



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

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**JOSEPH G. MURPHY**  
COMMISSIONER OF INSURANCE

April 5, 2010

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

The Honorable Paulette Thabault  
Sec'y, NAIC Northeastern Zone  
Commissioner  
The State of Vermont  
Department of Banking, Insurance,  
Securities & Health Care Admin.  
Insurance Division  
89 Main Street  
Montpelier, Vermont 05620-3101

The Honorable Joseph G. Murphy  
Commissioner of Insurance  
The Commonwealth of Massachusetts  
Division of Insurance  
1000 Washington Street – Suite 810  
Boston, Massachusetts 02118-6200

Honorable Commissioners:

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

**SAFETY INSURANCE COMPANY**

at its statutory home office located at 20 Custom House Street, Boston, Massachusetts 02110.  
The following report thereon respectfully is submitted.

## **SCOPE OF EXAMINATION**

### **Period Covered By Examination**

Safety Insurance Company ("Company") was last examined as of December 31, 2003, according to the Association Plan of the National Association of Insurance Commissioners ("NAIC") by the Massachusetts Division of Insurance ("Division"). The Division made the present examination by authority of Section 4, Chapter 175 of Massachusetts General Law, under the NAIC Association Plan. This examination covers the transactions of the Company in the five-year period from the date of the prior examination through December 31, 2008, with notation of significant events occurring through the date of this report.

This examination was conducted at the same time and in conjunction with the Division's statutory financial condition examination of the Company's subsidiaries, Safety Indemnity Insurance Company ("SInd") and Safety Property and Casualty Insurance Company ("SPC").

A separate market conduct examination is being performed on the Company, SInd and SPC by the Division.

### **Examination Procedure Employed**

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 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 an independent certified public accounting firm. The Company was audited by PricewaterhouseCoopers LLP ("PwC") for all of the years under examination. The firm expressed unqualified opinions on the Company's financial statements for the years ending December 31, 2004 through 2008. Review and use of PwC's workpapers were made to the extent deemed appropriate and effective.

The Division engaged the consulting actuarial advisory services of the Actuarial Advisory Services Unit of Ernst & Young LLP ("E&Y") to perform an actuarial review of the Company's loss and loss adjustment expense reserves.

## Safety Insurance Company

The Division's information systems auditor evaluated the adequacy and effectiveness of the Company's information technology controls to determine the level of reliance to be placed on summary information generated by the systems.

This Report of Examination is written on an exception basis. Explanations of and details pertaining to various phases of the examination will be found herein. Unless it is specifically noted otherwise, all references to the accounts, activities, and transactions of the Company are as of December 31, 2008. For a summary of findings contained within this report, refer to the section titled "Summary of Comments and Recommendations".

### **Status Of Findings From The Prior Examination**

This examination included a review to verify the current status of any exception conditions noted in the prior Report of Examination. The prior examination was made as of December 31, 2003, and that report recommended the following:

#### **SUBJECT**

#### **COMMENT**

##### **Corporate Records**

Minutes of the Board of Directors or its Investment Committee do not reflect a specific vote of ratifying authorized investments. It is strongly recommended that the Company comply with Section 64 of MGL Chapter 175 by recording the vote of members of such Board or Committee specifically ratifying its investments. The Company's minutes now reflect specific votes.

### **HISTORY**

#### **General**

The Company was organized and incorporated on December 12, 1979, under the laws of the Commonwealth of Massachusetts, as a stock company titled "Safety Insurance Company." Founded to write motor vehicle insurance in Massachusetts through independent agents and brokers, it commenced business on January 1, 1980. As part of the Safety Insurance Group ("Group"), it writes all of the private passenger automobile coverage of the Group, all of the standard commercial automobile coverage of the Group, and business assigned to the Group by Commonwealth Automobile Reinsurers, Inc. ("CAR"), the residual market mechanism for motor vehicle insurance in Massachusetts. Effective April 1, 2008, the Massachusetts private passenger automobile industry began the transition to a new system of managed competition and the CAR mechanism was replaced with the Massachusetts Automobile Insurance Plan ("MAIP"), an assigned risk plan.

## Safety Insurance Company

At December 31, 2008, the Company is a corporation in the stock form of organization that operates as a property and casualty insurance company. Licensed in Massachusetts since its inception and in New Hampshire since 2007, the Company writes several lines of business including the following coverages: private passenger and commercial motor vehicle insurance, homeowners insurance, dwelling fire insurance, personal and commercial umbrella coverages, BOP and commercial package policies.

### **Capital Stock**

From the Company's incorporation in late 1979 until early 1980, the authorized capital stock of the Company had been 400,000 shares of common stock at a par value of one dollar per share. On April 7, 1980, by vote of the Company's Board of Directors and subsequent filing duly made with the Secretary of State for the Commonwealth, the Articles of Organization were amended and the authorized capital stock was changed to 24,000 shares of no par value common stock.

Safety Insurance Group, Inc. ("SIG"), a Delaware corporation, owns the Company. SIG was established in October of 2001, and consists of the senior management team of the Company and certain private investors who purchased the former holding company, Thomas Black Corporation ("TBC"), from its prior owners. As a measure to streamline the organizational structure, in March 2004, TBC merged with and into SIG with SIG being the corporation surviving the merger. This change had no effect upon the group's financial condition or results of operations.

In November of 2002, SIG completed an initial public offering of 7,233,334 shares of common stock and obtained a new \$30.0 million revolving credit facility, the proceeds of which were applied to repay the principal and interest on the entire debt associated with the formation of SIG and its acquisition of TBC and TBC's subsidiaries; the percentage of common stock in SIG owned by the officers of the Company was thereby diluted. SIG is traded on the NASDAQ Global Select Market under the symbol "SAFT."

