

THE COMMONWEALTH OF MASSACHUSETTS

**OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION**

Division of Insurance

Report on the Statutory Examination of

*The Liquor Liability Joint Underwriting Association of
Massachusetts*

Westborough, Massachusetts

As of December 31, 2006

EMPLOYERS ID NUMBER: 04-2901190

Table of Contents

SALUTATION	1
SCOPE OF EXAMINATION	2
HISTORY	2
General	2
Growth of Association	3
PLAN OF OPERATION	3
Obligation of Members	4
Meeting of Members	4
Management of the Association	5
Powers and Duties of the Board	6
Board of Directors	6
Committees of the Board	7
Officers	10
Association Records	10
Conflict of Interest	10
EMPLOYEE WELFARE AND BENEFIT PLANS	11
FIDELITY BOND AND OTHER INSURANCE	11
TERRITORY AND PLAN OF OPERATION	11
SUBSEQUENT EVENTS	12
ACCOUNTS AND RECORDS	12
FINANCIAL STATEMENTS	13
Statement of Assets, Liabilities, Surplus and Other Funds of December 31, 2006	14
Statement of Income, Capital and Surplus for the year ended December 31, 2006	16
Reconciliation of Capital and Surplus for the Three Year Period Ended December 31, 2006	17
NOTES TO FINANCIAL STATEMENTS	18
COMMENTS AND RECOMMENDATIONS	19
ACKNOWLEDGEMENT	22



COMMONWEALTH OF MASSACHUSETTS

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May 30, 2008

Honorable Nonnie S. Burnes
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
One South Station
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Honorable Commissioner:

Pursuant to your instructions and in accordance with Section 12 of Chapter 223 of the Acts of 1985 of the Massachusetts Legislature and Massachusetts General Laws, Chapter 175, Section 4, an examination has been made of the financial condition and affairs of

THE LIQUOR LIABILITY JOINT UNDERWRITING ASSOCIATION OF MASSACHUSETTS

at its home office located at 95A Turnpike Road, Westborough, Massachusetts, 01581. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

The Liquor Liability Joint Underwriting Association of Massachusetts (hereinafter referred to as the "Association" or "LLJUA") was last examined for the year ended December 31, 2003 by the Massachusetts Division of Insurance (the "Division"). This examination covers the three-year period from January 1, 2004 through December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

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 Examiners Handbook, the examination standards of the Division and with Massachusetts General Laws. The principal focus of the examination was 2006 activity however transactions both prior and subsequent thereto were reviewed as deemed appropriate.

In addition to a review of the financial condition of the Association, the examination included a review of the Association's business policies and practices, corporate records, conflict of interest disclosure statements, fidelity bond and other insurance, employees' pension and benefits plans, disaster recovery plan, and other pertinent matters to provide reasonable assurance that the Association 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 Association is currently audited annually by Saslow, Lufkin & Buggy, LLP, an independent Certified Public Accounting firm. Prior to 2005, the Association was audited by Ernst & Young LLP. For each of the three years covered under this examination, the independent auditors expressed an unqualified opinion as to the conformity of the Association's financial statements. A review and use of the Certified Public Accountants' work papers were made to the extent deemed appropriate and effective.

The Tillinghast actuarial arm of Towers Perrin performs an independent actuarial analysis of the Association's loss and allocated loss adjustment expense liabilities each year. This independent report was also reviewed and relied upon where deemed appropriate and effective.

HISTORY

General

The Association was established on July 31, 1985 by the enactment of Chapter 223 of the Acts of 1985 to guarantee the availability of liquor liability insurance to any licensee or any person lawfully engaged in serving alcoholic beverages as an incident of its business. The Massachusetts Commissioner of Insurance (the "Commissioner") approved the Association's Plan of Operation on December 16, 1985 and the Association commenced operations on January 1, 1986.

Section 2 of the enabling legislation established that the Association shall consist of all insurers authorized to write and engage in writing, within the Commonwealth of Massachusetts on a direct basis, personal injury liability insurance pursuant to the provisions of Chapters 90 and 175 of the Massachusetts General Laws. Every such insurer shall be a “member” of the Association and shall remain a member as a condition of its authority to continue to transact such kind of business within the Commonwealth of Massachusetts. The purpose of the Association shall be to provide liquor legal liability insurance on a self supporting basis.

