



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

**DIVISION OF INSURANCE**

**REPORT OF EXAMINATION**

**OF THE**

**COMMONWEALTH MUTUAL INSURANCE COMPANY**

**100 CROWN COLONY DRIVE**

**QUINCY, MASSACHUSETTS 02269-9103**

**AS OF**

**DECEMBER 31, 2010**

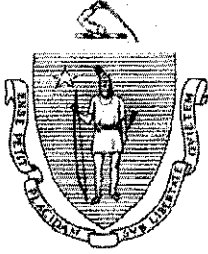
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**COMMONWEALTH OF MASSACHUSETTS**  
**Office of Consumer Affairs and Business Regulation**  
**DIVISION OF INSURANCE**

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COMMISSIONER OF INSURANCE

November 18, 2011

The Honorable Joseph Torti III  
Chairman, NAIC Financial Condition (E) Committee  
Superintendent  
State of Rhode Island  
Department of Business Regulation  
Division of Insurance  
1511 Pontiac Avenue, Building 69-2  
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Office of Consumer Affairs and  
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Division of Insurance  
1000 Washington Street, Suite 810  
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Honorable Superintendent and Commissioner:

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:

**COMMONWEALTH MUTUAL INSURANCE COMPANY**

at its statutory home office at 1100 Crown Colony Drive, Quincy, Massachusetts 02269-9103.  
The following report thereon respectfully is submitted.

**SCOPE OF EXAMINATION**

Commonwealth Mutual Insurance Company ("Company") was last examined as of December 31, 2005, under the Association Plan of the National Association of Insurance Commissioners ("NAIC") by the Commonwealth of Massachusetts, Division of Insurance ("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, 2006, through December 31, 2010, including any material transactions and/or events subsequent to the examination date as noted during the course of this examination.

This examination was conducted at the same time and in conjunction with the Division's statutory financial condition examination of the Company's affiliates Arbella Mutual Insurance Company ("Mutual"), Arbella Indemnity Insurance Company ("Indemnity"), Arbella Protection Insurance Company ("Protection"), and Commonwealth Reinsurance Company ("Commonwealth Re") by the Division. A separate examination of Covenant Insurance Company ("Covenant") is being conducted by the Connecticut Insurance Department. Representatives from the firm of PricewaterhouseCoopers LLP ("PwC") were engaged by the Division to assist in the examination by performing certain examination procedures, including an actuarial review of the Company's actuarially determined items.

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 Massachusetts General Laws. The principal focus of the examination was as of December 31, 2010, and the year 2010 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. The E&Y workpapers for the year 2010 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 PwC, and expedite the overall examination process.

### **Information Technology Review**

A review and an evaluation of the control environment of the Company's information technology systems were performed. The NAIC's Information Technology (IT) Questionnaire completed by the Company was reviewed and interviews with Company staff were conducted to gather supplemental information and corroborate the Company's responses to the questionnaire. A review was also made 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 reviewed and found to have in place sufficient internal controls.

This Report of Examination is written on an exception basis. Explanations and details pertaining to various phases of the examination will be found herein. Unless specifically noted otherwise, all references to the accounts, activities, and transactions of the Company are as of December 31, 2010. For a summary of findings contained within this report, refer to the section titled "Summary of Comments and Recommendations".

### **HISTORY**

#### **General**

Commonwealth Mutual Insurance Company is a property and casualty insurer domiciled and licensed in the Commonwealth of Massachusetts. The Company is organized as a mutual insurance company and is controlled through a management and reinsurance agreement by its affiliate, Commonwealth Re Insurance Company. Pursuant to the reinsurance agreement, Commonwealth Re assumes 60% of the Company's net underwriting results. Commonwealth Re is a wholly owned subsidiary of Arbella, Inc., which is 99.0% owned by Arbella Mutual Insurance Company, a property and casualty insurance company domiciled in the Commonwealth of Massachusetts. The Company commenced insurance operations in July 1845, and is the former Attleboro Mutual Insurance Company (Attleboro) that discontinued operations in 1992. Effective in 1995, Attleboro amended its articles of incorporation and license and changed its name to Commonwealth Mutual Insurance Company. The Company was subsequently re-capitalized with \$5,500,000 in cash from a surplus note it issued to its affiliate Commonwealth Re. This transaction was approved by the Division.

