# THE COMMONWEALTH OF MASSACHUSETTS

## OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION

## DIVISION OF INSURANCE

***REPORT OF EXAMINATION***

**OF THE**

# DANBURY INSURANCE COMPANY

**HINGHAM, MASSACHUSETTS**

**As of DECEMBER 31, 2004**

**N.A.I.C. GROUP CODE 1229**

**N.A.I.C. COMPANY CODE 37346**

**EMPLOYER ID NUMBER 06-0600334**

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June 9, 2006

The Honorable Alfred W. Gross
Chairman, Financial Condition (E) Committee, NAIC
Commissioner of Insurance
The Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
Post Office Box 1157
Richmond, Virginia 23218

The Honorable Julianne M. Bowler
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
The Commonwealth of Massachusetts
Office of Consumer Affairs and Business Regulation
Division of Insurance
One South Station
Boston, Massachusetts 02110-2208

Honorable Commissioners:

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

**DANBURY INSURANCE COMPANY**

at its home office located at 230 Beal Street, Hingham, Massachusetts 02043. The following report thereon is respectfully submitted.

## SCOPE OF EXAMINATION

Danbury Insurance Company ("Company") was last examined as of December 31, 1999, under the association plan of the National Association of Insurance Commissioners ("NAIC"). The current association plan examination was conducted by the Massachusetts Division of Insurance ("Division") and it covers the period from January 1, 2000, through December 31, 2004, including any material transactions and/or events occurring subsequent to the examination date and noted in the course of this examination.

This examination was conducted at the same time and in conjunction with the statutory financial condition examination made by the Division on the Company's ultimate parent insurer, Hingham Mutual Fire Insurance Company ("HMFIC") of Hingham, Massachusetts. The examination also was conducted for the same period as the financial condition examination made by the Maine Bureau of Insurance on the Company's partially owned subsidiary, Casco Indemnity Company ("Casco") of Saco, Maine.

The examination was conducted in accordance with standards established by the Financial Condition (E) Committee of the NAIC Financial Condition Examiners Handbook, with the examination standards of the Division, and with the General Laws of Massachusetts. The principal focus of the examination was 2004 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, treatment of policyholders, and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules, and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk, and examination efforts were directed accordingly.

The Company is audited annually by PricewaterhouseCoopers LLP ("PwC"), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2000 through 2004. A review and use of PwC's workpapers were made to the extent deemed appropriate and effective.

The Division retained the consulting actuarial services of KPMG LLP ("KPMG"), an independent certified public accounting firm, to evaluate the adequacy of the Company's loss and loss adjustment expense reserves as of December 31, 2004. An evaluation of the adequacy and effectiveness of controls over electronic data processing systems was done to determine the level of reliance to be placed on summary information generated by the data processing systems.

For a summary of findings contained within this Report, refer to the "Notes to the Financial Statements".

Status of Findings from the Prior Examination

The examination included a review to verify the current status of exception conditions commented upon in the Report of Examination as of December 31, 1999. It was determined that the Company had addressed satisfactorily all outstanding items of comment.

# HISTORY

## General

Under the laws of the State of Connecticut, the Company originally was formed and began business as Danbury Mutual Insurance Company in 1850 to insure risks against loss of real property by fire and lightning. In 1961, an amendment to its Charter empowered the Company to write fire, marine, casualty, liability, indemnity, fidelity, and any and all forms of insurance except life and endowment insurance and annuity contracts. In February 1988, the Company's Charter was amended by the Connecticut General Assembly to allow the Company, when authorized by a two-thirds vote of its Board of Directors, to submit a plan of restructuring for the approval of Connecticut's Insurance Commissioner. Effective January 1, 1991, the Company underwent demutualization and was incorporated as a stock company with its current name under the laws of the State of Connecticut; at that time, it was licensed to write business only in the State of Connecticut. On August 11, 1994, HMFIC purchased 80% of the stock of Danbury Holding Company ("DHC"), which was the sole parent company of Danbury Insurance Company; DHC later became a wholly owned subsidiary of HMFIC when HMFIC purchased all remaining outstanding shares of DHC on May 1, 1998.

The Company entered into a reinsurance pooling agreement with HMFIC, its ultimate parent company, whereby the Company cedes to HMFIC the business arising out of its insurance operations on and after January 1, 1999; HMFIC then retains 95% and the Company assumes 5% of the pooled business of both insurers.

The Company redomesticated to the Commonwealth of Massachusetts on December 15, 2000. It currently is licensed to conduct business in four states, Connecticut, Massachusetts, New Hampshire, and Rhode Island; however, it has not as yet written business in Rhode Island. As a licensed property and casualty insurer, the Company writes personal and commercial insurance through a network of independent agents.



