



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

**DIVISION OF INSURANCE**

**REPORT OF EXAMINATION**

**OF THE**

**COMMONWEALTH REINSURANCE COMPANY**

**1100 CROWN COLONY DRIVE**

**QUINCY, MASSACHUSETTS 02269-9103**

**AS OF**

**DECEMBER 31, 2010**

**NAIC GROUP CODE 0586**

**NAIC COMPANY CODE 10230**

**EMPLOYER ID NUMBER 04-3280936**

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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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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 REINSURANCE 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 Reinsurance Company ("Company") was last examined as of December 31, 2005, under the Association Plan of the National Association of Insurance Commissioners ("NAIC") by the 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 Mutual Insurance Company ("Commonwealth Mutual") 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.

## Commonwealth Reinsurance Company

### 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 of 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

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.

Commonwealth Reinsurance Company is a property and casualty insurer domiciled and licensed as a reinsurance company in the Commonwealth of Massachusetts. The Company is a wholly owned subsidiary of the Covenant Group, Inc. ("CGI"). CGI is a wholly owned subsidiary of Arbella, Inc. and a subsidiary of Arbella Mutual Insurance Company, a mutual property and casualty insurance company domiciled in the Commonwealth of Massachusetts. The Company commenced insurance operations in October 1998. Through a quota share arrangement with an affiliated entity, Commonwealth Mutual Insurance Company, the Company assumes 100% of the net underwriting results of Commonwealth Mutual. Commonwealth Mutual previously offered homeowners' and related property coverage products in Massachusetts through independent agents, however, beginning in 2009, Commonwealth Mutual no longer actively writes any business.

The Company is part of a group ("Group") of insurers that participate in an intercompany pooling agreement that includes the Company, Mutual, Protection, Indemnity and Covenant. These insurance companies are domiciled in the Commonwealth of Massachusetts except for Covenant which is domiciled in the State of Connecticut. The Group operates solely in the New England region and collectively writes private passenger auto, homeowners, commercial auto,

## Commonwealth Reinsurance Company

commercial multi-peril, umbrella, and workers' compensation primarily through independent agents.

Beginning in 2002, the Company, along with Protection, Indemnity and Mutual entered into an intercompany pooling arrangement ("Pool") in which it shares in the Pool's combined underwriting results and certain balance sheet accounts. After processing its external reinsurance, each affiliated pooled company cedes its remaining net underwriting activity to the lead company, Mutual, which subsequently retrocedes the pooled results to the participants based on their percentage share of the Pool. Effective January 1, 2008, the agreement was amended to change the pooling percentages of Mutual and Protection. Effective January 1, 2010, the agreement was amended to include Covenant and to modify the existing pooling percentages. Refer to the following chart for the percentages of the Pool participants over the course of the exam period:

	<u>2002-2007</u>	<u>2008-2009</u>	<u>2010</u>
Mutual	75%	71%	69%
Protection	18%	22%	20%
Covenant	N/A	N/A	5%
Indemnity	4%	4%	3%
Commonwealth Re*	3%	3%	3%
Total	100%	100%	100%

\* Commonwealth Mutual cedes 100% of its net book to the Company, and the Company 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 the examination. Any name changes, mergers, or any other material changes to its corporate structure since the last examination are discussed below in Acquisitions, Affiliations and Other Transactions.

### Capital Stock

The ownership of the Company resides with its stockholder, CGI, a wholly owned subsidiary of Arbella, Inc., which is 99.0% owned by Mutual. CGI 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. The stock is 100% owned by CGI.

### 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.

Commonwealth Reinsurance Company

<u>Year</u>	<u>Admitted Assets</u>	<u>Net Written Premium</u>	<u>Capital &amp; Surplus</u>
2010	\$35,761,225	\$19,255,852	\$13,760,150
2009	33,850,033	17,587,885	13,236,748
2008	35,552,202	18,684,156	13,762,031
2007	36,972,828	16,580,685	14,350,379
2006	37,442,289	19,244,391	14,374,434

**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 and 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.

As of December 31, 2010, the Board of Directors was comprised of five 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:



## Commonwealth Reinsurance Company

### Director

Patricia P. Bailey  
Francis X. Bellotti  
Janet R. Corcoran  
John F. Donohue  
Christopher E. Hall

### Business Affiliation

None  
Legal consultant for Company  
COO of Arbella Insurance Group  
CEO of Arbella Insurance Group  
CFO of Arbella Insurance Group

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 vote 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, 2010, are as follows:



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### Officer

### Title

John F. Donohue  
Christopher E. Hall  
Gail Eagan  
Beverly J. Tangvik

Chairman, President, Chief Executive Officer, Assistant Secretary  
Senior Vice President, Chief Financial Officer, Treasurer  
Vice President and General Counsel  
Secretary and Clerk

### 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 the 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. 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 177.

