# REPORT OF THE ANNUAL MEETING

April 19, 2005

Insurance Placement Facility of Pennsylvania

530 Walnut Street, Suite 1650
Philadelphia, PA 19106-3698

Board of Directors

2004 - 2005

| | |
|---|---|
| Mr. Karl M. Brondell, Chairman | State Farm Insurance Companies |
| Ms. Joanne K. Martyn, Vice Chairperson | Chubb Group of Insurance Companies |
| Ms. Susan A. Erney | The Harleysville Insurance Companies |
| Mr. John D. Fillippo | ACE USA |
| Ms. Wendy Lyles | Allstate Insurance Companies |
| Mr. William W. Martin | The Hartford |
| Mr. Terry McConnell | Erie Insurance Group |

| | |
|---|---|
| Mr. Samuel P. Gerace, Esq. | Jones, Gregg, Creehan & Gerace, LLP |
| Mr. John M. Ogle, General Manager | Insurance Placement Facility of Pennsylvania |

AGENDA FOR THE ANNUAL MEETING

INSURANCE PLACEMENT FACILITY OF PENNSYLVANIA

April 19, 2005 - 1:30 P.M.

---

1. Call to Order - 1:30 P.M. - Mr. Karl M. Brondell, Chairman, presiding
2. Approval of Minutes of Previous Year Annual Meeting - April 20, 2004
3. Ratification of Board Action
4. Report of the Chairman
5. Report of the General Manager
6. Treasurer's Report
7. Other Business
8. Election of Board of Directors 2005 - 2006

   Nominations are :

   1) ACE USA
   2) Allstate Insurance Companies
   3) Chubb Group of Insurance Companies
   4) Erie Insurance Group
   5) State Farm Insurance Companies
   6) The Harleysville Insurance Companies
   7) The Hartford
9. Adjournment of Meeting

Insurance Placement Facility of Pennsylvania
Minutes of the Annual Meeting
April 19, 2005
Administrative Offices of the Facility
1:30 p.m.
530 Walnut Street, Suite 1650
Philadelphia, PA

The Annual Meeting of the Insurance Placement Facility of Pennsylvania was called to order with Chairman Karl M. Brondell presiding. General Manger John M. Ogle served as secretary and reported that a quorum was present or by proxy. Mr. Ogle reported that attendees represented 176 companies or 58.18% of the membership.

Upon motion duly made, seconded and carried, the Minutes of the April 20, 2004 Annual Meeting were approved as distributed.

A motion to ratify the actions of the Board of Directors for the 2004-2005 term was duly made, seconded and carried.

Motions were made seconded and carried to waive the reading of the Chairman's report, the General Manger's report and the Treasurer's report as all three reports will be incorporated into the Annual Report submitted to Member Companies. The reports were accepted as presented.

The General Manger noted the 2004 financial audit report provided by the accounting firm of KPMG Peat Marwick was presented to the Facility's Audit Committee at a recent meeting. The final report will be presented to the Board of Directors and made part of the Annual Report submitted to Member Companies.

With no other new business, Nominating Committee Chairman Mr. William W. Martin, placed into nomination the following Member Companies to serve on the Board of Directors for the 2005-2006 term.

ACE USA
Allstate Insurance Companies
Chub Group of Insurance Companies
Erie Insurance Group
State Farm Insurance Companies
The Harleysville Insurance Companies
The Hartford

There being no other nominations, it was moved, seconded and carried to close nominations. Chairman Brondell requested and received confirmation from the secretary that a sufficient amount of ballots had been cast for the nominees. Mr. Ogle reported that 57.08% of the membership indicated their intention to cast ballots in person or by proxy in favor of the nominees. Therefore, upon motion duly made seconded and carried, the slate was declared elected.

The next annual meeting was set for April 2006.

There being no further business and upon motion duly made, seconded and carried, the meeting was adjourned.

| | |
|---|---|
| Approved by | Respectfully submitted by, |
| Mr. Karl M. Brondell | Mr. John M. Ogle |
| Chairman of the Board | General Manager |

Report of the Chairman

Mr. Karl M. Brondell

37th Annual Meeting of Members

of

The Insurance Placement Facility of Pennsylvania

April 19, 2005

1:30 p.m.

Good afternoon and welcome to the 37th Annual Meeting of the Members of the Insurance Placement Facility of Pennsylvania. As Chairman, it is my pleasure to report on the operations of the Association for the past year. While many of these areas will be covered in detail in the General Manager's Report, I am very pleased to report to you that the Association continues to fully meet its obligations as required by the relevant Pennsylvania laws and regulations.