Section 4 of the enabling legislation directed the Commissioner to promulgate a Plan of Operation which shall provide for the economic, fair and non-discriminatory administration, and for the prompt and efficient provision of liquor legal liability insurance, and shall contain other provisions including, but not limited to, management of the Association, assessment of members to defray losses and expenses, commission arrangements, reasonable and objective underwriting standards, acceptance of cessions of reinsurance, appointment of servicing carriers and procedures for determining amounts of insurance to be provided by the Association. Limits of coverage shall be based upon the type of license, gross volume of liquor sales or service, employee participation in alcohol training programs, and such other criteria as the directors shall develop. This section also provides for the offering of premium installment payment plans.

Section 13 of the enabling legislation was amended in 1992 and again in 1999 to extend the period of operation of the Association. Chapter 211 of the Acts of 2002 of the Massachusetts Legislature repealed Section 13 of the original enabling act, which in effect made the Association a permanent organization.

Section 3 of the enabling legislation, which established the original policy limits the Association could write was amended by Chapter 166 of the Acts of 2004 of the Massachusetts Legislature, which removed the original policy limits and made all policy limits subject to the approval of the Commissioner.

Growth of Association

The growth of the Association over the previous five year period ending December 31, 2006 is shown in the following table which was prepared from the Association’s filed statutory annual statements.

Year Ending	Written Premium	Admitted Assets	Total Liabilities	Surplus
2006	\$6,069,467	\$42,401,787	\$24,995,644	\$17,406,143
2005	5,582,343	37,788,667	28,797,917	8,990,750
2004	4,193,584	36,061,553	23,961,134	12,100,419
2003	3,302,277	34,188,509	20,148,326	14,040,183
2002	2,075,309	33,068,997	11,567,633	21,501,364

PLAN OF OPERATION

As prescribed by Chapter 223 of the Acts of 1985 and noted above, the Association established a Plan of Operation (the “Plan”) in part to guide the creation and management of the Association.

The Plan provides specific guidance on numerous issues relating to the operation of the Association including; obligation of members; meetings of members; management of the Association; powers and duties of the Board of Directors; application and payment for insurance coverage; cancellation and non-renewal of policies; commissions; premium rates and policy forms; guidelines for appeals; annual reporting; and Plan amendments. The Plan was last amended effective December 27, 1996.

Obligations of Members

Members are subject to and liable for various assessments. Each member is liable for an annual assessment estimated by the Commissioner to be necessary to cover the cost to be incurred by the Division in carrying out its responsibilities relative to the Association.

Per Section 6 of the enabling legislation, in the event that the Board of Directors or the Commissioner determine that sufficient funds are not available for the sound financial operation of the Association, members shall pay a temporary assessment which shall be computed based primarily on the proportion that a member's net premiums bears to the aggregate net direct premiums written in the Commonwealth of Massachusetts by all members. Each member's participation shall be determined annually based on premiums written during the preceding calendar year. No member will be obligated in any one year to reimburse the Association on account of its proportionate share in the deficit from operations of the Association in that year in excess of one percent of its surplus to policyholders, and the aggregate amount not so reimbursed shall be allocated among the remaining members. In the event of the failure of any insurer through insolvency or otherwise to pay any assessment, such unpaid assessment shall be paid by the remaining insurers, with each contributing its proportionate share of the unpaid assessment. Any such assessments shall be recouped by an assessment of policyholders, a rate increase or both, at a time and manner determined by the Commissioner. For the purpose of assessments, the term "policyholders" shall mean all those licensees insured under a policy of liquor legal liability insurance, whether obtained through the LLJUA or not.

In the event that sufficient funds are not available for the sound financial operation of the Association, all members shall, on a temporary basis contribute to the financial requirements of the Association, and any such contribution shall be reimbursed to the members following recoupment from policyholders as provided above.

It should be noted that the Association has not made an assessment of any kind of the members or policyholders since the Association's inception. Therefore, the Association has never calculated the participation ratio of the membership, as required by Section 7 of the enabling legislation, as the principal purpose for determining each member's participation ratio would be to calculate assessment amounts if applicable.

