$3,008,217	\$2,365,854



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 addition of a Data Analyst position; the development of new process documentation; and a review of all audit procedures which should conclude later this year. Some of the duties of the Audit Committee have been delegated to a newly formed Compliance Committee which met for the first time during this report period. These two committees now share oversight responsibilities and provide general direction for staff audit activities. These audit activities included review of over 4,000 files and more than 100 reporting companies 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 taxi cabs written on private passenger non-fleet policies, failure to correctly implement new rates changes, incorrect territory assignments, 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 both at the Facility Office and at member company offices. Currently the staff is collaborating 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.

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; statistical analysis of pending claims versus pending suits on ceded business from all ceding member companies; review and 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.

COMPLIANCE ACTIVITY

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 CONTROL

In view of a changing business environment as exemplified by passage of the Sarbanes-Oxley Act of 2002, the Organizations have taken steps to implement improvements in internal controls comparable to best practices in the industry.

Although the Organizations are not subject to Sarbanes-Oxley, they do embrace many concepts of good organizational governance similar to those promoted by the legislation. Accordingly, the Organizations are adopting on a voluntary basis selected aspects of established internal control frameworks, particularly the COSO Internal Control Integrated Framework developed by the Committee of Sponsoring Organizations of the Treadway Commission.

The framework defines internal control as "... a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- L Effectiveness and efficiency of operations
- L Reliability of financial reporting
- L Compliance with applicable laws and regulations."

INTERNAL CONTROL

The framework provides for achievement of these objectives through the five internal control components of (a) the control environment, (b) risk assessment, (c) control activities, (d) information and communication and (e) monitoring.

As part of these efforts, the Organizations have taken steps to strengthen governance by creating the Audit Committee of the Board of the North Carolina Insurance Guaranty Association, and by establishing charters outlining responsibilities of all committees, including the Compliance Committee and Audit Committee of the North Carolina Reinsurance Facility. In addition, the position of Manager of Internal Auditing was created to ensure implementation of standardized control systems and coordinated efforts among the Organizations.

Emphasis has been placed on promoting awareness of internal control principles in all activities and at all levels throughout the Organizations in the course of daily operations as well as incorporating effective controls in the design of new or improved business processes.

According to the control environment fostered by management in setting the "tone at the top", the increased focus on internal control and sound governance represents permanent change, and emphasis will be placed on further improvements on a continuing basis.

RATES, FORMS AND RULES CHANGES

RATE REVISIONS

1) 2001 Private Passenger Automobile Insurance Rate Filing

On May 1, 2001, 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 10.7% for private passenger automobiles and a decrease of 2.4% for motorcycles. The Rate Bureau's filing included liability insurance rates applicable to "clean risks" ceded to the Reinsurance Facility, as defined in G. S. 58-37-35(1), liability insurance rates applicable to motorcycles ceded to the Reinsurance Facility and uninsured/underinsured motorist coverage rates for use in connection with the non-fleet private passenger automobiles and motorcycles ceded to the Reinsurance Facility. It was proposed to become effective October 1, 2001.

On June 13, 2001, the Commissioner of Insurance issued a Notice of Public Hearing in connection with this filing and scheduled a public hearing to convene on September 9, 2001.

For various reasons, the public hearing was postponed and convened on September 25, 2001. Following the conclusion of the public hearing on October 31, 2001, the Commissioner of Insurance on December 12, 2001, entered an Order disapproving the Rate Bureau's filed rates and ordering overall rate level changes of -13.0% for non-fleet private passenger automobiles and -15.9% for motorcycles effective April 1, 2002.

During a meeting held on January 3, 2002, the Governing Committee of the Rate Bureau voted (1) to appeal to the North Carolina Court of Appeals those provisions included in the Commissioner's Order dealing with the disapproval of non-fleet private passenger automobile and motorcycle insurance rates filed by the Rate Bureau; (2) to proceed with implementation of rate level changes that result in an overall rate level change of +5.0% for non-fleet private passenger automobiles; and (3) to implement a rate level change of -4.9% for motorcycle liability coverage.

The Court of Appeals issued its opinion on October 7, 2003, ruling against the Rate Bureau on the issues appealed, including the treatment of investment income on capital and surplus and the treatment of dividends and deviations.

RATES REVISIONS

Following the Court of Appeals opinion, the Rate Bureau filed a Notice of Appeal with the Supreme Court on the issue of the treatment of dividends and deviations and a Petition for Discretionary Review with the Supreme Court on the issue of the treatment of investment income on capital and surplus, but the Petition was denied. After the Rate Bureau filed a Motion for Rehearing requesting the Supreme Court to reconsider its denial of the Petition, the Supreme Court decided on its own motion to review the issue of the treatment of investment income on capital and surplus.

