

**REPORT ON EXAMINATION AS TO THE CONDITION OF  
MERCER INSURANCE COMPANY OF NEW JERSEY, INC.**

**PENNINGTON, NEW JERSEY 08534**

**AS AT DECEMBER 31, 2004**

**N.A.I.C. GROUP CODE 1114**

**N.A.I.C. COMPANY CODE 43540**

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**State of New Jersey**  
DEPARTMENT OF BANKING AND INSURANCE  
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JON CORZINE  
*Governor*

STEVEN M. GOLDMAN  
*Commissioner*

June 9, 2006

Honorable Steven M. Goldman  
Commissioner of Banking and Insurance  
State of New Jersey  
20 West State Street  
Trenton, New Jersey 08625-0325

Commissioner:

Pursuant to instructions and in accordance with N.J.S.A. 17:23-22, an examination as of December 31, 2004 was made of the financial condition and affairs of

***MERCER INSURANCE COMPANY OF NEW JERSEY, INC.***  
**NAIC GROUP CODE 1114 NAIC COMPANY CODE 43540**

a domestic insurer duly authorized to transact the business of insurance in the State of New Jersey, hereinafter referred to as the "Company" or "Mercer" or "MICNJ".

**SCOPE OF EXAMINATION**

This financial condition examination was called by the Commissioner of Banking and Insurance of the State of New Jersey pursuant to the authority granted by Section 17:23-22 of the New Jersey Revised Statutes.

The examination was made as at December 31, 2004, and addressed the four-year period from December 31, 2000, the date of the last Financial Condition Examination. During this four-year period under examination, the Company's reported assets increased from \$12,054,400 to \$45,998,876. The Company's reported liabilities increased from \$4,529,336 to \$30,361,968 and MICNJ's reported surplus as regards policyholders increased from \$7,525,064 to \$15,636,908.

The conduct of the examination was governed by the procedures outlined in the NAIC Financial Condition Handbook and followed accepted procedures of regulatory authorities and generally accepted insurance company examination standards. In determining the emphasis to be placed on specific accounts, consideration was given to the Company's system of internal control, the nature and size of each account, its relative importance to solvency and the annual audit work performed by the Company's certified public accountants. There were no accounts assigned to a special emphasis category. Asset and liability accounts that are "generally material" were assigned to a standard emphasis category.

The accounts requiring standard emphasis are as follows:

- Bonds
- Preferred Stocks
- Common Stocks
- Cash and Short-term Investments
- Uncollected Premiums and Agents balances
- Receivables From Parent, Subsidiaries and Affiliates
- Losses and Loss Adjustment Expenses
- Unearned Premiums
- Ceded Reinsurance Premium Payable

All other balance sheet accounts were determined to have low control risk and were assigned to a reduced emphasis. Other areas, in part, reviewed during this examination included the following:

- History and Kind of Business
- Management and Control
- Territory and Plan of Operation
- Accounts and Records
- Fidelity Bond and Other Insurance Coverages
- Continuity of Operations
- Treatment of Policyholders

The control risk level will ultimately determine the amount of emphasis placed on each account. Based on our review of Exhibit B, discussions with the Department's EDP/IS Analyst concerning the completion of Exhibit C by the Company, the cycle questions and verification of Company responses to these questions, on a test basis, the intended reliance on the Company's control environment has been determined to be low.

The examination report, contained herein, will address significant balance sheet accounts and, if necessary, comments on those accounts which involve departures

from laws, regulations or rules, or which are deemed to require special explanation or description.

## **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

### Conflict of Interest

It is recommended that the Company's officers and Board of Directors complete the questionnaires on an annual basis.

The Company did comply with this recommendation.

### Transactions With Affiliates

It is again recommended that the Company revise the consolidated tax allocation agreement to specify the settling of such balances on a timely basis.

The Company complied with this recommendation.

### Accounts and Records

MMIC business continuity plan (disaster recovery plan) which includes all subsidiaries and affiliates has not been tested since December 31, 1999. It is recommended that the Company update the business continuity plan (disaster recovery plan) and schedule an annual testing of the plan.

