



**THE COMMONWEALTH OF MASSACHUSETTS**  
**OFFICE OF CONSUMER AFFAIRS AND BUSINESS**  
**REGULATION**

**DIVISION OF INSURANCE**

***REPORT OF EXAMINATION OF THE***  
**AMERICAN EMPLOYERS' INSURANCE COMPANY**

**Canton, Massachusetts**

**As of December 31, 2006**

**NAIC GROUP CODE 1129**

**NAIC COMPANY CODE 20613**

**EMPLOYERS ID NO. 04-1027270**

# AMERICAN EMPLOYERS' INSURANCE COMPANY

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**COMMONWEALTH OF MASSACHUSETTS**  
**Office of Consumer Affairs and Business Regulation**  
**DIVISION OF INSURANCE**

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Honorable Commissioners, Directors, and Superintendent:

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

**AMERICAN EMPLOYERS' INSURANCE COMPANY**  
**Canton, Massachusetts**

at its home office located at One Beacon Lane, Canton, MA, 02021-1030. The following report thereon is respectfully submitted.

### **SCOPE OF EXAMINATION**

American Employers' Insurance Company (hereinafter referred to as "the Company" or "American Employers") was last examined for the period January 1, 1997 through December 31, 2001. The current National Association of Insurance Commissioners ("NAIC") association plan examination covers the intervening period from January 1, 2002 through December 31, 2006, and any material transactions and/or events occurring subsequent and noted during the examination.

The current examination was conducted at the direction of, and under the overall management and control of the examination staff of the Massachusetts Division of Insurance (the "Division") representing the NAIC Northeastern Zone. Representatives from the firm of RSM McGladrey, Inc. were engaged by the Division to assist in the examination by performing certain examination procedures. The current examination was conducted concurrent with, and as part of the examination of the OneBeacon Group of companies and the OneBeacon Inter-company Reinsurance Pool, (the "OneBeacon Pool") with Pennsylvania as the lead state. RSM McGladrey was also retained by the Pennsylvania Insurance Department to assist the Pennsylvania Insurance Department in conducting its examination of the OneBeacon Pool and the Pennsylvania domiciled insurers in the OneBeacon Group. The Pennsylvania Insurance Department also retained the actuarial services of KPMG LLP to review the actuarially determined loss and loss adjustment expense reserves of the OneBeacon Pool. The Division has relied on Pennsylvania for all of the work performed on the pooled accounts and KPMG LLP for the work performed on the pooled loss reserves.

The examination was conducted in accordance with standards established by the NAIC Financial Condition (E) Committee as well as with the requirements of the NAIC Financial Condition Examiner's Handbook, the examination standards of the Division and with Massachusetts General Laws. The principal focus of the examination was 2006 activity; however transactions both prior and subsequent thereto were reviewed as deemed appropriate. The examination was conducted following the NAIC Risk Focused Examination model.

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 bonds and other insurance, disaster recovery plan 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, an independent certified public accounting firm, in accordance with 211 CMR 23.00. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2002 through 2006. A review and use of the Certified Public Accountants' work papers were made to the extent deemed appropriate and effective.

The Examination was performed in conjunction with and concurrent with the examination of four of its Massachusetts domiciled affiliates; OneBeacon America Insurance Company; The Employers' Fire Insurance Company; The Northern Assurance Company of America; and, Massachusetts Homeland Insurance Company.

## **HISTORY**

### **General**

The Company was incorporated under the laws of Massachusetts on February 10, 1923 and commenced business on March 2, 1923, under the sponsorship of Employers' Liability Assurance Corporation, Limited, of London, England, with authority to write casualty and bonding coverages. All of the Company's capital stock was purchased in 1928 by Employers' Group Associates, a Massachusetts voluntary trust. The Company became affiliated with CGU Group upon the 1968 unification of the Employers' Group Associates with the original Commercial Union Group. Commercial Union Corporation acquired all the outstanding shares through a tender offer in 1971.

On June 2, 1998, Commercial Union plc and General Accident plc were merged in a pooling of interests. The U.S. operations of the companies were formally combined on December 31, 1998 when all of the assets of General Accident Corporation of America were transferred to Commercial Union Corporation and the name was changed to CGU Corporation. The Company was a wholly owned subsidiary of General Accident Insurance Company which was renamed Pennsylvania General Insurance Company on August 28, 2001.