At December 31, 2008, the authorized capital stock of the Company consisted of 24,000 shares of no par value common stock, all of which have been issued and are outstanding. All of such stock at the date of examination was held by SIG.

### **Dividends To Stockholders**

In the period under examination, the Company paid stockholder dividends as follows:

- ◆ The Company paid shareholder dividends of \$22,735,089 to SIG in 2008.
- ◆ The Company paid shareholder dividends of \$27,315,662 to SIG in 2007.
- ◆ The Company paid shareholder dividends of \$7,859,040 to SIG in 2006.
- ◆ The Company paid shareholder dividends of \$24,900,000 to SIG in 2005.
- ◆ The Company paid shareholder dividends of \$6,496,080 to SIG and \$1,853,040 to TBC in 2004.

### **Growth Of The Company**

The growth of the Company throughout the examination period is indicated in the following schedule which was prepared from information in the Company's Annual Statements:

DEC. 31,	ADMITTED ASSETS	LIABILITIES	CAPITAL AND SURPLUS	PREMIUMS EARNED	LOSSES AND LAE INCURRED	NET INCOME
2008	\$1,226,134,961	\$665,672,685	\$560,462,276	\$518,900,255	\$332,840,501	\$68,509,163
2007	1,212,432,806	697,475,525	514,957,281	548,286,331	337,043,525	83,375,213
2006	1,155,524,760	698,019,944	457,504,816	593,687,225	336,211,021	110,074,792
2005	1,048,731,530	697,898,217	350,833,313	591,689,641	366,313,169	92,432,368
2004	982,536,303	704,375,736	278,160,567	562,677,518	403,659,065	42,251,041
2003	856,193,529	597,642,222	258,551,307	513,235,229	400,372,169	27,007,359

### **MANAGEMENT**

#### **Meetings of Stockholders**

According to the Company's By-laws, the annual meeting of stockholders shall be held on the third Wednesday in April of each year. At any meeting of the stockholders, a quorum for the transaction of business shall consist of one or more stockholders appearing in person or by proxy and owning or representing a majority of all of the shares then outstanding and entitled to vote. Stockholder entitled to vote shall have one vote for each share of stock held by them. A stockholder may vote either in person or by written proxy. Minutes document that a quorum was obtained at each annual meeting held during the examination period. Special meetings of stockholders may be called by the President or by the Board of Directors, and shall be called by the Secretary upon written application of one or more stockholders who hold shares representing at least ten per cent of the capital stock entitled to vote at such meeting. A written notice of each meeting of stockholders shall be given at least seven days before the meeting and shall state the place, date, time, and purposes of the meeting.

#### **Board of Directors**

According to the Company's By-laws, the business of the Company shall be managed under the direction of the Board of Directors who may exercise all of the powers of the Company except such as are reserved to the stockholders by law, by the Company's Articles of Organization, or by the By-laws. The Board of Directors shall be elected by a plurality of the votes cast at annual meetings of the stockholders and each Director so elected shall hold office until the next annual meeting of stockholders and thereafter until a successor is duly elected and qualified, or until his sooner resignation or removal. Any Director may resign at any time upon notice to the Company. Directors need not be stockholders. The By-laws, however, do not specify rules or procedures for the election of a Chairman of the Board.

## Safety Insurance Company

At December 31, 2008, the Company's Board of Directors was composed of five persons, which is in compliance with the Company's By-laws and the General Laws of Massachusetts. The members of the Board, with their business or professional affiliations and their residential addresses, are as follows:

<u>Name of Director:</u>	<u>Business Affiliation:</u>	<u>Residence:</u>
David Francis Brussard	President and Chief Executive Officer	Boston, Massachusetts
William Joseph Begley, Jr.	Vice President, Treasurer, and Chief Financial Officer	Norwell, Massachusetts
* Daniel David Loranger	Vice President, MIS	Boxford, Massachusetts
Edward Norman Patrick, Jr.	Vice President, Underwriting Clerk and Secretary	Westwood, Massachusetts
* David Ernest Krupa	Vice President, Claims	Raynham, Massachusetts

\* Newly elected to Directorship since 2003

The business affiliations listed above are positions held with the Company. Directors of the Company also serve simultaneously in similar capacities as Directors and Officers of Safety Indemnity Insurance Company and Safety Property and Casualty Insurance Company.

The By-laws do not specify the number of meetings of the Board of Directors to be held during a year. Regular meetings of the Board of Directors may be held at such places and times as the Directors may from time to time determine; a regular meeting of the Board of Directors shall be held without notice immediately after and at the same place as the annual meeting of stockholders. Special meetings of the Board of Directors may be held at any time and place when called by the President, the Treasurer, or one or more Directors. At any meeting of the Board of Directors, a majority but not less than four Directors shall constitute a quorum for the transaction of business. The minutes indicated that a quorum was obtained for all meetings of the Board of Directors held during the examination period.

### **Committees of the Board of Directors**

According to the Company's By-laws, the Board of Directors may, by the affirmative vote of a majority of the Directors then in office, and provided that a quorum is present for such vote, appoint an executive committee or other committees and may by like vote delegate thereto some or all of its powers except those which by law, the Articles of Organization, or the By-laws, it may not delegate. The Board of Directors shall have power at any time to fill vacancies in, change the membership of, or discharge any such committee. The Board of Directors shall have the power to rescind any action of any committee, but no such rescission shall have retroactive effect.

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The Company has an Investment Committee composed of Directors David F. Brussard and William J. Begley, Jr., and A. Richard Caputo, Jr., a member of the Board of Directors of SIG. Minutes of the Investment Committee documented regular meetings of these Investment Committee members with representatives of the Company's investment advisor/manager, Deutsche Asset Management ("Deutsche").