## Growth of the Company

The growth of the Company for the years 2000 through 2004 is shown in the following schedule which was prepared from information in the Company's annual statements:

| Year | Admitted Assets | Liabilities | Surplus |
|---|---|---|---|
| 2004 | $ 15,565,993 | $ 6,710,095 | $ 8,855,898 |
| 2003 | 14,828,525 | 6,218,793 | 8,609,732 |
| 2002 | 14,148,079 | 5,571,369 | 8,576,710 |
| 2001 | 12,013,996 | 3,516,671 | 8,497,325 |
| 2000 | 10,492,486 | 2,392,091 | 8,100,395 |



## Management

### *Annual Meeting*

In accordance with the By-Laws, the Annual Meeting of the Company shall be held at the home-office in Hingham, Massachusetts, on the third Thursday in February of each year. Eleven Members of the Company present in person or represented by proxy shall constitute a quorum. The minutes indicate that a quorum was obtained at each annual meeting held in the examination period.

### *Board of Directors*

According to the By-Laws, the Board of Directors shall consist of not fewer than seven or not more than nine Directors. The Directors are divided into three classes of not more than three Directors each. The term of office of the Directors of one class only expires each year, and successors are chosen by ballot at the annual meeting of members of the Company for a term of three years or until successors are elected and qualified. At December 31, 2004, the Board was composed of nine Directors, which is in compliance with the Company's By-Laws.

Directors duly elected and serving at December 31, 2004, with addresses and business affiliations, are as follows:

| Director | Business Affiliation | Residence |
|---|---|---|
| Brian Ralph Wilkin, Chairman of the Board | President and Chief Executive Officer, Danbury Insurance Co. | Cohasset, Massachusetts |
| John Burrow Arnold | President and Treasurer, H. H. Arnold & Company | Norwell, Massachusetts |
| Bruce Taylor Cameron | Senior Vice President, RBC Dain Rauscher, Inc. | Cohasset, Massachusetts |
| Alexander Thacher Catto | Executive Vice President, Retired, Danbury Insurance Company | Sandwich, Massachusetts |
| George Albert Cole, Jr. | President, Retired, George A. Cole Insurance Agency, Inc. | Hingham, Massachusetts |
| Charles Webster Dean | Director of Business Development, Boston Forms, LLC | Cohasset, Massachusetts |

*( continued from preceding page )*

| Director | Business Affiliation | Residence |
|---|---|---|
| Margaret Albertie Lynch | Attorney, Retired, Transportation Division of the Department of Telecommunications and Energy | Cohasset, Massachusetts |
| Philip Harper Ryder | President, Retired, Mutual Fire Insurance Association of New England | Eastham, Massachusetts |
| William Sumner Thayer | Architect | Hingham, Massachusetts |

All of the Directors listed above held these positions consistently since the prior examination and they simultaneously held similar positions on the Board of Directors for HMFIC. Director Brian R. Wilkin and George A. Cole, III, also served on the Board of Directors of Casco.

Subsequent to the date of examination, Mr. George A. Cole, Jr., died in 2005 and Mr. George A. Cole, III, the Company's Senior Vice President and Treasurer, succeeded his father on the Board. Effective December 1, 2005, Mr. John B. Arnold resigned as a member of the Board of Directors and on March 1, 2006, Mr. Brian A. Williams, President of Williams Coal and Oil of Braintree, Massachusetts, was elected a member of the Board of Directors.

The By-Laws specify that the Directors shall meet at least five times a year and that a regular meeting of the Board shall be held immediately following the annual meeting of the Company for the election of officers for the ensuing year. A majority of the Board of Directors, but not less than five, shall constitute a quorum. The minutes indicated that a quorum was obtained for all meetings of the Board of Directors held during the examination period.

The By-Laws specify that the Board of Directors may elect a Finance Committee**;** the Board did not elect one as the Board itself is active in directing and reviewing investment activities. The By-Laws also specify that the Board may appoint such other committee(s), composed of any designated number of its members, as it shall deem appropriate**;** in this latter regard, the Board appointed an Audit Committee and a Salary and Pension Committee. The purpose and membership of each committee at December 31, 2004, was as follows:

*Audit Committee*

The Audit Committee was established by the Board of Directors and charged with developing a Charter. Per such Charter, the Audit Committee shall consist of three or more Directors each of whom shall be independent of management of the Hingham Group and otherwise have no business directly or indirectly with the Hingham Group that could influence their judgment or interfere with the exercise of independent judgment in carrying out the responsibilities of a Director. Its members shall not be officers or employees of the Hingham Group and shall meet the definition of independent directors (as set forth under Sarbanes-Oxley Act); one member of the Audit Committee must have past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background which results in the individual's financial sophistication. The function of the Audit Committee is to assist the Board of Directors in its role as representatives of the policyholders by overseeing corporate accounting policies, reporting practices, and the quality and integrity of the financial reports of the Hingham Group, and by reviewing the financial information that is provided to policyholders, regulatory authorities, and others. To achieve such functions, the Charter enumerates several specific responsibilities of the Audit Committee and the Audit Committee must submit minutes of all its meetings and regularly report its activities to the Board of Directors. Directors serving on this Committee at December 31, 2004, were as follows:

