

Examination Warrant Number 11-03158-11242-R1

**Report of Examination of  
Allied Eastern Indemnity Company  
Lancaster, PA**

**As of December 31, 2011**

**For Informational Purposes Only**

# Allied Eastern Indemnity Company

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Harrisburg, Pennsylvania  
May 17, 2013

Honorable Stephen J. Johnson, CPA  
Deputy Insurance Commissioner  
Commonwealth of Pennsylvania  
Insurance Department  
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 11-03158-11242-R1, dated, February 25, 2011, an examination was made of

**Allied Eastern Indemnity Company, NAIC Code: 11242**

a Pennsylvania domiciled property and casualty company, hereinafter referred to as "Company." The examination was conducted at the Company's home office, located at 25 Race Avenue, Lancaster, PA 17603.

A report of this examination is hereby respectfully submitted.

**SCOPE OF EXAMINATION**

The Company was last examined as of December 31, 2006.

This examination covered the five-year period from January 1, 2007 through December 31, 2011, and consisted of a general survey of the Company's business practices, management, and operations, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department ("Department") and the National Association of Insurance Commissioners ("NAIC").

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a disclosure of other significant regulatory information.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of PricewaterhouseCoopers LLP provided unqualified audit opinions on the Company's year-end financial statements based on statutory accounting principles. Relevant work performed by the CPA firm, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

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The following companies were examined at the same time during the above examination:

<b>Company</b>	<b>NAIC Code</b>
Eastern Alliance Insurance Company (PA)	10724
Eastern Advantage Assurance Company (PA)	13019
Employers Security Insurance Company (IN)	32005

### HISTORY

The Company was incorporated on January 14, 2002, licensed by the Department on May 16, 2002, and commenced business on May 16, 2002.

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382, Subsection (c), Paragraph (14) Workers' Compensation.

### MANAGEMENT AND CONTROL

#### CAPITALIZATION

As of the examination date, December 31, 2011, the Company's total capitalization was \$9,103,100. The amount consists of \$2,501,250 of common capital stock consisting of 1,000 issued and outstanding shares of no par common stock; \$758,750 in paid in and contributed surplus; and \$5,843,100 in unassigned funds ("surplus").

The Company's minimum capital and minimum surplus requirements for the types of business for which it is licensed, pursuant to 40 P. S. § 386.1, is \$750,000 in capital and \$350,000 in surplus. The Company has met all governing requirements throughout the examination period.

#### STOCKHOLDER

The Company is a wholly owned subsidiary of Global Alliance Holdings, Ltd. ("Global Alliance"). Global Alliance is a wholly owned subsidiary of Eastern Insurance Holdings, Inc. ("EIHI").

The Company paid a \$2.0 million dividend to its parent in 2009.

#### INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement, and is in compliance with 40 P.S. §§ 991.1401-991.1413. A registration statement was properly filed with the Department for each year of the examination.

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Eastern Insurance Holdings, Inc. ("EIHI") is named as the ultimate controlling person in the system. EIHI was formed by Eastern Life and Health Insurance Company ("ELH") for the purpose of converting ELH from a mutual life and health insurance company to a stock life and health insurance company.

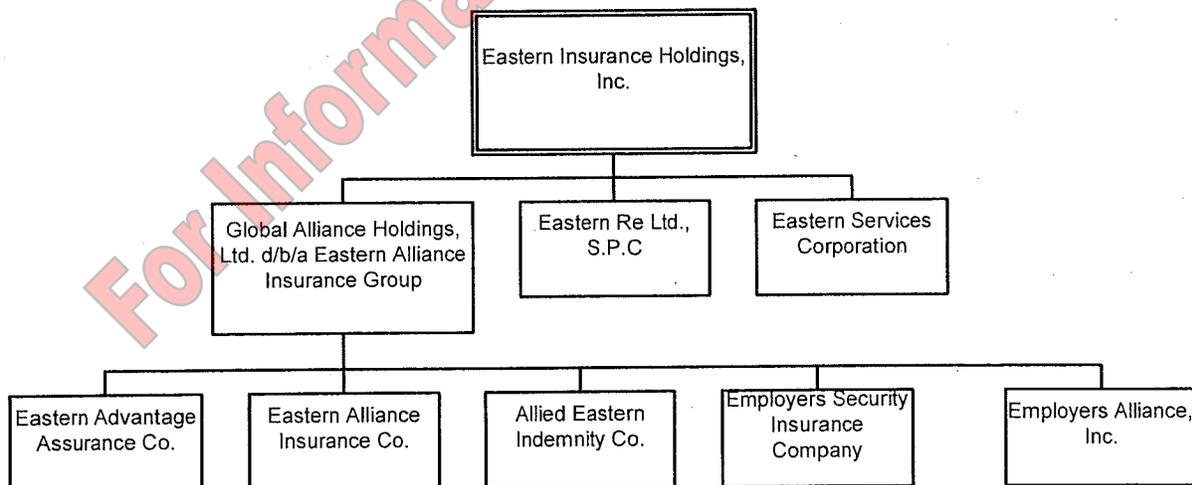
On June 16, 2006, ELH completed the mutual to stock conversion and EIHI completed a common stock offering. Immediately thereafter, EIHI purchased all of the outstanding common stock of Eastern Holding Company, Ltd. ("EHC") and its wholly-owned subsidiaries, Eastern Alliance Insurance Company ("Company"), Allied Eastern Indemnity Company, Employers Alliance, Inc. Global Alliance Holdings, Ltd, Global Alliance Statutory Trust I, Eastern Services Corporation, and Eastern Re Ltd., S.P.C..

