

STATE OF INDIANA )  
 ) SS:  
COUNTY OF MARION ) COMMISSIONER OF INSURANCE

IN THE MATTER OF: )  
 )  
American Economy Insurance Company )  
175 Berkley Street )  
Boston, Massachusetts 02116 )

**Examination of American Economy Insurance  
Company**


**NOTICE OF ENTRY OF ORDER**

Enclosed is the Final Order entered by Stephen W. Robertson, Commissioner of the Indiana Department of Insurance, after fully considering and reviewing the Verified Report of Examination of **American Economy Insurance Company**, any relevant examination work papers, and any written submissions or rebuttals. The Verified Report of Examination, as sent to you on May 2, 2011, has been adopted by the Commissioner.

Pursuant to Ind. Code § 27-1-3.1-12(b), within thirty (30) days of receipt of the Final Order, each director of **American Economy Insurance Company** shall file an affidavit with the Indiana Department of Insurance stating that he/she has received a copy of the Verified Report of Examination and the Final Order.

The Final Order is a final administrative decision that may be appealed pursuant to Ind. Code § 4-21.5-5.

6/29/2011  
Date

  
Cynthia D. Donovan  
Chief Financial Examiner

**CERTIFIED MAIL NUMBER: 7005 3110 0002 4443 8585**

STATE OF INDIANA ) BEFORE THE INDIANA  
 ) SS:  
COUNTY OF MARION ) COMMISSIONER OF INSURANCE

IN THE MATTER OF: )  
 )  
American Economy Insurance Company )  
175 Berkley Street )  
Boston, Massachusetts 02116 )

**Examination of American Economy Insurance  
Company**

### **FINDINGS AND FINAL ORDER**

The Indiana Department of Insurance conducted an examination into the affairs of the **American Economy Insurance Company** (hereinafter "Company") for the time period January 1, 2005 through December 31, 2009.

The Verified Report of Examination was filed with the Commissioner of the Department of Insurance (hereinafter "Commissioner") by the Examiner on April 4, 2011.

A copy of the Verified Report of Examination, along with a Notice of Opportunity to Make Written Submission or Rebuttal, was mailed to the Company via Certified Mail on May 2, 2011 and was received by the Company on May 6, 2011.

The Company did not file any objections.

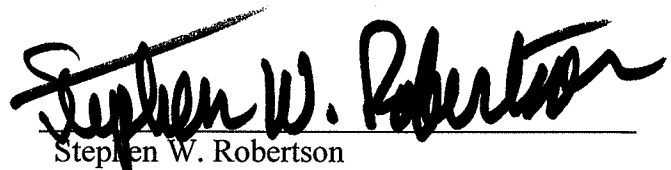
NOW THEREFORE, based on the Verified Report of Examination, I hereby make the following **FINDINGS**:

1. That the Verified Report of Examination is a true and accurate report of the financial condition and affairs of the **American Economy Insurance Company** as of December 31, 2009.
2. That the Examiner's Recommendations are reasonable and necessary in order for the **American Economy Insurance Company** to comply with the laws of the State of Indiana.

Based on the FINDINGS, the Commissioner does hereby ORDER:

1. Pursuant to Ind. Code § 27-1-3.1-11(a)(1), the Verified Report of Examination is adopted and shall be filed. Hereafter the Verified Report of Examination, may constitute prima facie evidence of the facts contained therein in any action or proceeding taken by the Indiana Department of Insurance against the Company, its officers, directors, or agents.
2. The Company shall comply with the Examiner's Recommendations enumerated in summary form and throughout the text of the Verified Report of Examination. A written response to these recommendations should be provided to the Department within 30 days of receipt of this order.
3. Compliance with the Examiner's recommendations shall be completed on or before the filing of the subsequent annual statement. In the event it is not feasible to comply with a recommendation before the filing of the subsequent annual statement, the Company shall submit a written explanation as to why it was not feasible with the filing of the annual statement.

Signed and Sealed this 29<sup>th</sup> day of  
June, 2011.

  
\_\_\_\_\_  
Stephen W. Robertson  
Insurance Commissioner  
Indiana Department of Insurance

**STATE OF INDIANA**

**Department of Insurance**

**REPORT OF EXAMINATION**

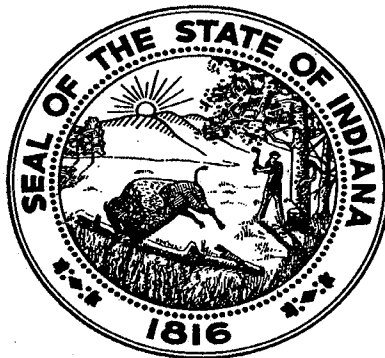
**OF**

**AMERICAN ECONOMY INSURANCE COMPANY**

NAIC Co. CODE 19690

As of

December 31, 2009



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# STATE OF INDIANA

MITCHELL E. DANIELS, JR., Governor

# IDOI

## INDIANA DEPARTMENT OF INSURANCE

311 W. WASHINGTON STREET, SUITE 300  
INDIANAPOLIS, INDIANA 46204-2787  
TELEPHONE: (317) 232-2385  
FAX: (317) 232-5251

April 5, 2011

Stephen W. Robertson, Commissioner

Honorable Joseph Torti, III  
Chair, NAIC Financial Condition (E) Committee  
Superintendent, State of Rhode Island  
Department of Business Regulation  
Division of Insurance  
1511 Pontiac Avenue, Building 69-2  
Cranston, Rhode Island 02920-4407

