June 14, 2005

To: Members, CSAC Excess Insurance Authority
    Members, California Public Entity Insurance Authority

From: Michael Fleming, Chief Executive Officer

Re: Broker Contingent Income

We are pleased to report that the CSAC Excess Insurance Authority has concluded its inquiries surrounding Driver Alliant Insurance Services’ (DAIS) receipt of contingent income. This report to our membership is intended to provide the final status report on this topic.

In October 2004, a scandal broke in the insurance industry when the New York Attorney General filed a law suit against broker Marsh & McLennan, leveling bid-rigging and steering charges in connection with the receipt of contingent income. Marsh has since settled their suit in New York and other brokers have also settled similar allegations in certain states. In addition, the County of Santa Clara brought suit against DAIS, Marsh, and Keenan and Associates in November 2004 alleging similar activity. This law suit has not been resolved to date.

The Executive Committee took a very proactive approach to this scandal, meeting several times in November and early December. The Executive Committee directed that a full report to the membership be released. This report, dated December 2, 2004, contains much of the background information and remains posted on the home page of the EIA website for reference.

As stated in the December 2, 2004 report, the Executive Committee found no evidence of steering, bid-rigging, or improper actions on the part of DAIS in connection with EIA business. There was an acknowledgement that contingent income is common in the industry and is not illegal. DAIS provided detailed information on commissions and contingent income received on all of the EIA’s major programs. As previously reported, as respects the EIA’s eight major programs, there was only one relationship that DAIS had where they received contingent income. This was with American Reinsurance Company (Am Re). This information was compared to the EIA’s contractual agreement with DAIS which limited commission income, as specified by Program, but was silent on
whether or not contingent income could be received. Both DAIS and EIA legal counsel indicated their belief that this contingent income would not be considered commission within the meaning of the contract. However, as the Am Re agreement was substantially based on volume that could be largely attributed to CSAC EIA placements (as opposed to more traditional contingent income agreements that are impacted by factors such as portfolio profitability, new business, persistency, etc), it was acknowledged that there was room for a different interpretation. In an abundance of caution, and in the spirit of maintaining a strong working relationship with the EIA, DAIS offered to consider the contingent income as subject to our contractual limitations and rebate all amounts in excess of the maximum specified in the contract. The EIA accepted this offer as respects this agreement and directed staff to continue to follow-up to obtain similar information on the Miscellaneous and Employee Benefit Programs.

This report is the result of the follow-up activities on the Miscellaneous and Employee Benefit Programs. In sorting this information out, the Executive Committee went through a process of determining the amount of contingent income received, determining if contractual limitations on income were violated, and determining if contingent income influenced DAIS in the placement of coverage.

DAIS has supplied information relating to all Miscellaneous and Employee Benefit Programs dating back to 1999. For reference, this includes the following programs:

<table>
<thead>
<tr>
<th>Miscellaneous Programs</th>
<th>Employee Benefits Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Course of Construction</td>
<td>Life/LTD</td>
</tr>
<tr>
<td>Boiler &amp; Machinery</td>
<td>EAP</td>
</tr>
<tr>
<td>Optional Excess Liability</td>
<td>Dental</td>
</tr>
<tr>
<td>Watercraft</td>
<td>Vision</td>
</tr>
<tr>
<td>Aviation</td>
<td>Personal Access</td>
</tr>
<tr>
<td>Crime / Bond</td>
<td>PLIP</td>
</tr>
<tr>
<td>Bond Buy-down</td>
<td></td>
</tr>
</tbody>
</table>

As part of the contingent income investigation, the Executive Committee received a report from DAIS disclosing all regular commission income on all Miscellaneous and Employee Benefit Programs dating back to 1999. As a result, it was discovered that DAIS is receiving 3.3% commission on the Vision Program (2004/05 year only); however, our contractual agreement limits the DAIS commission income on Vision to 3.0%. The difference, which is estimated to be less than $2,000 for the year, will be rebated back to the EIA.

As respects contingent income, enclosed is a letter of explanation dated May 24, 2005 from Jerry Hall, President and Chief Operating Officer of DAIS advising that contingent income and program administration income was received in some fashion relating to the Boiler and Machinery, Life/LTD, and Dental Programs. At the EIA's request, Mr. Hall attempted to show the EIA's premium volume as it relates to the entire premium volume to give Executive Committee members some perspective. The enclosures referred to in Mr. Hall's letter have not been included as part of this report.
Contingent Income Not “Commissions”

EIA legal counsel has reviewed the representations made by DAIS in Mr. Hall’s letter and has reviewed copies of the contingent and program services agreements. Legal counsel has concluded that the contingent income received by DAIS on the Boiler, Life/LTD, and Dental Programs is not subject to the contractual limitations on income specified in our agreement. This is because our agreement only limits the amount of commission income and does not limit receipt of contingent or other income. Legal Counsel’s advice is that the contingent and other income received should not be characterized as “commission” income.