On September 29, 2008, EIHI acquired all of the outstanding stock of Employers Security Holding Company ("ESHC"), an Indiana corporation, and its wholly-owned subsidiaries, Employers Security Insurance Company ("Employers Security") and Affinity Management Services, Inc. ("AMS").

On December 31, 2009, EIHI and its subsidiaries completed a corporate restructuring whereby EHC merged with and into EIHI; EIHI contributed all of the capital stock of ESHC to Global Alliance, and then ESHC was merged with and into Global Alliance; and AMS merged with and into Employers Alliance Inc.

In 2010, EIHI divested itself of two subsidiaries, namely Eastern Atlantic RE and Eastern Life and Health Insurance Company.

The following is an organizational chart of the insurance holding company system as of December 31, 2011:



## BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2011:

<b>Name and Address</b>	<b>Principal Occupation</b>
Robert M. McAlaine Bryn Mawr, PA	Chairman of the Board Eastern Alliance Insurance Group
Michael L. Boguski Lebanon, PA	President and Chief Executive Officer Eastern Alliance Insurance Group
Paul R. Burke Bronxville, NY	Principal Northaven Management, Inc.
Bruce M. Eckert Wyndmoor, PA	Vice Chairman of the Board Eastern Alliance Insurance Group
Ronald L. King Ocean City, MD	Consultant
Scott C. Penwell, Esq. Enola, PA	Attorney Stevens & Lee
William L. Snyder, III Haverford, PA	Investment Banker Snyder & Company
Charles H. Vetterlein, Jr. Villanova, PA	Commercial Insurance Broker Willis of Pennsylvania, Inc.

The Company maintains interlocking directorates with its affiliated and subsidiary companies within the EIHI Insurance Group corporate organizational structure.

The Company's Board of Directors are elected annual to serve for a period of one year and until their successors are duly elected and qualified.

In conjunction with its parent and affiliates, the Company's directors, officers, and key employees are required to sign a Conflict of Interest Disclosure Statement on an annual basis. The Company's Code of Ethics is updated annually by EIHI's Nominating/Corporate Governance Committee.

## COMMITTEES

The Directors and/or Officers were assigned to serve on the following Committees as listed below:

### **Audit Committee**

Paul R. Burke (Chair)  
Ronald L. King  
William L. Snyder III

### **Executive Committee**

Robert M. McAlaine (Chair)  
Bruce M. Eckert

### **Compensation/HR Committee**

Ronald L. King (Chair)  
Robert M. McAlaine  
Charles H. Vetterlein Jr.

### **Nominating/Governance Committee**

Charles H. Vetterlein Jr. (Chair)  
Paul R. Burke

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Scott C. Penwell  
Michael L. Boguski

Ronald L. King

### **Finance/Investment Committee**

William L. Snyder III (Chair)  
Paul R. Burke  
Robert M. McAlaine  
Scott C. Penwell

The Board appointed the committees in accordance with the Company's By-laws.

Pennsylvania Insurance Company Law, namely, 40 P.S. § 991.1405(c)(3) Standards of management of an insurer within a holding company system, states: "not less than one-third of the directors of a domestic insurer and not less than one-third of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of such insurer or of any entity controlling, controlled by or under common control with such insurer and who are not beneficial owners of a controlling interest in the voting stock of such insurer of any such entity. At least one such person must be included in any quorum for the transaction of business of business at any meeting of the board of directors or any committee thereof."

Likewise, 40 P.S. § 991.1405(c)(4), Standards of management of an insurer within a holding company system states: "The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have the responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating committees for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers."

The Company is in compliance with the aforementioned sections through 40 P.S. § 991.1405(c)(5), Standards of management of an insurer within holding company system states: "The provisions of paragraphs (3) and (4) shall not apply to a domestic insurer if the person controlling such insurer is an insurer or a publicly held corporation having a board of directors and committees thereof which already meet the requirements of paragraphs (3) and (4).