Charles W. Dean, Chairman

| | |
|---|---|
| John B. Arnold | Alexander T. Catto |
| George A. Cole, Jr. | Margaret A. Lynch |

*Salary and Pension Committee*

The Salary and Pension Committee was established by the Board of Directors. Directors serving on this Committee at December 31, 2004, were as follows:

Philip H. Ryder, Chairman

| | |
|---|---|
| Bruce T. Cameron | William S. Thayer |

*Officers*

The By-Laws of the Company provide that the regular officers of the Company shall be a President, a Treasurer, and a Secretary, all of whom shall be residents of Massachusetts and shall be elected annually by the Board of Directors. The President shall be the chief executive officer and head of the Company and shall have the general control and management of its business and affairs subject to the Board of Directors; additionally, the President shall be a member of the Board of Directors. Further, the Board of Directors regularly has voted that the President with the Secretary or Treasurer be authorized to buy or sell securities between meetings of the Board with the provision that such purchases and sales be reported at the next Board meeting and recorded in the minutes of such meeting. The Board of Directors may also from time to time elect or appoint such other officers or agents as it may deem proper, and may fix the term of office, powers, and duties of such officers or agents. Officers and Directors shall hold office until their successors are elected or appointed and qualified; any officer or Director may at any time resign or be deposed by the body electing or appointing him, and any vacancy may be filled for the unexpired part of the term by a majority vote of the Directors or remaining Directors.

The elected and appointed officers and their respective titles at December 31, 2004, were the following:

| | Name | Title |
|---|---|---|
| ***d c*** | Brian Ralph Wilkin | President |
| ***p*** | Bruce Michael Arnold, CIC | Senior Vice President and Secretary |
| ***p c*** | George Albert Cole, III | Senior Vice President and Treasurer |
| ***n*** | Robert Christopher Hunter | Vice President and Chief Information Officer |
| ***p*** | Cheryl Elizabeth Wigmore | Vice President |

*( continued from preceding page )*

| | Name | Title |
|---|---|---|
| ***p*** | Daniel Anthony Forlasto | Assistant Vice President |
| ***p*** | John Francis Keaveney, CPCU, CIC | Assistant Vice President |
| | Cheryl Mae Taylor | Assistant Vice President |
| ***n*** | Maryellen Halibozek | Assistant Secretary |
| | Barbara Anne White | Assistant Secretary |
| ***n*** | Mark Thomas Wilkin | Assistant Secretary |
| | Michael Stephen Wood | Assistant Secretary |
| ***n*** | James Albert McCarthy | Assistant Treasurer |
| ***n*** | Samuel Anthony Villani, II, CIC | Assistant Treasurer |

***d*** Also serves on the Board of HMFIC.
***c*** Also serves on the Board of Casco.
***n*** Newly elected to listed office since prior examination.
***p*** Newly promoted to listed office since prior examination.

All of the Company's Officers listed above simultaneously held similar positions in HMFIC. On March 1, 2005, Mr. Bruce M. Arnold resigned the office of Secretary and Ms. Cheryl E. Wigmore was elected Vice President and Secretary.

## Conflict of Interest Procedure

The Company has a policy statement pertaining to conflict of interest. In support of its answer to Question 14 of Part 1 Common Interrogatories of the annual statement, the Company has an established procedure for the reporting of any material interest or affiliation on the part of any officer or director or responsible employee which is in or is likely to conflict with his/her official duties; annually, each officer, director, or responsible employee signs a form attesting that there are no material conflicts of interests. The completed forms for the examination period were reviewed and no discrepancies were noted to contradict the Company's response to the General Interrogatory regarding conflicts of interests reported in the Company's 2004 Annual Statement.

## Corporate Records

### *Articles of Incorporation and By-Laws*

The By-Laws of the Company were read and were found to contain specific provision for the succession of Directors and Officers in event of an emergency.

### *Disaster Recovery and Business Continuity*

The Company provides for continuity of management and operations in the event of a catastrophe or national emergency in accordance with MGL c. 175, ss. 180M through 180Q.

*Board of Directors Minutes*

The minutes of meetings of the Board of Directors and its Committees for the period under examination were read and they indicated that all meetings were held in accordance with the Company's By-Laws and the Laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at meetings of the Board of Directors. The Company filed affidavits with the Division that its Directors received and reviewed the prior Report of Examination.

