



THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION

DIVISION OF INSURANCE

REPORT OF EXAMINATION

OF THE

ARROW MUTUAL LIABILITY INSURANCE COMPANY

Chestnut Hill, Massachusetts

as of December 31, 2007

N.A.I.C. COMPANY CODE 13374

EMPLOYERS ID NO. 04-1043485

ARROW MUTUAL LIABILITY INSURANCE COMPANY

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February 25, 2009

The Honorable Alfred W. Gross
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The Honorable Nonnie S. Burnes
Commissioner of Insurance
The Commonwealth of Massachusetts
Office of Consumer Affairs and Business Regulation
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Honorable Commissioners:

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 (hereinafter referred to as “Company” or “Arrow”) was last examined as of December 31, 2002 under the association plan of the National Association of Insurance Commissioners (“NAIC”) by the Massachusetts Division of Insurance (“Division”). The current examination was conducted by the Division and covers the five year period from January 1, 2003 through December 31, 2007, 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 established by the NAIC Financial Condition (E) Committee as well as with the requirements of the NAIC Financial Condition Examiners Handbook, the examination standards of the Division and with Massachusetts General Laws. The principal focus of the examination was 2007 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, 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 (“PwC”), 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 2003 through 2007. A review and use of PwC’s work papers were made to the extent deemed appropriate and effective. The adequacy and effectiveness of the IT systems were reviewed to determine the level of reliance to be placed on summary information generated by the data processing systems.

For a summary of findings contained within this report, refer to the Comments and Recommendations Section on page 15 of this Report.

Status of Prior Examination Findings

The previous report of examination, for the period ended December 31, 2002, did not contain any Comments or Recommendations.

Arrow Mutual Liability Insurance Company

HISTORY

General

The Company, a mutual company, was incorporated on June 20, 1920 under the laws of the Commonwealth of Massachusetts and commenced business on August 1, 1920.

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. 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.

Dividends to Policyholders

Arrow pays three types of dividends to its policyholders, Investment Earnings, Underwriting and Special. The dividends paid during the examination period are as follows:

2003	\$ 1,284,339
2004	1,325,261
2005	1,213,036
2006	1,233,559
2007	1,199,369

Growth of the Company

The growth of the Company for the years 2003 through 2007 is shown in the following schedule which was prepared from the Company's Annual Statements, including any changes as a result of the examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Direct Premiums Written</u>	<u>Net Premiums Written</u>
2007	\$49,212,001	\$20,156,564	\$29,055,437	\$7,548,383	\$7,001,808
2006	48,477,582	21,105,216	27,372,366	5,743,980	6,636,823
2005	46,731,844	21,416,946	25,314,898	5,147,883	5,318,387
2004	47,873,328	21,649,500	26,223,828	4,314,466	4,067,677
2003	47,303,376	19,697,586	27,605,790	(1,364,594)	(544,518)

MANAGEMENT

Annual Meeting

In accordance with the by-laws, the annual meeting of the Company is held on the first Thursday in May. Every partnership, corporation, or association to whom a policy has been issued by the Company, and whose policy has not expired or been cancelled, shall be a member of the Company and be entitled at any meeting of the Company to one vote for each policy. Five members constitute a quorum. The minutes indicated that a quorum was obtained at each annual meeting held 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. The board of directors shall consist of not fewer than seven or more than fifteen directors with the number determined at each annual meeting by resolution of the policyholders. Each director holds office for a term of one year. Upon expiration or resignation, his/her successor is elected at the next annual meeting.

At December 31, 2007, the board was comprised of eleven directors, which is in compliance with the Company's by-laws. Directors duly elected and serving at December 31, 2007, with business affiliations, follows:

<u>Director</u>	<u>Business Affiliation</u>
William H. Dykstra	- Retired
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
Robert P. Kelsey	- Retired
Dieter B. Morlock	- Retired
Dennis A. Paren	- Alliance One International
Charles P. Terry	- Retired
Joseph Tosches	- Seven Hills Foundation

The bylaws do not specify the number of meetings to be held during a year. 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, five directors constitute a quorum. The minutes indicated that a quorum was obtained at all meetings of the board of directors held during the examination period.

The board of directors appointed the following committees in accordance with the bylaws. The members of each committee at December 31, 2007 are as follows:

Compensation and Pension Trust Committee

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

Investment Committee

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

Audit Committee

Charles P. Terry, Chairman	Dennis A. Paren
Brooks R. Herrick	Robert P. Kelsey
	George Hughes

Officers

The by-laws of the Company provide that the officers of the Company shall be a Chairman, a president, a secretary, 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 officers and their respective titles at December 31, 2007 follow:

<u>Name</u>	<u>Title</u>
Jack A. Green	Chairman
Peter Gray	CEO, President and Treasurer
George Hughes	Secretary

Arrow Mutual Liability Insurance Company

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 employee or director, which is in or is likely to conflict with his/her official duties.