On June 1, 2001, White Mountains Insurance Group, Ltd. ("White Mountains") acquired CGU Corporation together with its subsidiaries, from London-based CGNU plc. On July 19, 2001 CGU Corporation was renamed OneBeacon Corporation, which merged into Fund American Companies, Inc. on December 30, 2001. On December 31, 2001, all assets formerly owned by OneBeacon Corporation were contributed by Fund American Companies, Inc. to OneBeacon Insurance Group LLC, a newly formed holding company.

### **Common Capital Stock**

As of December 31, 2006, the authorized capital stock of the Company consisted of 60,000 shares of \$100 par value common stock of which 45,000 shares were issued and outstanding with an aggregate stated value of \$4,500,000. All of the common stock was owned by Pennsylvania General Insurance Company, a wholly owned subsidiary of OneBeacon Insurance Group, LLC.

### **Dividends to Stockholders**

The following table summarizes the ordinary dividends paid by the Company during the examination period.

<u>Year</u>	<u>Dividend</u>
2006	\$ 3,300,000
2005	9,226,408
2004	15,900,000
2003	-0-
2002	-0-

Effective June 30, 2005, the Company and its sole stockholder, Pennsylvania General Insurance Company, entered into an "Instrument of Transfer and Assumption Agreement" (See REINSURANCE) with respect to certain assets and liabilities of the Company. Pursuant to the Instrument of Transfer and Assumption, on or about June 30, 2005, the Company paid an extraordinary dividend of \$88,753,505 to Pennsylvania General Insurance Company, consisting of all of the common stock of the Company's wholly owned subsidiary, American Central Insurance Company, and \$47,688,527 in cash and securities.

### **Growth of Company**

The growth of the Company for the years 2002 through 2006 is shown in the following schedule, which was prepared from the Company's Annual Statements. All amounts are in thousands.

	Admitted			Direct Premiums	Net Premiums
<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Written</u>	<u>Written</u>
2006	\$ 35,375	\$ 165	\$ 35,210	\$ 0	\$ 0
2005	37,480	36	37,444	87	0
2004	123,589	752	122,837	1,165	(34,212)
2003	341,338	211,801	129,536	19,940	71,949
2002	397,393	282,165	115,227	119,157	93,979

## **MANAGEMENT**

### **Annual Meeting of Stockholders**

The annual meeting of the stockholders was held on the first Tuesday in May each year during the examination period. At any meeting of the stockholders, a majority in interest of all stock issued and outstanding and entitled to vote upon a question to be considered at the meeting shall constitute a quorum for the consideration of such question. The minutes indicated that a written consent of the sole stockholder in lieu of an annual meeting was obtained for each year during the examination period.

## **Board of Directors**

The by-laws provide that the business and affairs of the Company shall be managed by the Board of Directors except as otherwise provided by the Articles of Incorporation or by a valid shareholder agreement. The Board of Directors shall consist of not less than seven or more than fifteen Directors with the number determined at each annual meeting by resolution of the shareholders. Each Director holds office for a term of one year.

The minutes of the Board of Directors meetings indicated that meetings were held four times per year during the examination period. At any meeting of the Board, a majority of Directors, but not less than four, shall constitute a quorum. The minutes indicated that a quorum was obtained at all meetings of the Board of Directors held during the examination period.

At December 31, 2006 the Board of Directors was comprised of nine Directors. Directors duly elected and serving at December 31, 2006, with business affiliations were as follows:

