



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION

ARROW MUTUAL LIABILITY INSURANCE COMPANY

Chestnut Hill, Massachusetts

As of December 31, 2012

NAIC COMPANY CODE 13374

EMPLOYER ID NO 04-1043485

Arrow Mutual Liability Insurance Company

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COMMONWEALTH OF MASSACHUSETTS
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JOSEPH G. MURPHY
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February 27, 2014

Honorable Joseph G. Murphy
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner:

Pursuant to your instructions and in accordance with Massachusetts General Laws, Chapter 175, Section 4, an examination has been made of the financial condition and affairs of

ARROW MUTUAL LIABILITY INSURANCE COMPANY

at its home office located at 23 Commonwealth Avenue, Chestnut Hill, MA, 02467-1099. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Arrow Mutual Liability Insurance Company (“Company” or “Arrow”) was last examined as of December 31, 2007 by the Massachusetts Division of Insurance (the “Division”). The current examination was conducted by the Division and covers the five year period from January 1, 2008 through December 31, 2012, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners (“NAIC”) Financial Condition (E) Committee and prescribed by the current NAIC *Financial Condition Examiners Handbook*. The handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company including corporate governance, identifying and assessing inherent risks within the company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions, where applicable to domestic state regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to a review of the financial condition of the Company, the examination included a review of the Company’s business policies and practices, corporate records, reinsurance treaties, conflict of interest disclosure statements, fidelity bond and other insurance, employees’ benefits plans, disaster recovery plan, treatment of policyholders and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk and examination efforts were directed accordingly.

The Company is audited annually by PricewaterhouseCoopers LLP (“PwC”), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company’s financial statements for the calendar years 2008 through 2012. A review and use of the Certified Public Accountants’ workpapers were made to the extent deemed appropriate and effective. Additionally, the Division reviewed the adequacy and effectiveness of the IT systems controls to determine the level of reliance to be placed on the information generated by the data processing systems.

SUMMARY OF SIGNIFICANT FINDINGS

For a summary of findings contained within this report, refer to the "Summary of Recommendations" section on page 16. The previous report of examination recommended the Company comply with its Business Practice Policy for directors and Proper Business Policy for employees, Massachusetts General Laws ("M.G.L."), Chapter 175, Section 78 requiring recording the votes of all meetings of the directors, NAIC guidelines for indemnification in the custody agreement and MGL Chapter 175 section 64 by recording investment transactions in the minutes. The Company has not adequately addressed the first three issues but has addressed the last issue by including a listing of the investment transactions with the minutes.

COMPANY HISTORY

General

The Company was incorporated on June 20, 1920 under the laws of the Commonwealth of Massachusetts and commenced business on August 1, 1920. Arrow writes workers compensation insurance only.

It was organized by interests identified with Hood Rubber Company, Watertown, Massachusetts, primarily to insure its interest under the provisions of the Workers' Compensation Act. In 1927 Arrow became a group captive and in 1939 it became a mutual company. The Company is authorized to write liability other than auto; however, none has been written since 1969. They are also authorized to transact group accident and health insurance.

CORPORATE RECORDS

Board of Directors Minutes

The minutes of meetings of the Board of Directors and its Committees for the period under examination were read and indicated that all meetings were held in accordance with the Company's bylaws and the laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at the meetings of the Board of Directors.

Articles of Incorporation and Bylaws

The Articles of Incorporation along with related bylaws and amendments thereto were read. There were no changes to the Articles of Incorporation or to the bylaws since the previous examination. The bylaws were last amended in May 2007.

Arrow Mutual Liability Insurance Company

Conflict of Interest Procedures

The Company has a policy pertaining to conflict of interest. In support of its answer to Question 18 of Part 1 Common Interrogatories of the annual statement, the Company has an established procedure for the disclosure to the Board of Directors of any material interest or affiliation on the part of any employee or director, which is in or is likely to conflict with his/her official duties.

Annually, each director and employee completes a questionnaire disclosing any material conflicts of interest. The completed questionnaires were reviewed and no discrepancies were noted to contradict the Company's response to the General Interrogatory regarding conflicts of interest reported in the Company's 2012 Annual Statement. However, questionnaires could not be produced for employees for the years 2009 and 2011.

Disaster Recovery and Business Continuity

The Company provides for the continuity of management and operations in the event of a catastrophe or national emergency in accordance with M.G.L., Chapter 175 Sections 180M-180Q.