<ins>Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance</ins>

In the examination period, a few significant transactions involving the Company in acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance occurred, key of which are summarized as follows**:**

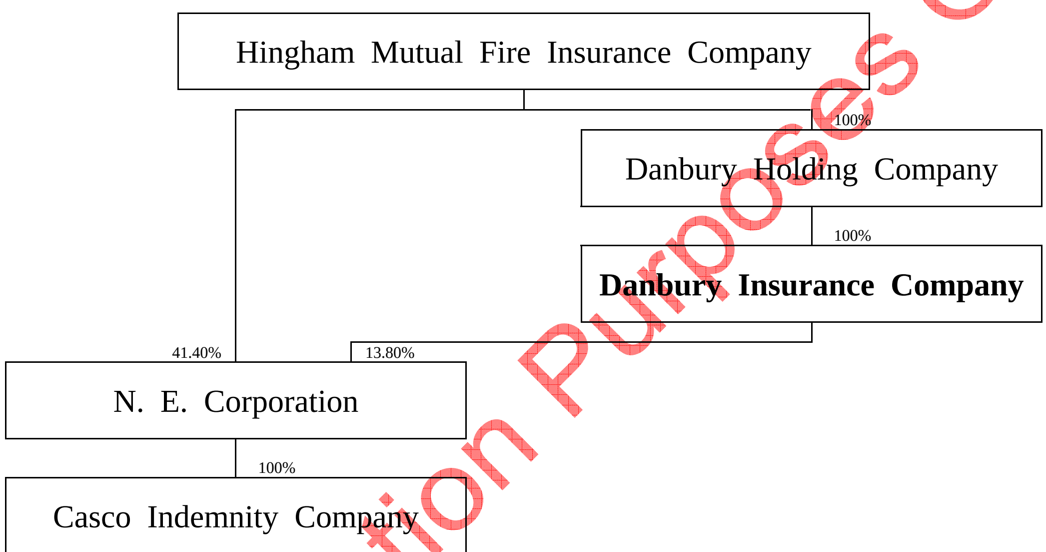
- In 1994, the Company purchased 7,416 shares (representing an ownership interest of approximately 8.37%) of common stock in N. E. Corporation ("NEC"), a Maine corporation which is the sole parent company and sponsor of Casco. NEC was formed in 1985 by several mutual insurance companies, domiciled in New England, to enable them to have an outlet (Casco) for motor vehicle coverages to balance their property-oriented books of business. HMFIC was one of these original owners but, over time, the number of owners of NEC has decreased**;** at December 31, 2004, NEC was owned by Phenix Mutual Fire Insurance Company (New Hampshire), HMFIC, and the Company. As has occurred with HMFIC, the Company's relative percentage of ownership increased during the period of examination (from approximately 8.37% in 2000, to 10.16% in 2002, to 13.80% in 2003) as the ownership interests of other partial owners were relinquished relative to certain restrictions as to transfer or sale of NEC stock.
- On December 15, 2000, the Company redomesticated from the State of Connecticut to the Commonwealth of Massachusetts.
- In 2001, the Company became licensed to transact business in the State of Rhode Island.
- In March 2002, in addition to its then existent holdings of stock in NEC, the Company acquired another 1,540 shares of NEC's common stock with a par value of $10 per share.
- In November 2002, the Company acquired 1,040 more shares of common stock in NEC.
- In January 2003, as approved by its Board of Directors in March 2003, the Company acquired a further 3,578 shares of NEC's common stock at $107.48 per share, thereby bringing its total holdings in NEC to 13,574 shares (representing ownership interest of approximately 13.80%) by December 31, 2004.
- In 2003, the Company became licensed to transact business in the State of New Hampshire.

## AFFILIATED COMPANIES

Per Form B as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of MGL c. 175, s. 206C and Regulation 211 CMR 7.00. The Company is the ultimate controlling party of the group consisting of five entities, including three insurance and two non-insurance companies.

### Organization Chart

The corporate organization of entities held by the Company at December 31, 2004, is represented as follows**:**




### Transactions and Agreements with Subsidiaries and Affiliates

Other than reinsurance agreements with Casco, the three predominant cost-sharing arrangements involving the Company are a management services arrangement, a tax sharing agreement, and an inter-company reinsurance pooling agreement. Each is described briefly in the following summary:

*Management and Service Arrangement*

The Company receives certain accounting, management, and other services from its ultimate parent company, HMFIC. Costs and expenses incurred by HMFIC relating to the Company are allocated to the Company.