It has been more than 36 years since the first FAIR Plan policy was written and the first claim paid. Over that time, much has changed in the world in which we do business. Our first policies were typed by a clerical staff, matched to the appropriate policy documents by a policy preparation staff and folded into envelopes by a mail room staff. In addition, the organization had separate job descriptions for rating, endorsements, cancellations, quality check, etc. Now, information is routinely imaged and faxed electronically. Much of the work is processed in just a few keystrokes and an interactive website and e-mail system have nearly replaced the routine handwritten letter.

As productivity increased and our work volumes rose, our staff levels declined. To illustrate, staffing levels have declined nearly 80% since 1979. Currently there are 41 employees. Today's employee performs his or her duties with an unparalleled knowledge of the inner workings of the underwriting, claims or accounting process. Employees now routinely complete all functions handled by their respective departments and in addition, often lend themselves to other departments to assist in times of increased volume or limited staffing. During the many ups and downs of the marketplace, from typewriters to E-mail, these employees have continued to provide high quality service to the property owners, the agents, and the Pennsylvania insurance industry in general.

I believe it is important to note these efforts because it is through these employees that the Plan is able to meet its goals and objectives. I am pleased to report that for many years now, the Pennsylvania FAIR Plan has produced high quality service while maintaining one of the lowest cost per policy of any of the other FAIR Plans in the nation. This past year has been no exception and my hat is off to all employees.

As 2003 rolled into 2004, work volumes fluctuated rather dramatically. The Plan closed 2003 with an additional 2,200 applications and a higher policy count of 48,779. Through the first half of 2004, those volumes continued, but beginning in July, the market began to change and our activity ebbed. By year end 2004, our applications counts were off 6.7% from 2003 while our policy count fell by just under 1.6%. Losses Reported rose slightly as did our Loss Incurred and Loss Adjustment Expense. Both numbers were offset by a drop in General Expenses and the Pennsylvania Plan finished 2004 with an operational surplus of $1,237,942.

During the year, the Pennsylvania FAIR Plan continued to provide management and functional support for both the Delaware FAIR Plan and the West Virginia Essential Property Insurance Association. In addition, the Pennsylvania Plan provides crime insurance protection as well as the basic property insurance offered to the citizens of Pennsylvania. Although these programs remain small, management has continued to provide the same high quality and professional service to all policyholders and member companies

Throughout the year, the organization experienced numerous changes to its Board and Governing Committees. To those individuals who have left us but gave so freely of their time and expertise, I would like to express my gratitude for their efforts. It is clear the insurance industry is made up of many talented and professional individuals and this organization is fortunate to have had many of those same people serving on our Board and Governing Committees.

As I complete my second term and step down as your Chairman, I am greatly appreciative of the efforts of so many people. I would like to thank General Manager John Ogle and his staff for their diligent efforts in operating the organization in an efficient and effective manner. Without their dedication, little of what we accomplish in the Board Room would ever become reality. I would also like to take this opportunity to thank General Counsel Samuel Gerace for his timely and thorough advice. I wish to also recognize and thank the Pennsylvania Insurance Department for their active participation and involvement. Lastly, I would like to thank each of my fellow Board and Committee Members for their individual contributions to this organization. Your support is gratifying and I am confident that the Pennsylvania FAIR Plan remains in capable hands.

Respectfully submitted,

Mr. Karl M. Brondell
Chairman of the Board

Report of the General Manager
Mr. John M. Ogle
Insurance Placement Facility of Pennsylvania
Annual Meeting
April 19, 2005
Philadelphia, PA
1:30 p.m.

Good Afternoon. It is a pleasure to be with you on this, the 37th Annual Meeting of the Insurance Placement Facility of Pennsylvania.

This past year the Plan saw the growth trend of the past two years finally come to an end. New Applications Received rose steadily for 18 consecutive months beginning in January 2002 but as we moved through mid summer 2004, growth slowed considerably and by the fourth quarter, application counts were appreciably lower. At year end 2004, the Plan recorded a 6.7% decline in total applications received. The drop in New Business impacted the total book in that our Total Policies Issued counts fell by 1.59%.

The Plan recorded Earned Premiums of $13,128,250 in 2004, an increase of 5.2%. Loss Incurred rose 3.8% to $5,892,613 and Loss Adjustment Expenses Incurred finished at $1,468,557. General Expenses declined 21% to $4,630,734 resulting in a 2004 Underwriting Surplus of $1,237,942. Taking into account Investment Income and other Income and Expenses, the Pennsylvania FAIR Plan recorded a Net Result of Operations of $1,237,942.