MANAGEMENT AND CONTROL

Board of Directors

According to the bylaws, the Company's business shall be managed by a Board of Directors which may exercise all of the powers of the Company except those exclusively conferred upon or reserved solely to the Members. The Board of Directors shall consist of not fewer than seven or more than fifteen directors. The directors shall be elected at the annual meeting of Members. Each director shall hold office for a term of one year. Upon expiration or resignation, his/her successor is elected at the next annual meeting. If the office of a director becomes vacant, the directors may fill any vacancy of the Board of Directors between annual meetings.

At December 31, 2012, the Company's Board of Directors consisted of the following:

<u>Name of Director</u>	<u>Business Affiliation</u>
James R. Flanagan	Flanagan Insurance Agency
Peter Gray	President, Arrow Mutual Liability Insurance Company
Jack A. Green	Wentworth Institute of Technology
Brooks R. Herrick	N.R.I. Community Services
George Hughes	Hughes & Associates
Dieter B. Morlock	Retired
Dennis A. Paren	City of Raleigh, North Carolina
Charles P. Terry	Retired
Joseph Tosches	Seven Hills Foundation

Arrow Mutual Liability Insurance Company

Committees of the Board of Directors

The bylaws allow that the directors may elect or appoint from their number one or more committees. In accordance therewith, the Board of Directors appointed the following committees as of December 31, 2012.

Compensation and Pension Trust Committee

Dieter B. Morlock, Chairman	Jack A. Green
James R. Flanagan	Joseph Tosches

Investment Committee

Charles P. Terry, Chairman	Jack A. Green
Peter Gray	Dennis A. Paren

Audit Committee

George Hughes, Chairman	Brooks Herrick
Jack Green	

Nominating Committee

George Hughes, Chairman	Dennis A. Paren
Dieter Morlock	

Officers

According to the Company's bylaws, the Board of Directors shall elect officers of the Company. The officers of the Company shall be the President, the Treasurer and the Secretary.

Officers of the Company at December 31, 2012 are as follows:

<u>Name of Officer</u>	<u>Title</u>
Peter Gray	CEO, President and Treasurer
George Hughes	Secretary

Arrow Mutual Liability Insurance Company

Organizational Chart

<u>Arrow Mutual Liability</u> <u>Insurance Company</u> <u>(MA)</u> <u>NAIC # 13374</u>

FIDELITY BONDS AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with M.G.L. Chapter 175, Section 60. The aggregate limit of liability meets the NAIC suggested minimum.

The Company has further protected its interests and property by acquiring policies of insurance covering other insurable risks. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts, and the policies were in force as of December 31, 2012.

PENSIONS AND INSURANCE PLANS

Defined Contribution Plan

Arrow sponsors a defined contribution plan that covers substantially all employees. Employees may voluntarily contribute a percentage of their salary which is matched by the Company up to 5% of gross salary. The Company also has a non-qualified deferred compensation plan for certain senior executives.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to write business in Massachusetts, New Hampshire, Maine and Rhode Island. Arrow's principal line of business is workers' compensation provided to commercial risks through its direct sales force and brokers.

Policy Forms and Underwriting Practices

The Company offers workers' compensation coverage utilizing policy forms, riders and endorsements that are subject to the approval of the individual state insurance departments. Rates that deviate from those filed by the Workers' Compensation Rating and Inspection Bureau ("WCRI") need to be filed with and approved by the Division.

Arrow Mutual Liability Insurance Company

Treatment of Policyholders

Claim Settlement Practices

During the claims test work, it was noted that the Company investigates and settles claims on a timely and fair basis.

Dividends to Policyholders

Arrow pays three types of dividends to its policyholders including an investment earnings, underwriting and special dividends. The dividends paid during the examination period are as follows:

<u>Year</u>	<u>Amount</u>
2008	\$ 477,275
2009	577,113
2010	715,302
2011	526,872
2012	360,292

GROWTH OF THE COMPANY

The growth of the Company for the years 2008 through 2012 is shown in the following schedule which was prepared from the Company's annual statements.

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Direct Premiums Written</u>	<u>Net Premiums Written</u>
2012	\$43,226,749	\$14,234,422	\$28,992,327	\$4,908,064	\$5,442,987
2011	42,494,863	14,408,778	28,086,085	5,222,403	5,062,416
2010	43,491,584	15,430,370	28,061,214	3,152,792	3,162,109
2009	45,070,164	17,586,212	27,483,952	3,876,961	3,691,103
2008	45,031,206	17,969,110	27,062,096	3,836,894	4,447,407

Arrow Mutual Liability Insurance Company

REINSURANCE

The Company writes workers' compensation insurance primarily in Massachusetts. All writers of workers' compensation insurance are members of the Massachusetts Workers' Compensation Assigned Risk Pool ("Pool").