## **OFFICERS**

As of the examination date, December 31, 2011, the following officers were appointed and serving in accordance with the Company's By-laws:

<b>Name</b>	<b>Title</b>
Michael Boguski	President
Kevin Shook, CPA	Chief Financial Officer and Treasurer
Scott Penwell	Secretary
Suzanne Emmet	Senior Vice President, Claims and Corporate

Robert Gilpin	Compliance Senior Vice President, Operations and Marketing
Cynthia Sklar	Senior Vice President, Underwriting and Risk Management
Brent Shirk, CPA	Vice President, Finance

## CORPORATE RECORDS

### MINUTES

The meeting minutes of the Board of Directors, Committees and Shareholders were reviewed for the period under examination. A compliance review of corporate minutes revealed the following:

- The Annual Meetings of the Company's stockholder were held in compliance with its By-laws.
- The stockholder elects directors at such meetings in compliance with the By-laws.
- The stockholder ratified the prior year's actions of the officers and directors.
- Quorums were present at all directors' meetings.
- The Company's investment transactions are approved by the Board.
- The Company's Board meeting minutes documented approval of the reinsurance agreements.

### ARTICLES OF AGREEMENT

There were no changes in the Articles of Agreement of the Company for the period under examination.

### BY-LAWS

There were no changes in the By-laws of the Company for the period under examination.

## SERVICE AND OPERATING AGREEMENTS

Effective January 1, 2011, Eastern Alliance Insurance Group ("EAIG") comprised of Eastern Alliance Insurance Company, Allied Eastern Indemnity Company, Eastern Advantage Assurance Company, Employers Security Insurance Company entered into a Claim Service Agreement with its affiliate, Employers Alliance, Inc. Under the terms of this agreement, Employers Alliance, Inc. provides claims adjusting and certain other administration services,

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including certain risk management services, related to EAIG's workers' compensation and employers' liability coverage. Employers Alliance, Inc. compensates EAIG two percent of revenue for this service, settled on a quarterly basis.

The Company files a consolidated federal income tax return with EIHI and its subsidiaries. The federal tax liability and related expense is allocated among the members of the consolidated group as a percentage each party's positive separate company taxable income bears to the total of the positive separate company taxable incomes of all parties. However, the amount allocable to any party that is an insurance company will not exceed the amount that the member would recognize if it were filing a separate federal income tax return. This method of allocation is subject to the terms of a written tax sharing agreement among the members of the consolidated group.

The Company is a party to a Risk Management Service Agreement with American Insurance Administration ("AIA"); the agreement was effective on January 1, 2011. Under the terms of the agreement, AIA acts as a consultant for risk management services on commercial workers' compensation policies in Pennsylvania, Delaware and Maryland per the written and oral instructions of the Company. The terms of the agreement is for one year and may be extended for additional annual terms by mutual verbal agreement. Consideration is on a monthly fee basis plus expenses.

The Company also entered into a Risk Management Services Agreement with The Securus Group on January 24, 2011. Under the terms of the agreement, The Securus Group will perform as a consultant who shall perform risk management services on such insured's policies and at such time as the Company deems appropriate. The policies covered will be those of The Securus Group and The Dunlop-Berkshire Agency.

## REINSURANCE

### INTERCOMPANY POOLING

The Company operates under an Intercompany Pooling Agreement with three of its affiliates. The current agreement was amended and restated effective September 30, 2008 to include Employers Security Insurance Company. The agreement provides that premiums, loss expenses, underwriting expenses, premiums in the course of collection and reinsurance recoverable on loss payments of the companies, net of reinsurance with non-affiliates, be pooled and then allocated to each company based on its proportional share. Premiums excluded from the agreement include premiums assumed from participation in mandatory pools and business classified as alternative markets. As of December 31, 2011, member companies of the pooling agreement, pooling percentages, and state of domicile are listed below:

<u>Company</u>	<u>Percentage</u>
Eastern Alliance Insurance Company (PA)	61.0%
Allied Eastern Indemnity Company (PA)	13.0%
Eastern Advantage Assurance Company (PA)	13.0%
Employers Security Insurance Company (IN)	13.0%

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### QUOTA SHARE REINSURANCE AGREEMENT

The Company maintains quota share reinsurance agreement with its affiliate, Eastern Re Limited ("Eastern Re"), in which Eastern Re assumes 100% of the premiums written on the Company's alternative market program. The agreements represent a fronting arrangement whereby the Company writes business for each insured which becomes a party to the segregated portfolio. The Company charges a fronting fee for such alternative market program.

### EXCESS OF LOSS

The Company entered into various excess of loss agreements with various Lloyd's Syndicates and Aspen Insurance UK Limited for its traditional workers' compensation and employers' liability coverage. The agreements are effective May 1, 2011 for one year. The agreement also provide reinsurance coverage to its affiliated insurance companies: Allied Eastern Indemnity Company, Eastern Advantage Assurance Company, and Employers Security Insurance Company.

The following is a summary of each agreement:

### TRADITIONAL EXCESS OF LOSS

Reinsureds: Eastern Alliance Insurance Group which includes Eastern Alliance Insurance Company, Allied Eastern Indemnity Company, Eastern Advantage Assurance Company and Employers Security Insurance Company.