The Company did not comply with the second part of this recommendation regarding testing of said plan.

### Bonds and Stocks

It is recommended that MICNJ amend their custodial agreements with Salomon Smith Barney and American General Securities to include these two safeguards to be in compliance with the NAIC.

The Company complied with this recommendation.

It is again recommended that the Company keep the first \$50,000,000 of debt investments with a qualified bank(s) and within the geographical confines of the State of New Jersey in accordance with N.J.S.A. 17:24-12.

The Company complied with this recommendation.

**HISTORY AND KIND OF BUSINESS**

The Company was incorporated under the laws of New Jersey dated October 14, 1981 and commenced business on September 15, 1982.

The Company's initial certificate of authority permitted the Company to write the kinds of insurance specified in paragraphs "a", "b", "e", "j" "k" "l" and "o" of N.J.S.A. 17:17-1 of the Revised Statutes of New Jersey.

MICNJ's Certificate of Amendment to the Certificate of Incorporation dated January 16, 1996 enabled the Company to write the kinds of insurance authorized by paragraph "e" of N.J.S.A. 17:17-1 et seq. except only that authority granted under paragraph "e" to write automobile bodily injury liability and automobile property damage liability, is specifically excluded.

MICNJ's Certificate of Amendment to the Certificate of Incorporation dated Dec. 17, 1997 occurred because the Company changed its name from Mercer Insurance Company to Mercer Insurance Company of New Jersey, Inc. (MICNJ).

MICNJ's Certificate of Amendment to the Certificate of Incorporation dated August. 12, 1998, fifth paragraph of N.J.S.A. 17:17-1 increased the common capital stock and gross paid in and contributed surplus from \$1,000,000 to \$3,500,000 and \$400,000 to \$600,000 respectively.

MICNJ's Certificate of Amendment to the Certificate of Incorporation dated August 12, 1998, third paragraph of N.J.S.A. 17:17-1 granted the Company authorization to transact the kinds of business specified in paragraph "a", "b", "e", "f", "g", "j", "k", "l", "m", "n", "o-1" and "o-3ii". The authorized capital stock of the Company is \$3,500,000 divided into 350,000 shares of common stock having a par value of \$10 per share. All authorized shares are issued and outstanding, and owned by Queenstown Holding Company, Inc.

The Company reported an increase for the period ending December 31, 2003, which amounted to an increase in the Company's gross paid in and contributed surplus of \$5,596,657 from \$600,000 to \$6,196,657.

**MANAGEMENT AND CONTROL**

The directors and officers of the Company as of the examination date were as follows:

**Directors and Address**

**Principal Occupation**

Ronald D. Boehm  
10 North Highway 31  
Pennington, NJ 08534

Self Employed Business Consultant

William V. R. Fogler  
10 North Highway 31  
Pennington, NJ 08534

Owner  
Van Rensselaer Ltd.

William C. Hart  
10 North Highway 31

Retired

Pennington, NJ 08534

George T. Hornyak, Jr.  
10 North Highway 31  
Pennington, NJ 08534

Self Employed Private Investor

Richard U. Niedt  
10 North Highway 31  
Pennington, NJ 08534

Retired

Richard G. Van Noy  
10 North Highway 31  
Pennington, NJ 08534

Retired

Andrew R Speaker  
10 North Highway 31  
Pennington, NJ 08534

President, Chief Executive Officer  
Mercer Insurance Group, Inc.

Samuel J. Malizia  
10 North Highway 31  
Pennington, NJ 08534

Managing Partner  
Mazilia Spidi & Fisch, PC

Henry T. Davis  
10 North Highway 31  
Pennington, NJ 08534

Sr. Vice President  
Mercer Insurance Group, Inc

**Officers:**

**Title**

Andrew R. Speaker

President, Chief Executive Officer

David B. Merclean

Sr. Vice President and CFO

Paul D. Ehrhardt

Sr. Vice President Underwriting & Secretary

Henry T. Davis, Jr.

Sr. Vice President

John G. Danka

V. P. Marketing & Assistant Secretary

Gordon A. Coleman

Treasurer

The Company is in compliance with **N.J.S.A.** 17:27A-4d(3).