<u>Director</u>	<u>Business Affiliation</u>
T. Michael Miller Chairman of the Board	Deputy Chairman, President and CEO, OneBeacon Insurance Group, Ltd.; Managing Director, Chairman of the Board, President and CEO, OneBeacon Insurance Group LLC
Alex C. Archimedes	Senior Vice President, OneBeacon Insurance Company
Andrew C. Carnase	Senior Vice President, OneBeacon Insurance Company
Mark K. Dorcus	Managing Director and President, White Mountains Advisors LLC
Thomas L. Forsyth	Secretary, OneBeacon Insurance Group, Ltd.; Managing Director, Senior Vice President, General Counsel and Secretary, OneBeacon Insurance Group LLC
Paul H. McDonough	Vice President and CFO, OneBeacon Insurance Group, Ltd.; Managing Director, Senior Vice President and CFO, OneBeacon Insurance Group LLC
Brian D. Poole	Managing Director, Senior Vice President and Chief Actuary, OneBeacon Insurance Group LLC
Thomas N. Schmitt	Senior Vice President and Chief Human Resources Officer, OneBeacon Insurance Company
Roger M. Singer	Senior Vice President, OneBeacon Insurance Company



## **Officers**

The by-laws of the Company provide that the officers of the Company shall be a president, one or more vice presidents, a secretary, and a treasurer and other officers as deemed necessary. Pursuant to the by-laws, the officers of the Company are elected by the Board of Directors. Vacancies among the officers shall be filled by the Board of Directors.

The elected senior officers and their respective titles at December 31, 2006 follow:

<u>Name</u>	<u>Title</u>
T. Michael Miller	Chairman of the Board, President and Chief Executive Officer
Alex C. Archimedes	Senior Vice President
Andrew C. Carnase	Senior Vice President
Michael J. Daly	Senior Vice President
Eugene C. Fazzie	Senior Vice President
Thomas L. Forsyth	Senior Vice President and General Counsel
Dana P. Hendershott	Senior Vice President and Chief Administrative Officer
Michael R. Keane	Senior Vice President
Paul H. McDonough	Senior Vice President and Chief Financial Officer
Michael J. Sally	Senior Vice President
John M. Meuschke	Senior Vice President
Michael F. Natan	Senior Vice President and Chief Information Officer
Donald P. Nibouar	Senior Vice President
Brian D. Poole	Senior Vice President and Chief Actuary
Kevin J. Rehnberg	Senior Vice President
Thomas N. Schmitt	Senior Vice President and Chief Human Resources Officer
Roger M. Singer	Senior Vice President
Kathleen M. Taylor	Senior Vice President
Dennis R. Smith	Secretary
Frederick J. Turcotte	Vice President and Treasurer

## **Conflict of Interest Procedures**

The Company has adopted a policy statement pertaining to conflict of interest. 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 officer or Director, which is in or is likely to conflict with his/her official duties.

Annually, each officer, Director and responsible employee completes a questionnaire disclosing any material conflicts of interest. The completed questionnaires were reviewed, and no discrepancies were noted in the responses to the General Interrogatories regarding conflicts of interest as reflected in the Company's 2006 Annual Statement.



## **Management Continuity and National Emergency**

The Company provides for the continuity of management in the event of a catastrophe or other emergency in accordance with sections 180M through 180Q of Chapter 175 of the Massachusetts General Laws.

## **Corporate Records**

### *Articles of Incorporation and By-laws*

The by-laws and Articles of Incorporation and amendments thereto were read. There was one change to the by-laws since the prior examination. This change was made to include an indemnification clause and was properly filed with the Secretary of the Commonwealth of Massachusetts.

## **AFFILIATED COMPANIES**

Per Form B, as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of Chapter 175, Section 206C of the Massachusetts General Laws. The Company is a wholly owned subsidiary of Pennsylvania General Insurance Company, a Pennsylvania domiciled insurance company, which is a wholly owned subsidiary of OneBeacon Insurance Group LLC, an insurance holding company domiciled in the state of Delaware. OneBeacon Insurance Group LLC is an indirect wholly-owned subsidiary of OneBeacon Insurance Group, Ltd., a publicly traded insurance holding company domiciled in Bermuda. White Mountains Insurance Group, Ltd., also an insurance holding company domiciled in Bermuda, is the "ultimate controlling person" for the Company, and indirectly owned 72.4% of the outstanding shares of OneBeacon Insurance Group, Ltd. as of December 31, 2006.