Reinsurers:	<u>Part 1</u>	<u>Part 2</u>
Lloyds Syndicate 435	20.66%	33.20%
Lloyds Syndicate 566	14.52%	15.33%
Lloyds Syndicate 4472	10.00%	7.00%
Lloyds Syndicate 1955	4.82%	4.77%
Lloyds Syndicate 1084	4.82%	4.29%
Lloyds Syndicate 2001	<u>4.88%</u>	<u>4.75%</u>
	59.70%	69.34%
Aspen Insurance UK Ltd	<u>40.30%</u>	<u>30.66%</u>
Total	<u>100.0%</u>	<u>100.0%</u>

Type of Contract Workers Compensation (Traditional) Excess of Loss  
Coverage Workers Compensation and/or Employers Liability  
Part 1 - \$4.5 million XS \$0.5 million per occurrence  
Part 2 - \$5.0 million XS \$5.0 million per occurrence  
Effective date May 1, 2011 to April 30, 2012

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Intermediary Towers Watson (Re)Insurance Brokers, Ltd  
Retention Part 1 - \$500,000 Ultimate Net Loss per occurrence  
Part 2 - \$5.0 million Ultimate Net Loss per occurrence

### FIRST CLASH EXCESS OF LOSS

Reinsureds: Eastern Alliance Insurance Group which includes Eastern Alliance Insurance Company, Allied Eastern Indemnity Company, Eastern Advantage Assurance Company and Employers Security Insurance Company.

Reinsurers:	<u>Participation</u>
Lloyds Syndicate 435	13.84%
Lloyds Syndicate 566	21.32%
Lloyds Syndicate 4472	5.69%
Lloyds Syndicate 727	2.84%
Lloyds Syndicate 1955	5.28%
Lloyds Syndicate 570	3.78%
Lloyds Syndicate 780	2.36%
Lloyds Syndicate 1084	4.85%
Lloyds Syndicate 2623	3.06%
Lloyds Syndicate 623	0.72%
Lloyds Syndicate 2001	5.28%
Lloyds Syndicate 2987	2.36%
Lloyds Syndicate 2003	<u>2.84%</u>
	74.22%
Aspen Insurance UK Ltd	<u>25.78%</u>
Total	<u>100.0%</u>

Type of Contract First Clash Excess of Loss

Coverage \$10.0 million XS \$10.0 million each Loss Occurrence. Reinsurers shall be liable for the Ultimate Net Loss in excess of \$10.0 million with a limit to Reinsurers of \$10.0 million Ultimate Net Loss per occurrence, subject to a maximum recoverable of \$10.0 million in the aggregate in respect of acts of terrorism.

Effective date May 1, 2011 to April 30, 2012

Intermediary Towers Watson (Re)Insurance Brokers, Ltd

## Allied Eastern Indemnity Company

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### SECOND CLASH EXCESS OF LOSS

Reinsureds: Eastern Alliance Insurance Group which includes Eastern Alliance Insurance Company, Allied Eastern Indemnity Company, Eastern Advantage Assurance Company and Employers Security Insurance Company.

Reinsurers:	<u>Participation</u>
Lloyds Syndicate 435	13.84%
Lloyds Syndicate 566	20.50%
Lloyds Syndicate 4472	5.20%
Lloyds Syndicate 2791	4.35%
Lloyds Syndicate 1955	4.85%
Lloyds Syndicate 570	3.50%
Lloyds Syndicate 780	2.36%
Lloyds Syndicate 2623	2.30%
Lloyds Syndicate 623	0.54%
Lloyds Syndicate 727	2.84%
Lloyds Syndicate 1084	4.85%
Lloyds Syndicate 2001	4.85%
Lloyds Syndicate 2987	2.68%
Lloyds Syndicate 2003	<u>2.84%</u>
	<u>75.40%</u>
Aspen Insurance UK Ltd	<u>24.60%</u>
Total	<u>100.0%</u>

Type of Contract Second Clash Excess of Loss

Coverage \$20.0 million XS \$20.0 million each Loss Occurrence. Reinsurers shall be liable for the Ultimate Net Loss in excess of \$20.0 million with a limit to Reinsurers of \$20.0 million Ultimate Net Loss per occurrence, subject to a maximum recoverable of \$20.0 million in the aggregate in respect of acts of terrorism.

Effective date May 1, 2011 to April 30, 2012

Intermediary Towers Watson (Re)Insurance Brokers, Ltd

The Company's reinsurance intermediary, Towers Watson (Re)Insurance Brokers, Ltd is licensed by the Department as required by 40 P.S. §321.2 (a) Reinsurance intermediaries; licensing. The Company also has this program operating pursuant to a properly executed written authorization between the Company and Towers Watson (Re)Insurance Brokers, Ltd as required by Pennsylvania Insurance Company Law.

All agreements include an appropriate insolvency clause and meet the risk transfer requirements.

**ASSUMED**

The Company assumes business from the Intercompany Pooling Agreement mentioned above and certain mandatory reinsurance pools.