Following the oral arguments before the Supreme Court, the Court issued an opinion on June 25, 2004 which ruled against the Rate Bureau on the issue of dividends and deviations and ruled that discretionary review of the issue of the treatment of investment income on capital and surplus had been improvidently allowed, thereby allowing the decision of the Court Appeals to stand.

On July 22, 2004, that Commissioner issued an Order requiring member companies to refund amounts held in escrow. The Order required the refunds to be issued no earlier than October 1, 2004 and to be completed by October 29, 2004.

2) 2002 Private Passenger Automobile Rate Filing

On February 1, 2002, 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 5.9% for private passenger automobile liability and physical damage and an increase of 3.5% for motorcycles. The Rate Bureau's filing included liability insurance rates applicable to "clean risks" ceded to the Reinsurance Facility, as defined in G. S. 58-37-35(1), liability insurance rates applicable to motorcycles ceded to the Reinsurance Facility and uninsured/underinsured motorist coverage rates for use in connection with non-fleet private passenger automobiles and motorcycles ceded to the Reinsurance Facility. The filing also proposed changes in the uninsured and uninsured/underinsured motorist rates, increased limits factors and classification and sub-classification factors. It was proposed to become effective October 1, 2001.

On March 14, 2002, the Commissioner of Insurance issued a Notice of Public Hearing in connection with this filing and the public hearing convened on July 15, 2002. The Public Hearing ended on August 28, 2002.

On October, 29, 2002, the Governing Committee of the Rate Bureau voted (1) to appeal to the North Carolina Court of Appeals those provisions included in the Commissioner's

RATES REVISIONS

order dealing with the disapproval of non-fleet private passenger automobile and motorcycle insurance rates filed by the Rate Bureau; (2) to proceed with implementation of rate level changes that result in an overall rate level change of +5.9% for non-fleet private passenger automobiles and (3) that the implemented rates become effective January 27, 2003.

Oral arguments were made before the Court of Appeals on June 8, 2004. Prior to the issuance of an opinion by the Court, the Rate Bureau entered into a Settlement Agreement with the Commissioner requiring the member companies to refund a portion of the monies held in escrow. The Settlement required the refunds to be issued no earlier than October 1, 2004 and to be completed by November 29, 2004.

3) 2004 Private Passenger Automobile Rate Filing

On February 2, 2004, 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 12.2% for private passenger automobile liability and physical damage and an increase of 0.1% for motorcycle liability. It was proposed to become effective October 1, 2004.

On July 22, 2004, the Rate Bureau entered into a Settlement Agreement with the Commissioner agreeing to a "no change" in the overall base rates effective January 1, 2005 other than the changes resulting from the approved update to the model year and symbol relativities.

4) 2004 Private Passenger Automobile Insurance Rate Filing for "Other Than Clean Risks"

On July 1, 2004, 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. The filed rates applied only to risks other than "clean risks" as defined in G.S. 58-37-35(1). These rate level changes resulted in an overall average rate level increase of 10.0%. These changes are to become effective with respect to policies effective on or after October 1, 2004.

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 September 30, 2004:

FILING DATE	SUBJECT
September 23, 2003	Personal Auto Policy Program – Forms Revision
September 23, 2003	Personal Auto Manual Revisions Rules Filing
October 3, 2003	2003 Personal Auto Policy Program – Revised Uninsured and Combined Uninsured/Underinsured Motorists Coverage – Rate Filing
December 5, 2003	Commercial Automobile Manual Revision Social Service Agency
March 29, 2004	Revision to Commercial Auto Forms – Revised Uninsured Motorist Coverage Endorsement CA 21 16 03 03

OTHER FACILITY ACTIVITY

INFORMATION TECHNOLOGY REVIEW

The IT Department went through a substantial evolution over the last year. This evolution was initiated by a refocused business strategy set forth by the General Manager:

- : We are a data collection business
- : We most effectively do business in an electronic environment
- : We are not software developers

In March 2004, a newly appointed IT manager set forth to turn this strategy into a reality. The hardware and network infrastructure technology was already in place. Knowing that a great deal of software development projects were going to occur, the IT Department spent the remainder of the year building staff, strategies, and frameworks to support these development efforts.

