

THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION

Division of Insurance

Report on the Examination of the

Montgomery Mutual Insurance Company

Boston, Massachusetts

As of December 31, 2009

NAIC GROUP CODE: 0111

NAIC COMPANY CODE: 14613

EMPLOYER'S ID NUMBER: 52-0424870

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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

MONTGOMERY MUTUAL INSURANCE COMPANY
Columbia, Maryland

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

SCOPE OF EXAMINATION

Montgomery Mutual Insurance Company (hereinafter referred to as "MMIC" or the "Company") was last examined as of December 31, 2004 for the period from January 1, 2000 thereto, and was conducted by the Maryland Insurance Administration. 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 (E) 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"), Liberty Mutual Mid-Atlantic Insurance Company ("LMMAIC"), and Liberty Mutual Personal Insurance Company ("LMPIC"). 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 MMIC 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 under the laws of Maryland on March 10, 1848. It first operated under the name "Mutual Fire Insurance Company of Montgomery County" until July 1, 1967, when it was merged with another company and changed its name to Montgomery Mutual Insurance Company. In 1996 it entered into an affiliation agreement with LMIC, and effective January 1, 1997, pooled 100% of its underwriting activity with the other members of the Liberty Mutual Group. LMIC has a controlling interest in the MMIC Board of Directors. The Company writes various property and casualty lines of business, the majority of which is in the State on Maryland. Effective June 8, 2010, the Company transferred its domicile from Maryland 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.

STATUTORY 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 ten states, the majority of its direct written premiums originate in Maryland, North Carolina and South Carolina, and is 100% ceded to the Peerless Pool after external reinsurance. The Peerless Pool consists of national property and casualty insurance companies with distribution through independent agents and brokers. The Peerless 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	\$48,380,865	\$41,118,830	\$1,245,033	\$43,728,662
2008	49,690,430	49,514,961	1,603,429	42,119,686
2007	49,747,716	50,460,056	1,029,576	41,120,617
2006	56,701,853	54,978,370	4,555,822	39,828,449
2005	68,156,460	35,239,026	8,850,657	52,958,114

MANAGEMENT, CONTROL AND CORPORATE GOVERNANCE

MMIC 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, Liberty Mutual Group Inc. 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>
Gary R. Gregg	Chairman of the Board, President and Chief Executive Officer
Michael J. Fallon	Treasurer and Chief Financial Officer
Joseph A. Giles	Executive Vice President
Scott R. Goodby	Executive Vice President and Chief Operating Officer
Anthony J. Fontanes	Executive Vice President and Chief Investment Officer
John D. Doyle	Director
Christopher C. Mansfield	Director
Michael A. Winner	Director
Debra B. Pooley	Director

The following individual held an officer position of the Company in addition to the directors designated above:

<u>Officer</u>	<u>Title</u>
Dexter R. Long	Secretary

Conflict of Interest Procedures

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, MMIC 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, MMIC 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
Montgomery Mutual Insurance Company

RELATED PARTY AGREEMENTS

The Company is party to a services agreement with Peerless Insurance Company ("PIC") and other affiliates. The Agreement allows PIC to provide services related to common management functions including coordinating marketing and advertising, information systems support, payroll and human resources, actuarial support, accounting and other financial services, as well as consulting and other services.

The Company is a party to a management services agreement with LMIC. Under this agreement, LMIC provides services related to common management functions including, but not limited to, accounting, financial, tax and auditing, information technology and support, purchasing, payroll and employee benefits, policy administration, real estate management, legal, general administration, as well as consulting and other services.

The Company is a party to an investment management agreement with LMIC, under which LMIC provides investment management services to the Company.

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 subsidiaries and 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 or authorized carriers in Massachusetts and were in force at December 31, 2009.

PENSION AND INSURANCE PLANS / EMPLOYEE WELFARE

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 Deposit</u>	<u>Book Value</u>	<u>Fair Value</u>
Delaware	Benefit of DE Policyholders	129,417	138,625
Florida	Benefit of all Policyholders & Creditors	232,044	252,046
Maryland	Benefit of all Policyholders & Creditors	309,749	407,752
Massachusetts	Special Workers' Compensation	110,352	159,937
North Carolina	Benefit of all Policyholders	1,015,995	1,076,854
South Carolina	Benefit of all Policyholders	239,987	255,600
Virginia	Benefit of all Policyholders	154,903	158,004
	Totals	<u>\$2,325,707</u>	<u>\$2,448,818</u>