*Inter-Company Pooling Agreement*

The Company has an inter-company pooling agreement with HMFIC, whereby the Company cedes all of its business to HMFIC and then assumes a portion of such amounts combined with balances arising from HMFIC's business; by the percentages listed in the agreement, HMFIC retains 95% and the Company assumes the remaining balance (5%) of such combined business.

*Tax Sharing Agreement*

Entered into as of January 1, 2001, the Company participates in a written tax allocation agreement with two of its affiliates, HMFIC and DHC. The allocation method is based upon the respective tax liability of each member computed as if a separate return were filed in accordance with the Internal Revenue Code. HMFIC is responsible for making tax payments quarterly with a final inter-company payment or refund to be made in the fourth quarter for the prior year.

## FIDELITY BONDS AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with MGL c. 175, s. 60. The aggregate limit of liability exceeds the NAIC suggested minimum.

The Company has further protected its interests and property by other policies of insurance covering other insurable risks. Coverages were provided by insurers licensed in the Commonwealth of Massachusetts and were in force as of December 31, 2004.

## PENSION AND INSURANCE PLANS

Whereas office and staff is provided to the Company by HMFIC, the Company itself does not have employees and it does not have retirement/pension plans or other post-retirement benefits.

## STATUTORY DEPOSITS

The statutory deposits of the Company as of December 31, 2004, are as follows:

| Location | Description of Deposit | Par Value | Statement Value | Fair Value |
|---|---|---|---|---|
| Massachusetts | US Treasury Note 3.000% due 2007 | $ 500,000 | $ 504,660 | $ 496,915 |
| Rhode Island | US Treasury Note 3.000% due 2007 | 500,000 | 498,874 | 496,915 |
| Totals | | $ 1,000,000 | $ 1,003,534 | $ 993,830 |

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Policy Forms and Underwriting Practices

The Company offers personal and commercial property and liability coverages utilizing policy forms, riders, and endorsements that are subject to the approval of the individual state insurance departments. At December 31, 2004, the Company's maximum retention limit, net of reinsurance, was $0.4 million per risk.

### Territory and Plan of Operation

The Company currently is licensed to write business in the following four states: Massachusetts, Connecticut, New Hampshire, and Rhode Island; however, it does not actively write business in Rhode Island. All Certificates of Authority were current and in force.

Through its appointed independent agents, the Company's lines of business include homeowners provided to personal risks and some commercial multiple peril provided to commercial risks. Its predominant concentration of business is homeowners coverage in the State of Connecticut.

### Treatment of Policyholders

*Claim Settlement Practices*

Procedures performed in conjunction with the claims testwork indicated that the Company investigates and settles claims on a timely and equitable basis.

*Dividends to Policyholders*

The Company did not declare or pay any dividends to its policyholders in the period of examination.



## REINSURANCE

In addition to participating in an inter-company reinsurance pooling arrangement, the Company has a limited program of reinsurance. The following briefly describes some of the major exchanges.

Inter-Company Reinsurance Pooling Agreement

Effective January 1, 1999, the Company began to participate in an inter-company reinsurance pooling agreement with its ultimate parent company, HMFIC, whereby the Company cedes to HMFIC the premiums, losses, loss adjustment expenses, and underwriting expenses of all of the Company's insurance risks underwritten or assumed on or after such effective date. HMFIC assumes these amounts and then retrocedes to the Company the specific, pre-agreed percentage (5%) of the total of such amounts and of similar amounts that arise from HMFIC's own insurance business. The agreement is prospective in nature. Assets equaling the net change in liabilities as a result of such pooling arrangement were transferred between the pool participants.

Aggregate balances for gross premiums associated with reinsurance transactions are compared in summary below for each company at the examination dates the agreement has been effective.

| | **2004** | | **1999** | |
|---|---|---|---|---|
| GROSS PREMIUMS | H.M.F.I.C. | D.I.C. | H.M.F.I.C. | D.I.C. |
| Direct Business | $ 48,587,767 | $ 7,287,311 | $ 35,548,828 | $ 1,935,281 |
| Reinsurance Assumed from: | | | | |
| Affiliates | 9,349,233 | 3,128,052 | 3,600,321 | 2,262,943 |
| Non-Affiliates | 4,629,777 | 39,148 | 1,265,192 | - |
| Reinsurance Ceded to: | | | | |
| Affiliates | 2,558,815 | 7,641,521 | 1,721,314 | 1,910,759 |
| Non-Affiliates | 11,390,518 | 254,175 | 6,348,717 | ( 24,375) |
| Net Premiums Written | $ 48,617,444 | $ 2,558,815 | $ 32,344,310 | $ 2,311,840 |

Assumed Reinsurance

*Involuntary Pools*

The Company has mandatory participation in the F.A.I.R. Plans of Connecticut, Massachusetts, and Rhode Island. As the Company has no premiums written in Rhode Island, it accepted property insurance risks only from Connecticut and Massachusetts; such business was reported as reinsurance assumed from non-affiliates.