The infrastructure support staff was bolstered to include a full-time Database Administrator, a dedicated Network Administrator, and two Help Desk Technicians. IT is currently identifying Application Support Analysts in the office to assist the business units with applications after they are developed. 3rd Party vendors have been identified and contracted to fill in any knowledge or resource gaps. An IT support strategy was developed to ensure that all technologies have adequate and efficient support and have a 98% availability rate. A disaster recovery effort will begin later this year to further meet this goal.

IT adopted a framework which leverages the common IT services shared by the Organizations. All three organizations have common needs that do not need to be duplicated. These include but are not limited to membership/contact management, accounting, communication and security.

The IT framework also ensures that "best-of-breed" technologies are chosen for new systems. This "technology framework" guides us to choose development and database products for each project that are mature, have wide-industry acceptance, follow a service-oriented architecture and can easily interoperate within the current IT infrastructure.

INFORMATION TECHNOLOGY REVIEW

IT acquired legal counsel specializing in software development to ensure that key contract and legal issues were well-thought out and resolved prior to engaging a development vendor. IT currently has its own software development agreement that all vendors must sign prior to obtaining a contract.

Two experienced Project Managers were hired to develop and implement a standardized, adaptable, and proven project methodology by which all projects would follow. By implementing a project methodology, IT is ensuring that projects are conducted in a disciplined, well-managed, consistent manner that promotes the delivery of quality products and results in projects that are completed on time and within budget.

The Organizations Senior Management team adopted the role of the “project steering committee” and identified over forty projects that could help the Organizations more efficiently and effectively meet their statutory obligations. Of those forty projects, the following ten are currently being managed by IT:

1	The NCRF Information System
2	A membership-based Contact Management System for the Organizations to track its customers
3	A secure Web-Portal for customer access to the Organizations website
4	A Document Management system for critical document archival and retrieval
5	An effort to produce a new Corporate Identity for the each organization
6	An Accounting System assessment
7	A new Assessment system for obtaining funding
8	Web-based workers comp applications for allowing agents and carriers to manage Assigned Risk and Unit Statistical Reporting
9	Improvements to the existing Industry Data collection web-based applications
10	Enhancements to the insolvency processing system of the IGA

HUMAN RESOURCES REVIEW

As a strategic partner with all Organizations, the Human Resources department strives to provide opportunities for each associate's personal and professional growth, which in turn, enables the best possible service to member companies.

During this report period Human Resources responsibilities included administering HR policies, programs and practices. Additionally, the Associate Handbook was updated, revised and made electronically available to all associates through the NCRB intranet.

During this report period twelve new associates joined the staff -- three within NCRF and nine within NCRB -- through recruitment guidelines of hiring experienced and skilled professionals.

Ongoing work in Compensation and Benefits included updating the compensation program by development of an incentive program and maintaining NCRB salary ranges and structure within market trend guidelines. In January educational sessions for the 401(k) plan were conducted and July 1 brought plan enhancements for this plan.

In-depth management training occurred early in the year for all supervisors and managers along with coordination of professional development seminars through out the year.

On a daily basis the Human Resources department assisted management in communicating clear expectations for all associates with a goal to effectively and efficiently work with all employee relation issues that arose.

Compliance with government regulations and employment practices were also critical responsibilities. By August all job positions were reviewed to ensure compliance with the new regulations issued under the Fair Labor Standards Act (FLSA), the federal wage-hour law.

FACILITY MANUAL AMENDMENTS

Section 3 of the North Carolina Reinsurance Facility Standard Practice Manual was amended to allow groups of companies under the same ownership and/or management to elect to be treated either separately or as a single group for reporting and participation purposes. Section 4 of the Manual was amended (1) to reflect the implementation of a new "clean risks" recoupment surcharge effective July 1, 2004 and (2) to update the language associated with premiums refunded for disapproved rates.

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 was one new request for exemption from writing private passenger non-fleet automobile insurance business other than specialty business. This request was denied.

Since inception of the Facility, the Board has approved five exemption requests. The two approved exemptions, which remained in effect on September 30, 2004, 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 2004 and enacted no legislation that affected automobile insurance coverages subject to the Rate Bureau or Reinsurance Facility jurisdiction.

DESIGNATED AGENT PROGRAM

The annual volume of business in the designated agent program has continued to decrease to approximately \$2.1 million, as market availability is generally not a problem. There were 21 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. One agent was eliminated from the program during the year through termination of appointment by the agent. There were 20 designated agents assigned to three designated carriers as of September 30, 2004. There were no agent applications pending assignment on that date.

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 20, 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, 2004. 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, 2004.