EIA Placements Not Influenced by Contingent Income

The contingency agreements in effect for these three programs were not based on premium volume. There were very complex calculations performed after the expiration of the policies on entire books of business. The amount of income received depended upon such factors as loss ratio, new business produced, amount of business non-renewed, services provided, etc. While certain DAIS personnel may have been aware of the existence of these agreements, it would have been impossible to calculate in advance, the income received. Further, it is inconceivable that the existence of the agreements would have had any influence over the recommendation for placement of coverage because of their common use in the industry and the presumption that no matter where coverage was placed some similar agreement was likely to be in effect, and there was no way of knowing which would ultimately be to the advantage of DAIS. There was no centralized marketing/placement function maintained by DAIS that would have exercised influence over the process and the personnel responsible for making recommendations did not directly receive any contingent income. Most importantly, the EIA through its committee structure and staff involvement reviewed and approved all placements and was convinced that the placements were in the best interest of the EIA.

Status of Contingent Income

As of January 1, 2005, DAIS announced a corporate decision to discontinue receipt of all contingent income. In addition, our revised contractual agreement with DAIS will prohibit receipt of contingent and other income unless expressly approved by the EIA. As stated in Mr. Hall’s letter, DAIS has received income for “Program Service Compensation” on the Life and LTD Programs as a result of providing certain services. This is not considered contingent income, but does represent an amount of income in addition to commission income for services rendered on our behalf. The Executive Committee expressly approved DAIS’s receipt of program service compensation from ING/Reliastar amounting to 2% of premium volume effective January 1, 2005. DAIS will receive this income through its wholly owned subsidiary, Alliant Specialty Insurance Services (ASIS).

Conclusion

This report relates to our Miscellaneous and Employee Benefit programs and contains the last remaining information on the broker contingent income situation. The previous report dealt with
contingent income received on all of the major programs. Based upon the information provided and advice of legal counsel, the EIA Executive Committee has determined that the contingent income received by DAIS was proper and did not influence the placement of coverage nor violate the contractual income limitations. DAIS has severed all contingent income agreements with all carriers as of January 1, 2005. The Executive Committee has acknowledged and expressly approved of DAIS’s receipt of income through its subsidiary, ASIS, on the Life and LTD Programs amounting to 2% of premium in exchange for certain underwriting services provided by ASIS, effective January 1, 2005. As respects the Vision Program, DAIS is required to rebate all amounts over the contractual income limitations for the 2004/05 year (3.3% vs. 3.0%). This is estimated to be less than $2,000 for the entire year.

cc: Driver Alliant Insurance Services

Enclosure
May 24, 2005

Mr. Mike Fleming
Chief Executive Officer
CSAC Excess Insurance Authority
3017 Gold Canal Drive, Suite 300
Rancho Cordova, CA 95670

RE: Miscellaneous Programs and Placements Report

Dear Mike,

Thank you for your request for information pertaining to CSAC EIA’s miscellaneous program and placements (i.e. those outside of the Major Programs previously addressed). Please note that while the request specified the period 1998 to present, in accordance with our File Retention Policy, I was able to research records as far back as the year 1999. Accordingly, the following discussion is specific to that timeframe. Please be advised as follows:

Placement history:
As a recap, a complete Placement History Schedule is enclosed.

Contingent Income Implications:
Our agreement with CSAC EIA of course limits the amount of commission income Driver Alliant may earn in any given year. Contingent Income is typically portfolio based, the results of which can be influenced by a number of factors, and therefore has not been considered as “commissions”. We have taken the same view regarding Carrier Program Servicing Compensation (such as that discussed below) for the reasons further elaborated on herein. This will confirm that as respects the miscellaneous programs, the only contingent income received for the period in question was as follows:

Traditional Contingent Income Agreements:
Outside of the Major Programs previously discussed, Driver Alliant received production credit on additional CSAC EIA placements for purposes of calculating traditional Contingent Income Agreements with the following carrier(s):

<table>
<thead>
<tr>
<th>Boiler/Mach</th>
<th>Carrier</th>
<th>Yr. Pd</th>
<th>Cont. Inc.</th>
<th>Total Vol.</th>
<th>CSAC Vol.</th>
<th>Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>CNA</td>
<td>2000</td>
<td>$ - 0 -</td>
<td>$1,944,446</td>
<td>$371,949</td>
<td>(1)</td>
</tr>
<tr>
<td>2000</td>
<td>CNA</td>
<td>2001</td>
<td>$ 41,027</td>
<td>$1,944,446</td>
<td>$371,949</td>
<td>(1)</td>
</tr>
</tbody>
</table>
• 2001 CNA 2002 $ - 0 -
• 2002 CNA 2003 $86,593 $3,395,821 $699,280 (1)
• 2003 CNA 2004 $ - 0 -
• 2004 CNA 2005 $ - 0 -

