



THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION

DIVISION OF INSURANCE

REPORT OF EXAMINATION OF THE
MERRIMACK MUTUAL FIRE INSURANCE COMPANY

Andover, Massachusetts

As of December 31, 2004

NAIC GROUP CODE 0022

NAIC COMPANY CODE 19798

EMPLOYERS ID NO. 04-1614490

MERRIMACK MUTUAL FIRE INSURANCE COMPANY

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November 14, 2005

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Honorable Commissioners,

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

MERRIMACK MUTUAL FIRE INSURANCE COMPANY
Andover, MA

at its home office located at 95 Old River Road, Andover, MA, 01810-1078. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

The Merrimack Mutual Fire Insurance Company (hereinafter referred to as “the Company”) was last examined as of December 31, 1999 under the association plan of the National Association of Insurance Commissioners (NAIC) by the Massachusetts Division of Insurance (the “Division”). The current association plan examination was conducted by the Division and covers the five year period from January 1, 2000 through December 31, 2004, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

Concurrent with this examination, the following insurance affiliates in the Andover Insurance Group were also examined and separate reports have been issued:

Cambridge Mutual Fire Insurance Company
Bay State Insurance Company

The examination was conducted in accordance with standards and procedures established by the NAIC Financial Condition (E) Committee and prescribed by the current NAIC Financial Condition Examiners Handbook.

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 bond 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, 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 the Certified Public Accountants’ workpapers were made to the extent deemed appropriate and effective. An independent actuarial and accounting consulting firm, KPMG LLP, was retained by the Division to evaluate the adequacy of the Company’s loss and loss adjustment expense reserves as of December 31, 2004. Additionally, the Division reviewed the adequacy and effectiveness of the EDP systems controls to determine the level of reliance to be placed on the information generated by the data processing systems.

For a summary of findings contained within this report, refer to the “Notes to Financial Statements” section.

Merrimack Mutual Fire Insurance Company

Status of Prior Examination Findings

The previous Report of Examination dated May 29, 2001 had one comment or recommendation. It was recommended that the company obtain a written tax sharing agreement with its subsidiary Bay State Insurance Company. An agreement was prepared with an effective date of January 1, 2001.

HISTORY

General

The Company, a mutual company, was incorporated on February 11, 1828 under the laws of the Commonwealth of Massachusetts and commenced business on April 8, 1828. The Company is authorized to issue non-assessable policies insuring personal and commercial property and liability risks.

Guaranty Fund

To satisfy the requirements of Massachusetts General Laws c. 175 s. 93C, the Company maintains a guaranty fund in the amount of \$500,000.

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 the Company's Annual Statements, including any changes as a result of the examination.

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Direct Premiums Written</u>	<u>Net Premiums Written</u>
2004	\$ 701,442,084	\$ 315,017,891	\$ 386,424,193	\$ 286,977,432	\$ 211,910,476
2003	616,421,741	258,727,189	357,694,553	256,492,958	190,640,221
2002	546,600,040	216,757,337	329,842,704	209,366,940	156,238,833
2001	507,647,920	185,579,573	322,068,349	169,822,267	125,743,742
2000	486,111,460	167,161,646	318,949,615	151,961,751	113,951,098

Management

Annual Meeting

In accordance with the bylaws, the Annual Meeting of the Company is held on the second Monday in May of each year. Eight members constitute a quorum for the transaction of business at any annual or special meeting. The minutes indicated that a quorum was obtained at each annual meeting held during the examination period.

Merrimack Mutual Fire Insurance Company

Board of Directors

The bylaws provide that the Board of Directors shall manage the business and affairs of the Company except as otherwise provided by the Articles of Incorporation. The Board of Directors shall consist of not fewer than seven or more than ten directors with the number determined at each annual meeting. Each director holds office for a term of four years. Upon expiration or resignation, his/her successor is elected at the next Annual Meeting.

At December 31, 2004 the Board was comprised of eight directors which is in compliance with the Company bylaws.

