



# COMMONWEALTH OF MASSACHUSETTS

## Office of Consumer Affairs and Business Regulation

### DIVISION OF INSURANCE

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March 30, 2007

The Honorable Alfred W. Gross  
Chairman, NAIC Financial Condition (E) Committee  
Commissioner, Bureau of Insurance  
Commonwealth of Virginia  
PO Box 1157  
1300 East Main Street  
Richmond, VA 23219

The Honorable Thomas E. Hampton  
Secretary, Northeast Zone  
Commissioner, Dept. of Insurance, Securities, and Banking  
Government of the District of Columbia  
810 First Street, N. E., Suite 701  
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The Honorable Nonnie S. Burnes  
Commissioner of Insurance  
The Commonwealth of Massachusetts  
One South Station, 5<sup>th</sup> Floor  
Boston, MA 02110

Honorable Commissioners:

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

### **ARBELLA PROTECTION INSURANCE COMPANY**

at its statutory home office at 1100 Crown Colony Drive, Quincy, Massachusetts 02269. The following report thereon respectfully is submitted:

## SCOPE OF EXAMINATION

Arbella Protection Insurance Company (hereinafter referred to as “Arbella” or the “Company”) was last examined as of December 31, 2000, under the Association Plan of the National Association of Insurance Commissioners (“NAIC”) by the Massachusetts Division of Insurance (the “Division”). The current Association examination was performed by the Division under the authority of Section 4, Chapter 175 of the Massachusetts General Laws, and covers the five year period from January 1, 2001, through December 31, 2005, including any material transactions and/or events subsequent to the examination date as noted during the course of this examination.

Concurrent examinations were also conducted of four other Massachusetts domiciled insurers of the Arbella Insurance Group: Arbella Mutual Insurance Company (“AMIC”), Arbella Indemnity Insurance Company (“AIIC”), Commonwealth Mutual Insurance Company (“CMIC”), Commonwealth Reinsurance Company (“CRC”) collectively, the “Group”, each of which is the subject of a separate examination report.

The examination was conducted in accordance with standards established by the Financial Condition (E) Committee of the NAIC 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 as of December 31, 2005, and the year 2005 activity, however transactions both prior and subsequent thereto were reviewed as deemed appropriate.

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, employees’ pension and benefits plans, 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 Ernst & Young LLP (“E&Y”), an independent certified public accounting firm, in accordance with 211 CMR 23.00. E&Y expressed unqualified audit opinions on the Company’s statutory basis financial statements for each of the years they audited the Company during the examination period (2001 through 2005). The E&Y workpapers for the year 2005 audit were reviewed as part of the examination process and used to assist in the planning of the examination, to supplement work performed by the Division and KPMG, and expedite the overall examination process.

Representatives from the independent certified public accounting firm of KPMG LLP (“KPMG”) were engaged to complete certain agreed upon procedures, including a review and evaluation of the adequacy of the Company’s loss and loss adjustment expense reserves as of December 31, 2005.

## HISTORY

### General

The Company was incorporated in 1992 under the laws of the Commonwealth of Massachusetts as a wholly-owned subsidiary of AMIC and commenced business on January 1, 1993. During 1994, all of the Company's common stock was contributed and ownership of the Company was transferred to Arbella, Inc., a holding company which is 99.3 % owned by AMIC. The Group operates solely in the New England region and collectively writes private passenger auto, commercial auto, commercial lines, homeowners, personal umbrella and workers' compensation products primarily through independent agents.

The Company is duly organized under Section 47 of Chapter 175 of the Massachusetts General laws to provide coverage for all commercial lines, workers' compensation, and personal lines other than life.

Effective January 1, 2002, the Company entered into an intercompany pooling agreement with its Massachusetts domiciled affiliates. Under the terms of this agreement the Company, AIIC, and CRC cede 100% of their net book to the AMIC. AMIC retains 75% of the pooled underwriting results and retrocedes the remaining 25% back to the other pool participants, including the Company, based on the percentages listed in the following table. Percentages have not changed since the pool's inception:

The Company	18%
AMIC	75%
AIIC	4%
CRC*	3%
<u>Total</u>	<u>100%</u>

\* CMIC cedes 100% of its net book to CRC and CRC retrocedes 100% of this book to the Pool.