Annually, each director and employee is required to complete a questionnaire disclosing any material conflicts of interest. However, the forms were only completed for the years 2003 and 2005.

Corporate Records

Articles of Incorporation and By-laws

The by-laws and Articles of Incorporation and amendments thereto were read. There were no changes to the Articles of Incorporation since the previous examination. The by-laws were amended in May 2007.

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. c.175 ss.180M-180Q.

Board of Directors Minutes

The minutes of the board of directors and committee meetings for the period under statutory examination were read and indicated that all meetings were held in accordance with the Company's by-laws and the laws of the Commonwealth of Massachusetts. Activities of the committees were ratified at each meeting of the board of directors.

ORGANIZATIONAL CHART

<u>Arrow Mutual Liability</u> <u>Insurance Company</u> (MA) <u>NAIC # 13374</u>
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FIDELITY BOND AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with M.G.L. c.175 s.60. The aggregate limit of liability meets 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, 2007.

STATUTORY DEPOSITS

The statutory deposits of the Company as of December 31, 2007 are as follows:

Location	Description of Deposit	Par Value	Statement Value	Market Value
Massachusetts	U.S. Treasury Note 4.75% due 2008	\$250,000	\$240,097	\$252,792
New Hampshire	U.S. Treasury Note 4.25% due 2013	1,000,000	986,034	1,036,800
	U.S. Treasury Note 4.75% due 2008	800,000	768,422	809,000
	U.S. Treasury Note 3.25% due 2009	500,000	495,310	500,860
Total		<u>\$2,550,000</u>	<u>\$2,489,863</u>	<u>\$2,599,452</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

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 (WCRB) need to be filed with the Division. They may not be used until approved.

Arrow Mutual Liability Insurance Company

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.

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.

Policyholder Complaints

The Company stated that during the period 2003 to 2007, no complaints were received.

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 and through a review of the work performed by the Company's independent Certified Public Accountants, PwC. No material internal control weaknesses were noted in connection with the examination, nor were any such matters reported by PwC, in their report filed with the Division.

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The questionnaire was completed by the Company. This was reviewed by the exam team and no material deficiencies were noted.

The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2007 annual statement. No material exceptions were noted.

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and the NAIC as of December 31, 2007:

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2007

Statement of Income for the Year Ended December 31, 2007

Statement of Capital and Surplus as of December 31, 2007

Reconciliation of Capital and Surplus for Each Year in the Five Year Period Ended December 31, 2007

Arrow Mutual Liability Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2007

Assets	Per Company	Examination Changes	Per Statutory Examination	Notes
Bonds	\$ 33,487,461	\$ 0	\$ 33,487,461	
Common stocks	11,729,443		11,729,443	
Real Estate: Property occupied by the company	20,000		20,000	
Cash and short term investments	2,832,285		2,832,285	
Other Invested Assets	157,700		157,700	
Subtotal cash and invested assets	48,226,889	0	48,226,889	
Investment income due and accrued	441,597		441,597	
Premiums and considerations:				
Uncollected premiums	275,939		275,939	
Accrued retrospective premiums	149,131		149,131	
Amounts recoverable from reinsurers	16,508		16,508	
Aggregate write-ins for other than invested assets	101,937		101,937	
TOTAL ASSETS	<u>\$ 49,212,001</u>	<u>\$ 0</u>	<u>\$ 49,212,001</u>	

Arrow Mutual Liability Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds (Continued)
As of December 31, 2007

Liabilities	Per Company	Examination Changes	Per Statutory Examination	Notes
Losses	\$ 14,042,401	\$ 0	\$ 14,042,401	
Loss adjustment expenses	2,440,000		2,440,000	
Other expenses	603,148		603,148	
Current federal and foreign income taxes	103,046		103,046	
Net deferred tax liability	11,490		11,490	
Unearned premiums	598,776		598,776	
Dividends declared but unpaid:				
Policyholders	529,240		529,240	
Provision for reinsurance	3,301		3,301	
Aggregate write-ins for liabilities	<u>1,825,162</u>		<u>1,825,162</u>	
Total liabilities	20,156,564		20,156,564	
Aggregate write-ins for special surplus funds	11,055,000		11,055,000	
Unassigned funds	<u>18,000,437</u>		<u>18,000,437</u>	
Total surplus	<u>29,055,437</u>	<u>0</u>	<u>29,055,437</u>	
TOTAL LIABILITIES AND SURPLUS	<u>\$ 49,212,001</u>	<u>\$ 0</u>	<u>\$ 49,212,001</u>	