The Company does not have a formal audit committee. This function is addressed by the Audit Committee of its parent company, SIG.

The Company has an Executive Committee composed of senior management which meets weekly to address various aspects of the day-to-day operations of the Company. Additionally, according to the Chief Financial Officer of the Company, functional committees and staff make formal presentations to the Executive Committee at regular intervals on specific topics or various aspects of the Company's business. Minutes of such meetings are not formally maintained.

### **Officers**

According to the Company's By-laws, the officers of the Company shall consist of a President, a Treasurer, a Secretary, and such other officers with duties and powers as the Board of Directors may in its discretion determine. The President, the Treasurer, and the Secretary shall be elected annually by the Directors at their first meeting following the annual meeting of stockholders; other officers may be chosen by the Directors at such meeting or at any other meeting. The term of office for all officers shall be one year or until respective successors are elected and qualified. An officer may but need not be a director or stockholder.

The By-laws state that the President shall be the Chief Executive Officer of the Company. The President shall have such duties and powers as are commonly incident to the office and such duties and powers as the Board of Directors shall from time to time designate. In addition to what is defined explicitly in the By-laws, the Company's officers shall have such powers and duties as generally pertain to their respective offices, as well as such powers and duties as from time to time may be conferred by the Board of Directors. Except as otherwise required or prohibited by law, any two or more offices may be held by the same person.

The minutes of the Board of Directors document that the Officers of the Company are elected each year. The Officers of the Company at December 31, 2008, were as follows:



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<u>Name of Officer:</u>	<u>Title:</u>
David Francis Brussard	President, Chief Executive Officer, and Director
William Joseph Begley, Jr.	Vice President, Treasurer, Chief Financial Officer, and Director
* James D. Berry	Vice President – Insurance Operations
* George M. Murphy	Vice President – Marketing
Janet Kelleher Catino	Assistant Vice President and Controller
Robert John Kerton	Vice President - Claims
David Ernest Krupa	Vice President - Claims and Director
Daniel David Loranger	Vice President - Management Information Systems and Chief Information Officer and Director
Edward Norman Patrick, Jr.	Vice President – Underwriting, Clerk, Secretary, and Director

\* Newly elected/appointed to listed Office since 2003

The Company's Officers listed above simultaneously held similar positions in SInd and SPC.

### **Conflict Of Interest Procedure**

The Company has a written Code of Business Conduct and Ethics with an established procedure for disclosure to the Board of Directors of any material interest or affiliation of any Officer or Director which is likely to conflict with his or her official duties. Annually, each Director of the Company completes and signs a questionnaire disclosing any material conflicts of interest. Since SIG became a publicly traded entity, extensive disclosure filings are made annually by its Directors, many of whom share common directorships with other entities in the Group. No exceptions were noted in the examination's review of the forms supporting the Company's responses to the General Interrogatories in its Annual Statements.

### **Corporate Records**

The By-laws and the Articles of Organization of the Company were read. On October 16, 2001, the Board of Directors voted that the Company's By-laws be amended and restated in their entirety. Throughout this Report, references to By-laws are to such Amended and Restated By-laws as were in effect at December 31, 2003.

Although the Company has disaster recovery and business continuity plans, its By-laws do not contain explicit provisions for the continuity of operations in the event of a national emergency; hence, under such circumstances, the succession of officers will be as prescribed in Sections 180M through 180Q of MGL Chapter 175.



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Minutes of the meetings of the Board of Directors held throughout the examination period were reviewed. Votes and authorizations over the examination period were found to be in order and the records indicated that the Company appeared to be conducting its affairs in compliance with its By-laws and the Laws of the Commonwealth of Massachusetts. The previous Examination Report was reviewed by the Directors as required by Massachusetts statute.

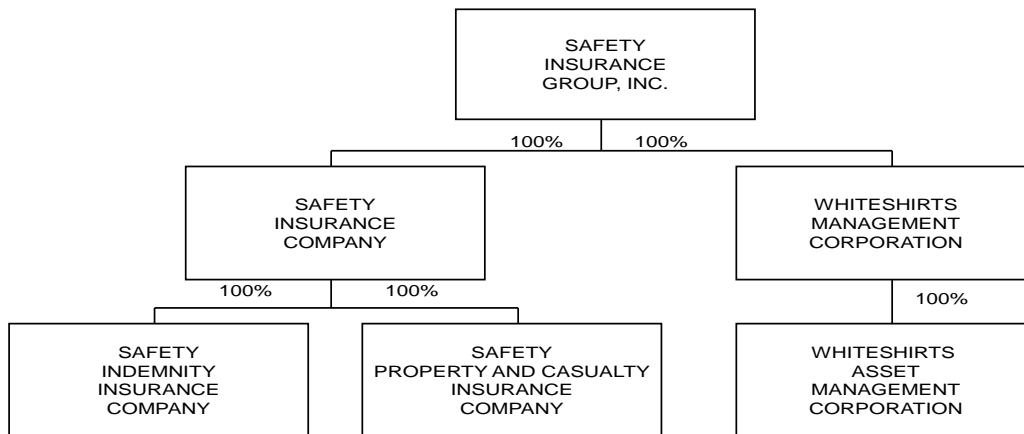
### **AFFILIATED COMPANIES**

#### **Holding Company Filings**

The Company is a member of an insurance holding company system as defined in Section 206 of Massachusetts General Law Chapter 175 and is subject to the registration requirements thereof. During the examination period, the Company filed Form B with the Division pursuant to Regulation 211 CMR 7.00 and Section 206C of Massachusetts General Law Chapter 175. Ultimate control of the holding company system is held by the owners of SIG, a Delaware corporation, the sole business of which is ownership of the group.