Meeting of Members

An annual meeting of members shall be held to elect directors of the Association on such a date and at such a place within the Commonwealth of Massachusetts as the Board or Directors may designate. Notice of each meeting shall be given at least 14 days prior to the date of the meeting

to all members of the Association, to all board members, and to the Commissioner. Special meetings to elect directors may be called at any time by the Chairman of the Board whenever requested in writing by members whose net direct premiums equal 20% or more of all members in the most recent calendar year. Voting at the annual meeting of members and at special meetings may be by written proxy.

Management of the Association

The management of the Association shall be governed by a Board of 15 directors. Eight directors shall be elected by the members voting cumulatively at the annual meeting of the members and shall represent the member companies. Six directors shall be appointed by the Commissioner as representatives of licensees and one director shall be appointed by the Commissioner as the representative of insurance producers. Directors may serve more than one term, which may be consecutive. The term of each director appointed by the Commissioner shall expire one year from his or her appointment except that such director may continue to serve until a replacement is appointed.

The Board shall elect a Chairman each year at the first meeting of the Board following the annual meeting of the members. The Board shall meet as often as may be required to carry out its duties under the Plan. Board meetings may be called by the Chairman, by written petition of four directors, or by the Commissioner. At least ten days written notice shall be given for any meeting of the Board unless a majority of directors, at least two of whom shall be of licensees, agree to waive such notice.

At any Board meeting each director shall have one vote. Any director appointed by the Commissioner may, with the prior approval of the Commissioner, designate an alternate to attend and vote at any meeting. Following the annual election, each elected member company shall designate an officer or employee to serve as its representative on the Board, and an alternate representative who may attend and vote at any meeting the designated representative cannot attend. Seven directors, at least two of whom are representatives of licenses, shall constitute a quorum for the transaction of business. The acts of a majority of the directors present at any meeting at which a quorum exist shall be binding on the Board. Voting by proxy shall not be permitted.

All meetings of the Board shall be conducted in accordance with the open meeting laws as found in Massachusetts General Laws, Chapter 30A, Section 11A ½.

Directors and alternates may be reimbursed by the Association for reasonable and necessary expenses incurred in attending Board meetings and in conducting the business of the Association. The Board may also authorize reimbursement of the reasonable and necessary expenses incurred by others in serving on committees established by the Board or otherwise assisting the Board in performance of its duties.

The Board shall elect officers from among the directors. The Chairperson shall appoint committee members.

Powers and Duties of the Board

The Board shall have the power on behalf of the Association to take such action as may be necessary to fulfill the responsibilities of the Association, including to issue or cause to be issued policies of liquor legal liability insurance and incidental coverage; adjust and pay losses under policies issued by the Association; assume reinsurance from members; make and collect assessments of members; and, receive, invest and disburse funds.

The Board shall, subject to the approval of the Commissioner, develop rates, rating classifications and plans, and policy and other forms applicable to liquor legal liability insurance and incidental coverage written by or on behalf of the Association; adopt rules of operation including reasonable and objective underwriting guidelines and rules governing the mandatory offer of coverage.

The Board shall also ensure that notice is given to the Massachusetts Attorney General within ten days of the payment of any claim that includes the name of the insured, date of the claim, amount paid, and a description of the incident for which the payment was made.

Board of Directors

The members of the Board of Directors along with their industry affiliation serving as of December 31, 2006 are as follows:

<u>Name of Director Appointed or Elected</u>	<u>Industry Affiliation</u>	<u>Director Since</u>
Joseph I. Quinn, Chairperson Insurance Producer Representative	Allan M. Walker & Co., Inc Taunton, MA	1987
E. Thomas McCabe, Jr. Appointed Licensee Representative	Restaurant Resources Westborough, MA	1987
Robert Bonin Appointed Licensee Representative	Cole & Bonin, Inc., Restaurant Consultants Worcester, MA	1997
Robert Shaughnessy Appointed Licensee Representative	The Other Place Pub Boylston, MA	1992
James Donaghue Appointed Licensee Representative	Tweed's Restaurant Pub Worcester, MA	1992
Chick Delano Appointed Licensee Representative	Delano's Restaurant Amherst, MA	1992
Allan G. Skole Appointed Licensee Representative	Chez Josef, Inc Longmeadow, MA	1992
Doreen Cusolito Insurer Elected Representative	ASIB, Inc. (Arbella Insurance) Quincy, MA	2003
James J. Moran Insurer Elected Representative	Quincy Mutual Insurance Company Quincy, MA	2006
Donald Vose Insurer Elected Representative	Merrimack Mutual Insurance Andover, MA	2006
John B. Sullivan Insurer Elected Representative	The Hanover Insurance Worcester, MA	2006

