

THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION

Division of Insurance

Report on the Examination of the

Liberty Mutual Mid-Atlantic Insurance Company

Boston, Massachusetts

As of December 31, 2009

NAIC GROUP CODE: 0111

NAIC COMPANY CODE: 14486

EMPLOYER'S ID NUMBER: 23-0867770

For Informational Purposes Only

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

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May 31, 2011

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Honorable Commissioners and Superintendents:

Pursuant to your instructions and in accordance with Massachusetts General Law, Chapter 175, Section 4, an examination has been made of the financial condition and affairs as of December 31, 2009 of the

Pursuant to your instructions and in accordance with Massachusetts General Law, Chapter 175, Section 4, an examination has been made of the financial condition and affairs as of December 31, 2009 of the

LIBERTY MUTUAL MID-ATLANTIC INSURANCE COMPANY
Camp Hill, Pennsylvania

at its main administrative office located at 175 Berkeley Street, Boston, Massachusetts, 02116.
The following report thereon is respectfully submitted

SCOPE OF EXAMINATION

Liberty Mutual Mid-Atlantic Insurance Company (hereinafter referred to as "LMMAIC" or the "Company") was last examined as of December 31, 2004 for the period from January 1, 2000 thereto by the Pennsylvania Insurance Department. The current association examination covers the intervening period from January 1, 2005 through December 31, 2009, and any material transactions and/or events occurring subsequent and noted during the examination.

The current examination was conducted at the direction of and under the overall management and control of the examination staff of the Massachusetts Division of Insurance (the "Division") in accordance with standards established by the National Association of Insurance Commissioners ("NAIC") Financial Condition Examination Committee, the requirements of the 2010 Edition of the *NAIC Financial Condition Examiner's Handbook*, the examination standards of the Division, and with Massachusetts General Laws. Representatives from the firm of PricewaterhouseCoopers LLP ("PwC") were engaged by the Division to assist in the examination by performing certain examination procedures at the direction of and under the overall management of the Division's examination staff. This assistance included a review of accounting records, information technology systems, taxes and investments. Examination procedures performed by PwC were reviewed and approved by the Division. PwC was also engaged to conduct concurrent examinations of Liberty Mutual Insurance Company ("LMIC"), Montgomery Mutual Insurance Company ("MMIC") and Liberty Mutual Personal Insurance Company ("LMPICO"). Each of those examinations is the subject of separate reports.

Substantial examination work performed on LMIC provided coverage in certain Liberty Mutual "Corporate" functions (i.e., Corporate Governance, Internal Audit, Investment Management/Treasury, and Related Party Transactions) which are centralized and provide services to all members of the holding company system. This exam work was leveraged and incorporated to every extent possible in the examination of LMMAIC to avoid duplication of effort.

The principal focus of the examination was 2009 activity however; transactions both prior and subsequent thereto were reviewed as deemed appropriate. The examination was conducted following the NAIC Risk Focused Examination Model.

In addition to the foregoing, 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 Ernst & Young LLP ("E&Y"), an independent certified public accounting firm, in accordance with 211 CMR 23.00. The firm expressed an unqualified opinion on the Company's statutory financial statements for each of the years under examination. E&Y's audit work was evaluated and relied upon where deemed appropriate and effective. The work of the Company's internal auditors was also reviewed and relied upon to the extent deemed appropriate.

COMPANY HISTORY

General

The Company was incorporated in 1920 in the state of Pennsylvania under the name Merchants and Business Men's Mutual Insurance Company. It became affiliated with the Liberty Mutual Group on June 25, 1997, and changed its name to Liberty Mutual Mid-Atlantic Insurance Company on March 20, 2006. Although affiliated with LMIC, the Company is a mutual insurer and not owned by any business entity. LMIC has a controlling interest on the LMMAIC Board of Directors. The Company writes private passenger automobile coverage in New Jersey. Effective June 8, 2010, the Company transferred its domicile to the Commonwealth of Massachusetts.

The Company is a member of the Peerless Insurance Company ("PIC") Amended and Restated Reinsurance Pooling Agreement whereby after external reinsurance, the Company cedes its net underwriting activity to the lead company in the Peerless Pool and its pooling participation is 0.00%. Therefore the Company reports no underwriting activity or reserve development.

TERRITORY AND PLAN OF OPERATION

The Company is a member of the Liberty Mutual Group (the "Group"). The Group is a diversified international group of insurance companies, and as a group is the 5th largest property and casualty insurer in the United States, based on direct premiums written. Although licensed in fifteen states, virtually all direct written premium is written in the state of New Jersey and is 100% ceded to LMIC, becoming part of the Liberty Pool after external reinsurance. The Liberty Pool consists of national property and casualty insurance companies with a diversified distribution channel. The Liberty Pool provides various lines of insurance including private passenger automobile, homeowners, workers' compensation, commercial multiple peril, fire, commercial automobile, and general liability.