Honorable Stephen W. Robertson, Commissioner  
Indiana Department of Insurance  
Secretary, Midwestern Zone  
311 West Washington Street, Suite 300  
Indianapolis, Indiana 46204-2787

Honorable Mila Kofman, Superintendent  
Department of Professional and Financial Regulation  
Maine Bureau of Insurance  
Secretary, Northeastern Zone  
34 State House Station  
Augusta, Maine 04333-0034

Honorable Monica J. Lindeen, Commissioner  
Montana Office of the Commissioner of Securities and Insurance  
Secretary, Western Zone  
840 Helena Avenue  
Helena, Montana 59601

Dear Superintendents and Commissioners:

Pursuant to the authority vested in Appointment Number 3630, an examination has been made of the affairs and financial condition of:

**American Economy Insurance Company  
350 East 96<sup>th</sup> Street  
Indianapolis, IN 46240-3702**

hereinafter referred to as the "Company," an Indiana domestic, stock, property and casualty insurance company. The examination was conducted at the corporate offices of Liberty Mutual Insurance Company, in Boston, Massachusetts.

The Report of Examination, reflecting the status of the Company as of December 31, 2009, is hereby respectfully submitted.

ACCREDITED BY THE  
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

AGENCY SERVICES  
(317) 232-2413

COMPANY COMPLIANCE  
(317) 233-0697

CONSUMER SERVICES  
(317) 232-2395  
In-State 1-800-622-4461

EXAMINATIONS / FINANCIAL SERVICES  
(317) 232-2390

MEDICAL MALPRACTICE  
(317) 232-2402

SECURITIES / COMPANY RECORDS  
(317) 232-1991

## SCOPE OF EXAMINATION

The Company was last examined by representatives of Noble Consulting Services, Inc. (Noble) as of the period ending December 31, 2005. The present coordinated risk-focused examination was conducted by Noble and covered the period from January 1, 2006, through December 31, 2009, and included any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. The coordinated risk-focused examination was conducted by the states of Illinois and Indiana, with Indiana serving as the lead state. Additionally, the Massachusetts Division of Insurance (MA DOI) conducted an examination of the Liberty Mutual Pool (LM Pool) of Liberty Mutual Group Inc. (LMG) as of December 31, 2009. Certain areas of the examination were coordinated with MA DOI. The coordinated risk-focused examinations will be reviewed by the states of New Hampshire, Oregon, Washington, and Wisconsin for intended reliance.

David M. Shepherd, FCAS, MAAA, of Merlinos and Associates, Inc. was appointed by the Indiana Department of Insurance (IN DOI) and conducted a review of the Company's statutory reserves as of December 31, 2009. There were no actuarial adjustments resulting from the review performed by Merlinos and Associates, Inc.

We conducted our coordinated risk-focused examination pursuant to and in accordance with the 2010 NAIC *Financial Condition Examiners Handbook* (Handbook). The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles, and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The working papers prepared by Ernst and Young, LLP, the Company's auditors, in their audit of the Company's accounts for the year ended December 31, 2009, were reviewed. A portion of the auditor's working papers have been incorporated into the working papers of the examiners and have been utilized for the purposes of this examination in accordance with the provisions contained in the Handbook.

## HISTORY

The Company was incorporated under the laws of the State of Indiana on September 23, 1959, and commenced business on October 23, 1959. The Company was a wholly-owned subsidiary of American States Insurance Company (ASIC), and ASIC was owned 100% by American States Financial Corporation (ASFC), an insurance holding company that was controlled through 83% ownership by Lincoln National Corporation until October 1, 1997, when Safeco Corporation (Safeco) completed the acquisition of ASFC. In 2000, ASFC was dissolved, and 100% of the Company's outstanding shares of stock were transferred to Safeco.

On April 23, 2008, Safeco agreed to a merger with an LMG subsidiary. As a result of the merger, Liberty Mutual Holding Company Inc. (LMHC), a Massachusetts mutual holding company, became the new ultimate parent. LMHC was formed in 2001 as part of the mutual holding company reorganization of Liberty Mutual Insurance Company (LMIC). Effective January 1, 2009, the Company became a part of

the Peerless Insurance Pool (Peerless Pool) and entered into the Amended and Restated Pooling Agreement (Pooling Agreement), with Peerless Insurance Company (PIC) as the lead pool company.