Directors duly elected and serving at December 31, 2004, with addresses and business affiliations, follow:

<u>Year Term Expires</u>	<u>Director</u>	<u>Business Affiliation</u>
2007	John Appleton Gloucester, MA	Retired, Senior Vice President Fidelity Investments
2005	Charles A. Austin, III Boston, MA	Senior Vice President Anchor Capital Advisors, Inc.
2005	Benjamin C. Bixby Kingston, NH	President and Director Bixby International Corporation
2006	Malcolm W. Brawn Ipswich, MA	Executive Vice President and Secretary The Andover Companies
2008	David F. Dietz Andover, MA	Partner Goodwin, Procter & Hoar LLP
2007	Robert P. McDonald Needham, MA	Chairman and Treasurer Erland Construction Inc.
2008	William E. Nichols North Andover, MA	President, CEO and Treasurer The Andover Companies
2006	Donald F. Vose Boxford, MA	Vice President The Andover Companies

The bylaws do not specify the number of meetings to be held during a year. The minutes of the Board of Directors meetings indicated that meetings were held four times per year during the examination period. At any meeting of the Board, five directors constitute a quorum. The minutes indicated that a quorum was obtained at all meetings of the Board of Directors held during the examination period.

Merrimack Mutual Fire Insurance Company

The Board of Directors appointed an Investment committee in accordance with the bylaws. The membership of the committee at December 31, 2004 follows.

John Appleton
Benjamin C. Bixby
William E. Nichols

Officers

The bylaws of the Company provide that the officers of the Company shall be a President, a Treasurer, a Secretary and other officers as deemed necessary. Pursuant to the bylaws, the officers of the Company are elected by the Board of Directors at the first meeting of the Board held after the Annual Meeting.

The elected officers and their respective titles at December 31, 2004 follow:

<u>Name</u>	<u>Title</u>
William E. Nichols	President, Chief Executive Officer and Treasurer
Malcolm W. Brawn	Executive Vice President and Secretary
Alan R. Kober	Vice President
Edward F. Stokham	Vice President
Donald F. Vose	Vice President
C. Edward Wallis	Vice President and Assistant Treasurer

Conflict of Interest Procedures

The Company has adopted a policy statement pertaining to conflict of interest in accordance with Question 10 of the General Interrogatories of the Annual Statement. The Company has an established procedure for the disclosure to the Board of Directors of any material interest or affiliation on the part of any officer or director, which is in or is likely to conflict with his/her official duties.

Annually, each officer, director and responsible employee completes a questionnaire disclosing any material conflicts of interest. The completed questionnaires were reviewed, and no discrepancies were noted in the responses to the General Interrogatories regarding conflict of interest as reflected in the Company's 2004 Annual Statement.

Merrimack Mutual Fire Insurance Company

Corporate Records

Articles of Incorporation and Bylaws

The bylaws and Articles of Incorporation and amendments thereto were read. There were no changes to the bylaws or Articles of Incorporation since the prior examination.