Growth of Company

The financial position of the Company for the years 2005 through 2009 is shown in the following schedule, which was prepared from the Company's statutory Annual Statements:

<u>Year</u>	<u>Admitted Assets</u>	<u>Direct Premium Written</u>	<u>Net Income (Loss)</u>	<u>Policyholder Surplus</u>
2009	\$17,250,438	\$155,682,368	\$877,907	\$15,707,422
2008	18,157,280	111,110,225	698,791	14,737,777
2007	15,601,624	53,991,709	682,459	11,088,986
2006	14,245,708	222,885	589,237	4,406,527
2005	14,116,517	1,252,755	446,601	12,817,290

Surplus Notes

On December 30, 2009 and prior to its re-domestication, the Pennsylvania Insurance Department approved the issuance of a \$9.5 million dollar surplus note to LMIC in exchange for the cancellation of \$9.5 million dollar outstanding surplus note. The corresponding interest rate varies per annum but shall not exceed 10%. The note matures on 12/30/2019.

MANAGEMENT, CONTROL AND CORPORATE GOVERNANCE

LMMAIC is a mutual company and not owned by any business entity. LMIC controls a majority of the Company's Board of Directors. The ultimate parent of LMIC is Liberty Mutual Holding Company Inc.

Board of Directors

The Company is managed by a Board of Directors which is controlled by LMIC and LMIC's parent LMGI. The following list represents the Directors of the Company as of December 31, 2009, many of which hold positions as Company officers.

<u>Director</u>	<u>Title</u>
Timothy M. Sweeney	Chairman of the Board, President and Chief Executive Officer
Dexter R. Legg	Vice President and Secretary
Laurance H. S. Yahia	Vice President and Treasurer
Melonie M. Foley	Vice President
Margaret Dillon	Vice President and Chief Financial Officer

Edward J. Gramer, III
Stephen J. McAnena
Jan Marie Dempsey
Gregory C. Gordon

The following individuals held positions as officers of the Company in addition to the directors listed above:

<u>Officer</u>	<u>Title</u>
Elizabeth J. Morahan	Vice President and General Counsel
Anthony A. Fontanes	Vice President, Chief investment Officer and Assistant Treasurer
John D. Doyle	Vice President and Controller
Gary J. Ostrow	Vice President
Donald Waardenburg	Vice President

Conflict of Interest Procedures

The Liberty Mutual group (the "Group") has developed an enterprise-wide approach to corporate compliance that specifically includes the means to manage conflict of interest issues. The enterprise-wide approach includes a *Code of Business Ethics and Conduct* as a reference guide to help personnel define and understand appropriate standards of business conduct and to establish compliance requirements. The approach also has established procedures for the disclosure of possible conflicts of interest involving directors, officers and key employees. The Group has established an Office of Corporate Compliance with responsibility for managing this disclosure program, investigating potential conflict situations, and making recommendations to management for the resolution of any such conflicts. The Group's General Counsel reports the results of the annual disclosure process to the Chief Executive Officer and to the Board of Directors. As a member of the Group, LMMaIC follows all requirements of the approach and is an active participant in it. As part of the examination, the following were obtained and reviewed:

- The Code of Business Ethics and Conduct
- Conflict of interest disclosure forms provided by elected officers, key employees and Directors during the 2009 annual disclosure process.

Management Continuity and National Emergency

The Company provides for the continuity of management in the event of a catastrophe or other emergency in accordance with sections 180M through 180Q of Chapter 175 of the Massachusetts General Laws.

Corporate Records

Board of Directors Minutes

The minutes of the Board of Directors meetings for the period under examination were read. The review indicated that all meetings were held in accordance with the laws of the Commonwealth of Massachusetts.

AFFILIATED COMPANIES

The following abbreviated listing illustrates the LMIC ownership chain. As a mutual company LMMAIC is owned by its policyholders, however the Company is managed by LMIC, which holds a majority of positions on its Board of Directors.

Liberty Mutual Holding Company Inc.
LMHC Massachusetts Holdings Inc.
Liberty Mutual Group Inc.
Liberty Mutual Insurance Company
Liberty Mutual Mid-Atlantic Insurance Company

RELATED PARTY AGREEMENTS

The Company is a party to a management services agreement with LMIC. Under this agreement, LMIC may provide the Company with services related to accounting, financial, tax and auditing; purchasing payroll and employee benefits; information technology and support; policy administration and production; real estate management; legal; and other services as may be requested.

The Company is a party to a management agreement with Peerless Insurance Company. Under this agreement, PIC provides services related to run-off business.

The Company is party to an investment management agreement with LMIC, an investment management agreement with Liberty Mutual Investment Advisors LLC ("LMIA") and a cash management agreement with LMIA.