The Pool is a state mandated insurance plan created due to the state requirement that all employers obtain workers' compensation insurance. Due to poor loss experience or high risk classification, some employers may not be able to find insurance in the marketplace. Members share in the underwriting results of the Pool on a policy year basis based on each member's share of direct premiums written to the direct premiums written by the industry as a whole.

On July 2, 1996, the Company received approval from the Division to participate in the results of the Pool for the years 1992, 1993 and 1994. As a result, they received a distribution of \$33,682,198 in 1996. Arrow entered into a retroactive reinsurance agreement with Transatlantic Reinsurance Company ("Transatlantic") to reinsure 100% of the Company's pool participation for these years at a cost of \$16,932,198. A net gain of \$16,750,000 was reported as a component of other income in 1996. The gain, net of taxes, is reported as surplus from retroactive reinsurance in the balance sheet.

Ceded Reinsurance

Arrow currently cedes to Swiss Re and Lloyd's. Both provide excess of loss reinsurance. Swiss Re provides \$500,000 in excess of \$500,000 and \$4,000,000 excess of \$1,000,000. Lloyd's provides catastrophe excess of loss of \$10,000,000 excess of \$5,000,000.

Assumed Reinsurance

Arrow assumes business from the Massachusetts Assigned Risk Workers' Compensation Pool and the National Workers' Compensation Pool.

ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires, interviews and through a review of the work performed by the Company's Independent Certified Public Accountants. No material deficiencies were noted.

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The questionnaire was completed by the Company and was reviewed by the Division to evaluate the adequacy of the IT controls. In addition to the questionnaire, interviews with Company staff were conducted to gather supplemental information and to corroborate the Company's responses to the questionnaire. No material deficiencies were noted.

Arrow Mutual Liability Insurance Company

The Company maintains its accounts and records on an electronic data processing basis. All entries are input to this data processing system which then generates general ledger and supporting reports as well as other reports common to the insurance industry. No material exceptions were noted.

The books and records of the Company are audited annually by PricewaterhouseCoopers LLP, independent Certified Public Accountants, in accordance with 211 CMR 23.00.

STATUTORY DEPOSITS

The statutory deposits of the Company as of December 31, 2012 are as follows:

<u>Jurisdiction</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Massachusetts	U.S. Treasury Note 4.875% due 2016	\$250,000	\$251,338	\$289,375
New Hampshire	U.S. Treasury Note 4.25% due 2013	1,000,000	955,430	1,035,230
	U.S. Treasury Note 4.875% due 2016	800,000	926,000	904,248
	U.S. Treasury Note 4.25% due 2013	500,000	566,915	512,635
	Totals	<u>\$2,550,000</u>	<u>\$2,699,683</u>	<u>\$2,741,488</u>

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance and by the NAIC as of December 31, 2012:

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2012

Statement of Income for the Year Ended December 31, 2012

Statement of Capital and Surplus for the Year Ended December 31, 2012

Reconciliation of Capital and Surplus for Each Year in the Five Year Period Ended December 31, 2012

Arrow Mutual Liability Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2012

Assets	As Reported by the Company	Examination Changes	Per Statutory Examination
Bonds	\$ 28,067,535	\$ 0	\$ 28,067,535
Common stocks	9,602,278		9,602,278
Real Estate: Property occupied by the company	20,000		20,000
Cash and short term investments	5,041,003		5,041,003
Other Invested Assets	157,700		157,700
Subtotals, cash and invested assets	42,888,516	0	42,888,516
Investment income due and accrued	258,383		258,383
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	(96,016)		(96,016)
Accrued retrospective premiums	51,996		51,996
Current federal and foreign income tax recoverable	6,290		6,290
Aggregate write-ins for other than invested assets	117,580		117,580
Total Assets	<u>\$ 43,226,749</u>	<u>\$ 0</u>	<u>\$ 43,226,749</u>

Arrow Mutual Liability Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds (Continued)
As of December 31, 2012