### CAPITAL AND SURPLUS

As of December 31, 2009, the Company had 1,000,000 shares of common stock authorized with a stated par value of \$5 per share, of which all shares were issued and outstanding to Safeco. The Company reported capital stock totaling \$5,000,000 and gross paid-in and contributed surplus totaling \$343,581,801, as of December 31, 2009. The Company has no preferred stock outstanding.

As of December 31, 2009, the Company paid the following dividends to Safeco during the examination period:

<u>Year</u>	<u>Ordinary Dividends</u>	<u>Extraordinary Dividends</u>
2009	\$ 7,200,000	\$ -
2008	\$ 77,912,004	\$ 29,087,996
2007	\$ 45,000,000	\$ 185,000,000
2006	\$ 105,000,000	\$ -

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to transact business in the District of Columbia and all states except New Jersey. The Company is a part of the Agency Markets (AM) Strategic Business Unit (SBU) of LMG. AM operates through four (4) operating units. Regional companies write small to medium-sized commercial accounts through eight (8) regionally branded companies. Personal lines products are written through Safeco insurance. Summit writes workers' compensation business, primarily in the southeastern United States. Surety provides contract surety bonds for construction firms, manufacturers, and suppliers. In 2009, the Company's top three (3) lines of business by direct premiums include commercial multi-peril, commercial automobile liability, and workers' compensation policies.

AM continues to expand distribution across market segments while providing a full range of personal and commercial products and services to independent agents, brokers and the customers they serve. Its unique national-regional approach leverages the responsiveness of regional operation with the power of national resources.



## GROWTH OF THE COMPANY

The following exhibit summarizes the financial results of the Company during the examination period:

<u>Year</u>	<u>Admitted</u> <u>Assets</u>	<u>Liabilities</u>	<u>Surplus and</u> <u>Other Funds</u>	<u>Premiums</u> <u>Earned</u>	<u>Net Income</u>
2009	\$ 1,546,119,817	\$ 1,037,489,151	\$ 508,630,666	\$ 586,685,671	\$ 62,275,673
2008	1,438,460,340	1,129,311,330	309,149,010	774,160,269	62,228,920
2007	1,525,338,883	1,125,004,856	400,334,027	782,878,667	97,912,004
2006	1,634,750,860	1,105,961,426	528,789,434	787,501,050	121,089,244

Assets and liabilities decreased over the examination period. The fluctuations in assets from 2006 to 2009 were primarily driven by the increasing and decreasing levels of invested assets, due to net decreases in cash flow from operations. Liabilities decreased from 2008 to 2009 primarily due to the Company entering into a new pooling agreement with PIC, effective January 1, 2009. Liabilities increased from 2006 to 2008 as a result of increased losses and loss expenses incurred. These increases were driven by an increase in severity primarily due to higher costs for bodily injury protection claims.

Surplus and other fund increased from 2008 to 2009 primarily due to a capital contribute from Safeco. Surplus and other funds decreased from 2006 to 2008 due to the Company paying ordinary and extraordinary dividends to Safeco out of unassigned funds (surplus).

Premiums earned decreased from 2008 to 2009. This decrease is primarily due to the Company entering into a new pooling agreement with PIC, effective January 1, 2009.

The decrease in net income from 2007 to 2008 was due to an increase in losses and loss expenses incurred, a decrease in net investment income earned, and a realized capital loss in investment income. The increase in losses and loss expenses incurred is primarily the result of catastrophe losses for 2008. The decrease in net investment income was driven by an overall lower invested asset base due primarily to 2007 sales of securities to fund debt maturities and redemption, share repurchase and dividends paid to Safeco. The 2008 realized investment losses include impairment losses and realized losses on the sale of bonds and preferred stocks, which were partially offset by realized gains on the sale of common stocks. The decrease in net income from 2006 to 2007 was mainly a result of the fluctuation reflected in liabilities noted above.

## MANAGEMENT AND CONTROL

### Directors

The Bylaws provide that the business affairs of the Corporation are to be managed by a Board of Directors consisting of no less than five (5) and no more than twenty-one (21) members. At least one (1) of the directors must be a resident of Indiana. The shareholders, at each annual meeting, elect the members of the Board of Directors. The following is a listing of persons serving as directors and their principal occupations as of December 31, 2009:

**Name and Address****Principal Occupation**

John Derek Doyle  
Boston, Massachusetts

Vice President and Comptroller  
Liberty Mutual Group

Gary Richard Gregg  
Boston, Massachusetts

President, LM Agency Markets  
Liberty Mutual Group

Michael Joseph Fallon  
Boston, Massachusetts

Chief Financial Officer, LM Agency Markets  
Liberty Mutual Group

Kevin John Kirschner  
Indianapolis, Indiana

Marketing Director for Safeco MidWest Region  
Liberty Mutual Group

Joseph Anthony Gilles  
Boston, Massachusetts

Manager of Strategy and Operations, LM Agency Markets  
Liberty Mutual Group

Christopher Charles Mansfield  
Boston, Massachusetts

Senior Vice President and General Counsel  
Liberty Mutual Group

Scott Rhodes Goodby  
Boston, Massachusetts

President, Regional Companies Commercial Lines Group  
Liberty Mutual Group

**Officers**

The Bylaws state the officers of the Corporation shall consist of a President, a Secretary, and a Treasurer. Each of these officers is elected by a majority of the Board and shall hold office one (1) year, or until such time as they might be removed. The President or the Chairman may appoint the number of Vice Presidents, Assistant Secretaries, Assistant Treasurers, or any such officer as the President or Chairman may determine is required in the best interest of the Company. Any two (2) or more offices may be held by the same person. The following is a listing of key officers and their respective titles as of December 31, 2009:

**Name****Office**

Gary Richard Gregg

President and Chief Executive Officer

Dexter Robert Legg

Secretary

Michael Joseph Fallon

Chief Financial Officer and Treasurer

Anthony Alexander Fontanes

Chief Investment Officer and Executive Vice President

Joseph Anthony Gilles

Executive Vice President

Scott Rhodes Goodby

Chief Operating Officer and Executive Vice President

## CONFLICT OF INTEREST

Officers and directors are required to review and sign Conflict of Interest statements annually. It was determined that officers and directors listed in the management and control section of this Report of Examination have reviewed and signed their statements as of year-end 2009.

## OATH OF OFFICE

Indiana Code (IC) 27-1-7-10(i) stipulates that every director, when elected, shall take and subscribe to an oath stating that he or she will faithfully, honestly, and diligently administer the affairs of the corporation and will not knowingly violate any of the laws applicable to such corporation. Each director signed an Oath of Office statement in 2009.

## CORPORATE RECORDS

### Articles of Incorporation

There were no amendments made to the Articles of Incorporation during the examination period.

### Bylaws

The Bylaws were amended effective January 1, 2009, to align with the Bylaws of the Company's AM affiliates.

### Minutes

The Board of Directors, Audit Committee, Compensation Committee, Investment Committee, and Board of Directors of LMHC meeting minutes were reviewed for the period under examination through the fieldwork date and significant actions taken during each meeting were noted.

IC 27-1-7-7(b) states an annual meeting of shareholders, members, or policyholders shall be held within five (5) months after the close of each fiscal year of the corporation and at such time within that period as the Bylaws may provide. It was noted that the annual meetings were not held in accordance with the Company's Bylaws or IC 27-1-7-7(b).

## AFFILIATED COMPANIES

### Organizational Structure

The following organizational chart, effective as of December 31, 2009, shows the upstream affiliates from the Company to the ultimate controlling entity:

	<u>NAIC Co.</u> <u>Code</u>	<u>Domiciliary</u> <u>State</u>
Liberty Mutal Holding Company Inc.		MA
LMHC Massachusetts Holdings Inc.		MA
Liberty Mutual Group Inc.		MA
Liberty Mutual Insurance Company *	23043	MA
Liberty Mutual Fire Insurance Company * ("LMFIC")	23035	WI
Employers Insurance Company of Wausau * ("EICW")	21458	WI
Liberty Insurance Holdings, Inc. **		DE
LIH US P&C Corporation		DE
Safeco Corporation		WA
American Economy Insurance Company *	19690	IN

\*denotes an insurer

\*\*denotes Company is owned by LMIC (93.06%), LMFIC (2.89%), and EICW (4.05%)

### Affiliated Agreements

The following affiliated agreements and transactions were disclosed as part of the Form B – Holding Company Registration Statement and were filed with the IN DOI as required, in accordance with IC 27-1-23-4.

#### Investment Management Agreement-LMIC

Effective September 22, 2008, the Company entered into an Investment Management Agreement with LMIC. Under this agreement, LMIC was appointed as the Company's investment advisor and shall manage the Company's portfolio pursuant to the terms of the agreement. Compensation amounts owing between the parties shall be settled on a quarterly basis and payments of amounts owing shall be made within forty-five (45) days after the end of the calendar quarter. During 2009, the Company paid \$410,672 for services provided under this agreement. This agreement was terminated effective January 1, 2010, by notice dated December 28, 2009. Effective January 1, 2010, the Company entered into an Investment Management Agreement with LMG to reflect the investment department personnel change from LMIC to LMG. The terms of the Investment management Agreement with LMG reflect similar terms as the previous Investment Management Agreement with LMIC.

#### Investment Management Agreement-LMIA

Effective September 22, 2008, the Company entered into an Investment Management Agreement with Liberty Mutual Investment Advisors LLC (LMIA). Under this agreement, LMIA was appointed as investment manager to manage and invest certain assets of the Company pursuant to the terms of the agreement. During 2009, the Company paid \$0 for services provided under this agreement. Effective January 1, 2010, the Company entered into an Amended and Restated Investment Management

Agreement with LMIA, which supersedes the Investment Management Agreement entered into with LMIA effective September 22, 2008. Under this agreement, LMIA was appointed as investment advisor and shall manage certain assets of the Company's portfolio pursuant to the terms of the agreement. This agreement includes only those affiliates that have made private equity investments. Compensation amounts owing between the parties shall be settled between the parties on a quarterly basis and payments of amounts owing shall be made within forty-five (45) days after the end of the calendar quarter.