The Company is a party to a revolving credit agreement under which the Company may borrow up to \$50,000,000 from LMIC. The purpose of the extension of credit is for operating liquidity to accommodate fluctuation in daily cash flow and to promote efficient management of investments. At December 31, 2009, there have been no drawings under this agreement.

FIDELITY BOND AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, under a Financial Institutions Bond designed for insurance companies, consistent with Massachusetts General Laws, Chapter 175, Section 60. The aggregate limit of liability on these policies is in excess of NAIC suggested minimum amounts for fidelity insurance. The Company is also a named insured, either itself or together with other affiliates, on policies with external carriers that provide coverage for aircraft liability, excess umbrella and property damage. The excess umbrella policies are with external carriers however, the lead umbrella carrier is Liberty Insurance Corporation. All policies evidencing the above coverage's were with licensed and authorized carriers in Massachusetts and were in force at December 31, 2009.

PENSION AND INSURANCE PLANS

The Company does not have any direct employees and therefore, does not have any direct obligations for a defined benefit plan, deferred compensation arrangements, compensated absences or other post retirement benefit plans. Services for the operation of the Company are provided under provisions of the management services agreements described previously.

SPECIAL DEPOSITS

The following identifies the special deposits maintained by the Company with numerous jurisdictions as of December 31, 2009 and are listed below in the aggregate per location:

<u>State</u>	<u>Purpose of Deposits</u>	<u>Book Value</u>	<u>Fair Value</u>
Delaware	Benefit of DE Policyholders	30,348	32,276
Florida	Benefit of FL Policyholders	210,454	220,584
Georgia	Benefit of GA Policyholders	51,331	53,800
Massachusetts	Workers' Compensation	50,580	53,793
North Carolina	Benefit of all Policyholders	327,441	351,954
Pennsylvania	Benefit of all Policyholders	1,157,016	1,223,314
South Carolina	Benefit of all Policyholders	133,009	139,878
Virginia	Benefit of VA Policyholders	533,387	570,206
	Totals	<u>\$2,493,566</u>	<u>\$2,645,805</u>

REINSURANCE

Effective February 19, 2007, LMMAIC became a party to a 100% Quota Share Reinsurance Agreement with LMIC and concurrently amended its participation in the Peerless Insurance Company ("PIC") Amended and Restated Reinsurance Pooling Agreement. The 100% Quota Share Reinsurance Agreement with LMIC applies to all of LMMAIC's risks under its policies issued through the Group's Personal Markets strategic business unit, which are the only policies issued by LMMAIC on and after February 19, 2007. Because LMIC is the lead company in the Liberty Pool, LMMAIC's new business became a part of the Liberty Pool. LMMAIC's

continued participation in the PIC Amended and Restated Reinsurance Pooling Agreement applies only to run-off business under policies written prior to February 19, 2007, which were policies issued through the Group's Agency Markets strategic business unit. LMMIAIC's pool participation percentage in the PIC Pool is 0.00%, and therefore, does not record any underwriting activity.

SUBSEQUENT EVENTS

Effective June 8, 2010, the Company re-domesticated to the Commonwealth of Massachusetts. As a result, the Massachusetts Division of Insurance and the Pennsylvania Insurance Department agreed that Massachusetts would exam the Company as a Massachusetts domestic even though it was a Pennsylvania domestic at the examination "as of" date and for the period since its previous examination.

Effective January 1, 2010, the Company cancelled its participation in the PIC Amended and Restated Reinsurance Pooling Agreement and concurrently became a participant in the Liberty Mutual Inter-Company Reinsurance Agreement with a 0.00% pool participation and entered into a 100% Quota Share Reinsurance Agreement with PIC. Pursuant to the Quota Share Agreement with PIC, the Company continues to cede the business it wrote for the Peerless Pool to PIC. New business is ceded to LMIC, the lead company in the Liberty Pool.

ACCOUNTS AND RECORDS

The Company's accounts and records are maintained on a general ledger system consisting of a general ledger ("ledger") and numerous automated feeder systems which interface with the ledger. Manual entries are also input into the ledger. The ledger maintains account level detail on a company basis. The ledger interfaces with a reporting tool that is used to produce financial statements and supplemental reports. The Company utilizes "Infor" for its general ledger and financial reporting.

All accounting entries have specific elements for company and statutory accounting basis. These elements serve as the basis for proper posting to the appropriate entity and accounting basis. Additionally, information is broken down into the appropriate segment, line of business and cost center. Cost center information is used to capture expense information and then to allocate those expenses to various reporting entities by ratios determined by line of business and function.

The core financial application systems including general ledger, accounts payable, payroll and cash disbursements run on an IBM Mainframe (z/OS) infrastructure. The core insurance administration systems run on IBM Mainframe and various Unix and Windows distributed infrastructure.