Disaster Recovery and Business Continuity

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

Board of Directors Minutes

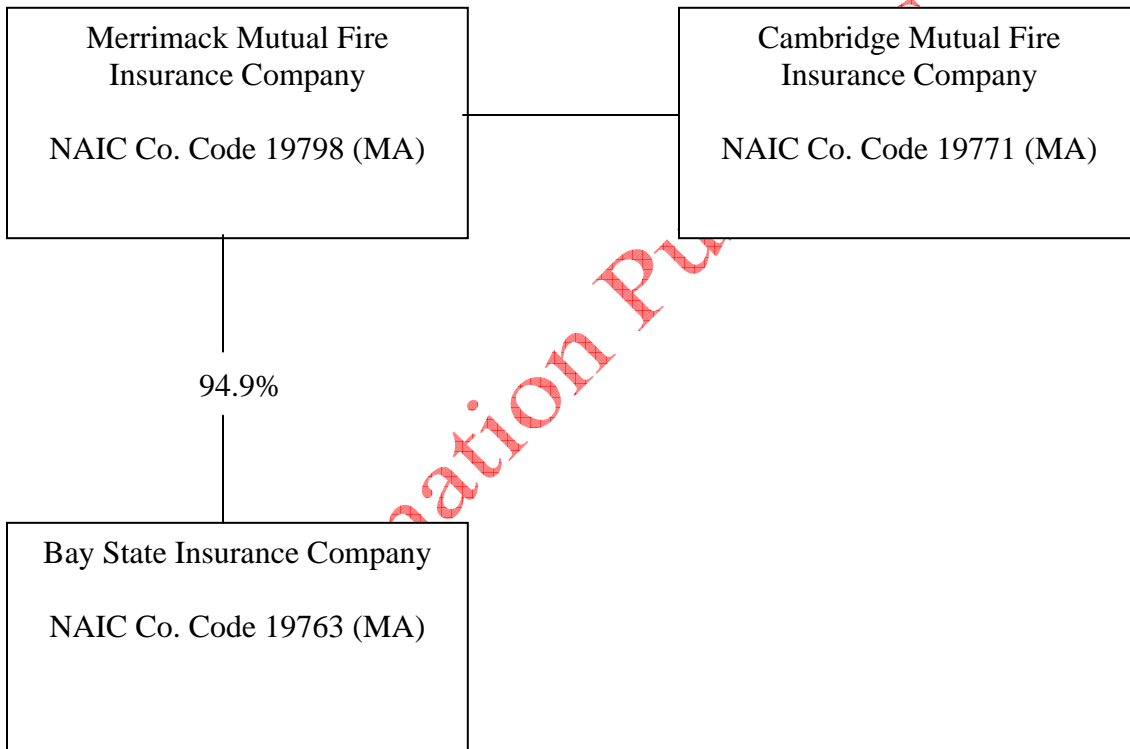
The minutes of the Board of Directors and Committee meetings for the period under statutory examination were read and indicated that all meetings were held in accordance with the Company bylaws and the laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at each meeting of the Board of Directors.

For Information Purposes Only

AFFILIATED COMPANIES

Per Form B, as filed with the Massachusetts Division of Insurance, the Company is a member of a holding company system and is subject to the registration requirements of Chapter 175, Section 206C of the Massachusetts General Laws. The Company is defined as the “ultimate controlling person”. The Company shares common management with Bay State Insurance Company (“Bay State”) and Cambridge Mutual Fire Insurance Company (“Cambridge”), an affiliated mutual insurer.

2004 Organizational Chart



Merrimack Mutual Fire Insurance Company

Transactions and Agreements with Subsidiaries and Affiliates

Management and Reinsurance Agreement

The Company participates in a Management and Reinsurance Agreement with its affiliates, Cambridge and Bay State. Under this agreement all net insurance shall be pooled and distributed in the following proportions: Merrimack 50%, Cambridge 35% and Bay State 15%. Merrimack provides management and administration services for Cambridge and Bay State. Cambridge and Bay State will reimburse Merrimack for the expenses incurred in providing these services based on the percentage set forth above.

Tax Sharing Agreement

The Company participates in a consolidated Federal Income Tax return with Bay State Insurance Company. There is a written tax sharing agreement between Merrimack and Bay State.

FIDELITY BOND AND OTHER INSURANCE

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

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

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company offers various insurance plans, including group and family life and health coverage, and long-term disability and personal accident insurance to all full time employees.

The Company offers a Savings and Investment Plan under section 401(k) of the Internal Revenue Code. The plan, which is a defined contribution plan, covers all participating employees of the Company beginning with the month following the date of employment.

The Company's employees participate in a defined benefit pension plan, which is reviewed annually by an independent consulting actuary. At December 31, 2004, the pension fund was fully funded. All pension fund financial information is disclosed in the Notes to the Financial Statements appearing in the Company's Annual Statement.

The Company provides health insurance benefits for retired employees. The Company utilizes the services of an independent consulting actuary to calculate the projected year end balance sheet liability. The projected amount of post-retirement benefit obligation for retirees and eligible or vested employees is included on page 3, lines 3 and 5 of the Annual Statement. The Company intends to fund the accumulated post-retirement benefit obligation as benefits become due.