The Company has not made any significant changes to its articles of incorporation or its by-laws during the period covered by this examination. Additionally, there have not been any name changes, mergers, or any other material changes to its corporate structure since the last examination except as discussed below in Acquisitions, Affiliations and Other Transactions.

The Company is a commercial automobile servicing carrier for Commonwealth Automobile Reinsurers ("CAR"), the automobile residual market mechanism in Massachusetts and participates in the Massachusetts and Rhode Island FAIR Plans, as well as the Massachusetts NCCI workers compensation pool.

### Capital Stock

The ownership of the Company resides with its stockholder, Arbella, Inc., a down stream holding company of AMIC, which controls the Company through the election of the Board of Directors. The Company has 97,500 shares authorized of \$28.00 par value common stock and 92,674 issued and outstanding. The stock is 100% owned by Arbella, Inc.

### Growth of Company

The growth of the Company for the years 2001 through 2005 is shown in the following schedule, which was prepared from the Company's statutory annual statements.

<u>Year</u>	<u>Admitted Assets</u>	<u>Net Written Premiums</u>	<u>Capital &amp; Surplus</u>
2005	\$ 229,741,355	\$ 111,613,528	\$ 85,225,883
2004	215,201,251	106,939,357	75,047,386
2003	199,140,573	108,547,434	64,757,090
2002	205,459,158	75,984,191	61,954,508
2001	256,984,197	146,852,051	41,848,898

### MANAGEMENT

#### Annual Meeting of Stockholder

In accordance with the by-laws, the Annual Meeting of the Stockholder is to be held on the third Tuesday in June of each year at the home office of the Company or at such location as determined by the Board of Directors. The holders of a majority interest of all stock issued, outstanding and entitled to vote at a meeting shall constitute a quorum, present either in person or by proxy. If two or more classes of stock are outstanding and entitled to vote as separate classes, then in the case of each such class, a quorum shall consist of the holders of a majority interest if the stock of that class issued, outstanding and entitled to vote. Additionally, the by-laws allow the stockholder to take action by written consent. The minutes indicate that a quorum was obtained at each annual meeting of the stockholder held during the examination period.

#### Board of Directors

The by-laws of the Company provide that the business and affairs of the Company shall be managed by the Board of Directors except as otherwise provided by the law, Articles of Organization, or the by-laws. The Board of Directors shall consist of not fewer than five members and shall hold office until the next annual meeting of stockholders and until his or her successors shall have been elected and qualified.

At December 31, 2005, the Board of Directors was comprised of five members, which is in compliance with the Company by-laws. Directors duly elected and serving at December 31, 2005, with business affiliations, follows:

<u>Director</u>	<u>Business affiliation</u>	<u>Residence</u>
Patricia P. Bailey	Consultant	Santa Fe, New Mexico
Francis X. Bellotti	Arbella Insurance Group	Quincy, Massachusetts
John F. Donohue	Chairman, Board of Directors	Belmont, Massachusetts
Douglas R. Jones	President, Chief Executive Officer, Assistant Secretary	Georgetown, Massachusetts
Robert P. Medwid	Executive Vice President, Chief Financial Officer, Treasurer	Cohasset, Massachusetts

The by-laws do not specify the number of meetings to be held during a given calendar year. The by-laws contain provisions allowing for special meetings. Additionally, the by-laws allow the Board of Directors to take action by written consent and/or telephone conference. The minutes of the Board of Directors meetings indicated that meetings were held at least four times per year during the examination period. At any meeting of the Board of Directors a majority of the directors then in office 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.

#### Committees of the Board

The by-laws state that the Board of Directors may elect an Executive Committee and may elect such other committees as may be required from time to time. The Board of Directors of Arbella, Inc. elects committees each year and the Board of Directors votes each year to direct and authorize the committees of Arbella, Inc. to act as advisory committees to the Boards of Directors of the subsidiary companies of Arbella, Inc. As of the date of this examination, Arbella, Inc. operated with designated Audit, Automation, Compensation, Executive, Investment and Planning Committees. The minutes of all of the committee meetings for the period covered by this examination were reviewed.