Michael L. Faron (Note – 1) Insurer Elected Representative	The Norfolk & Dedham Group Dedham, MA	2006
(Note – 2)	OneBeacon Insurance Company Canton, MA	2006
(Note – 3)	St. Paul Travelers	2006

Note 1: Mr. Faron from Norfolk and Dedham was a write-in candidate and included in the vote to elect all insurance industry representative. Mr. Faron participated in Board meetings during the year and also was a member of the Risk Management Committee and the Rating and Underwriting Committee.

Note 2: OneBeacon Insurance Company received 39 votes to be a representative on the Board however no representative from OneBeacon ever participated at any of the Board Meetings during the 2006 year term.

Note 3: St. Paul Travelers was nominated at the annual meeting to be added to the list of insurance industry representatives and included in the vote to elect all insurance industry representatives however no representative from St. Paul Travelers ever participated at any Board meetings during the 2006 year term. The designee previously representing St. Paul Travelers formally resigned in mid 2005.

The Board of Directors met four times during 2006.

Committees of the Board

The Board has established numerous committees and in accordance with the Plan of Operation the Chairperson shall appoint committee members. The committees in place and the members of each committee are listed below.

Audit Committee

The duties of the Audit Committee include the approval of the engagement of the independent auditors; review and approve segregation of duties and processes of internal controls; and meet periodically with auditors to receive their reports on the condition of the Association between year-end reports. The Audit Committee met twice during 2006.

The following were members of the 2006 Audit Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Doreen Cusolito	Insurer Representative
James J. Moran	Insurer Representative

Rating and Underwriting Committee

The duties of the Rating and Underwriting Committee include review of the independent actuarial report; review and approve management/actuaries rate adjustment recommendations; approve material changes to the policy issuance process; and work with management and actuaries to develop new products and rates in response to market demands. The Rating and Underwriting Committee met five times during 2006.

The following were members of the 2006 Rating and Underwriting Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Chick Delano	Licensee Representative
Robert Shaughnessy	Licensee Representative
Robert Bonin	Licensee Representative
Doreen Cusolito	Insurer Representative
Donald Vose	Insurer Representative
Michael L. Faron	Insurer Representative

Operations Committee

The duties of the Operations Committee include the review and approval of the annual budget; overseeing the compensation of the president; and oversee generally the administrative operations of the Association, including human resource issues. The Operations Committee met 9 times during 2006.

The following were members of the 2006 Operations Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Chick Delano	Licensee Representative
Robert Shaughnessy	Licensee Representative
Robert Bonin	Licensee Representative
Doreen Cusolito	Insurer Representative
John B. Sullivan	Insurer Representative
James J. Moran	Insurer Representative

Investment Committee

The duties of the Investment Committee include the review of quarterly reporting of investment performance and to approve recommendations presented by the Association's investment advisor for changes to asset allocation. The Investment Committee met 6 times during 2006.

The following were members of the 2006 Investment Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Chick Delano	Licensee Representative
Robert Shaughnessy	Licensee Representative
Robert Bonin	Licensee Representative
Doreen Cusolito	Insurer Representative
John B. Sullivan	Insurer Representative

Risk Management Committee

The duties of the Risk Management Committee include approval of alcohol training programs eligible for credit; approve security personnel training programs eligible for credit; review partnership with the Massachusetts Restaurant Association regarding training subsidies on a quarterly basis as well as track the program's effectiveness; and discuss alternatives for reducing risks to the Association utilizing internal and external options. The Risk Management Committee met 5 times during 2006.

The following were members of the 2006 Risk Management Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Chick Delano	Licensee Representative
Robert Shaughnessy	Licensee Representative
Robert Bonin	Licensee Representative
Michael L. Faron	Insurer Representative

Claims Committee

The duties of the Claims Committee include approval of settlement authority on high limit cases; receive detailed claims reports and analysis from management and act on the reports as necessary; and review claims with management to identify trends that need closer monitoring. The Claims Committee met 9 times during 2006.