Merrimack Mutual Fire Insurance Company

STATUTORY DEPOSITS

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

<u>Location</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Statement Value</u>
Georgia	U.S. Treasury Bonds 9.375 % due 2006	\$50,000	\$50,523
Total – All policyholders		<u>1,500,000</u>	<u>1,559,504</u>
Total Deposits		<u>\$1,550,000</u>	<u>\$1,610,027</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is licensed to write business in thirteen states. In 2004 the Company's direct business was written in the New England states, New Jersey, New York and Illinois.

The Company's principal line of business is homeowners' coverage provided to personal risks through its appointed independent agents.

Treatment of Policyholders – Market Conduct

During the financial examination of the Company, the Division's Market Conduct Department initiated a comprehensive market conduct examination of the Company for the period January 1, 2004 through December 31, 2004. The market conduct examination was called pursuant to authority in Massachusetts General Laws Chapter (M.G.L. c.) 175, Section 4. The market conduct examination is being conducted at the direction of, and under the overall management and control of, the market conduct examination staff of the Division. Representatives from the firm of Eide Bailly, LLP were engaged to complete certain agreed upon procedures which were developed using the guidance and standards of the NAIC Market Conduct Examiner's Handbook, the market conduct examination standards of the Division, and the Commonwealth of Massachusetts insurance laws, regulations and bulletins. The basic business areas that are being reviewed under this market conduct examination are Company Operations/Management; Complaint Handling; Marketing and Sales; Producer Licensing; Policyholder Services; Underwriting and Rating; Claims, in addition to an assessment of the Company's internal control environment. Once this market conduct examination is completed a Report on the Comprehensive Market Conduct Examination of the Company for the period January 1, 2004 through December 31, 2004 will be issued and become available as a public document.

Merrimack Mutual Fire Insurance Company

Dividends to Policyholders

The Company only issues non-participating policies. No policyholder dividends were declared or paid during the examination period.

REINSURANCE

The Company and its affiliates operate under a pooling agreement as described in the “Affiliated Companies” section of this report. Assumed and ceded reinsurance with unaffiliated companies is also subject to the inter-company pooling agreement.

Ceded Reinsurance

The Company has entered into various reinsurance agreements to protect their exposure. Below is a brief summary of the treaties.

XS of Loss		<u>Retention</u>	<u>Limit</u>
	Personal and Commercial Umbrella	\$2,000,000	\$3,000,000
Property Facultative Automatic	Homeowners	\$100,000	\$1,000,000
	EDP Equipment	\$0	\$10,000,000
	Equipment Breakdown	\$0	\$25,000,000

The Company has additional coverage with Excess Property Catastrophe reinsurance with the limits and retention as follows:

	<u>Limit and Retention</u>	<u>Percent Placed</u>	<u>Percent Retained</u>
First Layer	\$50,000,000 excess of \$50,000,000	90	10
Second Layer	\$75,000,000 excess of \$100,000,000	81.27	18.73
Third Layer	\$75,000,000 excess of \$175,000,000	95	5
Fourth Layer	\$300,000,000 excess of \$250,000,000	87.65	12.35

Each treaty reviewed contained an insolvency clause in accordance with M.G.L. c.175 s.20A.

Merrimack Mutual Fire Insurance Company

Assumed Reinsurance

The Company assumes business from four quota share agreements with the participation percentage varying by treaty. Coverage is limited to property business only. During 2004, one treaty was commuted. There are several treaties terminated in previous years that may still have a financial statement impact.

Pools

The Company participates in two voluntary pools, the Selected Insurance Risk Plan ("SIR") and Associated Inland Marine ("AIM"). SIR and AIM were established as a means for insurers to underwrite larger policies and spread the risk among the members. SIR is used for commercial policies and AIM for inland marine personal line policies. Membership in both is composed of New England Mutual Companies.

Additionally, the Company participates in various state mandated pools. These include the Illinois Mine Subsidence Program and state FAIR plans.

ACCOUNTS AND RECORDS

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

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The questionnaire was completed by the Company and reviewed by KMPG LLP, contracted by the Division to evaluate the adequacy of the IT 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 the 2004 Annual Statement. No material exceptions were noted.

The books and records of the Company are audited annually by PricewaterhouseCoopers LLP, independent Certified Public Accountants, in accordance with 211 CMR 23.00.