Although 2004 will be remembered by the insurance industry as the year of the big storms, their impact on the Pennsylvania FAIR Plan was limited. Of the 1,161 losses reported in 2004, 265 were catastrophe related with an Incurred of $264,984. Although the Plan saw an increase in large losses and an increase in the severity of loss; the year was strikingly similar to 2003 in that claim mix remained virtually unchanged despite a 2% increase in Losses Reported.

We will remember this past year not for the storms or any large fire loss, but for the uncertainties. Not only did the Plan have to contend with the uncertainties of the increasing business during the first part of the year, but also we contended with the retirements of two key individuals, Mrs. Alice Tracey, our long time Underwriting Department Supervisor and Mr. Wayne Rieck, our Accounting Department Manager for more than 20 years. Both individuals contributed greatly to the success of the organization and both will be missed for many years to come.

As we approach our 38th year of operation, the Plan appears headed for another change in the marketplace. As the insurance industry again adjusts itself to the changing conditions of the marketplace, the impact on the FAIR Plan is unknown. Although the future is cloudy, the Plan is prepared to meet the challenges that lie ahead. The Pennsylvania FAIR Plan remains committed to operating a professional and efficient organization to service the property insurance industry as well as the insurance buying public.

In closing, I would like to thank General Counsel Gerace for his tireless efforts and attention to detail in assisting the Plan throughout the year. I would also like to thank the Pennsylvania Insurance Department for their input and guidance throughout 2004.

The Pennsylvania FAIR Plan is fortunate to have the contribution of many talented Board and Committee Members. I would like to extend my gratitude to each individual for contributing their expertise, advice and most of all, their support. Specially, I would like to thank Chairman Karl Brondell for his years of service to the Plan. Karl proved to be of great assistance throughout these past years and his leadership will be missed. Lastly, I would like to thank the individual employees, management and staff alike, for their dedication and commitment to the organization. It is because of their fine efforts that we can look back on a successful year and look forward to the challenges of the future.

Respectively,

John M. Ogle, CPCU
General Manager

# INSURANCE PLACEMENT FACILITY OF PENNSYLVANIA

## PENNSYLVANIA FAIR PLAN

### Treasurer's Report

December 31, 2004

**ASSETS**

| | |
|---|---|
| Cash in Bank | 1,809,379.82 |
| Investments, Short term at cost plus accumulated discount | 8,585,466.11 |
| Accrued Investment Income | 0.00 |
| Due from Participating Members | 0.00 |
| Premiums Receivable | 19,287.31 |
| Other Receivables | 210,117.94 |
| Prepaid Premium Tax | 0.00 |
| Equipment * | 0.00 |
| Total Assets | 10,624,251.18 |

**LIABILITIES AND MEMBERS' EQUITY**

| | |
|---|---|
| Unearned Premiums | 7,066,260.00 |
| Unearned Advance Premiums | 282,683.00 |
| Outstanding Losses | 2,375,852.00 |
| Outstanding Loss Adjustment Expenses | 445,216.00 |
| Accrued Expenses | 116,730.00 |
| Unpaid Post Retirement Benefits | 2,027,948.00 |
| Accounts Payable | 162,224.97 |
| Claims Checks Payable | 551,184.26 |
| Unpaid Premium Tax | 47,880.46 |
| Total Liabilities | 13,075,978.69 |
| Members' Equity (Deficit) | (2,451,727.51) |
| Total Liabilities and Members' Equity | 10,624,251.18 |

Respectfully Submitted,

RoseMarie McDonald
Accounting Manager

* E. D. P. Equipment

KPMG

**KPMG LLP**
1601 Market Street
Philadelphia, PA 19103-2499

## Independent Auditors' Report

The Board of Directors
Insurance Placement Facility of Pennsylvania:

We have audited the accompanying statutory statements of admitted assets, liabilities, and members' deficit of Insurance Placement Facility of Pennsylvania (the Facility) as of December 31, 2004 and 2003, and the related statutory statements of operations and members' deficit and cash flows for the years then ended. These statutory financial statements are the responsibility of the Facility's management. Our responsibility is to express an opinion on these statutory financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in note 1 to the statutory financial statements, the Facility prepared these statutory financial statements using accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania, which differ from accounting principles generally accepted in the United States of America. The effects on the statutory financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

The Facility's liabilities exceeded its assets by $2,507,910 at December 31, 2004 and $3,647,430 at December 31, 2003. Such amounts, however, are recoverable from member companies (note 2).