*Affiliate*

In addition to the pooling agreement with HMFIC, the Company entered into a quota share contract to assume business from Casco, its indirectly held subsidiary. Effective January 1, 2000, Casco ceded 25% of its motor vehicle business to its parent insurance companies. At December 31, 2004, the Company's proportionate share of such business was 13.79% of the 25% cession; however, effective January 1, 2005, the company terminated this agreement and transferred all liabilities to HMFIC.

Ceded Reinsurance

The Company participated in a variety of treaties ceding reinsurance that limited, to some extent, its direct exposure. Effective January 1, 1999, the Company terminated all of its then existing reinsurance agreements and became part of HMFIC's reinsurance program with certain excess of loss and catastrophe treaties. Under the excess of loss treaty, the Company's retention for property and casualty losses was $400,000 at December 2004. With General Reinsurance Intermediaries, the Company purchased catastrophe excess of loss protection under which the Company retains the first $3.0 million of losses and a varying percentage of losses, as specified through several layers, up to a limit of $163.0 million. If any reinsurers are unable to fulfill their obligations under the reinsurance agreements, primary liability to policyholders and claimants for incurred losses would remain the sole obligation of the Company.

## ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires and through a review of work performed by the Company's independent Certified Public Accountants. No material deficiencies were noted.

The NAIC provides a questionnaire covering the evaluation of controls in the information systems environment. The questionnaire was completed by the Company and reviewed by the Division to evaluate the adequacy of the information systems controls. No material deficiencies were noted.

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

In accordance with 211 C.M.R. 23.00, the books and records of the Company are audited annually by a firm of independent certified public accountants. Throughout the examination period, the Company was audited by PwC.

## FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and the NAIC as of December 31, 2004:

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2004

Statement of Income for the Year Ended December 31, 2004

Reconciliation of Capital and Surplus for Each Year in the Five-Year Period Ended December 31, 2004

## Statement of Assets, Liabilities, Surplus and Other Funds
## As of December 31, 2004

| Assets | As Reported by the Company | Examination Changes | Per Statutory Examination | Notes |
|---|---|---|---|---|
| Bonds | $ 9,875,126 | $ 0 | $ 9,875,126 | |
| Preferred stocks | 26,180 | | 26,180 | |
| Common stocks | 1,807,879 | | 1,807,879 | |
| Mortgage loans on real estate: First liens | - | | - | |
| Real estate: Properties occupied by the Company | - | | - | |
| Cash and short-term investments | 436,162 | | 436,162 | |
| Other invested assets | - | | - | |
| Subtotals, cash and invested assets | 12,145,347 | - | 12,145,347 | |
| Investment income due and accrued | 72,927 | | 72,927 | |
| Premiums and considerations: | | | | |
| Uncollected premiums and agents' balances in course of collection | 296,588 | | 296,588 | |
| Deferred premiums, agents' balances, and installments booked but deferred and not yet due | 189,447 | | 189,447 | |
| Reinsurance: Amounts recoverable from reinsurers | 2,861,684 | | 2,861,684 | |
| Electronic data processing equipment | - | | - | |
| Receivable from parent, subsidiaries, and affiliates | - | | - | |
| Aggregate write-ins for other than invested assets: | | | | |
| Specify it | - | | - | |
| Equities in pools and associations | - | | - | |
| Total Assets | $ 15,565,993 | $ 0 | $ 15,565,993 | |

## Statement of Assets, Liabilities, Surplus and Other Funds
## As of December 31, 2004

| **Liabilities** | As Reported by the Company | Examination Changes | Per Statutory Examination | Notes |
|---|---|---|---|---|
| Losses | $ 832,507 | $ 0 | $ 832,507 | **( 1 )** |
| Reinsurance payable on paid loss and loss adjustment expenses | 128,393 | | 128,393 | |
| Loss adjustment expenses | 200,565 | | 200,565 | **( 1 )** |
| Commissions payable, contingent commissions, and other similar charges | 62,506 | | 62,506 | |
| Other expenses | 16,945 | | 16,945 | |
| Taxes, licenses, and fees | (5,956) | | (5,956) | |
| Current federal and foreign income taxes | 72,806 | | 72,806 | |
| Net deferred tax liability | 44,336 | | 44,336 | |
| Unearned premiums | 1,501,100 | | 1,501,100 | |
| Advance premiums | 236,068 | | 236,068 | |
| Ceded reinsurance premiums payable | 3,349,146 | | 3,349,146 | |
| Drafts outstanding | 5,530 | | 5,530 | |
| Payable to parent, subsidiaries, and affiliates | 244,744 | | 244,744 | |
| Aggregate write-in for liabilities**:** | | | | |
| Non-admitted asset -- F.A.I.R. Plan | 194 | | 194 | |
| F.A.I.R. Plan expenses payable | 21,211 | | 21,211 | |
| Total Liabilities | 6,710,095 | - | 6,710,095 | |
| Common capital stock | 1,150,000 | | 1,150,000 | |
| Gross paid-in and contributed surplus | 8,517,500 | | 8,517,500 | |
| Unassigned funds (surplus) | (811,602) | | (811,602) | |
| Surplus as regards policyholders | 8,855,898 | - | 8,855,898 | |
| Total Liabilities, Capital, and Surplus | $ 15,565,993 | $ 0 | $ 15,565,993 | |