Liabilities	As Reported by the Company	Examination Changes	Per Statutory Examination
Losses	\$ 10,200,185	\$ 0	\$ 10,200,185
Loss adjustment expenses	1,615,000		1,615,000
Other expenses	1,020,333		1,020,333
Net deferred tax liability	292,732		292,732
Unearned premiums	394,486		394,486
Dividends declared and unpaid:			
Policyholders	227,905		227,905
Aggregate write-ins for liabilities	483,781		483,781
Total liabilities	14,234,422		14,234,422
Aggregate write-ins for special surplus funds	11,055,000		11,055,000
Unassigned funds (surplus)	17,937,327		17,937,327
Surplus as regards policyholders	28,992,327	0	28,992,327
Total Liabilities, Surplus and Other Funds	\$ 43,226,749	\$ 0	\$ 43,226,749

Arrow Mutual Liability Insurance Company
Statement of Income
For the Year Ended December 31, 2012

	As Reported by the Company	Examination Changes	Per Statutory Examination
Premiums earned	\$ 5,256,485	\$ 0	\$ 5,256,485
Deductions:			
Losses incurred	1,972,436		1,972,436
Loss adjustment expenses incurred	2,609,933		2,609,933
Other underwriting expenses incurred	650,259		650,259
Total underwriting deductions	5,232,628	0	5,232,628
Net underwriting gain (loss)	23,857	0	23,857
Net investment income earned	865,037		865,037
Net realized capital gains (losses)	509,281		509,281
Net investment gain (loss)	1,374,318	0	1,374,318
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	1,398,175		1,398,175
Dividends to policyholders	360,292	0	360,292
Net income before federal taxes	1,037,883	0	1,037,883
Federal and foreign taxes incurred	29,923		29,923
Net Income	\$ 1,007,960	\$ 0	\$ 1,007,960

Arrow Mutual Liability Insurance Company
Statement of Capital and Surplus
For the Year Ended December 31, 2012

	<u>As Reported by the Company</u>	<u>Examination Changes</u>	<u>Per Statutory Examination</u>
Surplus as regards policyholders, December 31 prior year	\$ 28,086,085	\$ 0	\$ 28,086,085
Net income (loss)	1,007,960		1,007,960
Change in net unrealized capital gains or (losses)	353,918		353,918
Change in net deferred income tax	(812,557)		(812,557)
Change in nonadmitted assets	356,921		356,921
Change in surplus as regards policyholders for the year	<u>906,242</u>	<u>0</u>	<u>906,242</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$ 28,992,327</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 28,992,327</u></u>

Arrow Mutual Liability Insurance Company
Reconciliation of Capital and Surplus
For Each Year in the Five-Year Period Ended December 31, 2012

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Capital and Surplus, December 31, prior year	\$ 28,086,085	\$ 28,061,214	\$ 27,483,952	\$ 27,062,096	\$ 29,055,437
Net income (loss)	1,007,960	1,800,481	(54,660)	(1,371,166)	(208,413)
Change in net unrealized capital gains or (losses)	353,918	(1,516,709)	831,036	1,376,901	(2,134,394)
Change in net deferred income tax	(812,557)	(40,720)	(266,427)	(143,605)	812,615
Change in provision for reinsurance					3,301
Change in nonadmitted assets	356,921	(218,181)	67,313	471,374	(465,838)
Aggregate write-ins for gains and losses in surplus				88,352	(612)
Net change in capital and surplus for the year	<u>906,242</u>	<u>24,871</u>	<u>577,262</u>	<u>421,856</u>	<u>(1,993,341)</u>
Capital and Surplus, December 31, current year	<u>\$ 28,992,327</u>	<u>\$ 28,086,085</u>	<u>\$ 28,061,214</u>	<u>\$ 27,483,952</u>	<u>\$ 27,062,096</u>

SUMMARY OF RECOMMENDATIONS

1. Conflict of Interest – The Proper Business Policy for employee's states that they will on an annual basis certify compliance with the policy. However, Conflict of Interest Statements could not be provided for 2009 and 2011.

It is recommended that the company comply with its policy.

2. Minutes – M.G.L. Chapter 175 Section 59 which incorporates the recordkeeping sections of Chapter 156B Section 48 states that the clerk is to keep a record of all proceedings of the directors. Copies of the Audit committee minutes could not be provided.

It is recommended that the Company comply with M.G.L. Chapter 175 Section 59.

3. Investments – The custodial agreement does not contain the NAIC recommended indemnity language. The recommended indemnity language is as follows: "The bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank or trust company's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction." This finding was noted in our previous examination of the Company


It is again recommended that the agreement be amended to contain the NAIC recommended indemnity language.

ACKNOWLEDGEMENT

Acknowledgment is made of the cooperation and courtesies extended by the officers and employees of the Company during the course of the examination.

The assistance rendered by the following Division examiners who participated in this examination is hereby acknowledged:

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