Arrow Mutual Liability Insurance Company
Statement of Income
For the Year Ended December 31, 2007

	Per Company	Examination Changes	Per Statutory Examination	Notes
Premiums earned	\$ 6,538,830	\$ 0	\$ 6,538,830	
Deductions				
Losses Incurred	2,818,287		2,818,287	
Loss expenses incurred	2,044,522		2,044,522	
Other underwriting expenses incurred	784,200		784,200	
Total underwriting deductions	<u>5,647,009</u>	<u>0</u>	<u>5,647,009</u>	
Net underwriting gain (loss)	<u>891,821</u>	<u>0</u>	<u>891,821</u>	
Net investment income earned	1,793,845		1,793,845	
Net realized capital gains (losses)	<u>2,119,928</u>		<u>2,119,928</u>	
Net investment gain (loss)	<u>3,913,773</u>	<u>0</u>	<u>3,913,773</u>	
Net income before dividends to policyholders	4,805,594		4,805,594	
Dividends to policyholders	<u>1,199,369</u>		<u>1,199,369</u>	
Net income before federal taxes	3,606,225	0	3,606,225	
Federal and foreign taxes incurred	<u>115,130</u>		<u>115,130</u>	
Net Income	<u><u>\$ 3,491,095</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 3,491,095</u></u>	

Arrow Mutual Liability Insurance Company
Statement of Capital and Surplus
As of December 31, 2007

	Per Company	Examination Changes	Per Statutory Examination	Notes
Surplus as regards policyholders, December 31, 2006	\$ 27,372,366	\$ 0	\$ 27,372,366	
Net income	3,491,095		3,491,095	
Change in net unrealized capital gains or (losses)	(1,007,031)		(1,007,031)	
Change in net deferred income tax	(803,478)		(803,478)	
Change in nonadmitted assets	<u>2,485</u>		<u>2,485</u>	
Change in surplus as regards policyholders for the year	<u>1,683,071</u>	<u>0</u>	<u>1,683,071</u>	
Surplus as regards policyholders, current year	<u>\$ 29,055,437</u>	<u>\$ 0</u>	<u>\$ 29,055,437</u>	

Arrow Mutual Liability Insurance Company
Reconciliation of Capital and Surplus
For Each Year in the Five Year Period Ended December 31, 2007

	2007	2006	2005	2004	2003
Capital and Surplus, December 31, prior year	\$ 27,372,366	\$ 25,314,898	\$ 26,223,828	\$ 27,605,790	\$ 27,045,486
Net income	3,491,095	1,119,759	515,583	(2,514,975)	(222,008)
Change in net unrealized capital gains or (losses)	(1,007,031)	19,415	(815,595)	466,741	645,695
Change in net deferred income tax	(803,478)	171,486	(542,937)	328,419	149,617
Change in provision for reinsurance		(3,301)		57,000	(13,000)
Change in nonadmitted assets	2,485	(7,530)	(233,111)	280,853	
Aggregate write-ins for gains and losses in surplus		757,639	167,130		
Net change in capital and surplus for the year	1,683,071	2,057,468	(908,930)	(1,381,962)	560,304
Capital and Surplus, December 31, current year	\$ 29,055,437	\$ 27,372,366	\$ 25,314,898	\$ 26,223,828	\$ 27,605,790

COMMENTS AND RECOMMENDATIONS

1. Conflict of Interest – The Business Practice Policy for Directors and 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 2003, 2006 and 2007.

It is recommended that the company comply with its policy.

2. Investments – MGL Chapter 175 section 64 states that all investment acquisitions and disposals shall be reported to the board of directors or designated committee and recorded in the minutes of their next meeting. A listing of the transactions was not included in the board of director's minutes.

It is recommended that the Company comply with MGL Chapter 175 section 64 and include a listing of the investment transactions.

3. Minutes – MGL Chapter 175 section 78 states that the Secretary shall keep a record of the votes, which shall show whether cast in person or by proxy; a record of all other proceedings of all meetings of the directors or the members. Copies of the committee minutes could not be provided.

It is recommended that the Company comply with MGL Chapter 175 section 78.

4. 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."

It is 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 Company to all the examiners during the course of the examination.

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

Brian Knowlton, Examiner II

Raffaele J. Ciarabella, Jr., CFE
Supervising Examiner
Commonwealth of Massachusetts

Maria Gannon, CFE
Examiner-In-Charge
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