**Statement of Income**
**For The Year Ended December 31, 2004**

| | As Reported by the Company | Examination Changes | Per Statutory Examination | Notes |
|---|---|---|---|---|
| Premiums earned | $ 2,557,494 | $ 0 | $ 2,557,494 | |
| Deductions: | | | | |
| Losses incurred | 1,356,614 | | 1,356,614 | |
| Loss expenses incurred | 242,603 | | 242,603 | |
| Other underwriting expenses incurred | 1,071,083 | | 1,071,083 | |
| Total underwriting deductions | 2,670,300 | - | 2,670,300 | |
| Net underwriting gain | (112,806) | - | (112,806) | |
| Net investment income earned | 290,997 | | 290,997 | |
| Net realized capital gains | (10,488) | | (10,488) | |
| Net investment gain | 280,509 | - | 280,509 | |
| Net gain (loss) from agents' or premium balances charged off | - | | - | |
| Finance and service charges not included in premiums | 59,168 | | 59,168 | |
| Aggregate write-ins for miscellaneous income: | - | | - | |
| Total other income | 59,168 | - | 59,168 | |
| Net income before dividends to policyholders and before federal and foreign income taxes | 226,871 | - | 226,871 | |
| Dividends to policyholders | - | | - | |
| Net income after dividends to policyholders but before federal and foreign income taxes | 226,871 | - | 226,871 | |
| Federal and foreign income taxes incurred | 72,551 | | 72,551 | |
| Net Income | $ 154,320 | $ 0 | $ 154,320 | |

## Reconciliation of Capital and Surplus
## For Each Year in the Five Year Period Ended December 31, 2004

| | 2004 * | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Surplus as regards policyholders as of December 31, prior year | $ 8,609,732 | $ 8,576,710 | $ 8,497,325 | $ 8,100,395 | $ 7,582,813 |
| Net income | 154,320 | (29,194) | 93,119 | 61,346 | 183,934 |
| Change in net unrealized capital gains or (losses) | 139,754 | 139,451 | (43,420) | 331,823 | 307,258 |
| Change in net deferred income tax | (48,621) | (73,225) | 29,491 | - | - |
| Change in non-admitted assets | 644 | (3,830) | 278 | 3,761 | (4,872) |
| Aggregate write-ins for gains or (losses) in surplus: | | | | | |
| Change in amount of advance direct bill premiums collected | - | - | - | - | 31,262 |
| Change in non-admitted assets related to F.A.I.R. Plans | 69 | (180) | (83) | - | - |
| Net change in surplus as regards policyholders for the year | 246,166 | 33,022 | 79,385 | 396,930 | 517,582 |
| Surplus as regards policyholders as of December 31, current year | $ 8,855,898 | $ 8,609,732 | $ 8,576,710 | $ 8,497,325 | $ 8,100,395 |

* Per Examination

## NOTES TO FINANCIAL STATEMENT

NOTE 1:

| | |
|---|---|
| Losses | $ 832,507 |
| Loss Adjustment Expenses | $ 200,565 |

As part of the examination, the Division engaged the consulting actuarial services of KPMG LLP. The consulting actuaries for the Division performed an independent analysis of the loss and loss adjustment expense reserves carried by HMFIC and by the Company and rendered an actuarial opinion on the reasonableness of the reserves carried by HMFIC and by the Company as of December 31, 2004.

In light of the inter-company pooling agreement, KPMG's actuaries conducted their review on a consolidated companies basis for the insurers comprising the Hingham Group (Hingham Mutual Fire Insurance Company and Danbury Insurance Company). KPMG noted that the Group's loss and loss adjustment expense reserves as of December 31, 2004, are stated gross of salvage and subrogation recoverables and gross of expected interest income associated with the time value of money.