### AFFILIATED COMPANIES

As noted above, the Company's insurance affiliates include the following Massachusetts domiciled property and casualty insurance companies: Mutual, Protection, Indemnity, and Commonwealth Mutual. Covenant is domiciled in the State of Connecticut.

### Organization Chart

An organization chart of Mutual and subsidiaries is presented below.

# Commonwealth Reinsurance 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:

- In December 2006, Mutual entered into an Industry Loss Warranty ("ILW") reinsurance contract with Montpelier Re Ltd. that was to expire on December 31, 2007. Under the terms of the contract, the Group was liable for losses from natural perils which result in industry losses above established monetary thresholds in the specific geographic areas of North America, Europe and Japan. The ILW was subsequently retroceded to Poseidon Re Ltd. in 2007, prior to its expiration.
- On December 10, 2007, Mutual reached a settlement for a lawsuit brought by a Massachusetts automobile insurer whereby the insurer alleged damages arising out of interference with contractual relations and violation of M.G.L. c. 90A and other claims.
- Effective January 1, 2008, the intercompany pooling agreement was amended to align the pooling percentages of the Mutual and Protective in accordance to their proportionate share of the Group's unstacked statutory surplus as required by the pooling agreement.
- Effective January 1, 2008, Mutual entered into a quota share reinsurance contract with Brit Insurance Limited ("Brit Re"). Under the terms of the agreement, the Group assumed 40% of Brit Re's United Kingdom's auto insurance business subject to certain loss limits. In 2009 and 2010, the treaty was renewed, but the Group reduced its participation to 25%.
- 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.
- On December 31, 2008, the Company paid an ordinary dividend of \$1,810,000 to its stockholder, CGI.
- 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.
- On December 31, 2009, the Company paid an extraordinary dividend of \$3,433,000 to its stockholder, CGI.

## Commonwealth Reinsurance Company

- Effective January 1, 2010, the intercompany pooling agreement was amended to add Covenant as a participant and to modify the existing pooling participation percentages of the other members in accordance with the requirements of the pooling agreement.
- In October of 2010, the Mutual entered into a settlement with the Massachusetts Attorney General's Office on allegations that insurance companies used inflated and un-depreciated motorcycle values to calculate the premiums that they charged to their motorcycle insurance customers. The Group agreed to return premium payments to qualifying policyholders and pay interest and penalties to the AG Office.

### INTERCOMPANY AGREEMENTS

#### Management Agreement

Since its acquisition, the Company has been a participant in a Service 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 cost 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.

#### Tax Sharing Agreement

The Company files a consolidated tax return with Mutual and its subsidiaries. Since its acquisition, the Company and its affiliates have been participants to a Tax Allocation Agreement for the purpose of establishing a method for allocating the consolidated tax liability of the Participants and for reimbursing Mutual for the payment of such tax liability. The Agreement provides that all subsidiaries of Mutual shall be subject to the Tax Agreement. This agreement was amended and restated as of December 19, 2008, to ensure that settlement terms among the companies were in accordance with current statutory accounting guidance and to correct certain references to the Internal Revenue Code.

## **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, 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% 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.

## Commonwealth Reinsurance Company

### Stock Option Plan

Arbella, Inc. has stock option plans for certain executives and board members under which each option granted can be used to purchase one share of Arbella, Inc. stock, with a vesting period of three years and a ten-year expiration period. Stock options are granted at exercise prices not less than the fair value of Arbella, Inc.'s common stock on the date of the grant. The terms and conditions upon which options become exercisable vary depending on when the grant was made. There are 1,860,000 shares reserved for issuance under these plans as of December 31, 2010.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

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

## 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; 2nd 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; 2nd 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.



## Commonwealth Reinsurance Company

### *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.

### Assumed Reinsurance

As previously noted, the Company assumes business from its affiliate Commonwealth Mutual. This includes all direct business written by Commonwealth Mutual, as well as business generated from Commonwealth Mutual's former participation in CAR and the Fair Plan.