• 2001 ING / Reliastar 2002 $64,148 $5,831,604 $4,660,130 (2)
• 2002 ING / Reliastar 2003 $123,808 $6,516,195 $5,525,848 (2)
• 2003 ING / Reliastar 2004 $963 $8,292,192 $5,867,161 (3)
• 2004 ING / Reliastar 2005 (results still pending)

Note: While DAIS maintained a Contingent Income Agreement with The Hartford during the period in question, I am advised that the CSAC EIA Crime Bond “deductible buy-down program” would have been excluded.

“Carrier Override Agreement”
Driver Alliant received annual “override income” from the dental carrier on the CSAC EIA program, Delta Dental. However, documentation confirms that structure, which dates back to 1999, provided for a fixed, non-contingent payment. As such there is no direct correlation with the CSAC EIA program (4).

Program Service Compensation:
Beyond the commissions attributed directly to placements, Driver Alliant also received carrier compensation for program administration services for a Public Entity Life & LTD Program which included volume generated from the CSAC EIA business. A summary of this program administration income is as follows:

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lincoln National</td>
<td>1999</td>
<td>$101,170</td>
<td>$4,046,780</td>
<td>Unknown</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>$112,091</td>
<td>$4,483,653</td>
<td>Unknown</td>
</tr>
<tr>
<td>Lincoln National</td>
<td>2001</td>
<td>$28,085</td>
<td>$1,123,431</td>
<td>Unknown</td>
</tr>
<tr>
<td>ING / Reliastar</td>
<td>2001</td>
<td>$93,203</td>
<td>$3,650,021</td>
<td>$3,196,336</td>
</tr>
<tr>
<td>ING / Reliastar</td>
<td>2002</td>
<td>$110,517</td>
<td>$5,888,696</td>
<td>$5,192,004</td>
</tr>
<tr>
<td>ING / Reliastar</td>
<td>2003</td>
<td>$117,343</td>
<td>$6,230,438</td>
<td>$5,544,951</td>
</tr>
<tr>
<td>ING / Reliastar</td>
<td>2004</td>
<td>(results still pending)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Marketing Agreement with the intermediary on the Lincoln National placement, MGU of the West, is attached (5). DAIS was provided compensation from this intermediary via the 50% sharing of their commission override the MGU had with the carrier (2.5 of the 5 points provided), as well as the potential production and persistency bonus. In exchange DAIS provided underwriting and administration services that the MGU would have otherwise provided. The above volumes are estimates based on internal information and are intended to confirm CSAC-EIA’s volume in the program relative to the total. [Note: I have found no evidence of DAIS’S receipt of any income from the potential production and persistency bonus. Total volume has been estimated based on estimates of the percentage of CSAC EIA volume to the whole.]
ING / Reliastar provided DAIS with additional compensation (2% of premiums) in support of underwriting and program administration duties. This compensation has been suspended effective January 1, 2005 pending a resolution of this discussion. Barring any objection from participating program clients it is anticipated that these services will be formally contracted for through our Managing General Underwriting facility, Alliant Specialty Insurance Services ("ASIS"), with the compensation reinstated effective January 1, 2005.

Additional Comments:
- None of the insurance quotes provided by carriers to CSAC EIA were issued with any other carrier's knowledge of any quotes to be provided by any other carrier.

- CSAC EIA was provided with a description of every responsive insurance quote that Driver Alliant received for the placement of the CSAC EIA’s coverage.

In summary, Driver Alliant did not receive any commission on CSAC EIA direct placements over that which was agreed upon between the EIA. The extra compensation received relating to the referenced programs was either "contingent income" or "program service compensation". We trust that this information will provide adequate disclosure on the past implications of contingent income agreements as regards placements made on the behalf of CSAC EIA. If I can be of any further assistance on this matter, please feel free to contact me.

Sincerely,

Jerry Hall
President and
Chief Operating Officer

Enclosures:
(1) Carrier’s Contingent Income Agreement and compensation calculations enclosed.
(2) Carrier’s Contingent Income Agreement for San Diego office and compensation calculation enclosed.
(3) Carrier’s Contingent Income Agreement for Newport Beach office and compensation calculation enclosed (account transferred with Bob D’Angello).
(4) Carrier Override Agreement and backup information enclosed.
(5) Carrier Marketing Agreement and back up enclosed