In our opinion, because of the effects of the matter discussed in the third paragraph, the statutory financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Insurance Placement Facility of Pennsylvania as of December 31, 2004 and 2003, or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and members' deficit of Insurance Placement Facility of Pennsylvania as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in note 1.

As discussed in note 6, the Facility changed the manner in which its accounts for its additional minimum pension liabilities in 2004 to conform to the requirements of SSAP No. 89, *Accounting for Pensions, A Replacement of SSAP No. 8*.

Our audits were made for the purpose of forming an opinion on the basic statutory financial statements taken as a whole. The supplementary information included on the supplemental investment risk interrogatories in schedule 1 and the supplemental summary of investments in schedule 2 is presented for purposes of additional analysis and is not a required part of the basic statutory financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic statutory financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole.

KPMG LLP

March 25, 2005

**INSURANCE PLACEMENT FACILITY OF PENNSYLVANIA**

Statutory Statements of Admitted Assets, Liabilities, and Members' Deficit

December 31, 2004 and 2003

| **Admitted Assets** | | **2004** | **2003** |
|---|---|---|---|
| Fixed maturities at amortized cost (NAIC market – $6,817,983 in 2004) | $ | 6,825,907 | — |
| Cash and cash equivalents, at cost which approximates market value | | 3,568,939 | 8,345,734 |
| Due from related parties | | 210,118 | 170,819 |
| Premiums receivable | | 19,287 | 16,322 |
| Assessments receivable | | — | 141,170 |
| Total admitted assets | $ | 10,624,251 | 8,674,045 |
| **Liabilities and Members' Deficit** | | | |
| Liabilities: | | | |
| Unearned premiums | $ | 7,066,260 | 6,543,987 |
| Claims/drafts payable | | 551,184 | 544,966 |
| Unpaid losses and loss adjustment expenses | | 2,821,068 | 2,479,113 |
| Unearned advanced premiums | | 282,683 | 245,367 |
| Postretirement benefits payable | | 1,261,999 | 1,168,368 |
| Pension liability | | 822,131 | 1,025,653 |
| Other liabilities | | 326,836 | 314,021 |
| Total liabilities | | 13,132,161 | 12,321,475 |
| Members' deficit | | (2,507,910) | (3,647,430) |
| Total liabilities and members' deficit | $ | 10,624,251 | 8,674,045 |

See accompanying notes to statutory financial statements.

## INSURANCE PLACEMENT FACILITY OF PENNSYLVANIA

Statutory Statements of Operations and Members' Deficit

Years ended December 31, 2004 and 2003

| | | 2004 | 2003 |
|---|---|---|---|
| Underwriting: | | | |
| Premiums earned | $ | 13,128,250 | 12,480,467 |
| Less: | | | |
| Losses incurred | | 5,892,613 | 5,675,786 |
| Loss adjustment expenses incurred | | 1,468,557 | 859,659 |
| Underwriting and other expenses incurred | | 5,011,572 | 4,928,139 |
| | | 12,372,742 | 11,463,584 |
| Net underwriting gain | | 755,508 | 1,016,883 |
| Investment income | | 59,027 | 19,357 |
| Other income (expense): | | | |
| Premiums/assessments receivable charged off | | (10,945) | (24,528) |
| Other income | | 53,514 | 79,877 |
| Other income, net | | 42,569 | 55,349 |
| Net income | | 857,104 | 1,091,589 |
| Members' deficit, beginning of year | | (3,647,430) | (4,696,729) |
| Change in nonadmitted assets | | 74,952 | (48,952) |
| Change in minimum pension liability adjustment (note 6) | | 207,464 | — |
| Member contributions | | — | 2,232,480 |
| Refund to members | | — | (2,225,818) |
| Members' deficit, end of year | $ | (2,507,910) | (3,647,430) |

See accompanying notes to statutory financial statements.