#### **Chart Of Organization**

The ownership interests and hierarchy of companies in this corporate organization at December 31, 2008, are represented as follows:



### **Acquisitions, Mergers or Sales**

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

- ◆ In 2006, the Company purchased 175,000 no par value shares of SPC for a price of \$1.75 million and at the same time, made a capital contribution of \$7.3 million to its newly formed subsidiary.
- ◆ Effective January 1, 2004, the Company and SInd entered into an Administrative Service Agreement, pursuant to which SInd receives certain administrative and managerial services from the Company, as compensation for which SInd pays the actual costs and expenses incurred by the Company for providing such services. This agreement remains in effect to date.
- ◆ The Company and SPC entered into an Administrative Service Agreement effective on January 1, 2007, pursuant to which SPC receives certain administrative and managerial services from SIC, as compensation for which SPC pays the actual costs and expenses incurred by SIC for providing such services. This agreement remains in effect to date.
- ◆ Effective on January 1, 2007, an existing pooling agreement between the Company and its wholly-owned subsidiary SInd was amended to include the newly formed affiliated company, SPC. As amended, the agreement applies the pool participation percentages of 90% for the Company, 7% for SInd, and 3% for SPC to the net liabilities of the pooled companies (that is, reserves for unearned premiums, losses, and loss adjustment expenses, net of salvage and subrogation and third party reinsurance cessions). Prior to January 1, 2007, the pool participation percentages were 95% for the Company, 5% for SInd, and 0% for SPC. Assets equaling the net change in liabilities as a result of the changes to the pool participation percentages were transferred between companies as of the effective date of the amendment. This agreement remains in effect to date.

### **Summary Of Cost-Sharing Agreements**

The three predominant cost-sharing agreements involving the Company management services agreements with its subsidiaries and an inter-company reinsurance pooling agreement. These are described briefly among the following summaries:

- ◆ Until January 1, 2004, the Company had an agreement with an affiliate, Whiteshirts Asset Management Corporation (f/k/a/ Thomas Black Insurance Agency, Inc.) (“WAMC”), in which the Company designated WAMC as its managing agent and under which WAMC provided all underwriting, premium, and claims processing and other administrative functions for a management fee, subject to modification by agreement of the parties. Effective January 1, 2004, the Company and SInd each terminated their respective agreement with WAMC for services; effective that same date, the Company

entered into an administrative services agreement with SInd to provide SInd with management and administrative services. Thereupon, per an asset transfer agreement, WAMC and the Company agreed that WAMC would transfer to the Company ownership of all assets used by WAMC to provide services to the two insurers and the Company would assume all liabilities accrued by WAMC in connection with such services. The Company characterized the one-time non-cash transaction as a deemed dividend, as these liabilities exceeded assets as recorded by WAMC as of December 31, 2003.

- ◆ The Company and SPC entered into an Administrative Service Agreement effective on January 1, 2007, pursuant to which SPC receives certain administrative and managerial services from SIC, for which as compensation SPC pays the actual costs and expenses incurred by SIC for providing such services.
- ◆ Effective on January 1, 2007, an existing pooling agreement between the Company and its wholly-owned subsidiary SInd was amended to include the newly formed affiliated company, SPC. As amended, the agreement applies the pool participation percentages of 90% for the Company, 7% for SInd, and 3% for SPC to the net liabilities of the pooled companies (that is, reserves for unearned premiums, losses, and loss adjustment expenses, net of salvage and subrogation and third party reinsurance cessions). Prior to 1/1/2007, the pool participation percentages were 95% for the Company, 5% for SInd, and 0% for SPC. Assets equaling the net change in liabilities as a result of the changes to the pool participation percentages were transferred between companies as of the effective date of the amendment. This agreement remains in effect to date.
- ◆ The Company has a written tax allocation agreement. The Company files its Federal Income Tax Return on a consolidated basis with SIG and all of SIG's subsidiaries. The consolidated tax liability of SIG and subsidiaries is allocated on the basis of each corporation's proportionate contributions to consolidated taxable income. Any corporation which incurs a loss receives a credit in recognition of the benefit that the loss brings to other corporations through the filing of a consolidated return. The Company had no net losses carried forward as of December 31, 2008.

#### **FIDELITY BONDS AND OTHER INSURANCE**

The By-laws of the Company specify that the Secretary, the Treasurer, and each Assistant Secretary and each Assistant Treasurer shall give bond for the faithful performance of his duties to the Company in such amount as the Directors shall prescribe, which amount shall be at least \$10,000 for the Secretary and the Treasurer, and \$1,000 for each Assistant Secretary and each Assistant Treasurer. Any other officer may be required by the Directors to give bond for the faithful performance of his duties to the Company in such amount and with such sureties as the Directors may determine. For its key executive officers, the Company maintains a fidelity bond with an authorized Massachusetts insurer, consistent with its By-laws and Section 60 of MGL Chapter 175.

The Company is specified among the named insureds on a financial institutions bond with a

## Safety Insurance Company

policy limit of \$10.0 million which provides coverage to SIG and subsidiaries; this specifically provides dishonesty coverage. The aggregate limit of liability exceeds the NAIC suggested minimum. The Company and its affiliates have further protected their interests and property by other policies of insurance covering various insurable risks. Coverage is provided by insurers licensed in Massachusetts and was in force as of December 31, 2008.

### **PENSION AND INSURANCE PLANS**

Effective January 1, 2004, the Company became the employer of all persons employed by WAMC. Concurrently, the Company became the sponsor of the Safety Insurance 401(k) Retirement Plan (the "Plan"), previously sponsored by WAMC. The Plan is a defined contribution plan which is available to all eligible employees of the Company. An employee must be 21 years of age to be eligible to participate in the Plan, and is allowed to contribute on a pre-tax basis up to the maximum allowed under federal law. The Plan is administered by the Company and is subject to the provisions of the Employee Retirement Income Security Act of 1974.