**TERRITORY AND PLAN OF OPERATION**

The Company is licensed in twenty-eight (“28”) states and the District of Columbia.

The Company provides workers’ compensation insurance to employers and employer associations in the Mid-Atlantic, Southeast, and Mid-West Regions of the United States. The Company’s workers’ compensation products include guaranteed cost policies, policyholder dividend policies, retrospectively-rated policies, deductible policies and alternative market programs. The products are offered through a network of independent insurance agents.

The Company’s total net written premium for the year ending December 31, 2011, is as follows:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
December 31, 2011				
Workers’ compensation	57,366,053	42,755,969	14,610,084	100.0%
Totals	<u>\$ 57,366,053</u>	<u>\$ 42,755,969</u>	<u>\$ 14,610,084</u>	<u>100.0%</u>

**SIGNIFICANT OPERATING RATIOS AND TRENDS**

The underwriting ratios summarized below are on an earned/incurred basis, and encompass the five-year period covered by this examination.

	Amount	Percentage
Premiums earned	\$ 49,735,602	100.0 %
Losses incurred	\$ 26,633,089	53.6 %
Loss expenses incurred	4,347,822	8.7 %
Other underwriting expenses incurred	13,269,447	26.7 %
Net underwriting gain or (loss)	5,485,244	11.0 %
Totals	<u>\$ 49,735,602</u>	<u>100.0 %</u>

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The Company reported the following net underwriting, investment and other gains or losses during the period under examination:

	2011	2010	2009	2008	2007
Admitted assets	\$ 30,698,900	\$ 28,571,957	\$ 27,132,540	\$ 26,152,980	\$ 23,330,611
Liabilities	\$ 21,595,800	\$ 20,175,335	\$ 18,598,208	\$ 15,884,119	\$ 13,877,018
Surplus as regards policyholders	\$ 9,103,100	\$ 8,396,622	\$ 8,534,332	\$ 10,268,861	\$ 9,453,593
Gross premium written	\$ 57,366,053	\$ 47,128,113	\$ 42,022,033	\$ 36,581,466	\$ 39,819,763
Net premium written	\$ 14,610,084	\$ 11,930,599	\$ 10,026,016	\$ 9,015,301	\$ 7,663,757
Underwriting gain/(loss)	\$ 1,051,775	\$ (169,673)	\$ 385,343	\$ 1,479,636	\$ 2,738,163
Investment gain/(loss)	\$ 115,408	\$ 101,162	\$ 157,424	\$ 268,390	\$ 462,329
Other gain/(loss)	\$ 31,830	\$ (4,318)	\$ (31,966)	\$ (2,046)	\$ (32,003)
Net income	\$ 608,909	\$ (195,399)	\$ 213,944	\$ 1,013,202	\$ 2,035,661

### ACCOUNTS AND RECORDS

The Company's accounting, investment, policy and claim records are kept at the Home Office, located at 25 Race Avenue, Lancaster, Pennsylvania.

The Company uses the Enterprise Accounting System, a product of Sungard Insurance System ("Sungard"), for its General Ledger/Financial Reporting functions. The Investment Accounting functions are outsourced to Sungard.

Claims Management is handled internally using Corporate Systems ClaimSuite from Marsh & McLennan LLC.

Underwriting and premium records are processed and maintained on the workers' compensation system of AGO Insurance Software, Inc.

### PENDING LITIGATION

There is no pending litigation which could have a material effect on the Company's financial condition.

### FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2011, and the results of its operations for the five-year period under examination, are reflected in the following statements:

- Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
- Comparative Statement of Income;
- Comparative Statement of Capital and Surplus; and
- Comparative Statement of Cash Flow