KPMG reported that as of December 31, 2004, the Hingham Group recorded statutory-basis loss and loss adjustment expense reserves, gross of reinsurance recoverables, of $27.4 million. Based on its own independent review, KPMG estimated the Group's gross loss and loss adjustment expense liabilities as of December 31, 2004, at $26.3 million, with a range of reasonable gross loss and loss adjustment expense reserves which spans from a low of $24.1 million to a high of $28.4 million. In the opinion of KPMG, the gross loss and loss adjustment expense reserves carried by the Hingham Group as of December 31, 2004, make reasonable provision for all unpaid loss and loss adjustment expense obligations of the Group.

KPMG reported that as of December 31, 2004, the Hingham Group recorded statutory-basis loss and loss adjustment expense reserves, net of reinsurance recoverables, of $21.5 million. Based on its own independent review, KPMG estimated the Group's net loss and loss adjustment expense liabilities as of December 31, 2004, at $20.4 million, with a range of reasonable net loss and loss adjustment expense reserves which spans from a low of $19.0 million to a high of $21.9 million. In the opinion of KPMG, the net loss and loss adjustment expense reserves carried by the Hingham Group as of December 31, 2004, make reasonable provision for all unpaid loss and loss adjustment expense obligations of the Group.

KPMG noted that based on the inter-company pooling agreement, the aggregate reserve position of the Hingham Group generally reflects the position of each member insurer within the Group. Thus, in the opinion of KPMG, the net and gross loss and loss adjustment expense reserves carried by each insurer in the Hingham Group as of December 31, 2004, make reasonable provision for all unpaid loss and loss adjustment expense obligations of that respective Group member.

In specific regard to Danbury Insurance Company, on a gross basis, the following table summarizes KPMG's reserve ranges, KPMG selected point estimate reserve, and the Company's carried loss and loss adjustment expense reserves as of December 31, 2004:

Gross Loss and Loss Adjustment Expense Reserves

| ( 000 omitted ) Reserve Category | Low End of Range | KPMG Selection | High End of Range | Company Carried |
|---|---|---|---|---|
| Gross Loss Reserves | $ 932 | $ 1,015 | $ 1,097 | $ 1,077 |
| Gross D&CCE Reserves * | 157 | 173 | 189 | 94 |
| Gross A&OE Reserves # | 82 | 90 | 98 | 148 |
| Total Gross Reserves | $ 1,170 | $ 1,277 | $ 1,384 | $ 1,319 |

Similarly, on a net basis, the following table summarizes KPMG's reserve ranges, KPMG selected point estimate reserve, and the Company's carried loss and loss adjustment expense reserves as of December 31, 2004.

Net Loss and Loss Adjustment Expense Reserves

| ( 000 omitted ) Reserve Category | Low End of Range | KPMG Selection | High End of Range | Company Carried |
|---|---|---|---|---|
| Net Loss Reserves | $ 727 | $ 776 | $ 839 | $ 831 |
| Net D&CCE Reserves * | 121 | 134 | 143 | 78 |
| Net A&OE Reserves # | 64 | 69 | 75 | 123 |
| Total Net Reserves | $ 911 | $ 980 | $ 1,057 | $ 1,032 |

* D&CCE Reserves = Defense and Cost Containment Expense Reserves
\# A&OE Reserves = Adjusting and Other Expense Reserves

In the course of analyses, KPMG used several accepted loss reserving methods and procedures to derive reserve estimates and to construct ranges. KPMG gave consideration to the relative strengths and weaknesses of each of the methods in deriving the KPMG selected point estimate within the range. KPMG noted that the range of reasonable reserve estimates does not reflect all possible outcomes; rather, it is a range that has been constructed using alternative methodologies and assumptions that KPMG believed to be reasonable. KPMG stated its analyses were performed using accepted loss and loss expense reserving methods in conformance with sound actuarial practices and principles and that KPMG introduced assumptions and judgments that it considered appropriate in the circumstances.

In its Report, KPMG detailed HMFIC's reserve position similarly to the above presentation for loss and loss adjustment expense liabilities as of December 31, 2004. Whereas KPMG demonstrated that the Company's reserve position was conservative and that participation in the inter-company reinsurance pooling agreement had distribution percentages of 95% for HMFIC and 5% for the Company, the summary of analyses for HMFIC is not contained in this Report of Examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

**Custodial Agreement** The Company did not provide signed safe-keeping agreements with all of the custodians it uses for its securities. It is recommended that the Company obtain copies of all safe-keeping agreements it has with all custodial institutions it uses to hold its securities. Further, such agreements should contain provisions that satisfy the NAIC guidelines, especially in regard to indemnification for loss.

## CONCLUSION

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

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

| | |
|---|---|
| Hilton A. Irizarry, CFE | Insurance Examiner III |
| Linh Ngu | Insurance Examiner II |
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