In addition, the Company offers various employee insurance plans, including group and dependant life, group dental and health, and long-term disability.

### **STATUTORY DEPOSITS**

In Massachusetts, no statutory deposit is required of this domestic company as of December 31, 2008. The state of New Hampshire holds a statutory deposit of the Company in the form of a U.S. Treasury Note with par value of \$500,000 at 4.625% which matures on July 31, 2012. At December 31, 2008, this security had a statement value of \$500,145 and a fair value of \$525,000.

### **INSURANCE PRODUCTS AND RELATED PRACTICES**

#### **Territory and Plan of Operation**

A review of the Certificate of Authority indicated that the Company is a corporation duly organized under the laws of the Commonwealth of Massachusetts. The Company is authorized to write the following lines of insurance coverages: fire, ocean and inland marine, boiler, accident – all kinds, liability and automobile liability, glass, water damage and sprinkler leakage, elevator property damage and collision, burglary, robbery, theft, repair – replacement, reinsurance (except life), comprehensive motor vehicle and aircraft, personal property floater, and certain other extensions of coverage. The Company has limited its writings primarily to commercial motor vehicle insurance, private passenger motor vehicle insurance, homeowners insurance, and umbrella coverages. The vast majority of Company business is on a direct billing basis and the Company uses a lock-box collection system for premiums.

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The Company was founded to write motor vehicle insurance in Massachusetts through independent agents and brokers. The Group operates primarily in Massachusetts and offers private passenger and commercial automobile coverages, as well as, homeowners, dwelling fire, personal umbrella, BOP, commercial package and commercial umbrella policies throughout the state. The Company writes all of the Group's personal automobile coverage, standard commercial automobile coverage, standard homeowners and dwelling fire coverage, all personal and commercial umbrella coverage, standard BOP, and standard commercial package coverage. The Company also writes personal and commercial automobile business for CAR. SInd writes the Group's preferred commercial automobile, homeowners, dwelling fire, BOP and commercial package business. Effective September 2007, SPC began to write preferred homeowners and some commercial business. In 2007, the Group applied for and was issued a Certificate of Authority for each of its three operating companies to transact property and casualty insurance business in New Hampshire and began writing business there in late 2008.

Until April 1, 2008, premiums for private passenger coverages were written at standard rates which were established by the Commissioner of Insurance and at deviated rates approved by the Commissioner. Effective April 1, 2008, the Massachusetts private passenger automobile industry began the transition to a new system of managed competition. Under managed competition, Massachusetts automobile insurers are relatively free to determine their own rates, subject to regulatory oversight, but must maintain driving experience and driving record as the primary factors in their rate determination. In addition, the former assigned broker residual market CAR mechanism was replaced with the Massachusetts Automobile Insurance Plan (MAIP). MAIP is a mechanism by which eligible individual risks unable to obtain coverage in the voluntary automobile market are equitably assigned to all personal automobile market participants based on voluntary market share. Premium rates relating to commercial business are open and competitive for the voluntary market and are established by CAR for the involuntary market. The Company is a servicing carrier for CAR and, by contracts, processes business of a one large out-of-state insurer to be placed with MAIP.

### **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, 2007 through December 31, 2007. The market conduct examination was called pursuant to authority in M.G.L. c.175 s.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 were engaged to complete certain agreed upon procedures which were developed using the guidance and standards of the NAIC Market Regulation Handbook, the market conduct examination standards of the Division, and the Commonwealth of Massachusetts insurance laws, regulations and bulletins.

## Safety Insurance Company

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, 2007 through December 31, 2007 will be issued and become available as a public document.

### **REINSURANCE**

Other than mandatory pools and associations, the Company does not assume reinsurance from non-affiliated companies, but it does act as a Servicing Carrier for CAR risks and it does participate in an inter-company pooling arrangement.

The Company cedes risks through Service Agreements under the CAR Buyout Program and through reinsurance treaties with non-affiliates for property catastrophe excess of loss reinsurance. The retention and reinsurance limits for each of the servicing agreements or reinsurance treaties, as amended since their respective inception dates through the date of the examination, are summarized below

#### **Commonwealth Automobile Reinsurers (CAR) Servicing Buyout Agreements**

The Company acts as a Servicing Carrier for automobile insurance under the CAR Buyout Program according to CAR's Plan of Operation and Rules of Operation. Pursuant to agreement, the Company agrees to service CAR assignments to subject companies but it does not assume any of the financial obligations of such companies; that is, the subject companies retain all liability for financial obligations to CAR with respect to all Massachusetts automobile insurance business, including but not limited to such automobile insurance business written by the Company for the account of such contracting insurers (the buyout business is written on policies of the Company and is ceded 100% to the unaffiliated insurers). As compensation for the services of the Company, the subject companies agree to pay a fee equal to the total of all expense allowance components set forth in the automobile insurance rates promulgated by the Massachusetts Commissioner of Insurance, plus a percentage of the total written premiums on automobile insurance serviced by the Company for the account of such insurers. All such insurers are licensed in Massachusetts.

Insurance companies covered under the servicing agreements as described above are State Farm Mutual Automobile Insurance Company (Illinois domicile) and United States Fire Insurance Company (New York).



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In 2006, the Company terminated its CAR Servicing Agreement and the associated reinsurance treaties with United States Fire Insurance Company (New York). The following companies residual business was reflected in the Company's Annual Statements in a runoff mode: Great American Insurance Company (Ohio), Maryland Casualty Company (Maryland), and Zurich Insurance Company (Illinois).