The Company is licensed to write private passenger automobile and homeowners policies in Massachusetts, and since 2006 only actively wrote homeowners' business through independent agents. Beginning in 2009, the Company no longer actively wrote any business.

The Company has not made any material changes to its articles of incorporation or its by-laws during the period covered by this examination. Additionally, there have not been any name

## Commonwealth Mutual Insurance Company

changes, mergers, or any other material changes to its corporate structure during the examination period.

### Surplus Note

In connection with its recapitalization, on August 1, 1995, the Company issued a surplus note to Commonwealth Re in the amount of \$5,500,000 with a maturity date of August 1, 2025. The surplus note pays interest at three hundred basis points over three year treasury notes; the rate is adjusted semi-annually. Principal and interest is payable December 1 and June 1 and subject to prior approval of the Commissioner of Insurance of the Commonwealth of Massachusetts. During the examination period, the Company has requested and was approved each year for an interest payment on its note equal to its preceding year's annual net investment results.

### Growth of Company

The growth of the Company for the years 2006 through 2010 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 Premium</u>	<u>Capital &amp; Surplus</u>
2010	\$5,626,416	\$0	\$5,591,134
2009	5,648,700	0	5,500,000
2008	5,705,883	0	5,500,000
2007	6,042,923	0	5,500,000
2006	7,981,249	0	5,500,000

### MANAGEMENT

#### Annual Meeting of Members

In accordance with the by-laws, the Annual Meeting of the Company is to be held at the home office on the fourth Tuesday of February at 2:00 PM. Three members represented in person or by proxy constitute a quorum. The minutes indicate that a quorum was obtained at each meeting through 2009. No annual meeting of the policyholders was held in 2010 as the Company has no active policyholders.

#### 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 Articles of Incorporation. The Board of Directors may elect an Executive Committee and such other committees as it may determine, comprised of such number of its members as it may from time to time determine (but in any event not less than two), and delegate to such committee or committees all of its powers except those which by law, the Articles of Organization or these by-laws it is prohibited from delegating.

## Commonwealth Mutual Insurance Company

At December 31, 2010, the Board of Directors was comprised of eight directors, which is in compliance with the Company by-laws. The Directors and any business affiliation with the Company as of December 31, 2010, are as follows:

<u>Director</u>	<u>Business Affiliation</u>
Patricia P. Bailey	None
Francis X. Bellotti	Legal consultant for the Company
Edmund J. Doherty	None
John F. Donohue	CEO of Arbella Insurance Group
J. Robert Dowling	Partial owner of Dowling Insurance Agency, which does business with the Company
Andrea W. Gargiulo	None
Thomas R. Kiley	Legal consulting services provided to the Company by his firm, Coganove, Eisenberg & Kiley, P.C.
Jeannette M. Orsino	None

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 constitutes 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 Board of Directors may, by a majority vote elect an Executive Committee and such other committees as may be required from time to time. Each year the Board of Directors votes to direct and authorize the Committees of Arbella, Inc. to act as advisory committees to the Board of Directors of the company. As of the date of this examination, Audit, Automation, Compensation, Executive, Investment and Planning Committees advised the Company's Board of Directors. 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 Secretary and such 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 the annual meeting. Each officer shall hold office until the first meeting of the Board of Directors following the next annual meeting of the Company and until his or her successor is elected or appointed and qualified. The elected officers and their respective titles at December 31, 2010, are as follows:



## Commonwealth Mutual Insurance Company

### Officer

### Title

John F. Donohue	Chairman, President, Chief Executive Officer, Assistant Secretary
Christopher E. Hall	Senior Vice President, Chief Financial Officer, Treasurer
Gail Eagan	Vice President and General Counsel
Beverly J. Tangvik	Secretary and Clerk

The by-laws provide that the President shall be the Chief Executive Officer of the Company and shall preside at all meetings of the Board of Directors should the Chairman of the Board of Directors be absent.

### 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 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 significant changes to these documents. 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 M.G.L. Chapter 175.