## INSURANCE PLACEMENT FACILITY OF PENNSYLVANIA

Statutory Statements of Cash Flows

Years ended December 31, 2004 and 2003

| | | 2004 | 2003 |
|---|---|---|---|
| Cash flows from operations: | | | |
| Premiums collected, net | $ | 13,675,412 | 12,828,506 |
| Loss and adjustment expenses paid (net of salvage and subrogation) | | (7,012,998) | (6,298,149) |
| Underwriting expenses paid | | (4,894,110) | (4,593,673) |
| Investment income | | 47,436 | 19,357 |
| Premiums/assessments receivable charged off | | (10,945) | (24,528) |
| Other income | | 53,514 | 79,877 |
| Net cash from operations | | 1,858,309 | 2,011,390 |
| Cash from investments: | | | |
| Proceeds from investments sold, matured, or repaid: | | | |
| Fixed maturity investments | | 3,312,000 | — |
| Cost of investments acquired: | | | |
| Fixed maturity investments | | (10,126,315) | — |
| Net cash from financing and miscellaneous sources | | (6,814,315) | — |
| Cash flows from financing and other miscellaneous sources: | | | |
| Refunds to members, net of contributions | | 141,170 | (134,508) |
| Other, net | | 38,041 | (205,216) |
| Net cash from financing and other miscellaneous sources | | 179,211 | (339,724) |
| Net (decrease) increase in cash and cash equivalents | | (4,776,795) | 1,671,666 |
| Cash and cash equivalents: | | | |
| Beginning of year | | 8,345,734 | 6,674,068 |
| End of year | $ | 3,568,939 | 8,345,734 |

See accompanying notes to statutory financial statements.

## (1) Summary of Significant Accounting Policies

The statutory financial statements of Insurance Placement Facility of Pennsylvania (the Facility) have been prepared on the basis of accounting practices prescribed or permitted by the National Association of Insurance Commissioners (NAIC) and the Insurance Department of the Commonwealth of Pennsylvania.

The more significant accounting policies are as follows:

### *(a) Premiums*

Premiums are recognized as revenues ratably over the terms of the policies. Unearned premiums are computed on the monthly pro rata basis.

### *(b) Commissions*

Commissions and other costs of acquiring business are charged to operations as incurred.

### *(c) Nonadmitted Assets*

Certain assets designated as "nonadmitted" are not reflected in the statutory statements of admitted assets, liabilities, and members' deficit. Nonadmitted assets include furniture, fixtures, and leasehold improvements and are charged directly against members' deficit.

### *(d) Unpaid Losses and Loss Adjustment Expenses*

Unpaid losses and loss adjustment expenses are estimated based on losses reported and the Facility's past experience for losses incurred but not yet reported. Management believes that such provisions are adequate to cover the ultimate liability. However, such estimates could differ from the amounts ultimately paid when claims are settled. Subsequent changes in estimates are reflected in earnings currently.

### *(e) Use of Estimates*

The preparation of statutory financial statements in conformity with statutory accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### *(f) Variances from Generally Accepted Accounting Principles*

Certain of the prescribed or permitted insurance accounting practices followed by the Facility differ from accounting principles generally accepted in the United States of America. The principal differences are as follows. Under accounting principles generally accepted in the United States of America:

- Commissions and other acquisition costs, if recoverable from future operations, would be deferred and charged against operations on the same basis that related premiums are recognized as revenues.

- Certain assets designated as "nonadmitted" would be reflected in the statutory statements of admitted assets, liabilities, and members' deficit.

The effects on the statutory financial statements of these differences have not been determined.

*(g)* ***Invested Assets***

Bonds are carried at values prescribed by the Securities Valuation Office (SVO) of the NAIC. Bonds are generally carried at amortized cost. Estimated fair value of bonds is determined using values prescribed by the SVO that approximate quoted market values. Charges associated with investments that are other than temporarily impaired are reflected within the statutory statements of operations. Realized investment gains or losses are determined using the specific-identification method.

*(h)* ***Cash and Cash Equivalents***

Cash and cash equivalents include cash on hand and other highly liquid temporary investments. The carrying value of cash equivalents approximates fair value. Interest and dividend income from cash and cash equivalents is included in investment income on the statutory statements of operations.

*(i)* ***Reclassifications***

Certain prior year amounts have been reclassified to conform with the current year presentation.

**(2) General**

The Facility was created by an act of the General Assembly of the Commonwealth of Pennsylvania (The Pennsylvania Fair Plan Act) to make available basic property insurance against fire and other perils for residential and business properties located in the Commonwealth. Each authorized insurance company in the Commonwealth participates in the profits and losses of the Facility in the proportion that certain premiums written in the Commonwealth by each company during the second preceding calendar year bear to the aggregate of such premiums written by all authorized companies and is subject to future cash assessments, if required. Member deficits of $2,507,910 and $3,647,430 at December 31, 2004 and 2003, respectively, will ultimately be assessed to the participating companies.

The Facility shares office space and the service of certain employees with the Insurance Placement Facility of Delaware and the West Virginia Essential Property Insurance Association, both of which pay the Facility a portion of such joint expenses based on estimates of actual usage.

**(3) Federal Income Taxes**

The Facility files as a partnership for federal income tax purposes. Consequently, the Facility provides each member company with an annual statement of its relative share of the Facility's annual results of operations for inclusion in each participating member's tax return.