Cash Management Agreement

Effective September 22, 2008, the Company entered into a Cash Management Agreement with LMIA. Under this agreement, LMIA will make, hold, and administer certain short-term investments maturing in 365 days or less of purchase. Compensation amounts owing between the parties shall be settled on a quarterly basis and payments of amounts owing shall be made within forty-five (45) days after the end of the calendar quarter. Effective January 1, 2010, the Cash Management Agreement was amended and restated to include a specific fee rate. During 2009, the Company paid \$289 for services provided under this agreement.

Services Agreement

Effective January 1, 2009, the Company entered into a Services Agreement, as amended, with PIC. Under this agreement, PIC provides services related to common management functions, including but not limited to, coordinating marketing and advertising, information system support, payroll services, human resources support and personnel, accounting and other financial services, coordinating the development of corporate plans for the Company, and providing consulting and other services as the Company may request. Expenses are allocated based in accordance with the pooling percentage under the Pooling Agreement with PIC. Amounts owing between the parties shall be settled on a monthly basis, unless otherwise agreed to between such parties, provided, however, that the parties shall settle all amounts owing on at least a calendar quarterly basis. During 2009, the Company paid \$72,982,938 for services provided under this agreement.

Management Services Agreement

Effective January 1, 2009, the Company entered into a Management Services Agreement with LMIC. Under this agreement, LMIC may provide services related to common management functions, including but not limited to, accounting, financial, tax and auditing, purchasing, payroll and employee benefits, information technology and support, policy administration and production, real estate management, legal, general administration, reinsurance, and other services as the Company may request. Amounts owing between the parties shall be settled between the parties on a quarterly basis and payments owing shall be made within forty-five (45) days after the end of the calendar quarter. During 2009, the Company paid \$53,644,079 for services provided under this agreement.

Federal Tax Sharing Agreement

Effective September 22, 2008, the Company entered into a Federal Tax Sharing Agreement, as amended, with LMHC and affiliates. Under this agreement, the method of allocation is based upon separate return allocation with credit applied for losses as appropriate. The Company has the enforceable right to recoup prior year payments in the event of future losses. The agreement may be terminated for any party when that entity no longer is a member of the consolidated group for tax filing purposes. During 2009, the Company received \$499,463 under this agreement.

### Intercompany Short-Term Borrowing Agreement

Effective November 1, 2007, the Company entered into an Amended and Restated Intercompany Short-Term Borrowing Agreement with Safeco Insurance Company of America and affiliates. Under this agreement, each party within the agreement agrees to lend funds in the amount requested to any other party to this agreement; provided, however, that the regulatory body having jurisdiction over a party to the agreement may invoke such procedures that would require withdrawal by the party. For all Indiana domiciled companies party to the agreement, no loan may exceed the lesser of 3% of admitted assets or 25% of surplus as of December 31, of the preceding year. All loans must be repaid within twelve (12) months after the date of the borrowing. The companies will share and allocate expenses based on their participation within the parent Company. During 2009, the Company had loaned \$0 or borrowed \$0 to various affiliates under this agreement.

### FIDELITY BOND AND OTHER INSURANCE

The Company protects itself against the loss from any fraudulent or dishonest acts by any employees through a fidelity bond issued by Westchester Fire Insurance Company. The bond has blanket coverage of \$15,000,000 with a \$25,000,000 deductible. In addition, the Company has the \$25,000,000 deductible reinsured through St. James Insurance Company. The fidelity bond is adequate to meet the prescribed minimum coverage specified by NAIC.

The Company had additional types of coverage in-force at December 31, 2009, including but not limited to, auto, property, directors and officers liability, professional liability, aircraft, umbrella excess liability, general liability, and workers' compensation.

### STATUTORY AND SPECIAL DEPOSITS

The Company reported the following statutory deposits at December 31, 2009:

<u>State</u>	<u>Book Value</u>	<u>Fair Value</u>
For all Policyholders:		
Illinois	\$ 1,569,486	\$ 1,834,740
Indiana	1,915,712	2,220,154
All Other Special Deposits:		
Arizona	1,097,420	1,199,447
California	33,071,290	35,371,411
Delaware	111,230	130,228
Georgia	222,460	260,455
Idaho	411,917	433,028
Kansas	101,166	128,250
Massachusetts	359,358	420,735
Montana	36,039	37,926
Nevada	102,674	120,210
New Mexico	427,807	500,875
North Carolina	359,788	361,004
Oregon	5,808,107	6,079,500
Tennessee	85,561	100,175
Virginia	98,396	115,201
Total Deposits	<u>\$ 45,778,411</u>	<u>\$ 49,313,339</u>

## REINSURANCE

### Peerless Insurance Pool

The Peerless Pool consists of a group of affiliated member companies of the LMG. The Peerless Pool is comprised of approximately forty (40) companies which comprise the LMG AM SBU. These companies produce business in all fifty (50) states and operate pursuant to the terms of the Pooling Agreement.