### AFFILIATED COMPANIES

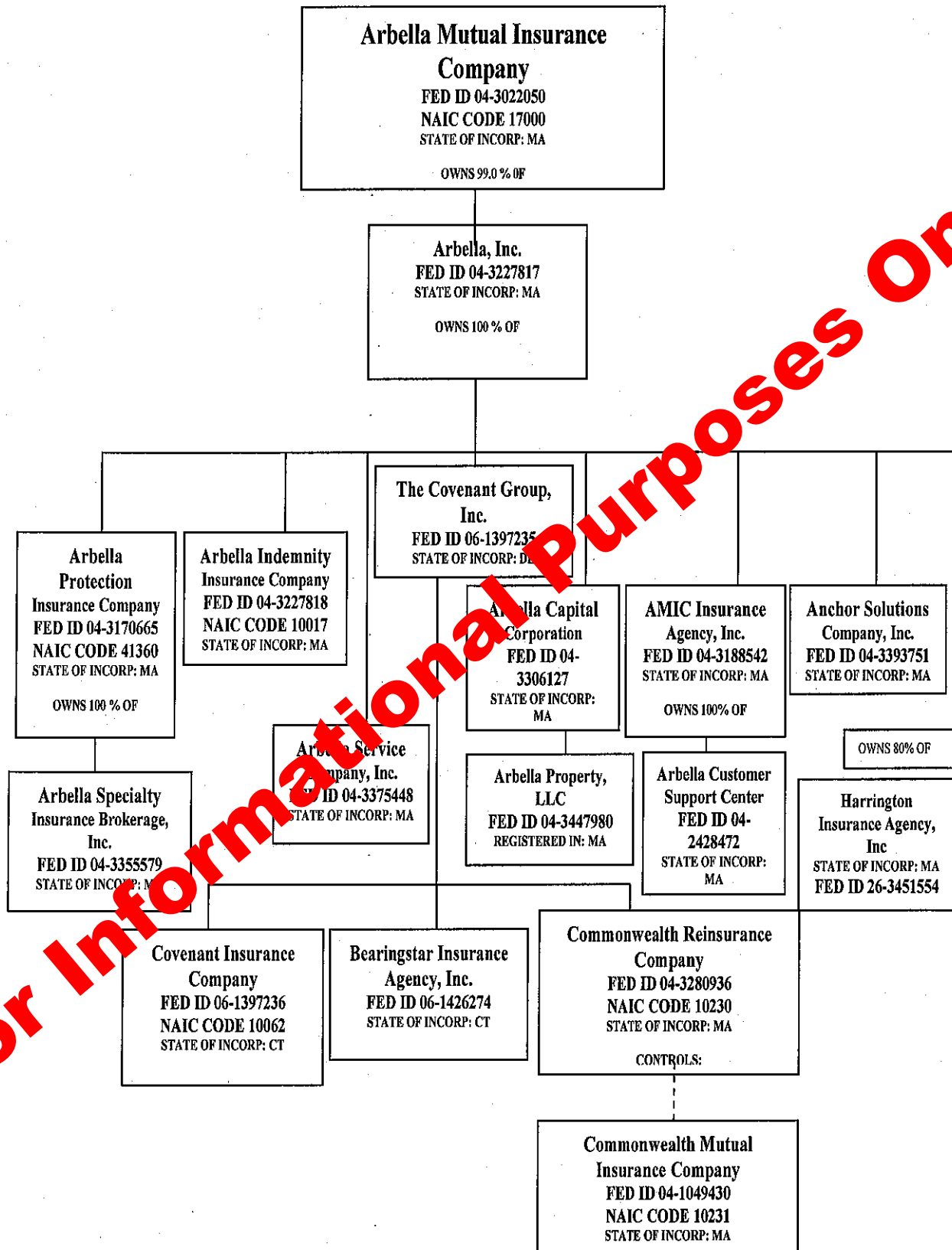
The Company's insurance affiliates, (collectively, the Group) include the following Massachusetts domiciled property and casualty insurance companies: Mutual, Indemnity, Protection, and Commonwealth Re. Covenant is domiciled in the State of Connecticut.

### Organization Chart

An organization chart of Mutual and subsidiaries is presented below.



Commonwealth Mutual Insurance Company



### **Acquisitions, Affiliations and Other Transactions**

During the period January 1, 2006, through December 31, 2010, the Company's material transactions included the following items:

- On December 19, 2008, the Intercompany Services Agreement was amended and restated to update the settlement terms between the companies and to clarify the expense allocation methodology.
- In October of 2009, the Group received a rating of A- from A.M. Best. Previously, the Group's A.M. Best rating was B++, which the Group had held since 2002.
- Effective December 31, 2009, the Group froze its sponsored qualified defined contribution retirement plan (retirement plan) and implemented a supplemental company contribution that would provide for a 4% employer contribution under the 401(K) savings plan subject to the Group's attainment of certain performance criteria.