## (4) Investments

Investments as of December 31, 2004, the amortized cost and NAIC market value of investments in fixed maturities are as follows. NAIC market value approximates estimated fair value.

| 2004 | | Amortized cost | Gross unrealized gains | Gross unrealized losses | NAIC market value |
|---|---|---|---|---|---|
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | $ | 6,825,907 | — | 7,924 | 6,817,983 |

All fixed maturity investments at December 31, 2004, have contractual maturity dates within one year.

Proceeds from the sales of fixed maturities during the year ended December 31, 2004 were $3,312,000. Gross gains of $11,591 were realized on those sales during 2004.

The Company held securities with unrealized losses representing declines that were considered temporary at December 31, 2004 as follows:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies corporations and agencies | $ 6,817,983 | 7,924 | — | — | 6,817,983 | 7,924 |

The components of net investment income earned for the years ended December 31, 2004 and 2003 are as follows:

| | 2004 | 2003 |
|---|---|---|
| Fixed maturities | $ 25,127 | — |
| Cash and short-term investments | 33,900 | 19,357 |
| Investment income | $ 59,027 | 19,357 |

## (5) Fair Value Disclosures

The fair values of statutory financial statements presented below are estimates of the values at a specific point in time using market values published by the SVO.

At December 31, 2004, the carrying amounts and fair values of the Company's financial investments were as follows:

| | 2004 | |
|---|---|---|
| | **Carrying value** | **Fair value** |
| Fixed maturities | $ 6,825,907 | 6,817,983 |

## (6) Employee Benefits

The Facility, in conjunction with the Insurance Placement Facility of Delaware and the West Virginia Essential Property Insurance Association and other unaffiliated organizations, is a participant in the Benefits Connection Group Pension Plan, which covers all of its employees. The pension plan qualifies under the provisions of Section 501(a) of the *Internal Revenue Code* and is exempt from federal income taxes. The pension plan is funded through the trustee by contributions to group annuity contracts with two insurance companies.

The Facility uses a December 31 measurement date for its pension plan.

The following table sets forth the year-end status of the plan as it relates to the Facility:

| | 2004 | 2003 |
|---|---|---|
| Change in projected benefit obligation: | | |
| Benefit obligation at January 1 | $ 6,520,531 | 5,593,688 |
| Service cost | 180,639 | 172,466 |
| Interest cost | 393,807 | 388,011 |
| Actuarial loss | 301,354 | 526,169 |
| Benefits paid | (196,420) | (159,803) |
| Benefit obligation at December 31 | 7,199,911 | 6,520,531 |
| Change in plan assets: | | |
| Fair value of plan assets at January 1 | 4,489,137 | 3,720,039 |
| Actual return on plan assets | 847,062 | 888,106 |
| Employer contributions | 200,980 | 40,795 |
| Benefits paid | (196,420) | (159,803) |
| Fair value of plan assets at December 31 | 5,340,759 | 4,489,137 |
| Funded status | (1,859,152) | (2,031,394) |
| Unrecognized net actuarial loss | 1,325,169 | 1,501,353 |
| | $ (533,983) | (530,041) |

Weighted average assumptions used to determine benefit obligations at December 31:

| | 2004 | 2003 |
|---|---|---|
| Discount rate | 5.75% | 6.25% |
| Rate of compensation increase | 3.25 | 3.50 |

The net periodic pension cost for the plan includes the following components:

| | | 2004 | 2003 |
|---|---|---|---|
| Components of net periodic pension cost: | | | |
| Service cost | $ | 180,639 | 172,466 |
| Interest cost | | 393,807 | 388,011 |
| Expected return on plan assets | | (380,986) | (309,138) |
| Amount of loss recognized | | 82,671 | 278,702 |
| Net periodic pension cost | $ | 276,131 | 530,041 |

Weighted average assumptions used to determine the net periodic pension cost:

| | 2004 | 2003 |
|---|---|---|
| Discount rate | 6.25% | 6.75% |
| Expected long-term rate of return | 8.50 | 8.50 |
| Weighted average rate of compensation increase | 3.50 | 4.00 |

The accumulated benefit obligation for the plan was $6,162,890 and $5,514,790 at December 31, 2004 and 2003, respectively.

Accrued benefit cost recognized in the accompanying statutory statements of admitted assets, liabilities, and members' deficit was $822,131 and $1,025,653 at December 31, 2004 and 2003, respectively.

An additional minimum pension liability (AML) is required when the actuarial present value of the accumulated plan benefit obligation exceeds plan assets and accrued pension liabilities. As of December 31, 2004 and 2003, the Facility had an AML of $288,148 and $495,612, respectively.