Per the terms of the Pooling Agreement, each affiliated member company cedes 100% of their net underwriting activity to PIC, which combines this business with their own direct and externally assumed reinsurance business. PIC then deducts reinsurance ceded to external parties and then retro-cedes a designated share of these remaining pooled accounts back to each of thirteen (13) other pool members based on each company's pre-determined share of the pool as defined in the Pooling Agreement. All other member companies cede 100% of their net underwriting activity into the Pool but receive a zero (0) share of the net pooled business and accordingly reported zero (0) net premium and/or losses in 2009.

Pursuant to the terms of the Pooling Agreement, 100% of the net reported premiums and losses of each member company is generated from their share of the business they re-assume through their participation in the Peerless Pool. Following is the list of those member companies receiving a share of the Peerless Pool as of December 31, 2009, and their respective shares of the pool as of that date:

<u>Company Name</u>	<u>Domiciliary State</u>	<u>NAIC Co. Code</u>	<u>Share of Pool</u>
Peerless Insurance Company	NH	24198	25.20%
The Ohio Casualty Insurance Company	OH	24074	20.40%
Safeco Insurance Company of America	WA	24740	15.20%
General Insurance Company of America	WA	24732	9.20%
American States Insurance Company	IN	19704	7.60%
American Economy Insurance Company	IN	19690	5.60%
Indiana Insurance Company	IN	22659	4.80%
Golden Eagle Insurance Corporation	NH	10836	3.00%
Peerless Indemnity Insurance Company	IL	18333	3.00%
Safeco Insurance Company of Illinois	IL	39012	2.00%
The Netherlands Insurance Company	NH	24171	1.80%
American States Preferred Insurance Company	IN	37214	0.80%
First National Insurance Company of America	WA	24724	0.80%
American Fire and Casualty Insurance Company	OH	24066	0.60%
Total Pool Percentage			100.00%
Avomark Insurance Company *	IN	10792	0%
Consolidated Insurance Company *	IN	22640	0%
National Insurance Association *	IN	27944	0%
Safeco Insurance Company of Indiana *	IN	11215	0%
West American Insurance Company *	IN	44393	0%

\* denotes other companies subject to examination not receiving a share of the net pool results

### RESERVES

William M. Finn, FCAS, MAAA, Vice President and Chief Actuary for the Company, was appointed by the Board of Directors on April 1, 2009, to render an opinion on the statutory-basis for the year ended December 31, 2009.

The scope of the opinion was to examine the actuarial assumptions and methods used in determining loss reserves and related items, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials as of December 31, 2009. In forming the opinion, information prepared by the Company was relied upon. This information was evaluated for reasonableness and consistency. In other respects, the examination included such review of the actuarial assumptions and methods used and such tests of the calculations as considered necessary.

The 2009, opinion stated that the balances of reserves and related actuarial values concerning the Annual Statement items: 1) meet the requirements of the insurance laws of Indiana; 2) are computed in accordance with accepted loss reserving standards and principles; and 3) make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

During the examination, it was determined that the material actuarial items in the Annual Statement of the



Company are materially correct and fairly stated in accordance with statutory accounting practices prescribed or permitted by the Commissioner of Insurance of the State of Indiana.

**ACCOUNTS AND RECORDS**

The Company's accounting procedures, practices, account records, and supporting data were reviewed and tested to the extent deemed necessary. The trial balances prepared from the Company's general ledger for the year ended December 31, 2008, and 2009, were agreed to the respective Annual Statements. The Annual Statement for the years ended December 31, 2006, through 2009, were reconciled to each year's independent audit report with no exceptions noted.