The following were members of the 2006 Claims Committee:

<u>Member</u>	<u>Industry Affiliation</u>
Joseph I. Quinn	Insurance Producer
E. Thomas McCabe	Licensee Representative
James Donoghue	Licensee Representative
Chick Delano	Licensee Representative
Robert Shaughnessy	Licensee Representative
Robert Bonin	Licensee Representative
Doreen Cusolito	Insurer Representative

Officers

The day-to-day operations of the Association are directed and managed by a President and Chief Executive Officer and a Vice-President of Claims. A small staff consisting of full and part-time employees supports the daily activity of the Association and other ancillary services are obtained through contracted third parties. Officers in place and serving as of the December 31, 2006 were as follows:

John W. Tympanick - President & Chief Executive Officer
Dana Marchant – Vice President of Claims

Association Records

The minutes of all Annual Meeting of the Members, Board of Directors and Committee meetings were reviewed. As noted during the previous examination recorded minutes from 2004 were not “signed”, or attested to by the recorder of the minutes. In 2005 and subsequent, minutes are signed by the person preparing the documents; however, that person is typically not a director or committee member. The guidelines surrounding this process appear vague and undocumented. Neither the Board of Directors nor any of the Committees have an appointed or elected secretary charged with the responsibility of maintaining these corporate documents. It is noted that the Board and the Chairman have the authority to appoint or elect a secretary or any other officer. Best practices of sound corporate governance would suggest appropriate guidelines be developed and implemented to assure minutes, proceedings, and actions taken at all Board and Committee meetings are properly documented.

Conflict of Interest

Noted during the previous examination, the Association lacked a formal conflict of interest policy. A recommendation to adopt a more comprehensive conflict of interest policy was included in the prior examination report. The Association acted upon this recommendation and a formal “Conflicts of Interest Policy” has been implemented, and signed conflict of interest statements for 2005 and 2006 were executed by all required individuals.

EMPLOYEE WELFARE AND BENEFIT PLANS

According to the Association's employee handbook, as of December 31, 2006 the Association provided certain benefits to its employees, the associated cost thereof are entirely provided for by the Association. The benefits include a health and dental insurance program, including an offset for supplemental coverage at retirement; life insurance, accidental death and dismemberment and long-term disability coverage; and a 401(K) tax-deferred saving plan and a defined benefit pension plan. It has been noted during the exam that certain employee benefits, including health and dental insurance coverage is being extended to a subcontracted individual that is actually a W-2 employee of another company. See the Comments and Recommendations Section at the conclusion of this report for additional details.

FIDELITY BOND AND OTHER INSURANCE

The Association appears to maintain adequate insurance coverage's from authorized insurers for the period covered by this examination. The Association has in place a Business Owners Policy covering commercial general liability, property coverage, and employee dishonesty risks.

TERRITORY AND PLAN OF OPERATION

The Association was established by Chapter 225 of the Acts of 1985 by the Massachusetts Legislature as a temporary, nonexclusive, joint underwriting association consisting of all insurers authorized to write and engage in writing, within the Commonwealth of Massachusetts on a direct basis, personal injury liability insurance pursuant to Chapters 90 and 175 of the General Laws. The purpose of the Association shall be to provide liquor legal liability insurance on a self supporting basis. The Associations "temporary" status was amended and removed from the Chapter 225 in 2002.

The original policy limits promulgated by the enabling statute were \$500,000 per person, \$1,000,000 per occurrence, including incidental coverage's. The Association now offers policy limits of \$2 million per person, \$2 million per occurrence. The Association offers policies of insurance both on an "occurrence" and a "claims-made" basis. Any applicant for coverage must first certify that they have been unable to obtain coverage from insurance companies authorized to write such business in Massachusetts, and must list the name of three insurers unwilling to voluntarily provide coverage to the applicant.

The Association does not have in place contracts or agreements with any agencies or agents. Any eligible risk shall be entitled to apply to the Association and shall authorize a licensed agent or broker to make application to the Association on their behalf. The licensed agent or broker shall be entitled to receive a commission for coverage obtained from the Association, based on rates established by the Association. Any applicant for coverage shall not be denied unless certain conditions exist, and any applicant denied coverage shall be notified of his or her right to appeal such declination to the Commissioner.