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

	2011	2010	2009	2008	2007
Bonds	\$ 4,945,898	\$ 3,514,373	\$ 2,531,351	\$ 4,981,921	\$ 3,160,989
Cash, cash equivalents, and short term investments	5,370,975	5,354,533	8,381,006	11,518,002	3,526,750
Subtotals, cash and invested assets	10,316,873	8,868,906	10,912,357	16,499,923	6,687,739
Investment income due and accrued	39,397	21,687	17,026	55,454	53,097
Premiums and agents' balances due	17,575,791	18,217,511	14,677,333	9,114,763	16,142,965
Amounts recoverable from reinsurers	726,582	0	0	0	0
Current federal and foreign income tax recoverable and interest thereon	0	20,866	0	0	0
Net deferred tax asset	752,937	620,959	540,770	482,840	446,810
Receivable from parent, subsidiaries and affiliates	1,287,320	822,028	985,054	0	0
<b>Total</b>	<b>\$ 30,698,900</b>	<b>\$ 28,571,957</b>	<b>\$ 27,132,540</b>	<b>\$ 26,152,980</b>	<b>\$ 23,330,611</b>
Losses	\$ 8,964,195	\$ 7,628,510	\$ 6,567,506	\$ 6,076,461	\$ 4,848,606
Reinsurance payable on paid loss and loss adjustment expenses	0	962,925	1,883,634	624,695	482,314
Loss adjustment expenses	1,100,472	1,030,474	880,223	682,554	558,153
Commissions payable, contingent commissions and other similar charges	795,884	593,163	661,288	626,758	289,279
Other expenses	69,937	451,741	582,717	132,581	233,782
Taxes, licenses and fees	446,914	270,215	466,963	199,472	275,841
Current federal and foreign income taxes	23,011	0	251,010	65,685	229,522
Unearned premiums	6,501,425	5,397,888	4,497,343	3,781,472	3,205,753
Advance premium	160,485	248,191	202,684	255,787	152,992
Dividends declared and unpaid:					
Policyholders'	38,770	6,513	2,861	34,592	3,927
Ceded reinsurance premiums payable (net of ceding commissions)	1,283,250	1,474,569	101,603	868,844	1,122,072
Funds held by company under reinsurance treaties	140,000	140,000	120,000	100,000	80,000
Amounts withheld or retained by company for account of others	2,013,731	1,932,928	2,023,932	1,848,422	2,036,366
Remittances and items not allocated	56,313	36,805	35,760	28,787	59,343
Drafts outstanding	1,413	1,413	1,413	0	0
Payable to parent, subsidiaries and affiliates	0	0	0	291,577	136,624
Aggregate write-ins for liabilities	0	0	319,271	266,432	162,444
<b>Total liabilities</b>	<b>21,595,800</b>	<b>20,175,335</b>	<b>18,598,208</b>	<b>15,884,119</b>	<b>13,877,018</b>
Common capital stock	2,501,250	2,025,000	2,025,000	2,025,000	750,000
Gross paid in and contributed surplus	758,750	1,235,000	1,235,000	1,235,000	2,510,000
Unassigned funds (surplus)	5,843,100	5,136,622	5,274,332	7,008,861	6,193,593
Surplus as regards policyholders	9,103,100	8,396,622	8,534,332	10,268,861	9,453,593
<b>Totals</b>	<b>\$ 30,698,900</b>	<b>\$ 28,571,957</b>	<b>\$ 27,132,540</b>	<b>\$ 26,152,980</b>	<b>\$ 23,330,611</b>

For Information Purposes Only

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Comparative Statement of Income  
For the Year Ended December 31,

	2011	2010	2009	2008	2007
<b>Underwriting Income</b>					
Premiums earned	\$ 13,565,234	\$ 11,030,053	\$ 9,310,146	\$ 8,439,582	\$ 7,390,587
Deductions:					
Losses incurred	7,963,051	6,578,977	4,974,721	4,190,173	2,926,167
Loss expenses incurred	1,028,534	1,145,712	1,020,179	651,880	501,517
Other underwriting expenses incurred	3,521,874	3,475,037	2,929,903	2,117,893	1,224,740
Total underwriting deductions	12,513,459	11,199,726	8,924,803	6,959,946	4,652,424
Net underwriting gain or (loss)	1,051,775	(169,673)	385,343	1,479,636	2,738,163
<b>Investment Income</b>					
Net investment income earned	117,799	101,162	114,698	268,390	438,668
Net realized capital gains or (losses)	(2,391)	0	42,726	0	23,661
Net investment gain or (loss)	115,408	101,162	157,424	268,390	462,329
<b>Other Income</b>					
Net gain or (loss) from agents' or premium balances charged off	(82,169)	(22,518)	(49,926)	(18,201)	(46,678)
Finance and service charges not included in premiums	113,999	18,200	17,960	16,155	14,675
Total other income	31,830	(4,318)	(31,966)	(2,046)	(32,003)
Net income before dividends to policyholders and before federal and foreign income taxes	1,199,013	(72,829)	510,801	1,745,980	3,168,489
Dividends to policyholders	99,988	80,967	62,294	66,181	37,045
Federal and foreign income taxes incurred	490,116	41,603	234,563	666,597	1,095,783
Net income	\$ 608,909	\$ (195,399)	\$ 213,944	\$ 1,013,202	\$ 2,035,661

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Comparative Statement of Capital and Surplus  
For the Year Ended December 31,

	2011	2010	2009	2008	2007
Surplus as regards policyholders,					
December 31, previous year	\$ 8,396,622	\$ 8,534,332	\$ 10,268,861	\$ 9,453,593	\$ 7,460,441
Net income	608,909	(195,399)	213,944	1,013,202	2,035,661
Change in net deferred income tax	109,869	115,653	220,548	65,400	46,487
Change in nonadmitted assets	(12,301)	(57,964)	(169,020)	41,976	(88,995)
Cumulative effect of changes in accounting principles	0	0	0	(305,310)	0
Capital changes:					
Transferred from surplus (Stock Dividend)	476,250	0	0	0	0
Transferred to surplus	0	0	0	1,275,000	0
Surplus adjustments:					
Paid in	(476,250)	0	0	(1,275,000)	0
Transferred to capital (Stock Dividend)	0	0	(2,000,000)	0	0
Aggregate write-ins for gains and losses in surplus	1	0	(1)	0	(1)
Change in surplus as regards policyholder for the year	<u>706,478</u>	<u>(137,710)</u>	<u>(1,734,529)</u>	<u>815,268</u>	<u>1,993,152</u>
Surplus as regards policyholders,					
December 31, current year	<u>\$ 9,103,100</u>	<u>\$ 8,396,622</u>	<u>\$ 8,534,332</u>	<u>\$ 10,268,861</u>	<u>\$ 9,453,593</u>