#### Officers

The by-laws of the Company provide that the officers of the Company shall be a President, Treasurer, the Clerk, the Secretary, and any other officers, as the Board of Directors deems necessary. Pursuant to the by-laws, the officers of the company are elected by the Board of Directors at their first meeting following the annual meeting of stockholders or special meeting in lieu thereof. Each officer shall hold office until the first meeting of the Board of Directors following the next annual meeting or special meeting in lieu thereof and until his successor is elected or appointed and qualified. The elected officers and their respective titles at December 31, 2005 are as follows:

**Officer**

John F. Donohue  
Douglas R. Jones  
Robert P. Medwid  
Thomas S. Carpenter  
Gail Eagan <sup>(1)</sup>  
Beverly T. Kenneally

**Title**

Chairman, Board of Directors  
President, Chief Executive Officer, Assistant Secretary  
Executive Vice President, Chief Financial Officer, Treasurer  
Executive Vice President and Chief Actuary  
Vice President & General Counsel  
Secretary and Clerk

(1) elected November, 2005

**Conflict of Interest Procedures:**

The Company has established procedures 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 and director completes a questionnaire disclosing any material conflicts of interest.

**Corporate Records:**

The Company's records were reviewed for the period covered by this examination. They were assessed for accuracy and compliance with the Company's by-laws, Articles of Incorporation, as well as for compliance with Massachusetts General Laws, and the Commonwealth of Massachusetts Regulations ("211 CMR"). During the examination period there were no changes to these documents and all changes made were properly disclosed to all regulatory authorities. All activity related to the company's funds, including all investments was examined for proper approval.

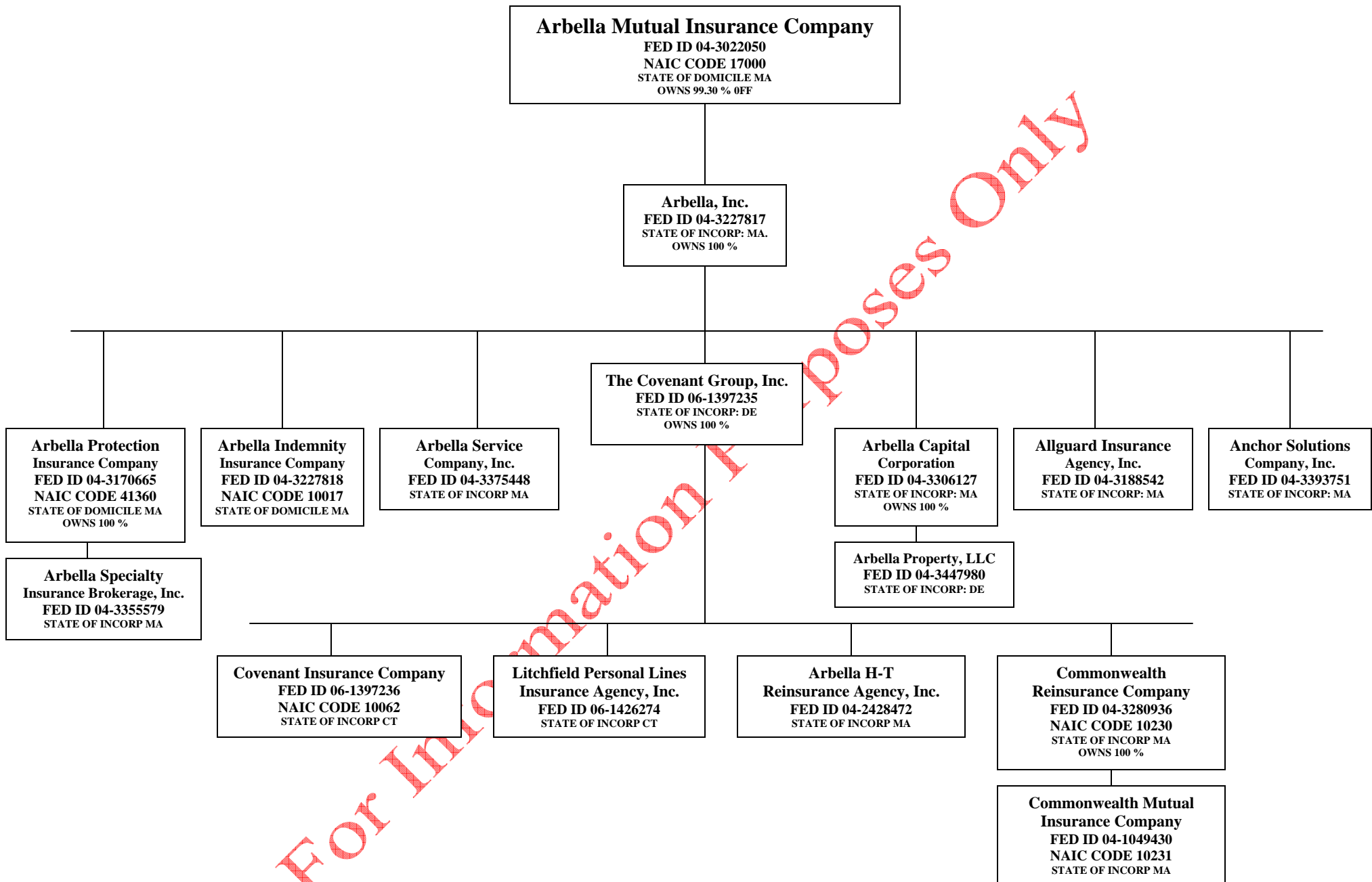
The Company has a disaster recovery plan and business continuity plan however, its by-laws do not contain explicit provisions for the continuity in the event of a national emergency; hence, under such circumstances, the succession of officers will be as prescribed in Sections 180M through 180Q of MGL Chapter 175.