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

*Excludes premium refunds totaling \$54.3 million.

NCRF RECOUPMENTS AND ALLOCATIONS

<u>Type</u>	<u>Applicable to Policies Effective</u>	<u>Which Policies?</u>	<u>Percent Surcharge</u>	<u>Recovered Thru 7/31/04 (Thousands)</u>
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% *	122,040
Clean Risk Recoupment	7/1/04- 6/30/05	All PPNF	5.35% *	11,427
φ Surcharges closed in prior years	* Excluding agent compensation or commission	† This surcharge closed February 28, 2004		

Data as of October 6, 2004

NORTH CAROLINA REINSURANCE FACILITY

BALANCE SHEET

June 30, 2004

ASSETS

Cash Unrestricted	\$2,163,783.68
Cash Restricted (Including Escrow)	99,032,640.36
Investments	575,290,739.69
Accrued Interest Receivable	7,263,420.71
Accounts Receivable - Member Company Balances	22,051,622.04
Miscellaneous Charges Receivable (Net)	16,417.91
Membership Fees Receivable	0.00
Assessments Receivable	3,507.27
Computer Equipment (Net)	0.00
Other Assets	0.00
Total Assets	\$705,822,131.66

LIABILITIES TO MEMBER COMPANIES

Miscellaneous Accounts Payable - Rounding	\$0.00
Reserve - Unearned Premiums	216,496,710.00
Earned But Unbilled Premium Reserve	(50,680.00)
Premium Deficiency Reserve	0.00
Reserve - Outstanding Losses - Case	370,534,276.31
Reserve - Outstanding Losses - IBNR	103,662,562.00
Advanced Premium Liability	112,171.00
Deferred Revenue - Recoupment	0.00
Provision for Premium Refunds	91,455,199.00
Accounts Payable - Member Company Balances	34,307,259.13
Accounts Payable - Miscellaneous	(164.69)
Total Liabilities	\$816,517,332.75
Participating Members' Equity	(110,695,201.09)
Total Liabilities and Members' Equity	\$705,822,131.66

NORTH CAROLINA REINSURANCE FACILITY
Statement of Income - All Policy Years Combined
Fiscal Year Commencing October 1, 2003
Quarter Ending June 30, 2004

	<u>Current Quarter</u>	<u>Fiscal Year-to-Date</u>	<u>Inception to Date</u>
Underwriting Income			
Premiums Written	\$93,009,906.19	\$457,568,775.08	\$10,776,709,332.66
Unearned Premiums (Prior)	223,895,648.00	216,568,136.00	0.00
Unearned Premiums (Current)	(216,496,710.00)	(216,496,710.00)	(216,496,710.00)
Earned but Unbilled Premium (Prior)	(42,034.00)	(110,855.00)	0.00
Earned but Unbilled Premium (Current)	50,680.00	50,680.00	50,680.00
	<hr/>	<hr/>	<hr/>
Premiums Earned	\$100,417,490.19	\$457,580,026.08	\$10,560,263,302.66
Clean Risk Subsidy	29,667,732.41	89,397,798.15	1,480,244,792.78
	<hr/>	<hr/>	<hr/>
Total Underwriting Income	\$130,085,222.60	\$546,977,824.23	\$12,040,508,095.44
Underwriting Deductions			
Losses Incurred	\$174,189,682.48	\$491,037,313.18	\$9,533,836,230.09
Change in Premium Deficiency Reserve	0.00	0.00	0.00
Claims Expense Allowance	20,798,270.10	65,365,503.95	1,253,414,265.32
Ceding Expense Allowance	46,131,518.31	142,942,663.00	2,695,611,462.06
	<hr/>	<hr/>	<hr/>
Total Deductions	(\$241,119,470.89)	(\$699,345,480.13)	(\$13,482,861,957.47)
	<hr/>	<hr/>	<hr/>
Net Underwriting Gain (Loss)	(\$111,034,248.29)	(\$152,367,655.90)	(\$1,442,353,862.03)
Miscellaneous Income & Expenses			
Membership Fees	\$0.00	\$48,300.00	\$1,042,100.00
Interest Earned	9,079,638.07	24,658,299.81	800,487,734.87
Other Income	158,104.00	226,989.36	3,943,403.68
Miscellaneous Charges	104,381.03	330,937.54	8,509,777.94
Other Expenses Incurred	(10,679,101.79)	(11,955,929.60)	(95,483,121.87)
	<hr/>	<hr/>	<hr/>
Total Miscellaneous Income & Expenses	(\$1,336,978.69)	\$13,308,597.11	\$718,499,894.62
	<hr/>	<hr/>	<hr/>
Net Operating Gain (Loss)	(\$112,371,226.98)	(\$139,059,058.79)	(\$723,853,967.41)