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**Comparative Statement of Cash Flow  
For the Year Ended December 31,**

	2011	2010	2009	2008	2007
<b>Cash from Operations</b>					
Premiums collected net of reinsurance	\$ 14,997,056	\$ 9,786,393	\$ 3,636,704	\$ 15,964,417	\$ 3,567,784
Net investment income	141,452	120,630	169,397	285,234	412,848
Miscellaneous income	31,830	(4,318)	(31,966)	(2,046)	(32,003)
Total income	<u>15,170,338</u>	<u>9,902,705</u>	<u>3,774,135</u>	<u>16,247,605</u>	<u>3,948,629</u>
Benefit and loss related payments	8,316,873	6,438,682	3,224,737	3,096,155	3,063,957
Commissions, expenses paid and aggregate write-ins for deductions	4,486,727	4,866,512	2,999,396	2,515,074	1,694,595
Dividends to policyholders	67,731	77,315	94,025	35,516	35,128
Federal and foreign income taxes paid (recovered)	446,239	313,479	72,245	830,434	1,577,609
Total deductions	<u>13,317,570</u>	<u>11,695,988</u>	<u>6,390,403</u>	<u>6,477,179</u>	<u>6,371,289</u>
Net cash from operations	<u>1,852,768</u>	<u>(1,793,283)</u>	<u>(2,616,268)</u>	<u>9,770,426</u>	<u>(2,422,660)</u>
<b>Cash from Investments</b>					
Proceeds from investments sold, matured or repaid:					
Bonds	320,888	38,024	2,499,170	62,441	1,512,185
Net gain or (loss) on cash and short-term investments	0	0	0	0	(112)
Total investment proceeds	<u>320,888</u>	<u>38,024</u>	<u>2,499,170</u>	<u>62,441</u>	<u>1,512,073</u>
Cost of investments acquired (long-term only):					
Bonds	1,792,236	1,045,009	0	1,902,053	1,980,325
Total investments acquired	<u>1,792,236</u>	<u>1,045,009</u>	<u>0</u>	<u>1,902,053</u>	<u>1,980,325</u>
Net cash from investments	<u>(1,471,348)</u>	<u>(1,006,985)</u>	<u>2,499,170</u>	<u>(1,839,612)</u>	<u>(468,252)</u>
<b>Cash from Financing and Miscellaneous Services</b>					
Other cash provided (applied):					
Capital and paid in surplus, less treasury stock	0	0	(2,000,000)	0	0
Other cash provided or (applied)	(364,978)	(226,205)	(1,019,898)	60,438	(240,851)
Net cash from financing and miscellaneous sources	<u>(364,978)</u>	<u>(226,205)</u>	<u>(3,019,898)</u>	<u>60,438</u>	<u>(240,851)</u>
<b>Reconciliation of cash and short-term investments:</b>					
Net change in cash and short-term investments	16,442	(3,026,473)	(3,136,996)	7,991,252	(3,131,763)
Cash and short-term investments:					
Beginning of the year	5,354,533	8,381,006	11,518,002	3,526,750	6,658,513
End of the year	<u>\$ 5,370,975</u>	<u>\$ 5,354,533</u>	<u>\$ 8,381,006</u>	<u>\$ 11,518,002</u>	<u>\$ 3,526,750</u>

### SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

### NOTES TO FINANCIAL STATEMENTS

#### ASSETS

#### INVESTMENTS

As of December 31, 2011, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 4,945,898	47.9 %
Cash	5,065,426	49.1 %
Short-term investments	305,549	3.0 %
Totals	<u>\$ 10,316,873</u>	<u>100.0 %</u>

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1 - highest quality	\$ 5,251,447	100.0 %
Totals	<u>\$ 5,251,447</u>	<u>100.0 %</u>

Years to Maturity	Amount	Percentage
1 year or less	\$ 681,351	13.0 %
2 to 5 years	3,860,149	73.5 %
6 to 10 years	590,542	11.2 %
11 to 20 years	5,470	0.1 %
over 20 years	113,935	2.2 %
Totals	<u>\$ 5,251,447</u>	<u>100.0 %</u>

As of December 31, 2011, the Company's bond portfolio consisted primarily of investments in Industrial and Miscellaneous and U.S. Government bonds, with 42.27% and 34.06%, respectively. All the securities within the portfolio received a NAIC Securities Valuation Office ("SVO") 'highest quality' rating.