**AFFILIATED COMPANIES**

The Company's insurance affiliates include the following Massachusetts domiciled property and casualty insurance companies: AMIC, AIIC, CRC and CMIC. Covenant Insurance Company ("CIC") is domiciled in the State of Connecticut.

**Organization Chart**

An organization chart of Arbella Mutual Insurance Company and subsidiaries is presented below.





## Acquisitions, Affiliations and Other Transactions

- During the period January 1, 2000, through December 31, 2005, the Company's material transactions included the following items:
- The Company recorded a cumulative effect of adoption of Codification that resulted in an adjustment that increased unassigned surplus as of January 1, 2001, by \$3,800,000, primarily as a result of recording a net deferred tax asset of \$1,600,000 and a change in its reserving basis of \$2,200,000.
- Effective June 1, 2001, AMIC purchased 2,462,122 shares of Arbella, Inc. stock for \$6,500,000. Arbella, Inc. in turn contributed \$6,000,000 to the Company.
- Effective December 20, 2001, AMIC purchased 4,924,243 shares of Arbella, Inc. stock for \$13,000,000. Arbella, Inc. in turn contributed \$5,000,000 to the Company.
- During 2001, Arbella, Inc. repurchased the .2% outstanding shares of capital stock from certain members of senior management. As of December 31, 2001, the Company is 100% owned by Arbella, Inc.
- Effective April 2, 2002, the Group received a rating of B++ from A.M. Best. Previously, the Group's A.M. Best rating was A-.
- In 2002, Arbella, Inc. contributed \$7.3 million to the Company (\$2 million on June 30 and \$5.3 million on July 31).

## INTERCOMPANY AGREEMENTS

### Management Agreement

Effective January 1, 1998, the Company entered into a management agreement with Arbella Service Company ("Service"), a wholly owned subsidiary of Arbella, Inc. whereby Service provides the Company (and its affiliates) with management services including data processing and system support, underwriting, marketing, claims, actuarial, cash and investment management, personnel, legal, accounting, and other such management oversight as is required and requested by the Company for the necessary and efficient management of its operation.

### Tax Sharing Agreement

The Company files a consolidated tax return with AMIC and its subsidiaries. The Company has executed a tax sharing agreement effective January 1, 1996, which provides for the allocation of taxes based upon the separate return calculations with current credit for net losses incurred by any one of the companies to the extent such losses are utilized in the consolidated return.