All the Committees are for the benefit of Mercer Insurance Group, Inc. and Mercer Insurance Company of New Jersey, Inc.

**Audit Committee:**

The following are the Audit Committee members:

George T. Hornyak, Jr.  
William C. Hart  
Richard U. Niedt  
Richard G. Van Noy

The Audit Committee is comprised entirely of outside directors who are not employees of the Company and is in compliance with N.J.S.A. 17:27A-4-d-4.

Additional committees maintained by the Company are as follows:

Compensation Committee  
Nominating/Governance Committee

### **CONFLICT OF INTEREST**

The Company, as part of the Mercer Insurance Group, Inc. and its ultimate parent, has a formal code of “Conduct and Ethics Policy”, which includes a conflicts of interest policy.

Annually all officers and employees of the company are required to certify in writing that they have read and understand their responsibility to comply with the policy, execute the related questionnaire and disclose any potential conflicts.

### **CORPORATE RECORDS**

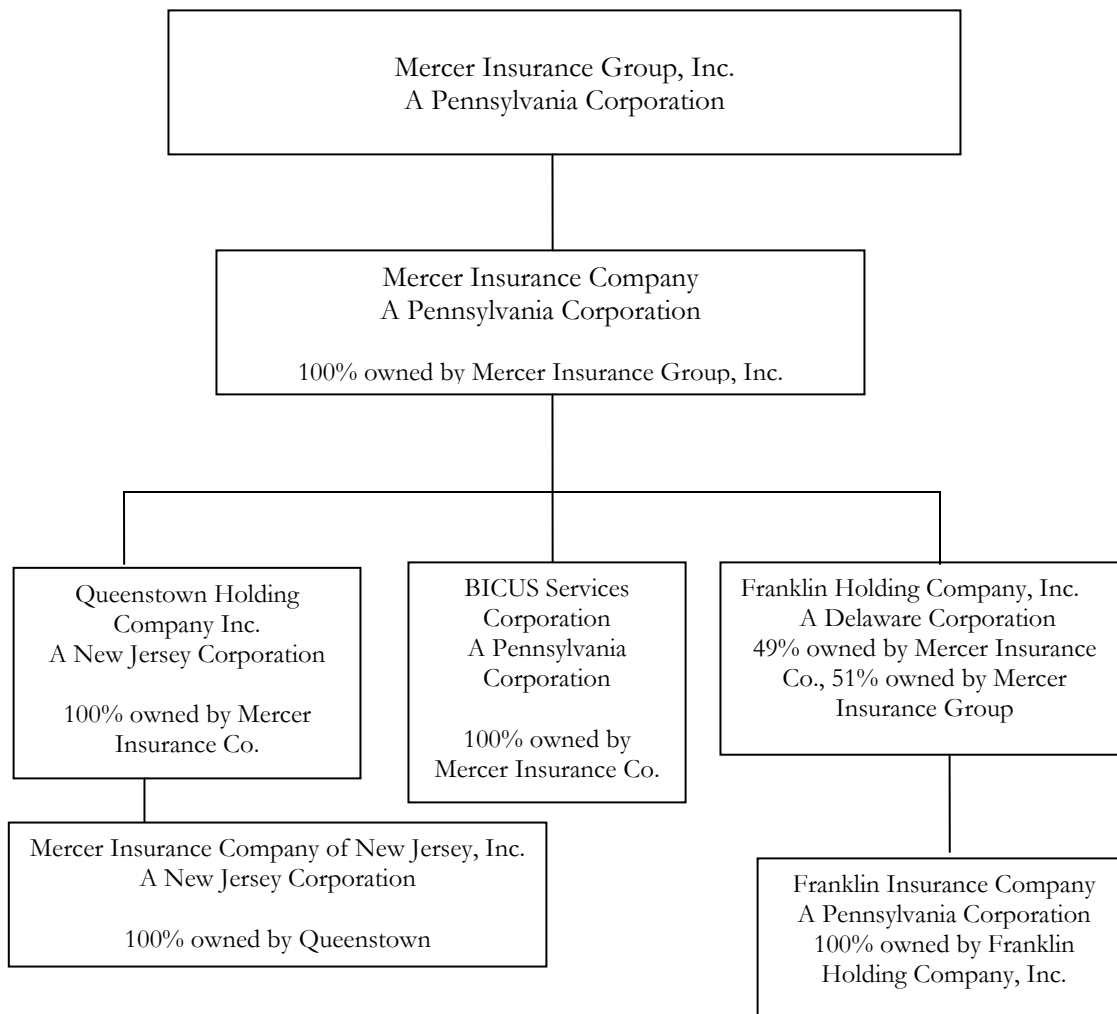
The review of the minutes of the Board of Directors, Stockholders and Audit Committee adequately support Company transactions, events and operations.