### **Inter-Company Pooling Agreement and Reinsurance Ceded to Affiliates**

Effective January 1, 1997, the Company has participated in an inter-company pooling agreement with its subsidiary, SInd, whereby the Company assumes for all lines of business the liability of SInd's policies in force on or issued or renewed after the effective date. The Company then retains 95% of the combined net liabilities (reserves for unearned premiums, losses, and loss adjustment expenses, net of salvage and subrogation and third party reinsurance cessions) and SInd assumes 5% of the combined net liabilities of the total pool. The agreement is prospective in nature and the insurers applied the participation percentages to the net liabilities as of December 31, 1997, and later, and to the related net earned premiums and incurred losses for the years then ended. Assets equaling the net change in liabilities as a result of such pooling arrangement were transferred between the pool participants.

Effective on January 1, 2007, the existing pooling agreement between the Company and its wholly-owned subsidiary SInd was amended to include the newly formed affiliated company, SPC. As amended, the agreement applies the pool participation percentages of 90% for the Company, 7% for SInd, and 3% for SPC to the net liabilities of the pooled companies (that is, reserves for unearned premiums, losses, and loss adjustment expenses, net of salvage and subrogation and third party reinsurance cessions). Prior to January 1, 2007, the pool participation percentages were 95% for the Company, 5% for SInd, and 0% for SP&C. Assets equaling the net change in liabilities as a result of the changes to the pool participation percentages were transferred between companies as of the effective date of the amendment. This agreement remains in effect to date.

### **Ceded Reinsurance**

For business placed with Swiss Reinsurance America Corp., the retention and limits for each of the reinsurance treaties as amended since their respective inception dates through 12/31/2008 are as follows:



## Safety Insurance Company

Contract Type	Effective Date	L.O.B. Insured	Retention & Deductible	Reinsurer Limits
Quota Share	1/1/2006	Personal/Commercial Umbrella	Annual Aggregate Deductible of \$75K  Retention 10% above deductible of \$75K	\$4.5M each policy or (90% \$5.0M)
Excess of Loss Casualty	1/1/2008	Auto Liab. & Coll. H.O. Sect 2, BOP Sect 2 Comm/Pers Umbrella	\$1,000,000	\$5,000,000
Catastrophe Excess of Loss	1/1/2008	Fire, Allied Lines Auto PD, H.O. Sect 1 CMP Sect. 1	10% of \$15.0M for loss > \$15.0M	\$13.5M or 90% of \$15M

The retention and limits for other key reinsurers are indicated by the following:

Reinsurer	Contract Type	Effective Date	L.O.B. Insured	Retention & Deductible	Reinsurer Limits
Various Lloyds of London Underwriters & Bermuda Companies via Benfield	Excess of Loss Property	1/1/2008	Fire, Allied Lines H.O. Sect. 1 CMP Sect. 1 Inland Marine	1 <sup>st</sup> Layer- \$1.5M	<u>Per Risk:</u> 1 <sup>st</sup> -1.0M
				2 <sup>nd</sup> Layer- \$2.5M	2 <sup>nd</sup> - \$2.5M
				3 <sup>rd</sup> Layer- \$5.0M	3 <sup>rd</sup> - \$10.0M
					<u>Per Occ:</u> 1 <sup>st</sup> - \$2.0M 2 <sup>nd</sup> - \$5.0M 3 <sup>rd</sup> - \$10.0M
Various Lloyds of London Underwriters & Bermuda Companies via Benfield	Catastrophe Excess of Loss	1/1/2008	Fire, Allied Lines Auto Comp. H.O. Sect. 1 CMP Sect. 1 Inland Marine	2 <sup>nd</sup> Layer- 15% of \$40.0M	<u>Per Occ:</u> 2 <sup>nd</sup> - 85% of \$40.0M
				3 <sup>rd</sup> Layer- 15% of \$210M	3 <sup>rd</sup> - 85% of 210.0M
					<u>Term Limit:</u> 1 <sup>st</sup> - \$4.0M 2 <sup>nd</sup> - \$7.5M 3 <sup>rd</sup> - \$20.0M
The Hartford Steam Boiler Inspection & Insurance Company	Equipment Breakdown	1/1/2007	Business Owners & Commercial Property	100% Ceded No Retention	\$25.0M per accident

Examiners reviewed the Company's reinsurance contracts and did not detect unusual features that would significantly have an adverse affect on the Company's financial condition, or that were in violation of law, regulation, or good practice. There were no guaranteed profit contracts, no portfolio reinsurance transfers, and no residual liability under expired contracts. The Company does not appear to be in a fronting arrangement for other companies. Under the treaties, there was a

## Safety Insurance Company

legitimate transfer of risk and none of the contracts appeared to be executed solely for surplus relief. The reinsurance agreements contained both an insolvency clause in accordance with Section 20A of MGL Chapter 175, and an errors and omissions clause to address errors found at a later date.

### **SUBSEQUENT EVENT**

On November 21, 2008, the Massachusetts Office of the Attorney General (the “AG”) delivered a civil investigative demand (the “CID”) to SIC. The CID directed the Company to produce certain information related to its policies and practices in connection with underwriting insurance policies on motorcycles and adjusting total loss claims under such policies. On January 14, 2010, an Assurance of Discontinuance (the “AOD”) was filed in Suffolk Superior Court whereby SIC agreed to pay \$7,216,676 into a “Settlement Fund” which will be paid by an independent trustee in settlement of all claims arising from the AG’s review in order to avoid litigation. SIC did not admit any wrong doing. In addition to the payment to the Settlement Fund, SIC agreed to pay \$330,000 in costs.

### **ACCOUNTS AND RECORDS**

The Company’s accounting and record-keeping are extensively automated. The Company maintains its records, ledgers, and accounts on a computerized accounting system. Trial balances were traced from the general ledger and supporting documents to annual statements. No material exceptions were noted.