MEMBERS' EQUITY ACCOUNT

Members' Equity - Beginning of Period	\$1,676,025.89	\$28,363,857.70	\$0.00
Net Operating Loss Distributed to Member Companies	0.00	0.00	77,699,060.55
Net Operating Gain (Loss)	(112,371,226.98)	(139,059,058.79)	(723,853,967.41)
Loss Recoupment/Allocation	0.00	0.00	535,459,705.77
	<hr/>	<hr/>	<hr/>
Members' Equity - End of Period	(\$110,695,201.09)	(\$110,695,201.09)	(\$110,695,201.09)

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

	Quarter Ending June 30, 2004	Quarter Ending June 30, 2003	Quarter Ending June 30, 2002	Quarter Ending June 30, 2001	Quarter Ending June 30, 2000
Underwriting Income					
Premiums Written	\$93,009,906.19	\$175,851,927.86	\$149,019,477.51	\$144,102,098.76	\$140,898,145.28
Unearned Premiums (Prior)	223,895,648.00	207,807,743.00	188,782,770.00	176,450,701.00	172,386,715.00
Unearned Premiums (Current)	(216,496,710.00)	(210,332,289.00)	(181,402,421.00)	(173,211,824.00)	(171,510,186.00)
Earned but Unbilled Premium (Prior)	(42,034.00)	(77,683.00)	(72,182.00)	(134,580.00)	0.00
Earned but Unbilled Premium (Current)	50,680.00	94,890.00	89,184.00	119,615.00	0.00
<hr/>					
Premiums Earned	\$100,417,490.19	\$173,344,588.86	\$156,416,828.51	\$147,326,010.76	\$141,774,674.28
Clean Risk Subsidy	29,667,732.41	39,588,833.52	38,204,935.72	26,322,312.77	7,315,876.40
<hr/>					
Total Underwriting Income	\$130,085,222.60	\$212,933,422.38	\$194,621,764.23	\$173,648,323.53	\$149,090,550.68
<hr/>					
Underwriting Deductions					
Losses Incurred	\$174,189,682.48	\$160,774,955.34	\$119,331,144.83	\$135,639,142.26	\$104,483,961.16
Change in Premium Deficiency Reserve	0.00	0.00	0.00	0.00	0.00
Claims Expense Allowance	20,798,270.10	24,591,149.11	18,953,940.86	19,933,437.46	19,175,062.59
Ceding Expense Allowance	46,131,518.31	46,415,918.19	38,182,049.20	37,695,051.73	34,775,467.38
<hr/>					
Total Deductions	(\$241,119,470.89)	(\$231,782,022.64)	(\$176,467,134.89)	(\$193,267,631.45)	(\$158,434,491.13)
<hr/>					
Net Underwriting Gain (Loss)	(\$111,034,248.29)	(\$18,848,600.26)	\$18,154,629.34	(\$19,619,307.92)	(\$9,343,940.45)
<hr/>					
Miscellaneous Income & Expenses					
Membership Fees	\$0.00	\$0.00	\$200.00	\$700.00	\$100.00
Interest Earned	9,079,638.07	9,295,602.87	10,156,044.10	11,821,310.32	9,963,603.99
Other Income	158,104.00	26,948.32	89,755.34	84,772.27	111,709.77
Miscellaneous Charges	104,381.03	112,268.99	163,743.70	204,521.29	170,098.95
Other Expenses Incurred	(10,679,101.79)	(527,838.95)	(447,728.22)	(696,854.20)	(548,258.35)
<hr/>					
Total Miscellaneous Income & Expenses	(\$1,336,978.69)	\$8,906,981.23	\$9,962,014.92	\$11,414,449.68	\$9,697,254.36
<hr/>					
Net Operating Gain (Loss)	(\$112,371,226.98)	(\$9,941,619.03)	\$28,116,644.26	(\$8,204,858.24)	\$353,313.91