SUBSEQUENT EVENTS

Subsequent to the December 31, 2006 examination date and during the examination field work, the Association's Board of Directors voted at a Special Meeting of the Board held on February 8, 2007, to "proceed to support the Legislation and take other steps necessary to convert the LLJUA to a mutual company". On April 29, 2008, the Massachusetts Senate adopted Senate Bill No. 2668, an amendment to Senate Bill No. 573, authorizing the conversion of the LLJUA into a mutual insurance company.

ACCOUNTS AND RECORDS

The Association maintains its accounts and records electronically through the use of various integrated software programs and information reporting systems. The LLJUA uses an automated general ledger system capable of producing various financial and management reports. The trial balances were reconciled and traced from the general ledger and supporting documents to the 2006 Annual Statement as filed with the Division. No significant exceptions were noted. The internal control structure was discussed with management and through a review of the work performed by the Association's independent Certified Public Accountants, Saslow, Lufkin & Buggy, LLP. The books and records of the Association have been audited annually by Saslow, Lufkin & Buggy, LLP, since 2005 in accordance with Article XII of the Plan of Operation and an unqualified audit opinion has been issued each year.

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance of the Commonwealth of Massachusetts and by the National Association of Insurance Commissioners, as of December 31, 2006.

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2006.

Statement of Income, Capital and Surplus for the Year Ended December 31, 2006.

Reconciliation of Capital and Surplus for the Three Year Period Ended December 31, 2006.

For Information Purposes Only

Liquor Liability Joint Underwriting Association of Massachusetts
Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2006

	Per Company	Examination Changes	Notes	Per Examination
Assets				
Bonds	\$27,465,546		\$0	\$27,465,546
Preferred stocks	846,228			846,228
Common stocks	8,182,710			8,182,710
Cash on hand and on deposit	2,806,059			2,806,059
Short-term investments	1,664,229			1,664,229
Investment income due and accrued	291,344			291,344
Premium and considerations:				
Uncollected premiums and agents' balances in the course of collection	1,145,671		1	1,145,671
Total Assets	<u>\$42,401,787</u>	<u>\$0</u>		<u>\$42,401,787</u>

Liquor Liability Joint Underwriting Association of Massachusetts
Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2006

	Per Company	Examination Changes	Notes	Per Examination
Liabilities, Surplus and Other Funds				
Losses	\$11,524,706	\$0	2	\$11,524,706
Loss adjustment expenses	10,395,204		2	10,395,204
Commissions payable, contingent commissions and other similar charges	191,725			191,725
Other expenses (excluding taxes, licenses and fees)	101,750			101,750
Taxes, licenses and fees (excluding federal income taxes)	14,587			14,587
Unearned premiums	2,720,013			2,720,013
Aggregate write-ins for liabilities				
Unearned finance charges	47,659			47,659
Total Liabilities	24,995,644	0		24,995,644
Unassigned funds (surplus)	17,406,143			17,406,143
Surplus as regards policyholders	17,406,143			17,406,143
Total liabilities and policyholders surplus	\$42,401,787	\$0		\$42,401,787

Liquor Liability Joint Underwriting Association of Massachusetts
Statement of Income, Capital and Surplus
For the Year Ended December 31, 2006

	Per Company	Examination Changes	Per Examination
Underwriting Income			
Premiums earned	\$6,072,111	\$0	\$6,072,111
Deductions:			
Losses incurred	(257,374)		(257,374)
Loss expenses incurred	(354,100)		(354,100)
Other underwriting expenses incurred	2,609,825		2,609,825
Aggregate write-ins for underwriting deductions			
Premium deficiency reserve	(1,769,727)		(1,769,727)
Total underwriting deductions	228,624		228,624
Net underwriting gain or (loss)	5,843,487		5,843,487
Net investment income earned	1,234,934		1,234,934
Net realized capital gains or (losses)	980,720		980,720
Net investment gain or (loss)	2,215,654		2,215,654
Net gain from agents' or premium balances charged off	21,004		21,004
Finance and service charges not included in premiums	165,192		165,192
Aggregate write-ins for miscellaneous income	17,449		17,449
Total other income	203,645		203,645
Net income before dividends to policyholders and before federal income taxes	8,262,786		8,262,786
Net income	\$8,262,786	0	8,262,786
Capital and Surplus Account			
Surplus as regards policyholders, December 31, prior year	\$8,990,750	0	\$8,990,750
Net income	8,262,786		8,262,786
Change in net unrealized capital gains (losses)	131,806		131,806
Change in net deferred income tax	(2,873,261)		(2,873,261)
Change in nonadmitted assets	2,894,062		2,894,062
Change in surplus	8,415,393	0	8,415,393
Surplus as regards policyholders, December 31 current year	\$17,406,143	\$0	\$17,406,143