## FIDELITY BOND AND OTHER INSURANCE

The Company and its affiliates maintain fidelity coverage with an authorized Massachusetts insurer, under a financial institutions bond designed for insurance companies, consistent with M.G.L. c. 175 s. 60. The Company, a member of the Group, is covered by a blanket fidelity bond with an aggregate liability of \$6,000,000 and a single loss limit of liability of \$3,000,000 and a single loss deductible of \$25,000. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts and was in force as of December 31, 2005. The aggregate limit of liability exceeds the NAIC suggested minimum as well as Massachusetts General Law requirements. Other coverage provided under the bond includes assorted loss of property coverage, losses due to forgery and counterfeit currency losses, and computer systems fraud. The Company has further protected its interest and property by policies of insurance covering other insurable risks.

## PENSION, INSURANCE PLANS AND EMPLOYEE WELFARE

### Retirement and Deferred Compensation Plans

The Company has no employees, however, it does participate in a qualified defined contribution retirement plan (retirement plan) for which all employees of Service are eligible to participate on the first month following their attainment of age 18 and completion of eleven months of service. The retirement plan is allocated to various companies within the Group under a Generally Accepted Accounting Practices (“GAAP”) cost sharing arrangement.

The Company has no employees, however, it does participate in a qualified 401K savings plan which uses the same eligibility requirements as the retirement plan. Under the terms of this plan employees contribute from 1% to 60% of their annual earnings, with the sponsor matching 100% of the employee’s first 3% and a 50% match for the next 2%, subject to Internal Revenue Service (“IRS”) annual limitations. The cost of this plan is allocated to various companies within the Group under a GAAP cost sharing arrangement.

The Company has no employees, however, it does participate in a defined contribution plan, which provides certain postretirement health and life insurance benefits. Substantially all employees may become eligible for these benefits if they reach retirement age (62) while working for Service, and have at least five years of service credit. Annually, the plan sponsor determines the amount of money it will contribute that year towards the cost of the benefits for the individuals that are currently retired. The sponsor retains the right to change or modify the plan at any time and makes no promise to current employees that it will annually contribute to the cost of their postretirement benefits.

## Stock Option Plan

Arbella, Inc. has an incentive bonus and stock option plans for senior management as well as the Board of Directors for shares of Arbella, Inc. Under the terms of these plans, each option granted can be used to purchase one share of Arbella, Inc.'s stock. There are 4,289,375 shares reserved for issuance under these plans as of December 31, 2005.

## STATUTORY DEPOSITS

The statutory deposits of the Company as of December 31, 2005, were as follows:

<u>Location</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Massachusetts	U.S., Treasury Note 7.00% due 5/15/2006	\$ 75,000	\$ 75,133	\$ 75,985
Massachusetts	U.S., Treasury Note 6.75% due 8/15/2026	425,000	533,206	544,268
New Hampshire	U.S., Treasury Note 6.625% due 5/15/2007	1,135,000	1,154,483	1,167,983
New York	U.S., Treasury Note 6.625% due 5/15/2007	50,000	51,100	51,655
Rhode Island	U.S., Treasury Note 7.725% due 5/15/2016	500,000	502,282	07,655

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

As of December 31, 2005, the Company is licensed in the Commonwealth of Massachusetts, the states of Connecticut, Rhode Island, Vermont, New York and the Commonwealth of Pennsylvania. The Company maintains a restricted license in the state of New Hampshire. The Company transacts business only in the Commonwealth of Massachusetts and the state of Rhode Island. The Company is duly organized under the laws of the Commonwealth of Massachusetts and is authorized to write all personal and commercial lines except life and reinsurance under section 47 of Chapter 175 of the Massachusetts General Laws.

### Rating and Statistical Reporting

The significant rating and statistical organizations to which the Company subscribes include the Workers' Compensation Rating and Inspection Bureau of Massachusetts, the Insurance Service Office, the National Council on Compensation Insurance, and Commonwealth Automobile Reinsurers.

## SUBSEQUENT EVENTS

There were no details noted as “subsequent events”, the disclosure of which in this Examination Report were considered appropriate.

## REINSURANCE

The Company and its insurance affiliates utilize and share the cost of a common reinsurance program to reduce loss exposures from catastrophe as well as individual risks. The Group maintains treaties for property excess of loss, casualty excess of loss, workers' compensation excess of loss and umbrella treaties placed directly with General Reinsurance Company. Additionally the Group maintains a facultative treaty with Hartford Steam Boiler for machinery and equipment coverage. The Group utilizes the services of a reinsurance broker, Guy Carpenter, to place certain catastrophe reinsurance. The Company remains contingently liable to the extent that its reinsurers are unable to meet their obligations under the reinsurance agreements.