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

	Fiscal YTD Through June 30, 2004	Fiscal YTD Through June 30, 2003	Fiscal YTD Through June 30, 2002	Fiscal YTD Through June 30, 2001	Fiscal YTD Through June 30, 2000
Underwriting Income					
Premiums Written	\$457,568,775.08	\$516,727,053.31	\$461,777,485.01	\$383,918,177.43	\$417,326,076.68
Unearned Premiums (Prior)	216,568,136.00	190,605,628.00	177,315,375.00	176,102,003.00	174,739,956.00
Unearned Premiums (Current)	(216,496,710.00)	(210,332,289.00)	(181,402,421.00)	(173,211,824.00)	(171,510,186.00)
Earned but Unbilled Premium (Prior)	(110,855.00)	(102,964.00)	(93,260.00)	0.00	0.00
Earned but Unbilled Premium (Current)	50,680.00	94,890.00	89,184.00	119,615.00	0.00
Premiums Earned	\$457,580,026.08	\$496,992,318.31	\$457,686,363.01	\$386,927,971.43	\$420,555,846.68
Clean Risk Subsidy	89,397,798.15	117,844,307.76	115,341,363.68	79,844,497.27	19,054,684.94
Total Underwriting Income	\$546,977,824.23	\$614,836,626.07	\$573,027,726.69	\$466,772,468.70	\$439,610,531.62
Underwriting Deductions					
Losses Incurred	\$491,037,313.18	\$423,803,406.73	\$383,468,003.98	\$395,735,109.54	\$354,398,675.05
Change in Premium Deficiency Reserve	0.00	0.00	0.00	0.00	0.00
Claims Expense Allowance	65,365,503.95	72,047,433.86	58,423,749.40	59,640,677.15	56,780,413.03
Ceding Expense Allowance	142,942,663.00	136,584,724.58	117,626,462.09	112,973,738.13	103,153,400.10
Total Deductions	(\$699,345,480.13)	(\$632,435,565.17)	(\$559,518,215.47)	(\$568,349,524.82)	(\$514,332,488.18)
Net Underwriting Gain (Loss)	(\$152,367,655.90)	(\$17,598,939.10)	\$13,509,511.22	(\$101,577,056.12)	(\$74,721,956.56)
Miscellaneous Income & Expenses					
Membership Fees	\$48,300.00	\$48,600.00	\$47,900.00	\$46,900.00	\$44,700.00
Interest Earned	24,658,299.81	29,582,039.31	27,146,821.91	33,905,851.74	30,471,819.20
Other Income	226,989.36	63,840.93	359,800.16	216,591.19	393,081.23
Miscellaneous Charges	330,937.54	350,520.07	514,908.95	708,993.22	404,515.71
Other Expenses Incurred	(11,955,929.60)	(1,888,765.53)	(1,641,671.12)	(23,229,003.90)	(1,516,993.54)
Total Miscellaneous Income & Expenses	\$13,308,597.11	\$28,156,234.78	\$26,427,759.90	\$11,649,332.25	\$29,797,122.60
Net Operating Gain (Loss)	(\$139,059,058.79)	\$10,557,295.68	\$39,937,271.12	(\$89,927,723.87)	(\$44,924,833.96)

SPECIAL-PURPOSE FINANCIAL STATEMENTS

North Carolina Reinsurance Facility
(A Partnership)

Years ended September 30, 2003 and 2002 with Report of Independent Auditors

North Carolina Reinsurance Facility (A Partnership)

Audited Special-Purpose Financial Statements

Years ended September 30, 2003 and 2002

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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, 2003 and 2002 and the related special-purpose statements of operations, members' 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as 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, 2003 and 2002, 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

December 20, 2003

North Carolina Reinsurance Facility (A Partnership)

Special-Purpose Balance Sheets

	September 30	
	2003	2002
Assets		
Cash and short-term investments	\$ 13,704,911	\$ 17,520,272
Long-term investments, at amortized cost	653,949,661	600,484,164
Accrued interest receivable	7,483,784	7,156,769
Receivables from member companies:		
Settlements	26,994,885	28,314,179
Late premium charges and penalties	33,773	93,424
	<u>27,028,658</u>	<u>28,407,603</u>
Earned but unbilled premiums	110,855	102,964
Total assets	<u>\$ 702,277,869</u>	<u>\$ 653,671,772</u>
Liabilities and members' equity		
Loss and loss adjustment expense reserves		
In course of settlement	\$ 340,886,672	\$ 325,066,246
Incurred but not reported	88,513,340	78,358,757
Total loss and loss adjustment expense reserves	<u>429,400,012</u>	<u>403,425,003</u>
Unearned premium reserves	216,568,136	190,605,628
Settlements payable to member companies	27,885,500	30,957,635
Other liabilities	60,363	69,280
Total liabilities	<u>673,914,011</u>	<u>625,057,546</u>
Commitments and contingencies		
Members' equity	28,363,858	28,614,226
Total liabilities and members' equity	<u>\$ 702,277,869</u>	<u>\$ 653,671,772</u>