## **Corporate Governance**

OneBeacon Insurance Group, Ltd. is a publicly traded company listed on the New York Stock Exchange ("NYSE"). As such, OneBeacon Insurance Group, Ltd. is subject to the rules and regulations of the Sarbanes-Oxley Act of 2002, the Securities Exchange Commission and the NYSE. OneBeacon Insurance Group, Ltd. has ultimate fiduciary responsibility for the Company's operations, corporate actions, and treatment of constituents, particularly, policyholders, claimants, employees, shareholders, etc.

It should be noted that OneBeacon Insurance Group, Ltd. has an audit committee of its Board of Directors that is comprised of "independent" Directors; it meets four times a year, appears to have a financially sound acumen within its outside Directors composition; is ultimately responsible to the full Board for outside external auditor selection (CPA firm) and review of such services; for the financial reporting accounting and disclosure environment; for the internal control environment from which the corporation operates; and for control of selection of other consulting firms services as to "independence" from a "sound practices" perspective.

## **Transactions and Agreements with Subsidiaries and Affiliates**

### *Investment Management Agreement*

The Company maintains an agreement with White Mountains Advisors, LLC to act as investment advisor. Under this agreement, White Mountains Advisors, LLC provides investment management services, including the investment and reinvestment of the Company's invested assets. The fee for these services is paid on a quarterly basis at rates applied to its investment portfolio.

### *Tax Sharing Agreement*

The Company is a party to a consolidated income tax agreement which covers the allocation, settlement, and financial statement presentation of current federal income taxes among companies included in the consolidated income tax return of the Fund America Financial Services, Inc. and its subsidiaries.

## **ORGANIZATION CHART**

White Mountains Insurance Group, Ltd. (Bermuda)  
White Mountains Holdings Bermuda, Ltd. (Bermuda)  
OneBeacon Insurance Group, Ltd. (Bermuda) (72.4%)  
Mill Shares Holdings (Bermuda), Ltd.  
OneBeacon Holdings (Gibraltar), Ltd.  
OneBeacon Holdings (Luxembourg) S.a.r.l.  
Fund American Financial Services, Inc. (DE)  
Fund American Enterprise Holdings, Inc. (DE)  
Fund American Companies, Inc. (DE)  
OneBeacon Insurance Group LLC (DE)  
OneBeacon Insurance Company (PA)  
Atlantic Specialty Insurance Company (NY)  
AutoOne Insurance Company (NY)  
AutoOne Select Insurance Company (NY)  
Homeland Insurance Company of New York (NY)  
Farmers and Merchants Insurance Company (OK)  
Midwestern Insurance Company (OK)  
Traders and General Insurance Company (TX)  
OneBeacon America Insurance Company (MA)  
York Insurance Company of Maine (ME)  
OneBeacon Lloyd's of Texas (TX)  
The Employers' Fire Insurance Company (MA)  
Massachusetts Homeland Insurance Company (MA)  
The Northern Assurance Company of America (MA)  
OneBeacon Midwest Insurance Company (WI)  
The Camden Fire Insurance Company (NJ)  
Pennsylvania General Insurance Company (PA)  
**American Employers' Insurance Company (MA)**  
American Central Insurance Company (MO)  
Potomac Insurance Company (PA)  
New Jersey Skylands Management LLC Attorney-In-Fact (DE)  
New Jersey Skylands Insurance Association (NJ)  
New Jersey Skylands Insurance Company (NJ)  
Adirondack AIF, LLC Attorney-In-Fact (NY)  
Adirondack Insurance Exchange (NY)

**Organization Chart, Continued**

Houston General Insurance Management Company Attorney-In-Fact (TX)  
Houston General Insurance Exchange (TX)  
Houston General Insurance Company (TX)

**FIDELITY BOND AND OTHER INSURANCE**

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with Massachusetts General Laws, Chapter 175, Section 60. The aggregate limit of liability exceeds the NAIC suggested minimum.

The Company has further protected its interests and property by policies of insurance covering other insurable risks. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts and was in force as of December 31, 2006.