### Intercompany Reinsurance

As previously noted, since 2002, the Company has been a member of the Group's intercompany pooling agreement. During the examination period, there were two amendments to this agreement as follows: effective January 1, 2008, the agreement was amended to change the pooling percentages of Mutual and Protection, and effective January 1, 2010, the agreement was amended to include Covenant and to modify the existing pooling percentages.

### SUBSEQUENT EVENT

The following details are noted as a "subsequent event", the disclosure of which in this Examination Report is considered appropriate.

- Effective January 1, 2011, Mutual did not renew its quota share reinsurance contract with Brit Re. The Group remains liable for its share of losses related to the prior years in which it participated.

There were no other 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 the evaluation of the controls in the information technology (IT) 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 IT controls. No material deficiencies were noted.

The Company maintains its accounts and records on an electronic data processing basis. All entries are inputted 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, 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.

# Commonwealth Reinsurance Company

## Commonwealth Reinsurance 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	\$ 18,717,886	\$ -	\$ 18,717,886	
Cash and short-term investments	4,589,643		4,589,643	
Other invested assets	5,500,000		5,500,000	
Cash and invested assets	28,807,529	-	28,807,529	
Investment income due and accrued	281,745		281,745	
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collection	153,258		153,258	
Deferred premiums, agents' balances and installments booked but deferred	4,905,898		4,905,898	
Current federal and foreign income tax recoverable and interest thereon	58,700		58,700	
Net deferred tax asset	958,584		958,584	
Receivables from parent, subsidiaries and affiliates	595,510		595,510	
<b>Total assets</b>	<b>\$ 35,761,224</b>	<b>\$ -</b>	<b>\$ 35,761,224</b>	
<b><u>Liabilities</u></b>				
Losses	\$ 9,241,274	\$ -	\$ 9,241,274	1
Loss adjustment expenses	1,740,660		1,740,660	1
Commissions payable, contingent commission and other similar charges	617,128		617,128	
Unearned premiums	9,817,777		9,817,777	
Advance premium	328,896		328,896	
Ceded reinsurance premiums payable	252,827		252,827	
Aggregate write-in to other liabilities	2,513		2,513	
<b>Total liabilities</b>	<b>22,001,074</b>	<b>-</b>	<b>22,001,074</b>	
Common capital stock	500,000		500,000	
Gross paid in and contributed surplus	20,000,000		20,000,000	
Unassigned funds (surplus)	(6,739,850)		(6,739,850)	
<b>Surplus as regards policyholders</b>	<b>13,760,150</b>	<b>-</b>	<b>13,760,150</b>	
<b>Total liabilities, surplus and other funds</b>	<b>\$ 35,761,224</b>	<b>\$ -</b>	<b>\$ 35,761,224</b>	

# Commonwealth Reinsurance Company

## Commonwealth Reinsurance Company Statement of Income For the Year Ended December 31, 2010

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
<b><u>Underwriting income</u></b>				
Premiums earned	\$ 18,145,996	\$ -	\$ 18,145,996	
Deductions:				
Losses incurred	10,705,522		10,705,522	
Loss adjustment expenses incurred	1,553,505		1,553,505	
Other underwriting expenses incurred	6,581,201		6,581,201	
Total underwriting deductions	18,840,228	-	18,840,228	
Net underwriting gain (loss)	(694,232)	-	(694,232)	
<b><u>Investment income</u></b>				
Net investment income earned	875,835		875,835	
Net realized capital gains (losses) less capital gains tax	56,614		16,614	
Net investment gain (loss)	892,449	-	892,449	
<b><u>Other income</u></b>				
Net gain (loss) from agents' or premium balances charged off	(89,442)		(89,442)	
Finance and service charges	396,675		396,675	
Aggregate write-ins for miscellaneous income	(114,680)		(114,680)	
Total other income	192,553	-	192,553	
Net income before dividends to non-policyholders, after capital gains tax and before all other federal and foreign income taxes	390,771	-	390,771	
Dividends to policyholders	-		-	
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	390,771	-	390,771	
Federal and foreign income taxes incurred	(69,159)		(69,159)	
Net income	\$ 459,930	\$ -	\$ 459,930	