### Ceded Reinsurance

#### *Property Per Risk Excess of Loss Treaty*

This reinsurance agreement with Gen Re covers homeowners property losses as follows: 1<sup>st</sup> layer: \$1,000,000 xs \$1,000,000; 2<sup>nd</sup> layer: \$4,000,000 xs \$2,000,000. The limit for other property losses is: 1<sup>st</sup> layer: \$800,000 xs \$1,200,000; 2<sup>nd</sup> layer: \$4,000,000 xs \$2,000,000.

#### *Casualty Per Risk Excess of Loss Treaty*

This reinsurance agreement with Gen Re covers casualty losses as follows: 1<sup>st</sup> layer \$800,000 xs \$1,200,000; 2<sup>nd</sup> layer: \$4,000,000 xs \$2,000,000.

#### *Property Catastrophe Excess of Loss Treaty*

This reinsurance agreement is placed with various subscribing reinsurers through a broker, Guy Carpenter, as follows:

1<sup>st</sup> layer: \$25,000,000 xs \$25,000,000; 2<sup>nd</sup> layer: \$120,000,000 xs \$50,000,000; 3<sup>rd</sup> layer: \$50,000,000 xs \$170,000,000.

### Assumed Reinsurance

The Company assumes business is through its participation in Commonwealth Automobile Reinsurers ("CAR") and certain other involuntary pools and associations. As a servicing carrier for CAR the Company provides coverage on certain commercial auto policies which are ceded to CAR. The Company is required to assume from CAR a percentage of CAR's aggregate commercial auto premiums, losses and expenses based on participation ratios as determined by CAR. The Company also assumes business from the Massachusetts FAIR Plan and the Massachusetts NCCI worker's compensation pool.

### Intercompany Reinsurance

As previously noted on January 1, 2002 the Company entered into an intercompany pooling agreement with several of its affiliates. Under the terms of this agreement the Company, AIIC and CRC cede 100% of their net book to the AMIC. AMIC retains 75% of the pooled underwriting results and retrocedes the remaining 25% to the other pool participants.

### ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires and through transaction testing and 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 information systems (IS) environment. The Company operates on information systems owned, operated and maintained by the Company. The NAIC Exhibit C Questionnaire was completed by the Company. These independent work products were reviewed by the Division as part of the evaluation of the adequacy of the IS controls. No material deficiencies were noted.

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.

## FINANCIAL STATEMENTS

The following financial statements are presented on the basis prescribed by the NAIC Accounting Practices and Procedures Manual which are the principal accounting practices and procedures promulgated by the National Association of Insurance Commissioners and the Commonwealth of Massachusetts Division of Insurance:

- Statement of Assets, Liabilities, Surplus and Other Funds, December 31, 2005;
- Statement of Income for the Year Ended December 31, 2005;
- Statement of Capital and Surplus for the Year Ended December 31, 2005;
- Reconciliation of Capital and Surplus for the Five Year Period Ended December 31, 2005.

For Information Purposes Only

Arbella Protection Insurance Company  
Statement of Assets, Liabilities, Surplus and Other Funds  
December 31, 2005