**STATUTORY DEPOSITS**

The statutory deposits of the Company at December 31, 2006 are as follows:

<u>State</u>	<u>Purpose of Deposit</u>	<u>Book Value</u>	<u>Fair Value</u>
Arizona	Reserved for Workers' Compensation	\$126,476	\$127,052
California	Reserved for Workers' Compensation	126,476	127,052
Connecticut	Reserved for Workers' Compensation	87,000	86,317
Delaware	Reserved for Workers' Compensation	121,877	122,432
Georgia	Benefit of Georgia Policyholders	121,608	120,111
Idaho	Reserved for Workers' Compensation	295,495	296,840
Illinois	Reserved for Workers' Compensation	57,489	57,751
Indiana	Reserved per Ins Code Stat 27-01-20-12	32,002	31,608
Kansas	Reserved for Workers' Compensation	76,805	75,860
Louisiana	Reserved for Fidelity and Surety	89,606	88,503
Maryland	Reserved for Workers' Compensation	57,489	57,751
Massachusetts	Benefit of All Policyholders	3,460,855	3,476,612
Nevada	Reserved for Workers' Compensation	128,008	126,433
New Hampshire	Reserved for Workers' Compensation	63,725	63,575
New Mexico	Benefit of New Mexico Policyholders	382,879	384,622
New York	Reserved for Workers' Compensation	57,489	57,751
North Carolina	Multiple Purposes	309,368	309,050
Oregon	Reserved for Surety	425,421	427,358
Texas	Reserved for Fidelity and Surety	86,234	86,627
Vermont	Reserved for Workers' Compensation	76,805	75,860
Virginia	Reserved per Ins Code Stat 382-1945	<u>256,017</u>	<u>252,866</u>
	Totals	<u>\$6,439,124</u>	<u>\$6,452,031</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

The Company is licensed to write business in all 50 states, the District of Columbia and the U.S. Virgin Islands. In 2005, the Company entered into a Transfer and Assumption Agreement under the terms of which all direct insurance assets and liabilities were transferred to Pennsylvania General Insurance Company. The Company did not actively underwrite or market any business in 2006.

### **REINSURANCE**

Effective January 1, 2001, the Company and twelve (12) of its affiliates (collectively called "pool members") entered into an Amended and Restated Reinsurance Agreement ("Pooling Agreement") pursuant to which each pool member cedes 100% of its direct underwriting activity to the OneBeacon Insurance Company, the lead company in the pool. After recording all assumed and ceded reinsurance from other affiliates and third parties, the remaining net underwriting activity is retroceded by OneBeacon Insurance Company to each pool member in accordance with each company's pooling percentage. The Company's participation at January 1, 2001 was 4.2%. On January 1, 2004 the Pooling Agreement was amended and the Company's assuming participation was reduced to 0.0%.

On July 1, 2004 the Company's ceding and assuming participation in the Pooling Agreement was effectively terminated. The Company then entered into a 100% quota share agreement with OneBeacon Insurance Company. On July 1, 2005 the 100% quota share agreement with OneBeacon Insurance Company was terminated and effective June 30, 2005 the Company entered into a Transfer and Assumption Agreement with its immediate parent, Pennsylvania General Insurance Company. As such, as of the examination date, the Company had no direct or net written premium, and all liabilities have been assumed by Pennsylvania General Insurance Company. The Company was sold by Pennsylvania General Insurance Company on August 9, 2007. See the Subsequent Events section (next page) for additional details relating to the change in ownership.

### **ACCOUNTS AND RECORDS**

The Company's internal control structure was discussed with management through questionnaires and through a review of the work performed by the Company's independent Certified Public Accountants, PricewaterhouseCoopers LLP, including work papers generated to support the requirements of the Sarbanes-Oxley Act of 2002. As part of its engagement for the Pennsylvania Insurance Department, RSM McGladrey performed a review and evaluation of the control environment of OneBeacon Group's IT systems. The NAIC's Information Systems Questionnaire (ISQ) completed by the Company was reviewed and interviews with Company management and IT staff were conducted to gather supplemental information and corroborate the Company's responses to the ISQ. Included was a review of the documentation supporting Management and Organization Controls, Application Systems Development and Maintenance Controls, Operating and Processing Controls, Logical and Physical Security Controls, Contingency Planning Controls, Personal Computer, Local Area Network (LAN), Wide Area

Network (WAN) and Internet Controls. The control environment of the Company's information systems was found to have in place sufficient internal controls.