Commonwealth Reinsurance Company

Commonwealth Reinsurance 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	\$ 13,236,748		\$ 13,236,748	
Net income	459,930		459,930	
Change in net deferred income tax	(151,460)		(151,460)	
Change in nonadmitted assets	214,932		214,932	
Dividend to stockholders	-		-	
Change in surplus as regards policyholders for the year	523,402		523,402	
Surplus as regards policyholders, December 31 current year	<u>\$ 13,760,150</u>	<u>-</u>	<u>\$ 13,760,150</u>	

# Commonwealth Reinsurance Company

## Commonwealth Reinsurance 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	\$ 13,236,748	\$ 13,762,031	\$ 14,350,379	\$ 14,374,434	\$ 12,569,698
Net income	459,930	841,272	1,207,232	1,810,062	1,726,266
Change in net deferred income tax	(151,460)	107,076	(85,536)	(233,300)	79,000
Change in nonadmitted assets	214,932	(97,630)	99,957	125,183	37,469
Dividend to stockholders	-	(1,376,000)	(1,810,000)	(1,720,000)	-
Change in surplus as regards policyholders for the year	523,402	(525,283)	(588,348)	(24,055)	1,804,737
Surplus as regards policyholders, December 31 current year	<u>\$ 13,760,150</u>	<u>\$ 13,236,748</u>	<u>\$ 13,762,031</u>	<u>\$ 14,350,379</u>	<u>\$ 14,374,434</u>

\* Per Statutory Examination



**NOTE TO FINANCIAL STATEMENT****NOTE 1:**

As part of the examination by the Division, PwC was directed to review the reasonableness of the reserves for loss and loss adjustment expenses of the Company as of December 31, 2010.

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 PwC's actuarial review indicated that the Company's reserves at December 31, 2010, 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 PwC, the selected point estimate reserve and the Company's carried loss and loss adjustment expense reserves as of December 31, 2010, for each reserve category (all amounts in thousands of dollars).

**Net of Reinsurance**

<b><u>Reserve Category</u></b>	<b><u>Low End of Range</u></b>	<b><u>PwC Selection</u></b>	<b><u>High End of Range</u></b>	<b><u>Company Carried</u></b>
Loss Reserves	\$8,369	\$8,824	\$9,514	\$9,241
Loss Adjustment Expense Reserves	1,576	1,645	1,792	1,741
Total Loss and Loss Adjustment Expense Reserves	\$9,945	\$10,469	\$11,306	\$10,982

**Gross of Reinsurance**

<b><u>Reserve Category</u></b>	<b><u>Low End of Range</u></b>	<b><u>PwC Selection</u></b>	<b><u>High End of Range</u></b>	<b><u>Company Carried</u></b>
Loss Reserves	\$8,569	\$9,534	\$11,040	\$9,951
Loss Adjustment Expense Reserves	1,669	1,842	2,150	1,938
Total Loss and Loss Adjustment Expense Reserves	\$10,238	\$11,376	\$13,190	\$11,889

The following table summarizes the reserve ranges as developed by PwC, the selected point estimate reserve, and the carried loss and loss adjustment expense reserves as of December 31, 2010, (all amounts in thousands of dollars) for the Arbella Insurance Group.

Commonwealth Reinsurance Company

Net of Reinsurance

<u>Reserve Category</u>	<u>Low End of Range</u>	<u>PwC Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Loss Reserves	\$279,434	\$294,141	\$317,667	\$308,042
Loss Adjustment Expense Reserves	52,074	54,815	59,199	58,022
Total Loss and Loss Adjustment Expense Reserves	\$331,508	\$348,956	\$376,866	\$366,064

Gross of Reinsurance

<u>Reserve Category</u>	<u>Low End of Range</u>	<u>PwC Selection</u>	<u>High End of Range</u>	<u>Company Carried</u>
Loss Reserves	\$331,722	\$317,821	\$368,034	\$331,722
Loss Adjustment Expense Reserves	64,597	61,390	71,600	64,597
Total Loss and Loss Adjustment Expense Reserves	\$396,319	\$379,211	\$439,634	\$396,319

CONCLUSION

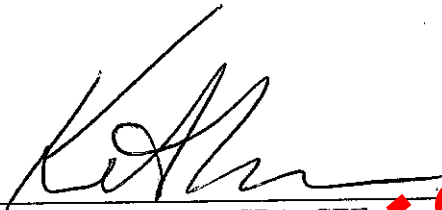
The undersigned gratefully acknowledges the participation of the following member of the Commonwealth of Massachusetts, Division of Insurance in this examination:

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