	Per Annual Statement	Examination Adjustments	Per Examination	Note
<b><u>Assets</u></b>				
Bonds	\$ 184,088,806	\$ -	\$ 184,088,806	
Common stocks	409,081		409,081	
Cash	(2,873,607)		(2,873,607)	
Short-term investments	4,774,844		4,774,844	
Investment income due and accrued	1,510,090		1,510,090	
Uncollected premiums	1,565,268		1,565,268	
Deferred premiums	29,740,078		29,740,078	
Amounts recoverable from reinsurers	5,071,621		5,071,621	
Net deferred tax asset	5,200,000		5,200,000	
Other assets	255,174		255,174	
Total assets	<u>\$ 229,741,355</u>	<u>\$ -</u>	<u>\$ 229,741,355</u>	
<b><u>Liabilities, Surplus and Other Funds</u></b>				
Losses	\$ 60,777,927	\$ 3,872,000	\$ 64,649,927	1
Loss adjustment expenses	8,688,937	(3,872,000)	4,816,937	1
Commissions payable	3,805,017		3,805,017	
Current federal income taxes	3,285,000		3,285,000	
Unearned premiums	53,233,147		53,233,147	
Advance premiums	1,542,535		1,542,535	
Payable to parent, subsidiaries and affiliates	9,197,752		9,197,752	
Other liabilities	3,985,157		3,985,157	
Total liabilities	<u>144,515,472</u>	<u>-</u>	<u>144,515,472</u>	
Common capital stock	2,594,872		2,594,872	
Gross paid in and contributed surplus	55,863,191		55,863,191	
Unassigned funds	26,767,820		26,767,820	
Surplus as regards policyholders	<u>85,225,883</u>	<u>-</u>	<u>85,225,883</u>	
Total liabilities, surplus and other funds	<u>\$ 229,741,355</u>	<u>\$ -</u>	<u>\$ 229,741,355</u>	

Arbella Protection Insurance Company  
Statement of Income  
for the Year Ended December 31, 2005

	Per Annual Statement	Examination Adjustments	Per Examination	Note
Premiums earned	\$ 108,864,759	\$ -	\$ 108,864,759	
Losses incurred	59,165,943	3,872,000	63,037,943	1
Loss expenses incurred	10,982,819	(3,872,000)	7,110,819	1
Other underwriting expenses incurred	36,314,249		36,314,249	
Net underwriting gain	2,401,748	-	2,401,748	
Net investment income earned	8,220,541		8,220,541	
Net realized capital gains and (losses)	87,582		87,582	
Net investment gain or (loss)	8,308,123		8,308,123	
Net gain or (loss) from agents' or premium balances charged off	(445,523)		(445,523)	
Finance or service charges	2,629,620		2,629,620	
Miscellaneous income	(735,859)		(735,859)	
Net income before dividends and taxes	12,158,109	-	12,158,109	
Federal income taxes incurred	3,258,543		3,258,543	
Net income	\$ 8,899,566	\$ -	\$ 8,899,566	



Arbella Protection Insurance Company  
Statement of Capital and Surplus  
for the Year Ended December 31, 2005

	Per Annual <u>Statement</u>	Examination <u>Adjustments</u>	Per <u>Examination</u>	<u>Note</u>
Surplus as regards policyholders, December 31, 2004	\$ 75,047,386	\$ -	\$ 75,047,386	
Net income	8,899,566		8,899,566	
Change in net unrealized capital gains and (losses)	41,125		41,125	
Change in net deferred income tax	228,000		228,000	
Change in nonadmitted assets	1,009,806		1,009,806	
Change in surplus as regards policyholders for the year	10,178,497	-	10,178,497	
Surplus as regards policyholders, December 31, 2005	<u>\$ 85,225,883</u>	<u>\$ -</u>	<u>\$ 85,225,883</u>	

For Information Purposes Only

Arbella Protection Insurance Company  
Reconciliation of Capital and Surplus  
for the Five Year Period Ended December 31, 2005

	2005 *	2004	2003	2002	2001
Surplus as regards policyholders, December 31, prior year	\$ 75,047,386	\$ 64,757,090	\$ 61,954,508	\$ 41,848,898	\$ 38,628,512
Net income	8,899,566	9,188,903	3,343,906	10,133,720	(11,207,208)
Change in net unrealized capital gains and (losses)	41,125	(168,405)	(164,803)	(5,532)	(1,675)
Change in net deferred income tax	228,000	1,180,000	-	2,600,000	-
Change in nonadmitted assets	1,009,806	89,798	(376,521)	77,422	(463,783)
Cumulative effect of changes in accounting principles	-	-	-	-	3,877,000
Capital changes - Paid in	-	-	-	7,300,000	11,016,052
Change in surplus as regards policyholders for the year	10,178,497	10,290,296	2,802,582	20,105,610	3,220,386
Surplus as regards policyholders, December 31, current year	\$ 85,225,883	\$ 75,047,386	\$ 64,757,090	\$ 61,954,508	\$ 41,848,898

\* As per Examination

## NOTES TO FINANCIAL STATEMENT

### NOTE 1:

The Company's Annual Statement, as filed, did not reflect a reclassification necessary to bring the Loss Reserves and Reserve for Loss Adjustment Expenses into agreement with the actuarial analysis prepared by the Company's Appointed Actuary. This examination reclassified those amounts in both the liabilities and in the underwriting expenses. There was no effect on Surplus.