### **INTERCOMPANY AGREEMENT**

#### **Management Agreement**

Company has been a participant in a Services Agreement pursuant to which an affiliate, Arbella Service Company, provides administrative, operational and managerial services to all the individual companies in the Group ("Participants"). The Participants have agreed to a method to allocate the costs of the services which is based on Generally Accepted Accounting Principles. This Agreement was amended and restated as of December 19, 2008, to update the settlement terms between the companies and to clarify the expense allocation methodology. The settlement terms among the companies are in accordance with statutory accounting guidance. Additionally, an affiliate, Arbella Capital Corporation, provides all members of the Group with property and related property management services.

### **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 Mutual Insurance Company

Commonwealth of Massachusetts and was in force as of December 31, 2010. 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 share the cost of a qualified defined contribution retirement plan ("retirement plan") sponsored by Mutual under 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. Plan participants vest based on the years of service contributed. The expense of the retirement plan is allocated to various companies under Mutual under an expense sharing arrangement. Effective December 31, 2009, Mutual froze the plan at which point all participants became 100% vested and future contributions would no longer be made.

The Company also shares the cost of a qualified 401(k) savings plan sponsored by Mutual 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% of contributions and a 50% match of the next 2%, subject to Internal Revenue Service ("IRS") annual limitations. Mutual retains the right to change, modify, or terminate the plan at any time. The cost of this plan is allocated to various companies under Mutual under an expense sharing arrangement.

Effective with the aforementioned freezing of the retirement plan, Mutual implemented a supplemental company contribution that would provide for a 4% employer contribution under the 401(k) savings plan subject to the Group's attainment of certain performance criteria beginning with the year ending December 31, 2010. For the year ended December 31, 2010, the Group did not meet these performance criteria.

### **INSURANCE PRODUCTS AND RELATED PRACTICES**

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

As of December 31, 2010, the Company is authorized to provide coverage in the Commonwealth of Massachusetts only. The Company is duly organized under the laws of the Commonwealth of Massachusetts and is authorized under section 47 of Chapter 175 of the Massachusetts General Laws

## Commonwealth Mutual Insurance Company

to provide the following coverages: fire, inland, earthquake, liability other than automobile, automobile liability, comprehensive motor vehicle and aircraft, personal property floater and dwelling.

### REINSURANCE

#### Ceded 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 ("Gen Re"). 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. At December 31, 2010, the following reinsurance agreements were in place, as follows:

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

This reinsurance agreement with Gen Re is for homeowners property damage business as follows: 1<sup>st</sup> layer: \$500,000 xs \$1,500,000; 2<sup>nd</sup> layer: \$4,000,000 xs \$2,000,000. The limit for other property damage business is 1<sup>st</sup> layer: \$500,000 xs \$1,500,000; 2<sup>nd</sup> layer: \$4,000,000 xs \$2,000,000. The limit for workers compensation business is 1<sup>st</sup> layer: \$3,500,000 xs \$1,500,000; 2<sup>nd</sup> layer: \$5,000,000 xs \$5,000,000.

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

This reinsurance agreement with Gen Re is for casualty damage business as follows: 2<sup>nd</sup> layer: \$3,000,000 xs \$2,000,000.

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

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

1<sup>st</sup> layer: \$25,000,000 xs \$25,000,000; 2<sup>nd</sup> layer: \$85,000,000 xs \$50,000,000; 3<sup>rd</sup> layer: \$165,000,000 xs \$135,000,000; 4<sup>th</sup> layer: \$100,000,000 xs \$300,000,000.

Additionally, as noted above, pursuant to the 100% quota share agreement with Commonwealth Re, the Company cedes 100% of its net risks to Commonwealth Re.

## Commonwealth Mutual Insurance Company

### Assumed Reinsurance

The Company assumes premiums, losses and expenses from its mandatory participation in the Fair Plan through December 2010. All business assumed by the Company is 100% ceded to Commonwealth Re under the Quota Share treaty.