Liquor Liability Joint Underwriting Association of Massachusetts
Reconciliation of Capital and Surplus
For Each Year in the Three Year Period Ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Surplus as regards policyholders, December 31 previous year	\$8,990,750	\$12,100,419	\$14,040,183
Net income (loss)	8,262,786	(2,668,761)	(809,551)
Change in net unrealized capital gains (losses)	131,806	(534,082)	(1,130,213)
Change in net deferred income taxes	(2,873,261)	6,545,993	0
Change in nonadmitted assets	<u>2,894,062</u>	<u>(6,452,819)</u>	<u>0</u>
Change in surplus	<u>8,415,393</u>	<u>(3,109,669)</u>	<u>(1,939,764)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$17,406,143</u></u>	<u><u>\$8,990,750</u></u>	<u><u>\$12,100,419</u></u>

For Information Purposes Only

NOTES TO FINANCIAL STATEMENTS

Note 1 – Premiums and Considerations

Based on the findings of the prior examination, the Division recommended that the Association properly segregate premiums deferred and not yet due from premiums due current and in the course of collection. The enabling statute and Plan of Operation require the Association to offer various payment options, which essentially creates premium receivables as deferred and not yet due. In order to comply with statutory accounting guidelines, premium receivables should be properly segregated and reclassified within the annual statement. In response to this prior examination finding, management asserted it would follow the NAIC's Annual Statement Instructions, but has yet to do so. Additionally, the nature of the business written by the Association is subject to premium audit at the end of each policy period, which in many cases leads to accrued retrospective premiums. The Division therefore recommends that this issue be revisited and the Association take the necessary steps to comply with the reporting requirements.

Note 2 - Loss and Allocated Loss Adjustment Expenses (ALAE) Reserves

The Association retained the Tillinghast business of Towers Perrin, an independent actuarial consulting firm, to prepare an independent actuarial analysis of the Association's loss and allocated loss adjustment expense (ALAE) reserves as of December 31, 2006. The analysis is performed on a gross (and therefore net) basis, as the Association has no ceded or assumed reinsurance.

Based on the Tillinghast analysis of the Association's experience at December 31, 2006, Tillinghast concluded that the estimated expected total value of unpaid losses and ALAE as of December 31, 2006 are \$21.9 million. This includes reserves on both a case basis and reserves for losses incurred but not reported (IBNR). The Association's held reserves for both loss and ALAE at December 31, 2006 totaled \$21.9 million.

The following chart illustrates loss and ALAE reserve liabilities held by the Association for the three-year period covered by this examination.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Unpaid Losses	\$11,524,706	\$12,420,328	\$10,414,880
Unpaid ALAE	10,395,204	11,582,055	9,195,620
Total	\$21,919,910	\$24,002,383	\$19,610,500

During 2006, the Association experienced favorable development of approximately \$5.9 million on estimated ultimate losses and ALAE for accident years 2005 and prior. Tillinghast noted that most of the favorable development during 2006 is attributable to better than expected loss and ALAE development in accident years 2001 through 2005.

COMMENTS AND RECOMMENDATIONS

Corporate Governance

As detailed earlier in this report, the Association was created by statute of the Massachusetts Legislature in 1985. The enabling legislation called for the Association to be governed by a Board of Directors, and a Plan of Operation was to be promulgated consistent with the provision of the enabling statute. The current Plan of Operation was last amended effective December 27, 1995. Accordingly, the Association was to be governed by a Board of 15 directors, eight of which are to be elected by the members, six to be appointed by the commissioner as representatives of licensees, and one director appointed by the Commissioner as a representative of insurer producers.