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)
Special-Purpose Statements of Operations

	Year ended September 30	
	2003	2002
Premiums earned	\$ 675,038,074	\$ 614,436,680
Clean risk subsidies	148,975,070	152,560,917
Total underwriting income	824,013,144	766,997,597
Losses incurred	578,602,857	557,472,391
Ceding expense allowances	185,013,506	159,996,167
Claims expense allowances	98,065,040	79,539,493
Total underwriting expenses	861,681,403	797,008,051
Net underwriting loss	(37,668,259)	(30,010,454)
Other income (expense):		
Net investment income	28,594,682	31,679,901
Net realized capital gains	10,341,071	3,035,344
Late premium charges and penalties	537,945	833,108
Membership fees	48,900	48,400
Cession notice charges	24,970	12,175
General and administrative expense	(2,126,267)	(1,581,781)
Interest expense	–	(46,902)
Other miscellaneous expenses	(3,410)	(502)
Total other income – net	37,417,891	33,979,743
Net operating (loss) income	\$ (250,368)	\$ 3,969,289

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)
Special-Purpose Statements of Changes in Members' Equity

	Year ended September 30	
	2003	2002
Members' equity at beginning of year	\$ 28,614,226	\$ 24,644,937
Net operating (loss) income	(250,368)	3,969,289
Members' equity at end of year	\$ 28,363,858	\$ 28,614,226

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)
Special-Purpose Statements of Cash Flows

	Year ended September 30	
	2003	2002
Operating activities		
Net operating (loss) income	\$ (250,368)	\$ 3,969,289
Change in operating assets and liabilities:		
Net realized capital (gains) on investments	(10,341,071)	(3,035,344)
Amortization of bond premiums	3,855,713	1,903,315
Loss and loss adjustment expense reserves	25,975,009	14,663,712
Unearned premium reserves	25,962,508	13,290,253
Receivables/payables from member companies	(1,693,190)	4,021,542
Premium refunds	–	2,728,618
Accrued interest receivable	(327,015)	(836,479)
Earned but unbilled premiums	(7,891)	(9,704)
Other assets and liabilities	(8,917)	47,551
Net cash provided by operating activities	43,164,778	36,742,753
Investing activities		
Proceeds from sale or maturity of invested assets	409,639,016	252,557,952
Purchase of invested assets	(456,619,155)	(290,585,745)
Net cash used in investing activities	(46,980,139)	(38,027,793)
Net decrease in cash and short-term investments	(3,815,361)	(1,285,040)
Cash and short-term investments:		
Beginning of year	17,520,272	18,805,312
End of year	\$ 13,704,911	\$ 17,520,272

See accompanying notes.

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements

September 30, 2003

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.
- Member companies may be assessed for operating losses from other than private passenger non-fleet business, which the member companies then recoup from their policyholders. The companies must submit a cash settlement to the Facility at the time of the initial assessment. All amounts recouped from insureds by the companies that are under the initial assessment deposit are kept by the companies. Once the cumulative amounts recouped exceed the initial deposit, the companies then submit this excess cash to the Facility. 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

Member company assessments for operating losses are initially recorded as deferred surcharges and are credited directly to members' equity as they are written by member companies and reported to the Facility. Loss recoupment surcharges 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, 2001 to June 30, 2002 or July 1, 2002 to June 30, 2003.

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, 2002, the clean risk recoupment was 6.79%. For the twelve months beginning July 1, 2003, the clean risk recoupment was 5.05%.

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 \$7,157,261 and \$7,180,038 of anticipated salvage and subrogation at September 30, 2003 and 2002, 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>2003</u>	<u>2002</u>
Written premiums	\$ 739,608	\$ 1,435,604
Paid losses	2,344,596	3,280,853
Case basis loss reserves	4,826,078	4,599,882

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, 2003 and 2002 include paid losses of \$1,031,835 and \$1,863,742, 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, 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>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
At September 30, 2002:				
United States Government and governmental agencies and authorities	\$ 220,761,962	\$ 13,045,500	\$ —	\$ 233,807,462
Corporate bonds	173,313,178	10,863,903	399,837	183,777,244
Mortgage-backed securities	206,409,024	13,720,364	—	220,129,388
Total investments	<u>\$ 600,484,164</u>	<u>\$ 37,629,767</u>	<u>\$ 399,837</u>	<u>\$ 637,714,094</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, 2003, 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	\$ 60,776,883	\$ 60,811,360
After one through five	328,027,806	338,827,429
After five through ten	55,125,283	58,967,415
After ten years	—	—
Mortgage-back securities	210,019,689	218,405,256
Total	<u>\$ 653,949,661</u>	<u>\$ 677,011,460</u>

Proceeds from the sale of investments in bonds during 2003 and 2002 were \$409,639,016 and \$252,557,952; gross gains of \$12,299,782 and \$4,559,210 and gross losses of \$1,958,711 and \$1,523,866 were realized on those sales, respectively.