The Company has a written investment policy as required by 40 P.S. § 653 b (b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company, at December 31, 2011, was following its investment policy.

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The Company's custodian agreement for its invested assets was determined to be in compliance with 31 Pa. Code §148a3.

### LIABILITIES

#### LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

Loss and loss adjustment expense reserves were reported in the Company's 2011 Annual Statement is as follows:

Loss reserves	\$ 8,964,195
Loss adjustment expense reserves	1,100,472
Total loss & adjustment expense reserves	<u>\$ 10,064,667</u>

The Company participates in an inter-company pooling arrangement. As of December 31, 2011, member companies of the pooling agreement, state of domicile, and pooling percentages are listed below:

<u>Company</u>	<u>Percentage</u>
Eastern Alliance Insurance Company (PA)	61.0%
Allied Eastern Indemnity Company (PA)	13.0%
Eastern Advantage Assurance Company (PA)	13.0%
Employers Security Insurance Company (IN)	13.0%

The Company's pooled loss and loss adjustment expense reserves for the period 2007 to 2011 were opined upon by Arthur I. Cohen, ACAS, MAAA of Ernst & Young, LLP ("E&Y") the Company's appointed actuary. In addition, semi-annual reviews are conducted by E&Y. For each year of the examination period, the Company's appointed actuary issued a Statement of Actuarial Opinion concluding that the Company's reserves make a reasonable provision in the aggregate for all unpaid loss and loss adjustment expenses, gross and net as to reinsurance ceded, under the terms of the Company's contracts and agreements.

The Company performs a full reserve analysis on a quarterly basis with any changes to carried Incurred But Not Reported reserve levels being made as necessary. In addition, the Company monitors and analyzes case reserve development for each quarter and year-end.

Effective July 1, 2008, the Company discontinued its policy of discounting its workers compensation loss reserves. As a result of this change in accounting principle and in accordance with SSAP #3, Accounting Changes and Corrections of Errors, the Company recorded an adjustment totaling \$305,310 that decreased statutory surplus as of January 1, 2008.

In order for the examination team to gain an adequate comfort level with the Company's loss and loss adjustment expense reserve estimates, the Department's internal actuarial staff performed a risk-focused review of the Company's loss and loss adjustment expense reserves in conjunction with this examination. Based upon the procedures performed and results obtained, the Department believes that the Company's reported loss and loss adjustment reserves makes a

reasonable provision for all unpaid loss and loss expense obligations of the Company as of December 31, 2011.

### **SUBSEQUENT EVENTS**

There were no material subsequent transactions or events at the close of the examination.

### **RECOMMENDATIONS**

#### **PRIOR EXAMINATION**

The prior examination report contained the following recommendations:

1. It was recommended the Company hold stockholder and Board of Directors meetings and ensure all actions are taken as required by the Company's By-laws and 15 Pa. C.S §§ 1725(a) and 1755(a).

The Company has complied with this recommendation.

2. It was recommended the Company enter into formal written agreements with all affiliates for which it receives services, as required under the provisions of 40 P.S. § 991.1405(a)(1)(iii).

The Company has complied with this recommendation.

3. It was recommended the Company enter into a formal written agreement with all affiliates which are included in the consolidated tax return, as required under the provisions of SSAP No. 10 and 40 P.S. § 432(a)(2).

The Company has complied with this recommendation.

4. It was recommended the Company change its reinsurance contracts which renew on May 1, 2008 to include an insolvency clause which complies with 40 P.S. § 442.1(c) and (d).

The Company has complied with this recommendation.

5. It was recommended the Company enter into a custodial agreement only with financial institutions and which includes all required provisions to comply with 31 Pa. Code § 148(a)3.

The Company has complied with this recommendation.

#### **CURRENT EXAMINATION**

There were no recommendations made as a result of this examination.

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### CONCLUSION

As a result of this examination, the financial condition of Allied Eastern Indemnity Company, as of December 31, 2011, was determined to be as follows:

	<b>Amount</b>	<b>Percentage</b>
Admitted assets	<u>\$ 30,698,900</u>	<u>100.0 %</u>
Liabilities	\$ 21,595,800	70.3 %
Surplus as regards policyholders	<u>9,103,100</u>	<u>29.7 %</u>
Total liabilities and surplus	<u>\$ 30,698,900</u>	<u>100.0 %</u>

Since the previous examination, made as of December 31, 2006, the Company's assets increased by \$8,716,904, its liabilities increased by \$7,074,243, and its surplus increased by \$1,642,661.

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This examination was conducted by Noble Consulting Services, Inc. representing Indiana Department of Insurance and the following from the PA Insurance Department: Matt Council, actuarial assistance from Melissa Greiner, and Robert A. Woronko, CPA, CFE with the latter in charge.

Respectfully



Annette B. Szady, CPA  
Director, Bureau of Financial Examinations



David R. Evans, CFE  
Examination Manager



Robert A. Woronko, CFE, CPA  
Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies.

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