During the period covered by this examination, the composition of the Board did not meet the requirements of the Plan of Operation and therefore the enabling statute. As of December 31, 2006, the Board consisted of only 14 directors, seven of which were designated as "elected representatives of the members". Of those seven, one director resigned his position on the Board in July 2005, and did not participate in any Association activity since the time of resignation. Another member company elected to a Board position appears to have never appointed a representative and therefore also never participated in any Association activity. This resulted in the members being represented on the Board of Directors by only five directors, three less than called for by the Plan of Operation. Efforts have since been undertaken and for the 2008 year term, the composition of the Board is in compliance with the statute and Plan of Operation

Association Corporate Records

As noted previously in this report and based on the prior examination, the Association has taken steps to assure all minutes of the Board of Directors and Board Committees are signed, however not always by a member of the Board or respective Committee. Neither the Board of Directors nor any of the Committees have an appointed or elected secretary charged with the responsibility of maintaining these corporate documents. It is noted that the Board and the Chairman have the authority to appoint or elect a secretary or any other officer. Best practices of corporate governance would suggest that the Board exercise this authority, and the Division recommends that the Association review its policy regarding this practice, and that all corporate minutes be signed or attested to by a responsible representative of the Board or the Committee, preferably by a secretary designated to assume that responsibility.

Board and Committee Fees

The Association has adopted a policy whereby Board and Committee fees, when being paid to a member representative, are made payable to the insurance company being represented, not the individual. This has not been observed in one case, and the Division recommends that the Association adhere to this policy consistently on a going forward basis.

Sub-contracting Servicing Agreement

Effective January 1, 2005 the Association amended its Facility and Services License Agreement with the Massachusetts Medical Malpractice Reinsurance Plan (the “MMMRP”) covering primarily rent and accounting and administrative services. Under the original Facility and Services Agreement, the Association provided certain administrative and accounting services to MMMRP as provided by the Association’s CFO and other Association staff. This arrangement was terminated upon the Association’s CFO’s ascension to the position of President, also effective 1/1/2005.

Subsequently, since the MMMRP no longer had certain services included in the original agreement, the MMMRP hired a part-time employee to fill the position vacated as a result of the amended agreement. In order to extend full employee benefits to this part-time employee, the position was subsequently given a full-time status. The Association and the MMMRP agreed that this employee’s time would be divided evenly between the two entities, and the Association agreed to reimburse the MMMRP 50% of the total cost associated with this employee’s new full-time position.

There is no formal written agreement in place governing this relationship between the Association and the MMMRP. Furthermore, the Association has enrolled this individual in the LLJUA employee health and dental insurance plans, although he is not an employee. The Association also pays for 50% of the associated cost of these benefits.

This current arrangement with the MMMRP should be terminated as structured. Should the Association desire to obtain sub-contracted services from the MMMRP, a formal agreement should be executed, addressing what services are to be provided and the cost associated with these services along with other applicable terms and conditions. Any such agreement should be submitted before the Board of Directors for approval. Furthermore, since this individual is not an employee, LLJUA employee benefits currently being provided should be terminated immediately. Employee benefits established for and provided to employees of the Association should not be granted to individuals that are not employees.

Fidelity Bond and Other Insurance

It has been noted that the Association’s Business Owners Insurance Policy covering commercial general liability, property coverage, and employee dishonesty risks, does not include fiduciary protection for the Association’s 401K Deferred Compensation Plan. The Division recommends that coverage be extended to protect the assets of this plan.

General Expenses

The Association reimburses employees for certain business related expenses and has issued credit cards for the employee to use for paying business related expenses. Upon receipt of the billing statement from the credit card company, receipts are provided supporting most charges, but not all. There is no other supporting documentation required such as an expense report

detailing or supporting the reason for the expenditure. Submitted receipts or invoices, which are not self explanatory, do not include the reason for the expenditure. Without proper documentation expenses that do not appear to be business related can not readily be validated.

The Division recommends that the Association implement new procedures governing the expense reimbursement process, including requiring increased documentation to support the reason for the expense, as well as proper documentation evidencing the amount disbursed.

For Information Purposes Only

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Supervising Examiner and Examiner-in-Charge
Commonwealth of Massachusetts
Division of Insurance

For Information Purposes Only