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

One South Station • Boston, MA 02110-2208
(617) 521-7794 • FAX (617) 521-7475
TTY/TDD (617) 521-7490
http://www.mass.gov/doi

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
Washington, DC 20002

The Honorable Nonnie S. Burnes
Commissioner of Insurance
The Commonwealth of Massachusetts
One South Station, 5th 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:

COMMONWEALTH REINSURANCE COMPANY

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

SCOPE OF EXAMINATION

Commonwealth Reinsurance Company (hereinafter referred to as “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 Protection Insurance Company (“APIC”), Arbella Indemnity Insurance Company (“AIIC”), Commonwealth Mutual Insurance Company (“CMIC”) (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 on August 1, 1995, under the laws of the Commonwealth of Massachusetts. The Company is duly organized under Section 47 of Chapter 175 of the Massachusetts General laws as a licensed reinsurer only in the Commonwealth of Massachusetts and is a subsidiary of the Covenant Group Inc. (the "Covenant Group"). The Covenant Group is a wholly owned subsidiary of Arbella, Inc. (Inc), which is 99.3% owned by AMIC. The Covenant Group also owns 100% of the Covenant Insurance Company (CIC), Litchfield Personal Lines Insurance Agency, Inc. and the Arbella H-T Insurance Agency, Inc.

The Company maintains significant control over its affiliate CMIC through a 100% quota share reinsurance agreement. Under the terms of this agreement, 100% of CMIC's net premium is ceded to the Company, including activity CMIC assumes as a former servicing carrier for Commonwealth Automobile Reinsurers ("CAR"), a Massachusetts residual market mechanism. Additionally the Company holds a $5,500,000 in a surplus note issued by CMIC.

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 APIC 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	3%
AMIC	75%
APIC	18%
AIIC	4%
Total	100%

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.

Capital Stock

The ownership of the Company resides with its stockholder, Covenant Group, a wholly owned subsidiary of Inc. Covenant Group controls the Company through the election of the Board of Directors. The Company has 500,000 shares authorized of $2.00 par value common stock and 250,000 issued and outstanding.

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.

Year	Admitted Assets	Net Written Premiums	Capital & Surplus
2005	$ 34,954,286	$ 18,602,255	$ 12,569,697
2004	36,294,559	17,823,226	11,005,440
2003	33,503,661	18,091,240	9,728,087
2002	32,198,284	13,131,322	9,874,944
2001	37,027,967	29,692,929	9,694,961

MANAGEMENT

Annual Meeting of Stockholder

In accordance with the by-laws, the Annual Meeting of the Company is to be held at ten o'clock on a date to be determined by the Board of Directors within six months after the end of each fiscal year. The by-laws also contain provisions allowing for special meetings and action by written consent. 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 holders of a majority in interest of the stock of that class issued, outstanding and entitled to vote shall constitute a quorum. In addition, the Chairman of the Board of Directors or his designee, or if there is no Chairman or designee, then a person appointed by a majority of the Board of Directors shall preside at any meeting of the stockholders.

Board of Directors

The by-laws of the Company provide that the Board of Directors may exercise all the powers of the Corporation except such as are required by law or by the Articles of Organization or the by-laws to be otherwise exercised, and the business and the affairs of the Corporation shall be managed by the Board of Directors. The Board of Directors shall consist of a number fixed by the stockholders at the annual meeting but not fewer than is required by law or the Articles of Organization. The exact number of directors shall be fixed and determined from time to time by the stockholders. Each director shall hold office until the next annual meeting of the stockholders and until his successors shall have been elected and qualified.

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

Director	Business affiliation	Residence
Patricia P. Bailey	Consultant	Santa Fe, New Mexico
Francis X. Bellotti	Arbella Insurance Group	Quincy, Massachusetts
Thomas S. Carpenter	Executive Vice President and Chief Actuary	Mansfield, Massachusetts
John F. Donohue	Chairman, President and Chief Executive Officer	Belmont, Massachusetts
Douglas R. Jones	President and Chief Executive Officer	Georgetown, 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 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. The Board of Directors of Arbella, Inc. elect 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. 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, and any other officers, as the Board of Directors deems necessary. Pursuant to the by-laws officers are elected at the first meeting of the Board of Directors following the annual meeting of the stockholders.

Each officer elected shall hold office until the first meeting of the Board of Directors following the Annual meeting of the Stockholders or the 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	**Title**
John F. Donohue	Chairman, President, Chief Executive Officer, Assistant Secretary
Robert P. Medwid	Executive Vice President, Chief Financial Officer, Treasurer
Thomas S. Carpenter	Executive Vice President and Chief Actuary
Gail Eagan (1)	Vice President and General Counsel
Beverly T. Kenneally	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.