**AMERICAN ECONOMY INSURANCE COMPANY**

**FINANCIAL STATEMENTS**

**Assets**

	As of December 31, 2009			
	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
<b>Assets:</b>				
Bonds	\$ 1,143,819,088	\$ -	\$ 1,143,819,088	\$ 972,983,469
Stocks:				
Preferred stocks	28,935,150	-	28,935,150	34,573,382
Common stocks	30,598,833	-	30,598,833	21,443,495
Mortgage loans on real estate:				
First liens	10,739,145	-	10,739,145	-
Cash, cash equivalents, and short-term investments	55,429,467	-	55,429,467	111,773,748
Other invested assets	1	-	1	-
Receivables for securities	-	-	-	107,756
Subtotals, cash and invested assets	\$ 1,269,521,684	\$ -	\$ 1,269,521,684	\$ 1,140,881,850
Investment income due and accrued	14,518,720	-	14,518,720	14,431,108
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collection	22,186,815	-	22,186,815	69,671,737
Deferred premiums, agents' balances and installments booked but deferred and not yet due	157,537,260	-	157,537,260	117,162,078
Accrued retrospective premiums	914,463	-	914,463	326,924
Reinsurance:				
Amounts recoverable from reinsurers	22,903,080	-	22,903,080	24,995,531
Current federal and foreign income tax recoverable and interest thereon	93,943	-	93,943	13,329,106
Net deferred tax asset	51,446,500	-	51,446,500	38,055,533
Guaranty funds receivable or on deposit	1,036,769	-	1,036,769	1,090,663
Receivables from parent, subsidiaries and affiliates	1,245,430	-	1,245,430	17,894,729
Aggregate write-ins for other than invested assets	4,715,153	-	4,715,153	621,081
<b>Total assets</b>	<b>\$ 1,546,119,817</b>	<b>\$ -</b>	<b>\$ 1,546,119,817</b>	<b>\$ 1,438,460,340</b>

**AMERICAN ECONOMY INSURANCE COMPANY**

**FINANCIAL STATEMENTS**

**Liabilities, Surplus and Other Funds**

	As of December 31, 2009			
	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
<b>Liabilities:</b>				
Losses	\$ 526,416,697	\$ -	\$ 526,416,697	\$ 542,818,524
Reinsurance payable on paid losses and loss adjustment expenses	33,937,724	-	33,937,724	37,317,391
Loss adjustment expenses	125,330,551	-	125,330,551	126,537,370
Commissions payable, contingent commissions and other similar charges	14,917,027	-	14,917,027	20,105,667
Other expenses	17,708,600	-	17,708,600	35,678,759
Taxes, licenses and fees	5,368,189	-	5,368,189	10,162,081
Unearned premiums	257,663,511	-	257,663,511	282,825,872
Advance premium	1,834,069	-	1,834,069	4,443,431
Dividends declared and unpaid:				
Policyholders	475,439	-	475,439	918,478
Ceded reinsurance premiums payable	10,854,026	-	10,854,026	23,767,735
Account withheld or retained by company for account of others	(169,811)	-	(169,811)	2,518,792
Drafts outstanding	18,401,187	-	18,401,187	-
Payable to parent, subsidiaries and affiliates	2,918,616	-	2,918,616	39,169,322
Payable for securities	-	-	-	2,562
Aggregate write-ins for liabilities	21,833,326	-	21,833,326	3,045,346
<b>Total liabilities</b>	<b>\$ 1,037,489,151</b>	<b>\$ -</b>	<b>\$ 1,037,489,151</b>	<b>\$ 1,129,311,330</b>
Aggregate write-ins for special surplus funds	19,012,578	-	19,012,578	-
Common capital stock	5,000,000	-	5,000,000	5,000,000
Gross paid in and contributed surplus	343,581,801	-	343,581,801	225,413,332
Unassigned funds (surplus)	141,036,287	-	141,036,287	78,735,678
<b>Surplus as regards policyholders</b>	<b>\$ 508,630,666</b>	<b>\$ -</b>	<b>\$ 508,630,666</b>	<b>\$ 309,149,010</b>
<b>Total liabilities, surplus and other funds</b>	<b>\$ 1,546,119,817</b>	<b>\$ -</b>	<b>\$ 1,546,119,817</b>	<b>\$ 1,438,460,340</b>