In accordance with 211 C.M.R. 23.00, the books and records of the Company are audited annually by a firm of independent certified public accountants. For the year ended December 31, 2008, the Company was audited by PwC

The Company’s claims inventory was tested on a sample basis for completeness and accuracy. No material errors or exceptions were detected.

The NAIC Evaluation of Controls in Information Systems Questionnaire was completed by the Company. The Division’s IT Auditor reviewed the Company’s management responses to the NAIC IS Questionnaire and interviewed key management personnel in the Company’s Information Technology Department. In addition to such interviews, various internal audit reports and audit workpapers of PwC were reviewed. The Company has internal control procedures in place to protect its data processing and information, and it has comprehensive disaster recovery and business continuity plans in place.

### **FINANCIAL STATEMENTS**

The following pages present a Statement of Assets, Liabilities, Surplus and Other Funds as determined by this examination, showing the financial condition of the Company as of December 31,

Safety Insurance Company

2008. The statement is followed by supporting statements and reconciliations presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds As of December 31, 2008

Statement of Income For the Year Ended December 31, 2008

Capital and Surplus Account As of December 31, 2008

Reconciliation of Capital and Surplus For Each Year in the Five Year Period Ended December 31, 2008

For Information Purposes Only

# Safety Insurance Company

## Safety Insurance Company Statement of Assets, Liabilities, Surplus and Other Funds December 31, 2008

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
<b><u>Assets</u></b>				
Bonds	\$ 842,931,622	\$ -	\$ 842,931,622	
Common stocks	59,982,237		61,106,300	
Cash	105,983,688		105,983,688	
Cash and invested assets	1,008,897,547	-	1,008,897,547	
Investment income due and accrued	9,286,981		9,286,981	
Uncollected premiums	5,952,550		5,952,550	
Deferred premiums	120,656,860	1,124,063	121,780,923	2
Reinsurance:				
Amounts recoverable from reinsurers	22,923,838		22,923,838	
Current federal and foreign income taxes recoverable	5,858,874		5,858,874	
Net deferred tax asset	24,057,435		24,057,435	
Electronic data processing equipment and software	801,422		801,422	
Equities and deposits in pools and associations	27,626,033		27,626,033	
Miscellaneous assets	73,421		73,421	
Total assets	<u>\$ 1,226,134,961</u>	<u>\$ 1,124,063</u>	<u>1,227,259,024</u>	
<b><u>Liabilities, Surplus and Other Funds</u></b>				
<b><u>Liabilities</u></b>				
Losses	\$ 304,978,929	\$ -	\$ 304,978,929	1
Loss adjustment expenses	46,983,624		46,983,624	1
Commissions payable	13,868,736		13,868,736	
Other expenses	20,380,721		20,380,721	
Taxes, licenses and fees	83,526		83,526	
Unearned premiums	241,267,596		241,267,596	
Advance premium	13,054,377		13,054,377	
Ceded reinsurance premiums payable	24,161,059		24,161,059	
Payable to parent, subsidiaries and affiliates	-	1,124,063	1,124,063	2
Miscellaneous liabilities	894,117		894,117	
	<u>665,672,685</u>	<u>1,124,063</u>	<u>666,796,748</u>	
<b><u>Surplus and Other Funds</u></b>				
Common capital stock	1,150,000		1,150,000	
Gross paid in and contributed surplus	8,323,309		8,323,309	
Unassigned funds (surplus)	550,988,967		550,988,967	
Surplus as regards policyholders	560,462,276	-	560,462,276	
Total liabilities, surplus and other funds	<u>\$ 1,226,134,961</u>	<u>\$ 1,124,063</u>	<u>\$ 1,227,259,024</u>	

# Safety Insurance Company

## Safety Insurance Company Statement of Income For the Year Ended December 31, 2008

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
Premiums earned	\$ 518,900,255	\$ -	\$ 518,900,255	
Deductions:				
Losses incurred	286,125,769		286,125,769	
Loss adjustment expenses incurred	46,714,732		46,714,732	
Other underwriting expenses incurred	152,646,364		152,646,364	
Total underwriting deductions	485,486,865	-	485,486,865	
Net underwriting gain (loss)	33,413,390	-	33,413,390	
Net investment income earned	40,905,044		40,905,044	
Net realized gains (losses), net of capital gains tax	469,508		469,508	
Net investment gain (loss)	41,374,552	-	41,374,552	
Finance and service charges not included in premiums	16,876,460		16,876,460	
Miscellaneous income	8,610		8,610	
Total other income	16,885,070	-	16,885,070	
Net income before dividends to policyholders and before federal and foreign income taxes	91,673,012	-	91,673,012	
Dividend to policyholders	-		-	
Net income after dividends to policyholders but before federal and foreign income taxes	91,673,012	-	91,673,012	
Federal and foreign income taxes	23,163,849		23,163,849	
Net income	\$ 68,509,163	\$ -	\$ 68,509,163	

# Safety Insurance Company

## Safety Insurance Company Statement of Capital and Surplus For the Year Ended December 31, 2008

	As Reported by Company	Examination Changes	Per Statutory Examination	Notes
Surplus as regards policyholders, December 31, 2007	\$ 514,957,281	\$ -	\$ 514,957,281	
Net income	68,509,163	-	68,509,163	
Change in unrealized capital gains (losses)	6,054,721		6,054,721	
Change in net deferred income tax	420,436		420,436	
Change in nonadmitted assets	(6,622,541)		(6,622,541)	
Surplus adjustments:				
Paid in	(121,695)		(121,695)	
Dividends to stockholders	(22,735,089)		(22,735,089)	
Change in surplus as regards policyholders for the year	45,504,995		45,504,995	
Surplus as regards policyholders, December 31, 2008	\$ 560,462,276	\$ -	\$ 560,462,276	