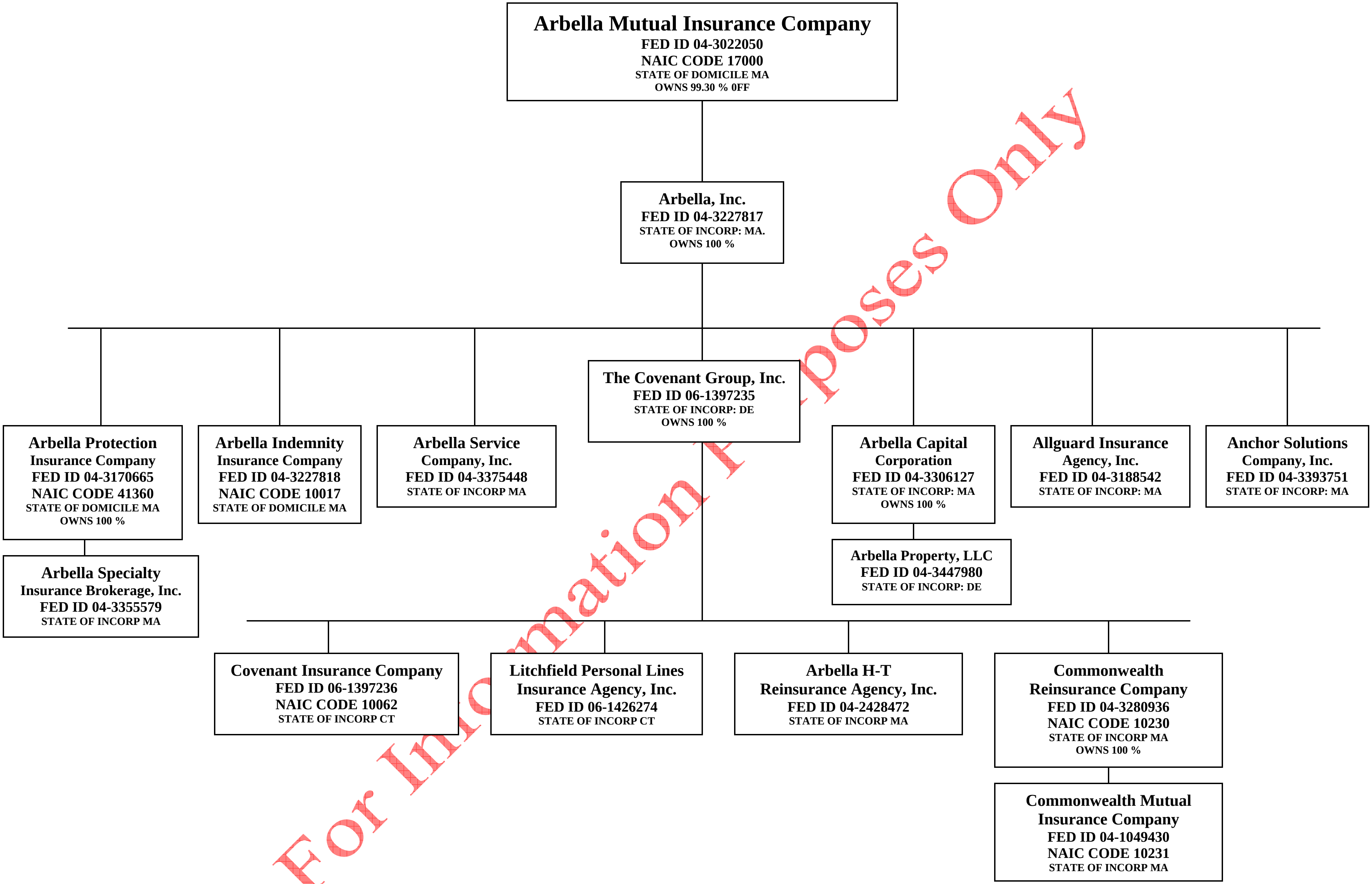
The Company has a disaster recovery plan and business continuity plan however, its by-laws do not contain explicit provisions for the continuity in the event of a national emergency; hence, under such circumstances, the succession of officers will be as prescribed in Sections 180M through 180Q of MGL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

AFFILIATED COMPANIES

The Company's insurance affiliates include the following Massachusetts domiciled property and casualty insurance companies: AMIC, APIC, AIIC 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.