**AMERICAN ECONOMY INSURANCE COMPANY**

**FINANCIAL STATEMENTS**

**Statement of Income**

	As of December 31, 2009			
	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
<b>UNDERWRITING INCOME</b>				
Premiums earned	\$ 586,685,671	\$ -	\$ 586,685,671	\$ 774,160,269
DEDUCTIONS:				
Losses incurred	297,538,442	-	297,538,442	429,776,183
Loss adjustment expenses incurred	69,657,215	-	69,657,215	89,004,627
Other underwriting expenses incurred	194,757,093	-	194,757,093	234,757,918
Aggregate write-ins for underwriting deductions	91,528	-	91,528	-
Total underwriting deductions	<u>\$ 562,044,278</u>	<u>\$ -</u>	<u>\$ 562,044,278</u>	<u>\$ 753,538,728</u>
Net underwriting gain (loss)	24,641,393	-	24,641,393	20,621,541
<b>INVESTMENT INCOME</b>				
Net investment income earned	56,808,372	-	56,808,372	58,772,529
Net realized capital gains (losses) less capital gains tax	(1,903,251)	-	(1,903,251)	(9,137,594)
Net investment gain (loss)	<u>\$ 54,905,121</u>	<u>\$ -</u>	<u>\$ 54,905,121</u>	<u>\$ 49,634,935</u>
<b>OTHER INCOME</b>				
Net gain (loss) from agents' or premium balances charged off	(2,596,945)	-	(2,596,945)	(4,641,486)
Finance and service charges not included in premiums	5,001,924	-	5,001,924	3,624,979
Aggregate write-ins for miscellaneous income	(3,405,093)	-	(3,405,093)	2,274,368
Total other income	<u>\$ (1,000,114)</u>	<u>\$ -</u>	<u>\$ (1,000,114)</u>	<u>\$ 1,257,861</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	78,546,400	-	78,546,400	71,514,337
Dividends to policyholders	2,510,199	-	2,510,199	930,371
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	76,036,201	-	76,036,201	70,583,966
Federal and foreign income taxes incurred	13,760,528	-	13,760,528	8,355,046
Net income	<u><u>\$ 62,275,673</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 62,275,673</u></u>	<u><u>\$ 62,228,920</u></u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>				
Surplus as regards policyholders, December 31 prior year	\$ 309,149,009	\$ -	\$ 309,149,009	\$ 400,334,027
Net income	62,275,673	-	62,275,673	62,228,920
Change in net unrealized capital gains or (losses) less capital gains tax	8,660,867	-	8,660,867	(31,019,580)
Change in net deferred income tax	405,165	-	405,165	(10,950,869)
Change in nonadmitted assets	(1,131,030)	-	(1,131,030)	(4,757,004)
Cumulative effect of changes in accounting principles	-	-	-	4,458,964
Surplus adjustments:				
Paid in	118,168,469	-	118,168,469	-
Dividends to stockholders	(7,200,000)	-	(7,200,000)	(107,000,000)
Aggregate write-ins for gains and losses in surplus	18,302,513	-	18,302,513	(4,145,449)
Change in surplus as regards policyholders for the year	<u>199,481,657</u>	<u>-</u>	<u>199,481,657</u>	<u>(91,185,018)</u>
Surplus as regards policyholders, as of December 31 current year	<u><u>\$ 508,630,666</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 508,630,666</u></u>	<u><u>\$ 309,149,009</u></u>

## COMMENTS ON THE FINANCIAL STATEMENTS

There were no recommended adjustments to surplus as of December 31, 2009, based on the results of this examination.

## OTHER SIGNIFICANT FINDINGS

It is recommended, for all future periods, that the Company hold an annual meeting of shareholders, members, or policyholders within five (5) months after the close of each fiscal year of the corporation and at such time within that period as the Bylaws may provide, in compliance with IC 27-1-7-7(b).

## SUBSEQUENT EVENTS

Effective January 1, 2010, Bridgefield Casualty Insurance Company and Bridgefield Employers Insurance Company canceled their 100% Quota Share Reinsurance Agreements with PIC and entered into 100% Reinsurance Agreements with LMIC.

Effective February 23, 2010, Avomark Insurance Company was merged into West American Insurance Company, with West American Insurance Company as the surviving entity.

On April 14, 2010, LIH US P&C was renamed Liberty Mutual Agency Corporation (LMAC).

On May 10, 2010, LMG announced that its subsidiary, LMAC filed a registration statement with the U.S. Securities and Exchange Commission (SEC) for an initial public offering (IPO) of shares of its common stock. On September 29, 2010, LMG announced that it was postponing the IPO of stock in LMAC due to the stalled economic recovery, volatile stock markets, and undervalued property and casualty insurance stock prices create an unfavorable environment for receiving appropriate value for the business. On January 11, 2011, LMG announced there are no immediate plans to IPO a portion of its U.S. business.

On February 1, 2011, the Board voted to accept Gary R. Gregg's resignation as the Chairman of the Board, a director, the President, and the CEO. J. Paul Condrin, III, was elected to take the place of Gary R. Gregg until the next annual meeting or until his successor is elected and qualified.

**AFFIDAVIT**

This is to certify that the undersigned is a duly qualified Examiner-in-Charge appointed by the Indiana Department of Insurance and that she, in coordination with staff assistance from Noble Consulting Services, Inc. and actuarial assistance from Merlino & Associates, Inc., hereinafter collectively referred to as the "Examiners", performed an examination of American Economy Insurance Company, as of December 31, 2009.

The Indiana Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.

This examination was performed in accordance with those procedures required by the 2010 NAIC Financial Condition Examiner's Handbook and other procedures tailored for this examination. Such procedures performed on this examination do not constitute an audit made in accordance with generally accepted auditing standards and no audit opinion is expressed on the financial statements contained in this report.

The attached report of examination is a true and complete report of condition of American Economy Insurance Company, as of December 31, 2009, as determined by the undersigned.



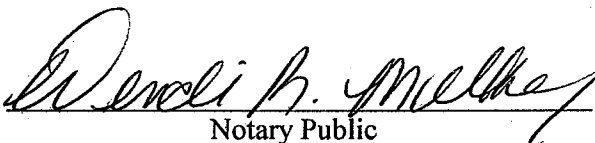
Nadine Treon, CFE  
Noble Consulting Services, Inc.

State of:  
County of:

On this 12 day of April, 2011, before me personally appeared, Nadine Treon, to sign this document.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal in said County and State, the day and year last above written.

My commission expires:

3/1/18   
Notary Public