No material internal control weaknesses were noted in connection with the examination, nor were any such matters reported in the CPA firm's filings with the Division.

The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2006 Annual Statement. No material exceptions were noted.

### **SUBSEQUENT EVENTS**

Effective August 9, 2007, all of the issued and outstanding capital stock of the Company was sold by its parent, Pennsylvania General Insurance Company, to SPARTA Insurance Holdings, Inc., an unrelated party. Pennsylvania General Insurance Company's obligations to SPARTA Insurance Holdings, Inc. in connection with the sale were guaranteed by OneBeacon Insurance Company.

Concurrent with the purchase Sparta Insurance Holding Inc. made a capital contribution of \$219,630,000 of cash and short term securities increasing the surplus of the Company to \$255,405,931.

Effective August 9, 2007 the Company filed Articles of Amendment with the Commonwealth of Massachusetts. The Company's Articles of Incorporation and the By-Laws were amended to change the name of the Company to SPARTA Insurance Company; change the home address to 155 Federal Street, Suite 700, Boston Massachusetts 02110; and change the mailing address of the Company to CityPlace II, 185 Asylum Street, Hartford, Connecticut 06103. The amendment was approved by the Division on August 30, 2007.

**FINANCIAL STATEMENTS**

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance of the Commonwealth of Massachusetts and by the NAIC as of December 31, 2006.

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2006

Statement of Income for the Year Ended December 31, 2006

Statement of Capital and Surplus as of December 31, 2006

Reconciliation of Capital and Surplus for Each Year in the Five Year Period Ended December 31, 2006

For Information Purposes Only

American Employers' Insurance Company  
Statement of Assets, Liabilities, Surplus and Other Funds  
As of December 31, 2006

	As Reported by the Company	Examination Changes	Per Statutory Examination
<b>Assets</b>			
Bonds	\$29,271,738		\$29,271,738
Cash and short-term investments	2,445,542		2,445,542
Other invested assets	<u>2,557,700</u>		<u>2,557,700</u>
Subtotals, cash and invested assets	<u>34,274,980</u>		<u>34,274,980</u>
Investment income due and accrued	353,179		353,179
Net deferred tax asset	616,009		616,009
Guaranty funds receivable or on deposit	130,321		130,321
Aggregate write-ins for other than invested assets	<u>949</u>		<u>949</u>
Total Assets	<u><u>\$35,375,438</u></u>		<u><u>\$35,375,438</u></u>

For Information Purposes Only



American Employers' Insurance Company  
Statement of Assets, Liabilities, Surplus and Other Funds (Continued)  
As of December 31, 2006

	As Reported by the Company	Examination Changes	Per Statutory Examination
<b>Liabilities</b>			
Other expenses	\$27,450		\$27,450
Payable to parent, subsidiaries and affiliates	17,176		17,176
Aggregate write-ins for liabilities	120,722		120,722
Total Liabilities	<u>165,348</u>		<u>165,348</u>
 Common capital stock	4,500,000		4,500,000
Gross paid in and contributed surplus	29,583,144		29,583,144
Unassigned funds (surplus)	<u>1,126,946</u>		<u>1,126,946</u>
Surplus as regards policyholders	<u>35,210,090</u>		<u>35,210,090</u>
 Total Liabilities, Capital and Surplus	<u>\$35,375,438</u>		<u>\$35,375,438</u>

American Employers' Insurance Company  
Statement of Income  
For the Year Ended December 31, 2006

	As Reported by the Company	Examination Changes	Per Statutory Examination
Net investment income	\$991,104		\$991,104
Net realized capital gains	3,333,663		3,333,663
Net investment gain	4,324,767		4,324,767
Net income before dividends to policyholders and before federal and foreign income taxes	4,324,767		4,324,767
Federal and foreign income taxes incurred	0		0
Net Income	<u>\$4,324,767</u>		<u>\$4,324,767</u>

For Information Purposes Only

American Employers' Insurance Company  
Statement of Capital and Surplus  
For the Year Ended December 31, 2006