The Facility changed the manner in which it accounts for the AML in 2004 to conform to the requirements of SSAP No. 89, *Accounting for Pensions, A Replacement of SSAP No. 8*. Pursuant to the requirements of SSAP No. 89, changes to the AML were recorded directly to members' deficit. Previously, changes to the AML were recorded through the statutory statement of operations. The decrease in the AML during 2004 was $207,464 and was credited directly to members' deficit. The decrease in the AML during 2003 was $323,116 and was recorded as a reduction of underwriting and other expenses in the accompanying statutory statement of operations. This accounting change did not have any effect on members' deficit at December 31, 2004 or 2003.



(Continued)

The benefit obligation excludes liabilities for nonvested employees, which were $607 and $9,180 at December 31, 2004 and 2003, respectively.

The expected long-term rate of return on assets assumption is 8.50%. As defined in *Financial Accounting Standards* (FAS 87), this assumption represents the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the benefit obligation. The assumption has been determined by reflecting expectations regarding future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class.

The plan's weighted average asset allocations at December 31, 2004 and 2003, by asset category are as follows:

| | 2004 | 2003 |
|---|---|---|
| Asset category | | |
| Equity securities | 59.0% | 61.5% |
| Debt securities | 38.0 | 38.5 |
| Cash | 3.0 | — |

The primary investment objective for the pension plan assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the plan administrator's board of directors. The pension asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the pension portfolio while maintaining acceptable levels of risk. The target asset allocation is 60% equity securities and 40% debt securities.

The Facility expects to contribute $324,984 to the plan in 2005.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | |
|---|---|
| 2005 | $ 214,246 |
| 2006 | 240,410 |
| 2007 | 253,166 |
| 2008 | 284,451 |
| 2009 | 309,870 |
| 2010-2014 | 2,175,422 |

The Facility provides life insurance for active employees upon the date of hire. The amount of insurance provided is equal to two times the employee's basic annual salary. For employees who are under age 65 at retirement, the Facility continues to pay the full cost of life insurance until the employee reaches age 65, at which time coverage is reduced to $5,000. For employees who retire at age 65 or older, the Facility pays the full cost of life insurance with coverage limited to $5,000.

Retired employees of the Facility are provided Medicare Supplement coverage. The Supplement provides coverage for certain hospital, surgical, and medical costs not covered by Medicare. To be eligible for the Supplement, a retiree must be 65 years of age or older and have at least five years of service with the Facility.

The Facility uses a December 31 measurement date for its postretirement benefit plan.

The following table sets forth the postretirement health care and life insurance benefit plan's funded status as of December 31, 2004 and 2003:

| | | 2004 | 2003 |
|---|---|---|---|
| Accumulated postretirement benefit obligation: | | | |
| Postretirement benefit obligation for retirees and fully vested plan participants | $ | 1,804,247 | 1,279,167 |
| Plan assets at fair value | | — | — |
| Accumulated postretirement benefit obligation in excess of plan assets | | 1,804,247 | 1,279,167 |
| Unrecognized loss | | (701,165) | (298,186) |
| Unrecognized prior service | | 158,917 | 187,387 |
| Accrued postretirement benefit cost | $ | 1,261,999 | 1,168,368 |

The following table represents a reconciliation of postretirement benefit cost for the years ended December 31, 2004 and 2003:

| | | 2004 | 2003 |
|---|---|---|---|
| Accrued postretirement benefit cost at January 1 | $ | 1,168,368 | 931,186 |
| Benefit expense for year | | 164,784 | 288,986 |
| Benefits paid during year | | (71,153) | (51,804) |
| Accrued postretirement benefit cost at December 31 | $ | 1,261,999 | 1,168,368 |

Weighted average assumptions used to determine benefit obligations at December 31:

| | 2004 | 2003 |
|---|---|---|
| Discount rate | 5.75% | 6.25% |
| Rate of compensation increase | 3.50 | 3.50 |



(Continued)

Net periodic postretirement benefit cost for 2004 and 2003 includes the following components:

| | | 2004 | 2003 |
|---|---|---|---|
| Service cost/eligibility cost | $ | 81,959 | 243,970 |
| Interest cost | | 80,816 | 62,620 |
| Amortization of loss | | 27,821 | 8,579 |
| Amortization of prior service cost | | (25,812) | (26,183) |
| Net periodic postretirement benefit cost | $ | 164,784 | 288,986 |

Weighted average assumptions used to determine the net periodic postretirement cost:

| | 2004 | 2003 |
|---|---|---|
| Discount rate | 6.25% | 6.75% |
| Weighted average rate of compensation increase | 3.50 | 3.50 |