In addition to the mainframe, the Company operates a multi-vendor distributed environment including Hewlett Packard UNIX, IBM AIX and Sun Solaris for various applications including investment management and pension and 401(K) administration. Local area network systems are used widely throughout the organization at the home office, field services, and for real estate processing.

The accounts and records of the Company are subject to review by the Company's Corporate Auditing Department and are audited annually by Ernst and Young LLP ("E&Y"), independent certified public accountants.

No material deficiencies were noted in the Company's accounts and records in the course of this examination.

FINANCIAL STATEMENTS

The Financial Statements section includes the following, as determined by our examination: Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2009; Statement of Income, Capital and Surplus for the Year Ended December 31, 2009; and Reconciliation of Capital and Surplus For Each Year in the Five Year Period Ended December 31, 2009.

The financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and by the NAIC, as of December 31, 2009.

Liberty Mutual Mid-Atlantic Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2009

	Per Company	Examination Changes	Per Examination
Assets			
Bonds	\$14,481,388	\$0	\$14,481,388
Common Stock	56,890		56,890
Cash on hand and on deposit	2,059,406		2,059,406
Subtotals, cash and invested assets	16,597,684		16,597,684
Investment income due and accrued	118,556		118,556
Current federal and foreign income tax recoverable and interest thereon	39,202		39,202
Receivables from parent, subsidiaries and affiliates	70,527		70,527
Aggregate write-ins for other than invested assets	424,469		424,469
Total Assets	17,250,438	\$0	17,250,438
Liabilities, Surplus and Other Funds			
Payable to parent, subsidiaries and affiliates	110,289		110,289
Aggregate write-ins for liabilities	1,432,725		1,432,725
Total Liabilities	1,543,014		1,543,014
			0
Surplus Notes	9,500,000		9,500,000
Unassigned funds (surplus)	6,207,424		6,207,424
Surplus as reported to policyholders	15,707,424		15,707,424
Total liabilities and policyholder surplus	17,250,438	\$0	17,250,438

Liberty Mutual Mid-Atlantic Insurance Company
Statement of Income, Capital and Surplus
For the Year Ended December 31, 2009

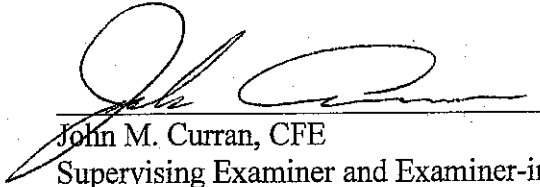
	Per Company	Examination Changes	Per Examination
Investment Income			
Net investment income earned	\$647,907	\$0	\$647,907
Net investment gain or (loss)	647,907	0	647,907
Net income before dividends to policyholders and before federal income taxes	647,907		647,907
Foreign and federal income taxes incurred	(230,000)		(230,000)
Net income	<u>\$877,907</u>	<u>\$0</u>	<u>877,907</u>
Capital and Surplus Account			
Surplus as regards policyholders, December 31 prior year	\$14,787,777	\$0	\$14,787,777
Net income	877,907		877,907
Change in net unrealized capital gains or (losses)	27,131		
Change in net deferred income tax	(277,101)		
Change in nonadmitted assets	291,710		291,710
Change in surplus	<u>919,647</u>	<u>0</u>	<u>1,169,617</u>
Surplus as regards policyholders, December 31 current year	<u>\$15,707,424</u>	<u>\$0</u>	<u>\$15,957,394</u>

Liberty Mutual Mid-Atlantic Insurance Company
Reconciliation of Capital and Surplus
For Each Year in the Five Year Period Ended December 31, 2009

	2009	2008	2007	2006	2005
Surplus as regards policyholders, December 31 previous year	\$14,787,777	\$14,088,986	\$13,406,527	\$12,817,290	\$12,460,216
Net income (loss)	877,907	698,791	682,459	589,237	466,601
Change in net unrealized capital gains or (losses)	27,131				
Change in net deferred income taxes	(277,101)	(411,000)	(307,000)	(138,000)	(208,000)
Change in nonadmitted assets	291,710	411,000	307,000	138,000	102,999
Aggregate write-ins for gains and losses in surplus					9,474
Change in surplus	919,647	698,791	682,459	589,237	371,074
Surplus as regards policyholders, December 31 current year	\$15,707,424	\$14,787,777	\$14,088,986	\$13,406,527	\$12,837,290

ACKNOWLEDGEMENT

Acknowledgment is made of the cooperation and courtesies extended by the officers and employees of the Company to all the examiners during the course of the examination.



John M. Curran, CFE
Supervising Examiner and Examiner-in-Charge
Commonwealth of Massachusetts
Division of Insurance
Representing Northeastern Zone, NAIC

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