	As Reported by the Company	Examination Changes	Per Statutory Examination
Capital and Surplus, December 31, prior year	\$37,443,925		\$37,443,925
Net income	4,324,767		4,324,767
Change in net unrealized capital gains or (losses)	(2,831,324)		(2,831,324)
Change in net unrealized foreign exchange	(283)		(283)
Change in deferred tax	(473,328)		(473,328)
Change in nonadmitted assets	46,333		46,333
Paid in surplus adjustments	0		0
Dividends to stockholders	(3,300,000)		(3,300,000)
Aggregate write-ins	0		0
Change in surplus	<u>(2,233,835)</u>		<u>(2,233,835)</u>
Capital and Surplus, December 31, current	<u>\$35,210,090</u>		<u>\$35,210,090</u>

American Employers' Insurance Company  
Reconciliation of Capital and Surplus  
For Each Year in the Five Year Period Ended December 31, 2006

	2006	2005	2004	2003	2002
Capital and Surplus, December 31, prior year	\$37,443,925	\$122,836,649	\$129,535,994	\$115,227,269	\$103,688,791
Net Income	4,324,767	11,525,938	11,889,196	17,698,331	10,436,645
Change in net unrealized capital gains or (losses)	(2,831,324)	(5,492,265)	(592,339)	(1,242,804)	4,610,695
Change in net unrealized foreign exchange	(283)	(8,334)	8,619	0	0
Change in deferred tax	(473,328)	(2,186,069)	(8,808,686)	(5,745,654)	8,717,431
Change in nonadmitted assets	46,333	(478,489)	6,703,865	3,598,852	(8,172,636)
Paid in surplus adjustments	0	(79,527,097)	0	0	0
Dividends to stockholders	(3,300,000)	(\$9,226,408)	(15,900,000)	0	0
Aggregate write-ins	0	0	0	0	(4,053,657)
Change in capital and surplus	(2,233,835)	(85,392,724)	(6,699,345)	14,308,725	11,538,478
Capital and Surplus, December 31, current year	\$35,210,090	\$37,443,925	\$122,836,649	\$129,535,994	\$115,227,269

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## **NOTES TO FINANCIAL STATEMENTS**

### **Loss and Loss Adjustment Expense Reserves**

As part of the coordinated financial examination of the OneBeacon Insurance Companies by the Pennsylvania Insurance Department, the “lead state” of the group, it retained the actuarial services of KPMG LLP (“KPMG”) to perform an actuarial analysis of the loss and loss adjustment expense reserves of the OneBeacon Pool, which includes all its reinsured affiliates as of December 31, 2006. KPMG has made an independent assessment of the OneBeacon Pool’s loss and loss adjustment expense reserves as of December 31, 2006 to determine whether the reserve amounts carried are reasonably stated in accordance with sound actuarial principals. This analysis was performed both gross and net of reinsurance.

As noted previously in this report and subsequent to the examination date, the Company was sold by its immediate parent, Pennsylvania General Insurance Company (“PA General”), to an unrelated party effective August 9, 2007. Prior to this sale, the Company discontinued writing business and ceased to be a participant in the OneBeacon Pool. To facilitate the sale, the Company entered into a Transfer and Assumption Agreement effective June 30, 2005 with PA General, its direct parent within the group, which assumed all remaining underwriting assets and liabilities including all loss and loss adjustment expense reserves of the Company.

As of December 31, 2006, PA General was a member of the OneBeacon Pool with a ten percent participation ratio. As such, all outstanding loss and loss adjustment expense reserves of the Company assumed by PA General were retro-ceded by PA General to the OneBeacon Pool and therefore included in KPMG’s actuarial analysis of the OneBeacon Pool’s loss and loss adjustment expense reserves. KPMG has concluded that based on its review of OneBeacon’s reserve calculations, as well as its own independent testing, that the OneBeacon Pool’s gross and net loss and loss adjustment reserves are reasonably stated and fall within a range of reasonableness as of December 31, 2006.

**ACKNOWLEDGEMENT**

Acknowledgment is made of the cooperation and courtesies extended by the officers and employees of the Company to all the examiners and RSM McGladrey, Inc. during the course of the examination.

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John M. Curran, CFE  
Supervising Examiner and Examiner-in-Charge  
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