### SUBSEQUENT EVENTS

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

### 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 an 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 our 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:

Commonwealth Mutual Insurance Company

- Statement of Assets, Liabilities, Surplus and Other Funds, December 31, 2010;
- Statement of Income for the Year Ended December 31, 2010;
- Statement of Capital and Surplus for the Year Ended December 31, 2010;
- Reconciliation of Capital and Surplus for the Five Year Period Ended December 31, 2010.

**For Informational Purposes Only**

Commonwealth Mutual Insurance Company

Commonwealth Mutual Insurance Company  
Statement of Assets, Liabilities, Surplus and Other Funds  
December 31, 2010

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
<b><u>Assets</u></b>				
Bonds	\$ 3,552,362	\$ -	\$ 3,552,362	
Other invested assets	1,373,402		1,373,402	
Cash and invested assets	4,925,764	-	4,925,764	
Investment income due and accrued	42,792		42,792	
affiliates	43,203		43,203	
Aggregate write-ins for other than invested assets	614,656		614,656	
<b>Total assets</b>	<b>\$ 5,626,416</b>	<b>\$ -</b>	<b>\$ 5,626,416</b>	
<b><u>Liabilities</u></b>				
Current federal and foreign income taxes	\$ 35,282	\$ -	\$ 35,282	
<b>Total liabilities</b>	<b>35,282</b>	<b>-</b>	<b>35,282</b>	
Surplus notes	5,500,000		5,500,000	
Unassigned funds (surplus)	91,134		91,134	
Surplus as regards policyholders	5,591,134	-	5,591,134	
<b>Total liabilities, surplus and other funds</b>	<b>\$ 5,626,416</b>	<b>\$ -</b>	<b>\$ 5,626,416</b>	



Commonwealth Mutual Insurance Company

Commonwealth Mutual Insurance Company

Statement of Income

For the Year Ended December 31, 2010

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
<b><u>Investment income</u></b>				
Net investment income earned	\$ 126,416		\$ 126,416	
Net realized capital gains (losses) less capital gains tax	-		-	
Net investment gain (loss)	126,416	-	126,416	
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	126,416		126,416	
Dividends to policyholders	-		-	
Net income after, dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	126,416	-	126,416	
Federal and foreign income taxes incurred	35,282		35,282	
<b>Net income</b>	<b>\$ 91,134</b>	<b>\$ -</b>	<b>\$ 91,134</b>	

Commonwealth Mutual Insurance Company

Commonwealth Mutual Insurance Company

Statement of Capital and Surplus

For the Year Ended December 31, 2010

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
Surplus as regards policyholders, December 31 prior year	\$ 5,500,000		\$ 5,500,000	
Net income	91,134		91,134	
Change in surplus as regards policyholders for the year	91,134	-	91,134	
Surplus as regards policyholders, December 31 current year	<u>\$ 5,591,134</u>	<u>\$ -</u>	<u>\$ 5,591,134</u>	

Commonwealth Mutual Insurance Company

Commonwealth Mutual Insurance Company  
Reconciliation of Capital and Surplus  
For the Five Year Period Ended December 31, 2010

	<u>2010 *</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Surplus as regards policyholders, December 31 prior year	\$ 5,500,000	\$ 5,500,000	\$ 5,500,000	\$ 5,500,000	\$ 5,699,215
Net income	91,134	-	-	-	(199,215)
Change in surplus as regards policyholders for the year	91,134	-	-	-	(199,215)
Surplus as regards policyholders, December 31 current year	<u>\$ 5,591,134</u>	<u>\$ 5,500,000</u>	<u>\$ 5,500,000</u>	<u>\$ 5,500,000</u>	<u>\$ 5,500,000</u>

\* Per Statutory Examination

**For Informational Purposes Only**

CONCLUSION

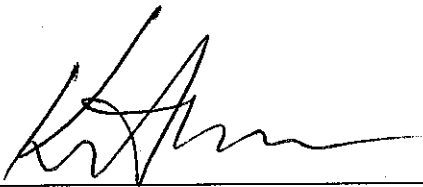
The undersigned gratefully acknowledges the participation of the following member of the Commonwealth of Massachusetts, Division of Insurance in this examination:

Linh La, CFE

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,



---

Kenneth R. Brenner, CPA, CFE  
Supervising Examiner  
Commonwealth of Massachusetts  
Division of Insurance