Arbella Mutual Insurance Company
FED ID 04-3022050
NAIC CODE 17000
STATE OF DOMICILE MA
OWNS 99.30 % 0FF
Arbella, Inc.
FED ID 04-3227817
STATE OF INCORP: MA.
OWNS 100 %
Arbella Protection Insurance Company
FED ID 04-3170665
NAIC CODE 41360
STATE OF DOMICILE MA
OWNS 100 %
Arbella Specialty Insurance Brokerage, Inc.
FED ID 04-3355579
STATE OF INCORP MA
Arbella Indemnity Insurance Company
FED ID 04-3227818
NAIC CODE 10017
STATE OF DOMICILE MA
Arbella Service Company, Inc.
FED ID 04-3375448
STATE OF INCORP MA
The Covenant Group, Inc.
FED ID 06-1397235
STATE OF INCORP: DE
OWNS 100 %
Arbella Capital Corporation
FED ID 04-3306127
STATE OF INCORP: MA
OWNS 100 %
Arbella Property, LLC
FED ID 04-3447980
STATE OF INCORP: DE
Allguard Insurance Agency, Inc.
FED ID 04-3188542
STATE OF INCORP: MA
Anchor Solutions Company, Inc.
FED ID 04-3393751
STATE OF INCORP: MA
Covenant Insurance Company
FED ID 06-1397236
NAIC CODE 10062
STATE OF INCORP CT
Litchfield Personal Lines Insurance Agency, Inc.
FED ID 06-1426274
STATE OF INCORP CT
Arbella H-T Reinsurance Agency, Inc.
FED ID 04-2428472
STATE OF INCORP MA
Commonwealth Reinsurance Company
FED ID 04-3280936
NAIC CODE 10230
STATE OF INCORP MA
OWNS 100 %
Commonwealth Mutual Insurance Company
FED ID 04-1049430
NAIC CODE 10231
STATE OF INCORP MA

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 which resulted in no adjustment to unassigned surplus as of January 1, 2001.
- Effective January 1, 2001, the Company entered into reinsurance agreement to assume 100% of certain private passenger auto business written by AMIC on behalf of CMIC.
- 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 APIC and $500,000 to CGI.
- Effective December 2001, Mass Managers, Inc. was merged into Mass Holdings, Inc. and Connecticut Managers, Inc. was merged into Constitution Holdings, Inc. Subsequently, Constitution Holdings, Inc. and Mass Holdings, Inc. merged into CGI. As a result, CGI is the sole stockholder of CIC and 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 APIC, $4,000,000 to the Company and $4,000,000 to CIC.
- 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-.

INTERCOMPANY AGREEMENTS

Management Agreement

Effective July 1, 2000, 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 July 1, 2000 that 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 participates 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 participates 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 participates 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.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is authorized and licensed as a reinsurer in the Commonwealth of Massachusetts.

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 is for homeowners property damage business as follows: 1st layer: $1,000,000 xs $1,000,000; 2nd layer: $4,000,000 xs $2,000,000. The limit for other property damage business in 1st layer: $800,000 xs $1,200,000; 2nd layer: $4,000,000 xs $2,000,000.

Casualty Per Risk Excess of Loss Treaty

This reinsurance agreement with Gen Re is for casualty damage business as follows: 1st layer $800,000 xs $1,200,000; 2nd layer: $4,000,000 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:
1st layer: $25,000,000 xs $25,000,000; 2nd layer: $120,000,000 xs $50,000,000; 3rd layer: $50,000,000 xs $170,000,000.

Quota Share Treaty

The Company has in place a 35% quota share treaty with American Reinsurance Company to cede its net personal property and liability business.

Assumed Reinsurance

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

As previously noted the Company assumes business from its affiliate CMIC. This includes all direct business written by CMIC as well as business generated from CMIC's former participation in Commonwealth Automobile Reinsurers ("CAR") and CMIC's ongoing participation the Massachusetts FAIR Plan.

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 APIC 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 review 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:

- 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.

Commonwealth Reinsurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
December 31, 2005

Assets	Per Annual Statement	Examination Adjustments	Per Examination	Note
Bonds	$ 20,867,457	$ -	$ 20,867,457	
Short-term investments	1,666,811		1,666,811	
Other invested assets	5,500,000		5,500,000	
Investment income due and accrued	233,281		233,281	
Uncollected premiums	260,882		260,882	
Deferred premiums	4,956,777		4,956,777	
Amounts recoverable from reinsurers	566,023		566,023	
Net deferred tax asset	890,000		890,000	
Other assets	13,055		13,055	
Total assets	$ 34,954,286	$ -	$ 34,954,286	
Liabilities, Surplus and Other Funds				
Losses	$ 10,129,655	$ 645,000	$ 10,774,655	**1**
Loss adjustment expenses	1,448,156	(645,000)	803,156	**1**
Commissions payable	634,169		634,169	
Current federal income taxes	437,000		437,000	
Unearned premiums	8,872,191		8,872,191	
Advance premiums	257,089		257,089	
Payable to parent, subsidiaries and affiliates	606,329		606,329	
Total liabilities	22,384,589	-	22,384,589	
Common capital stock	500,000		500,000	
Gross paid in and contributed surplus	20,000,000		20,000,000	
Unassigned funds	(7,930,303)		(7,930,303)	
Surplus as regards policyholders	12,569,697	-	12,569,697	
Total liabilities, surplus and other funds	$ 34,954,286	$ -	$ 34,954,286	