### NOTE 2:

As part of the examination by the Division, KPMG was directed to review the reasonableness of the reserves for loss and loss adjustment expenses of the Company as of December 31, 2005.

The review was conducted in a manner consistent with the Code of Professional Conduct and the Qualification Standards of the American Academy of Actuaries and the Standards of Practice adopted by the Actuarial Standards Board.

The results of KPMG's actuarial review indicated that the Company's reserves at December 31, 2005 fell within the range of reasonable estimates for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its policies and reinsurance agreements.

The following table summarizes the reserve ranges as developed by KPMG, the selected point estimate reserve and the Company's carried loss and loss adjustment expense reserves as of December 31, 2005, for each reserve category (all amounts in millions of dollars).

#### Net of Reinsurance

<u>Reserve Category</u>	<u>Low End of Range</u>	<u>KPMG Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Loss Reserves	\$ 52.2	\$ 56.7	\$ 62.5	\$ 60.8
Loss Adjustment Expense				
Reserve	<u>14.2</u>	<u>14.7</u>	<u>15.4</u>	<u>8.7</u>
Total Loss and Loss Adjustment Expense				
Reserves	<u>\$ 66.4</u>	<u>\$ 71.4</u>	<u>\$ 77.9</u>	<u>\$ 69.5</u>

#### Gross of Reinsurance

<u>Reserve Category</u>	<u>Low End of Range</u>	<u>KPMG Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Loss Reserves	\$ 62.0	\$ 67.7	\$ 74.7	\$ 73.0
Loss Adjustment Expense				
Reserve	<u>16.9</u>	<u>17.6</u>	<u>18.5</u>	<u>10.6</u>
Total Loss and Loss Adjustment Expense				
Reserves	<u>\$ 78.9</u>	<u>\$ 85.3</u>	<u>\$ 93.2</u>	<u>\$ 83.6</u>

The following table summarizes the reserve ranges as developed by KPMG, the selected point estimate reserve and the Arbella Insurance Group carried loss and loss adjustment expense reserves as of December 31, 2005, for each reserve category (all amounts in millions of dollars).

<u>Reserve Category</u>	<u>Low End of Range</u>	<u>KPMG Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Net Loss Reserves	\$ 289.8	\$ 314.8	\$ 347.2	\$ 337.7
Net Defense & Cost Containment Expense Reserves	52.2	53.8	56.0	32.7
Net Adjusting & Other Expense Reserves	<u>13.3</u>	<u>14.4</u>	<u>15.2</u>	<u>15.6</u>
Total Net Loss and Loss Adjustment Expense Reserves	<u>\$ 355.3</u>	<u>\$ 383.0</u>	<u>\$ 418.4</u>	<u>\$ 386.0</u>
<u>Reserve Category</u>	<u>Low End of Range</u>	<u>KPMG Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Gross Loss Reserves	\$ 344.2	\$ 375.9	\$ 414.9	\$ 405.6
Gross Defense & Cost Containment Expense Reserves	67.4	69.8	73.1	42.4
Gross Adjusting & Other Expense Reserves	<u>13.3</u>	<u>14.4</u>	<u>15.2</u>	<u>16.6</u>
Total Gross Loss and Loss Adjustment Expense Reserves	<u>\$ 424.9</u>	<u>\$ 460.1</u>	<u>\$ 503.2</u>	<u>\$ 464.6</u>

## CONCLUSION

The undersigned gratefully acknowledges the participation of the following members of the Massachusetts Division of Insurance in this examination:

Yvette P. Nelson-Smith  
Steven C. Tsimtsos

Insurance Examiner II  
Insurance Examiner II

The undersigned also express their appreciation for the courteous cooperation of the officers and employees of the Company in the course of the examination.

Respectfully submitted,

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*For Information Purposes Only*