# Safety Insurance Company

Safety Insurance Company  
Reconciliation of Capital and Surplus  
For Each Year in the Five Year Period Ended December 31, 2008

	<u>2008 *</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance, beginning of period	\$ 514,957,281	\$ 457,504,816	\$ 350,833,313	\$ 278,160,567	\$ 258,551,307
Net income (loss)	68,509,163	83,375,213	110,074,792	92,432,368	42,251,041
Change in unrealized capital gains or (losses)	6,054,721	7,470,498	6,075,411	4,972,258	2,468,859
Change in net deferred income tax	420,436	(1,230,610)	480,900	1,443,157	5,140,850
Change in nonadmitted assets	(6,622,541)	(5,026,069)	(2,100,560)	(1,275,037)	(4,285,972)
Surplus adjustments:					
Paid in	(121,695)	179,094	-	-	-
Dividends to sockholders	(22,735,089)	(27,315,662)	(7,859,040)	(24,900,000)	(8,349,120)
Deemed dividend	-	-	-	-	(17,616,398)
Rounding	-	1	-	-	-
Balance, end of period	<u>\$ 560,462,276</u>	<u>\$ 514,957,281</u>	<u>\$ 457,504,816</u>	<u>\$ 350,833,313</u>	<u>\$ 278,160,567</u>

\* Per Statutory Examination



**NOTES TO FINANCIAL STATEMENTS****Note 1:**

<b>Losses</b>	<b>\$ 304,978,929</b>
<b>Loss Adjustment Expenses</b>	<b>\$ 46,983,624</b>

The Company's Board of Directors appointed an actuary from the Actuarial Consulting Services Unit of PwC, the Company's independent certified public accounting firm, to render a Statement of Actuarial Opinion as of December 31, 2008, on the Company's loss and loss adjustment expense (LAE) reserves. Among the items in the Opinion for the Company and in the similar Opinion for SInd and for SPC, the appointed actuary specifically listed the following amounts for each respective insurer separately; they are shown herein on a combined basis for ease of general reference:

	<b>Company</b>	<b>SInd</b>	<b>SPC</b>	<b>Combined</b>
Reserve for Unpaid Losses	\$304,978,929	\$23,720,583	\$10,165,964	\$338,865,476
Reserve for Unpaid Loss Adjustment Expenses	46,983,624	3,654,283	1,566,122	52,204,029
Aggregate Total – Net Basis	\$351,962,553	\$27,374,866	\$11,732,086	\$391,069,505
Reserve for Unpaid Losses	\$367,218,000	\$28,562,000	\$12,240,000	\$408,020,000
Reserve for Unpaid Loss Adjustment Expenses	53,585,000	4,168,000	1,786,000	59,539,000
Aggregate Total – Direct and Assumed	\$420,803,000	\$32,730,000	\$14,026,000	\$467,559,000

After reviewing the above reserves and other items, the Company's appointed actuary concluded that, in his opinion, the amounts identified above:

1. meet the requirements of the insurance law of Massachusetts;
2. were computed in accordance with accepted loss reserving standards and principles; and
3. make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its policies and agreements.

As part of the examination, the Division engaged the consulting actuarial advisory services of Ernst & Young, LLP, an independent firm. The consulting actuaries for the Division prepared independent estimates for the Company's loss and LAE liabilities as of December 31, 2008, using data evaluated as of March 31, 2009 (the Company's appointed actuary relied on data evaluated as of December 31, 2008). The consulting actuaries also updated their independent estimates for the Company's loss and LAE liabilities as of December 31, 2008 based on actual versus expected loss emergence analysis results using data as of December 31, 2009.

The consulting actuaries summarized the results of their analysis of the loss and LAE liabilities in the following table:

## Safety Insurance Company

(\$000 omitted)		Carried	Indicated by Ernst & Young		
		<u>Reserve</u>	<u>Low</u>	<u>Central</u>	<u>High</u>
Safety Insurance Company	Gross	\$ 420,802	\$324,295	\$ 352,947	\$383,851
With 90% of Pooled Business	Net	351,953	261,628	284,109	308,841
Safety Indemnity Ins Company	Gross	32,729	25,223	27,451	29,855
With 7% of Pooled Business	Net	27,375	20,349	22,097	24,021
Safety P&C Insurance Company	Gross	14,027	10,810	11,765	12,795
With 3% of Pooled Business	Net	11,732	8,721	9,470	10,295
Group Combined	Gross	\$467,558	\$360,328	\$ 392,163	\$426,501
	Net	391,070	290,698	315,676	343,157

In conclusion, the consulting actuaries noted that the indicated net Loss and LAE liability range for the combined group is \$290.7 million to \$343.2 million. The net carried reserve at December 31, 2008, exceeds the “High” end of the consulting actuaries estimated liability range by \$47.9 million and the “Central” estimate by \$74.4 million on a group combined basis. They also observed that the Company has consistently reported favorable loss and LAE development in each of the past four years and during the year of 2009 reported favorable development of approximately \$40 million on year-end 2008 loss and LAE reserves.

Had the reserves been booked at the “High” end of the consulting actuaries’ range, the Loss and LAE reserve in the accompanying financial statements would have been \$43.1 million lower, the incurred losses would have been \$43.1 million lower and, assuming a 35.0% tax rate, Surplus would have increased by approximately \$31.1 million.

### Note 2:

#### **Payable to parent, subsidiaries and affiliates**

**\$ 1,124,063**

During the course of the examination, it was noted that cash belonging to Safety Property and Casualty Insurance Company was inadvertently deposited to an account owned by Safety Insurance Company. This error was corrected in January of 2009.

**ACKNOWLEDGEMENT**

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

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

Guangping Wei

Financial Examiner II

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