Major categories of net investment income are summarized as follows:

	Year ended September 30	
	2003	2002
Income:		
Bonds and short-term investments	\$ 28,932,355	\$ 32,035,371
Cash	24,226	61,537
Total investment income	28,956,581	32,096,908
Less investment expenses	(361,899)	(417,007)
Net investment income	<u>\$ 28,594,682</u>	<u>\$ 31,679,901</u>

North Carolina Reinsurance Facility (A Partnership)

Notes to Special-Purpose Financial Statements (continued)

3. Members' Equity

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

4. Related Party Transactions

The employees of the Facility provide management and other services to 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 \$860,000 and \$749,000 in 2003 and 2002, 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:

	2003	2002
	<i>(In Thousands)</i>	
Reserve for losses and LAE, at beginning of year	\$ 403,425	\$ 388,761
Add provision for claims occurring in:		
Current year	572,584	540,726
Prior years	6,019	16,746
Incurred losses and LAE during the current year	578,603	557,472
Deduct payments for claims occurring in:		
Current year	298,149	287,364
Prior years	254,479	255,444
Claim payments during the current year	552,628	542,808
Reserve for losses and LAE, at end of year	\$ 429,400	\$ 403,425

The \$6,019,000 and \$16,746,000 of unfavorable development on prior accident years experienced in the years ended September 30, 2003 and 2002, 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 are based on quoted market values as of the close of business on September 30, 2003 and 2002 (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, 2003 and 2002.

8. Rate Filings Pending Resolution

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” are subject to judicial review and escrow requirements. For that reason, the Facility has 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 rate cases. For these cases, the period is from April 1, 2002 through June 30, 2003. If it is finally determined that such rates are excessive, member companies that ceded policies to the Facility covered by these cases will be 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. Any premium refunds will be recorded in the Statement of Operations in the year the cases are settled. As of September 30, 2003, the balance in the escrow accounts was \$90,935,639.

Board of Directors
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, 2003, 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 Directors 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.

Ernst + Young LLP

December 20, 2003

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**NORTH CAROLINA
REINSURANCE FACILITY**

NORTH CAROLINA REINSURANCE FACILITY

The Year in Review

- ✦ Message from the Chairman
- ✦ The Year in Review
- ✦ History
- ✦ Governance
- ✦ NCRF Team
- ✦ Facility Operations
- ✦ Rates, Forms and Rule Changes
- ✦ Other Facility Activity

NORTH CAROLINA REINSURANCE FACILITY

The Year in Review

★ Governance - The Year of the Meeting

- Audit Committee
- Claims Committee
- Compliance Committee
- Investment Committee
- Market Committee
- Task Force on Expense Allowances
- Task Force on Recoupment
- Board of Governors

★ NCRF Team - Staff Additions

New Positions:

- Manager of Internal Audit
- Data Analyst
- Two Additional Claims Auditors
- Additional Commercial Auditor
- Two Project Managers
- Data Base Administrator
- Network Administrator

NORTH CAROLINA REINSURANCE FACILITY

The Year in Review

★ Facility Operations – Operating Results

- Premium Volume
- Losses
- Recoupment
- Cession Volume
- Member's Equity at 6/30/04

★ Facility Operations – New Information System
Vision

➤ Create a true Information System vs. Data
Processing

➤ Produce More Timely & Meaningful Information

★ Facility Operations – New Info System Vision

- Interactive web-based information system
- Provide on-line access to companies via new Web Security and Contact Management System
- Reduce Cycle times from months to hours
- Electronic transfer of Data and Funds
- Integrate with other organization systems
 - ✓ Accounting, NCRB Industry Data

NORTH CAROLINA REINSURANCE FACILITY

The Year in Review

- ★ Facility Operations – New Info System Status
 - Board Approved Initiative December 2003
 - Development of Business Specifications
 - Preparation of Request For Proposal (RFP)
 - Vendor Evaluations



**NORTH CAROLINA
REINSURANCE FACILITY**