Commonwealth Reinsurance Company
Statement of Income
for the Year Ended December 31, 2005

	Per Annual Statement	Examination Adjustments	Per Examination	Note
Premiums earned	$ 18,144,127	$ -	$ 18,144,127	
Losses incurred	9,860,991	645,000	10,505,991	**1**
Loss expenses incurred	1,830,470	(645,000)	1,185,470	**1**
Other underwriting expenses incurred	6,052,375		6,052,375	
Net underwriting gain	400,291	-	400,291	
Net investment income earned	1,039,082		1,039,082	
Net gain or (loss) from agents' or premium balances charged off	(74,254)		(74,254)	
Finance or service charges	438,272		438,272	
Miscellaneous income	(122,642)		(122,642)	
Net income before dividends and taxes	1,680,749	-	1,680,749	
Federal income taxes incurred	437,000		437,000	
Net income	$ 1,243,749	$ -	$ 1,243,749	

Commonwealth Reinsurance Company
Statement of Capital and Surplus
for the Year Ended December 31, 2005

	Per Annual Statement	Examination Adjustments	Per Examination	Note
Surplus as regards policyholders, December 31, 2004	$ 11,005,440	$ -	$ 11,005,440	
Net income	1,243,749		1,243,749	
Change in net deferred income tax	493,000		493,000	
Change in nonadmitted assets	(544,838)		(544,838)	
Prior period tax adjustment	372,346		372,346	
Change in surplus as regards policyholders for the year	1,564,257	-	1,564,257	
Surplus as regards policyholders, December 31, 2005	$ 12,569,697	$ -	$ 12,569,697	

Commonwealth Reinsurance 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	$ 11,005,440	$ 9,728,087	$ 9,874,944	$ 9,694,961	$ 7,125,427
Net income	1,243,749	615,465	(190,281)	(255,430)	(1,409,175)
Change in net deferred income tax	493,000	650,000	-	300,000	-
Change in nonadmitted assets	(544,838)	11,888	43,424	135,413	(21,291)
Capital changes - Paid in	-	-	-	-	4,000,000
Prior period tax adjustment	372,346	-	-	-	-
Change in surplus as regards policyholders for the year	1,564,257	1,277,353	(146,857)	179,983	2,569,534
Surplus as regards policyholders, December 31, current year	$ 12,569,697	$ 11,005,440	$ 9,728,087	$ 9,874,944	$ 9,694,961

* 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

Reserve Category	Low End of Range	KPMG Selection	High End of Range	Company Carried
Loss Reserves	$ 8.7	$ 9.4	$ 10.4	$ 10.1
Loss Adjustment Expense Reserve	1.6	1.7	1.8	1.5
Total Loss and Loss Adjustment Expense Reserves	$ 10.3	$ 11.1	$ 12.2	$ 11.6

Gross of Reinsurance

Reserve Category	Low End of Range	KPMG Selection	High End of Range	Company Carried
Loss Reserves	$ 10.3	$ 11.3	$ 12.4	$ 12.2
Loss Adjustment Expense Reserve	2.1	2.1	2.3	1.7
Total Loss and Loss Adjustment Expense Reserves	$ 12.4	$ 13.4	$ 14.7	$ 13.9

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).

Reserve Category	Low End of Range	KPMG Selection	High End of Range	Company Carried
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	13.3	14.4	15,2	15.6
Total Net Loss and Loss Adjustment Expense Reserves	$ 355.3	$ 383.0	$ 418.4	$ 386.0

Reserve Category	Low End of Range	KPMG Selection	High End of Range	Company Carried
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	13.3	14.4	15.2	16.6
Total Gross Loss and Loss Adjustment Expense Reserves	$ 424.9	$ 460.1	$ 503.2	$ 464.6

CONCLUSION

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

Yvette P. Nelson-Smith	Insurance Examiner II
Steven C. Tsimtsos	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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Hilton A. Irizarry, CFE
Examiner-in-Charge
Commonwealth of Massachusetts

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Kenneth R. Brenner, CPA
Supervising Examiner
Commonwealth of Massachusetts