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, 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 the five year period ended
December 31, 2004

For Information Purposes Only

Merrimack Mutual Fire Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2004

Assets	As Reported by the Company	Examination Changes	Per Statutory Examination
Bonds	\$ 438,740,596	\$ 0	\$ 438,740,596
Common stocks	153,310,896		153,310,896
Real estate occupied by the company	16,360,940		16,360,940
Cash and short-term investments	20,473,062		20,473,062
Subtotals, cash and invested assets	628,885,494		628,885,494
Investment income due and accrued	6,350,347		6,350,347
Agents' balances and uncollected premiums:			
Premiums and agents' balances in course of collection	22,167,587		22,167,587
Premiums, agents' balances and installments booked but deferred and not yet due	20,844,482		20,844,482
Amounts recoverable from reinsurers	9,826,857		9,826,857
Funds held by reinsured companies	59,947		59,947
Net deferred tax asset	10,680,023		10,680,023
Electronic data processing equipment	84,154		84,154
Receivable from parent, subsidiaries and affiliates	2,543,194		2,543,194
Total Assets	\$ 701,442,084	\$ 0	\$ 701,442,084

Merrimack Mutual Fire Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds (Continued)
As of December 31, 2004

Liabilities	As Reported by the Company	Examination Changes	Per Statutory Examination	Notes
Losses	\$ 115,477,837	\$ 0	\$ 115,477,837	(1)
Reinsurance payable on paid loss and LAE	5,492,437		5,492,437	
Loss adjustment expenses	20,896,500		20,896,500	(1)
Commissions payable	7,629,000		7,629,000	
Other expenses	13,390,500		13,390,500	
Taxes, licenses and fees	1,021,000		1,021,000	
Current federal income taxes	300,000		300,000	
Borrowed money	6,017,000		6,017,000	
Unearned premiums	105,007,882		105,007,882	
Advance premiums	3,721,000		3,721,000	
Ceded reinsurance premiums payable	25,103,390		25,103,390	
Funds held by company under reinsurance treaties	27,411		27,411	
Provision for reinsurance	494		494	
Drafts outstanding	10,680,441		10,680,441	
Aggregate write-ins for liabilities	253,000		253,000	
Total Liabilities	<u>315,017,891</u>		<u>315,017,891</u>	
Guaranty fund	500,000		500,000	
Unassigned funds (surplus)	<u>385,924,193</u>		<u>385,924,193</u>	
Surplus as regards policyholders	<u>386,424,193</u>		<u>386,424,193</u>	
Total Liabilities, Capital and Surplus	<u>\$ 701,442,084</u>	<u>\$ 0</u>	<u>\$ 701,442,084</u>	

Merrimack Mutual Fire Insurance Company
Summary of Operations
For the Year Ended December 31, 2004

	As Reported by the Company	Examination Changes	Per Statutory Examination
Premiums earned	\$ 202,529,841	\$ 0	\$ 202,529,841
Deductions:			
Losses incurred	101,566,781		101,566,781
Loss expenses incurred	16,279,360		16,279,360
Other underwriting expenses incurred	79,907,690		79,907,690
Total underwriting deductions	197,753,832		197,753,832
Net underwriting gain (loss)	4,776,009		4,776,009
Net investment income earned	23,419,675		23,419,675
Net realized capital gains	2,317,633		2,317,633
Net investment gain	25,737,308		25,737,308
Net gain (loss) from agents' balances or premium balances charged off	(3,991)		(3,991)
Finance and service charges not included in premiums	691,818		691,818
Aggregate write-ins for miscellaneous income	(112,000)		(112,000)
Total other income	575,827		575,827
Net income before dividends to policyholders and before federal and foreign income taxes	31,089,143		31,089,143
Federal and foreign income taxes incurred	12,310,290		12,310,290
Net Income	\$ 18,778,853	\$ 0	\$ 18,778,853

Merrimack Mutual Fire Insurance Company
Capital and Surplus
For the Year Ended December 31, 2004