For measurement purposes, for participants younger than age 65, healthcare cost trend increases of 12% and 11% were assumed for 2004 and 2003, respectively. These rate increases were assumed to decrease through 2011 and later when they level off at 5%. The healthcare cost trend rate assumption has an effect on the amounts reported. For example, increasing the assumed healthcare cost trend rate by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 2004 by $232,875 and net periodic postretirement benefit cost for the year ended December 31, 2004 by $26,716.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | | |
|---|---|---|
| 2005 | $ | 79,738 |
| 2006 | | 87,045 |
| 2007 | | 94,486 |
| 2008 | | 106,834 |
| 2009 | | 116,614 |
| 2010-2014 | | 773,131 |

The employees of the Facility are eligible to participate in the Benefits Connection Group 401(k) Savings Plan, a defined contribution plan. The plan is administered by the Administration Committee for Benefits Connection Group Savings Plan. Participation in the plan is voluntary. Employees are vested in employer contributions upon participation. Employees may contribute 1% to 16% of their annual compensation on a before-tax basis and/or 1% to 16% of their annual compensation on an after-tax basis for a total of 16%. The Facility matches employee contributions up to a maximum of 6% of an employee's annual compensation. Contributions by the Facility amounted to $99,987 and $106,356 in 2004 and 2003, respectively.

## (7) Liability for Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

| | | 2004 | 2003 |
|---|---|---|---|
| Balance, January 1 | $ | 2,479,113 | 2,326,834 |
| Incurred related to: | | | |
| Current year | | 7,940,428 | 6,339,427 |
| Prior years | | (579,258) | 196,018 |
| Total incurred | | 7,361,170 | 6,535,445 |
| Paid related to: | | | |
| Current year | | 5,250,567 | 3,940,874 |
| Prior years | | 1,768,648 | 2,442,292 |
| Total paid | | 7,019,215 | 6,383,166 |
| Balance, December 31 | $ | 2,821,068 | 2,479,113 |

As a result of changes in estimates for anticipated losses and loss adjustment expenses to insured events of prior years, the liability for losses and loss adjustment expenses (decreased)/increased by ($579,258) and $196,018 in 2004 and 2003, respectively.

## (8) Lease Commitments

The Facility conducts its operations in a leased premises under a lease that will expire April 30, 2008. At December 31, 2004, minimum rental commitments under this noncancelable lease are as follows:

| | | |
|---|---|---|
| Year ending December 31: | | |
| 2005 | $ | 239,838 |
| 2006 | | 250,839 |
| 2007 | | 250,839 |
| 2008 | | 83,613 |
| Total payments | $ | 825,129 |

Total rental expense was $259,326 and $255,637 in 2004 and 2003, respectively.

Rentals included above are net of amounts allocated to the Insurance Placement Facility of Delaware and the West Virginia Essential Property Insurance Association for common facilities.

## (9) Related Party Transactions

The Facility issues all checks for claims and other payables for the Insurance Placement Facility of Delaware and the West Virginia Essential Property Insurance Association, and is then reimbursed by these facilities. Throughout 2004 and 2003, $489,626 and $344,371, respectively, was paid on behalf of the Insurance Placement Facility of Delaware and $352,621 and $349,620, respectively, was paid on behalf of the West Virginia Essential Property Insurance Association. At December 31, 2004 and 2003, $30,077 and $14,773, respectively, is due from the Insurance Placement Facility of Delaware and $180,041 and $156,046, respectively, is due from the West Virginia Essential Property Insurance Association.

## (10) Annual Statement Reconciliation

The following is a reconciliation between the accompanying statutory financial statements and the annual statement for the years ended December 31, 2004 and 2003:

| | | 2004 | |
|---|---|---|---|
| | | **Net income** | **Members' deficit** |
| As reported in the annual statement | $ | 1,237,942 | (2,451,728) |
| 2003 underwriting and other expense adjustment | | (117,192) | — |
| 2004 underwriting and other expense adjustment | | (263,646) | (56,182) |
| As reported herein | $ | 857,104 | (2,507,910) |

| | | 2003 | |
|---|---|---|---|
| | | **Net income** | **Members' deficit** |
| As reported in the annual statement | $ | 128,468 | (3,764,622) |
| 2002 underwriting and other expense adjustment | | 845,929 | — |
| 2003 underwriting and other expense adjustment | | 117,192 | 117,192 |
| As reported herein | $ | 1,091,589 | (3,647,430) |

The underwriting and other expense adjustments relate to the additional minimum pension liability adjustments discussed in note 6.