REINSURANCE

The Company is a member of and participates in the PIC Restated Reinsurance Pooling Agreement. Pursuant to the agreement, PIC is the Lead Company and each affiliated company, including MMIC cedes its net underwriting activity to PIC. After recording the assumed affiliated underwriting transactions, PIC records 100% of its external assumed and ceded reinsurance activity, after which it is retroceded to the pool members in accordance with each company's pool participation percentage. MMIC's pool participation percentage 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 Maryland Insurance Administration agreed that Massachusetts would exam the Company as a Massachusetts domestic even though it was a Maryland domestic at the examination "as of" date and for the period since its prior examination.

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 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, 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 a 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.

Montgomery Mutual Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
as of December 31, 2009

	Per Company	Examination Changes	Per Examination
Assets			
Bonds	\$42,021,648	\$0	\$42,021,648
Common Stock	120,164		120,164
Cash on hand and on deposit	4,942,393		4,942,393
Subtotals, cash and invested assets	47,084,205		47,084,205
Investment income due and accrued	380,652		380,652
Net deferred tax asset	180,250		180,250
Receivables from parent, subsidiaries and affiliates	235,758		235,758
Aggregate write-ins for other than invested assets	500,000		500,000
Total Assets	48,380,865	\$0	48,380,865
Liabilities, Surplus and Other Funds			
Current federal and foreign income taxes	32,461		32,461
Payable to parent, subsidiaries and affiliates	430,250		430,250
Payable for securities	1,000,156		1,000,156
Aggregate write-ins for liabilities	3,189,336		3,189,336
Total Liabilities	4,652,203		4,652,203
Unassigned funds (surplus)	43,728,662		43,728,662
Surplus as regards policyholders	43,728,662		43,728,662
Total Liabilities and policyholder surplus	48,380,865	\$0	48,380,865

Montgomery Mutual Insurance Company
Statement of Income, Capital and Surplus
For the Year Ended December 31, 2009

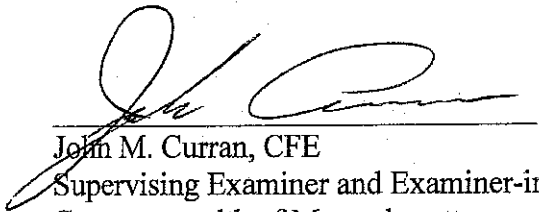
	Per Company	Examination Changes	Per Examination
Investment Income			
Net investment income earned	\$1,817,450	\$0	\$1,817,450
Net realized capital gains or (losses)	(47,662)		(47,662)
Net investment gain or (loss)	1,769,788	0	1,769,788
Aggregate write-ins for miscellaneous income	(831)		(831)
Net income before dividends to policyholders and before federal income taxes	1,768,957		1,768,957
Foreign and federal income taxes incurred	523,924		523,924
Net income	\$1,245,033	\$0	1,245,033
Capital and Surplus Account			
Surplus as regards policyholders, December 31 prior year	\$42,119,686	\$0	\$42,119,686
Net income	1,245,033		1,245,033
Change in net unrealized capital gains (losses)	262,705		262,705
Change in net deferred income taxes	(170,873)		(170,873)
Change in nonadmitted assets	272,299		272,299
Aggregate write-ins for gains and losses in surplus	(188)		(188)
Change in surplus	1,608,976	0	1,608,976
Surplus as regards policyholders, December 31 current year	\$43,728,662	\$0	\$43,728,662

Montgomery Mutual 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	\$42,119,686	\$41,120,617	\$39,828,449	\$52,958,114	\$51,795,361
Net income (loss)	1,245,033	1,603,429	1,029,576	4,555,822	85,657
Change in net unrealized capital gains or (losses)	262,705	(345,458)	39,883	(525,127)	(3,485,075)
Change in net deferred income taxes	(170,873)	(885,016)	(1,006,524)	47,240	(4,242,143)
Change in nonadmitted assets	272,299	626,114	1,229,233	572,397	347,021
Change in surplus notes				(8,000,000)	
Aggregate write-ins for gains and losses in surplus	(188)				(307,667)
Change in surplus	1,608,976	999,069	292,168	(13,129,665)	1,162,793
Surplus as regards policyholders, December 31 current year	\$43,728,662	\$42,119,686	\$41,120,617	\$39,828,449	\$52,958,114

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.



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