	<u>As Reported by the Company</u>	<u>Examination Changes</u>	<u>Per Statutory Examination</u>
Surplus as regards policyholders, December 31, 2003	\$ 357,694,553	\$ 0	\$ 357,694,553
Net income	18,778,853		18,778,853
Change in net unrealized capital gains or (losses)	7,984,815		7,984,815
Change in net deferred tax	1,282,739		1,282,739
Change in nonadmitted assets	533,222		533,222
Change in provision for reinsurance	11		11
Change in minimum pension liability	150,000		150,000
	<u>28,729,640</u>		<u>28,729,640</u>
Change in surplus as regards policyholders for the year	28,729,640		28,729,640
Surplus as regards policyholders, December 31, 2004	<u>\$ 386,424,193</u>	<u>\$ 0</u>	<u>\$ 386,424,193</u>

Merrimack Mutual Fire Insurance Company
Reconciliation of Capital and Surplus
For the Five Year Period Ended December 31, 2004

	2004	2003	2002	2001	2000
Capital and surplus, December 31, prior year	\$ 357,694,553	\$ 329,842,704	\$ 322,068,349	\$ 318,949,615	\$ 292,680,509
Net income	18,778,853	13,807,869	10,531,672	5,946,131	11,396,861
Change in net unrealized capital gains or (losses)	7,984,815	11,521,952	(1,762,920)	(7,254,619)	15,517,543
Change in net deferred income tax	1,282,739	2,610,586	1,729,356	820,255	
Change in nonadmitted assets	533,222	314,631	(2,723,752)	(345,426)	(10,550)
Change in provision for reinsurance	11	(189)	(2)	(210)	252
Change in excess of statutory reserves over statement reserves					(635,000)
Cumulative effect of changes in accounting principles				3,952,602	
Aggregate write-ins for gains and (losses) in surplus	150,000	(403,000)			
Net change in capital and surplus for the year	28,729,640	27,851,849	7,774,355	3,118,733	26,269,106
Capital and surplus, December 31, current year	<u>\$ 386,424,193</u>	<u>\$ 357,694,553</u>	<u>\$ 329,842,704</u>	<u>\$ 322,068,349</u>	<u>\$ 318,949,615</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: Losses and Loss Adjustment Expenses

The Division requested that KPMG review the reasonableness of the Loss and Loss Adjustment Expense Reserves (the “Reserves”) of the Company as of December 31, 2004. The review was conducted in a manner consistent with the Code of Professional Conduct and Qualification Standards of the American Academy of Actuaries and the Standards of Practice adopted by the Actuarial Standards Board.

KPMG’s actuarial review utilized year-end paid and incurred loss data developed through December 31, 2004. The tables below summarize a comparison of KPMG’s range of reasonable gross and net estimates for the Reserves to the Company’s carried gross and net Reserves as of December 31, 2004.

**COMPARISON OF INDICATED GROSS RESERVES
TO CARRIED GROSS RESERVES as of 12/31/04**

	Low Point of Range	Selected Estimate	High Point of Range
KPMG Total Gross Loss & Loss Adjustment Expense Reserves	\$123,868,500	\$133,658,500	\$146,447,000
Total Company Carried Gross Loss & LAE Reserves	137,246,500	137,246,500	137,246,500
Difference	13,378,000	3,588,000	(9,200,500)

**COMPARISON OF INDICATED NET RESERVES
TO CARRIED RESERVES as of 12/31/04**

	Low Point of Range	Selected Estimate	High Point of Range
KPMG Total Net Loss & Loss Adjustment Expense Reserves	\$119,392,000	\$130,435,500	\$141,695,000
Total Company Carried Net Loss & LAE Reserves	136,376,500	136,376,500	136,376,500
Difference	16,984,500	5,941,000	(5,318,500)

The Company’s total net carried reserves are above KPMG’s selected estimate and below their high point. Therefore the Division concludes the Company’s reserves are a reasonable estimate of their ultimate liability.

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.

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

Ravinder Chana, Examiner III
Linda Dow, Examiner II

Kenneth Plumb, CFE, CPA
Supervising Examiner
Commonwealth of Massachusetts
Division of Insurance

Maria Gannon, CFE
Examiner-In-Charge
Commonwealth of Massachusetts
Division of Insurance

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