### **REGULATION OF INSURANCE HOLDING COMPANY SYSTEMS**

The Company is a wholly owned subsidiary of Queenstown Holding Company, Inc. a New Jersey Corporation, which is a 100% owned subsidiary of the Mercer Insurance Company, a Pennsylvania corporation.

The Mercer Insurance Group, Inc. also a Pennsylvania corporation and the Company’s ultimate parent, owns 100% of the Mercer Insurance Company. The Company is a member of an insurance holding company system as defined under N.J.S.A. 17:27A-1 and as such is required to file a registration statement in accordance with N.J.S.A. 17:27A-3. Mercer Insurance Group, Inc., filed a registration statement on behalf of and in the name of its subsidiaries in accordance with N.J.S.A. 17:27A-3.

An organizational chart follows showing the Mercer Insurance Company of New Jersey, Inc. and its affiliated companies:



## **INTER-COMPANY AGREEMENTS**

The Company participated in several agreements with its parent and or affiliates. The agreements are as follows:

### **Reinsurance Pooling Agreement**

The Mercer Insurance Company, Mercer Insurance Company of New Jersey, Inc. and Franklin Insurance Company are parties to a reinsurance pooling agreement whereby Mercer Insurance Company of New Jersey, Inc. and Franklin Insurance Company each cede 100% of its business to Mercer Insurance Company.

Mercer Insurance Company then retrocedes a portion back to Mercer Insurance Company of New Jersey, Inc. and Franklin Insurance Company based upon each company's surplus in relation to total pooled surplus.

### **Service Allocation Agreement**

Mercer Insurance Company; Queentown Holding Company, Inc.; Mercer Insurance Company of New Jersey, Inc.; BICUS Services Corporation; Franklin Holding Company, Inc.; and Franklin Insurance Company are parties to a Service Allocation Agreement which stipulates that certain services and functions for all of the parties will be performed by BICUS Services Corporation. The parties reimburse BICUS for their respective shares of such services and functions.

### **Tax Allocation Agreement**

Effective January 1, 2002 Mercer Insurance Company, Queenstown Holding Company, Inc., Mercer Insurance Company of New Jersey, Inc. and BICUS Services Corporation are parties to a consolidated tax agreement.

Each company is allocated a pro-rata share of the consolidated income tax expense based upon its contribution of taxable income to the consolidated tax return. Additionally, allocation is based upon separate return calculations with current credit for net losses.

Inter-company tax balances are settled annually in the first quarter.

### **FIDELITY BOND AND OTHER INSURANCE COVERAGES**

MICNJ's insurance coverage's are maintained and insured under Mercer Insurance Group, Inc. as a named insured. The fidelity bond coverage for \$1,000,000 was determined to be adequate, based on NAIC minimum suggested guidelines.

Other Insurance Coverages include:

Commercial Automobile	Combined single limit, each accident, each person	\$1,000,000
	Comprehensive	Actual cash value or cost of repair
	Collision	Actual cash value or cost of repair
Commercial General Liability	Aggregate/total limits	\$2,000,000
	Each Occurrence	\$1,000,000
	Medical payments per person	\$5,000
	Fire legal liability	
	Supplementary coverage	\$50,000
	Personal/advertising injury	
	Supplemental coverage	\$1,000,000

Employer Liability	Each accident	\$500,000
	Disease	\$500,000
Commercial Umbrella Liability	Each occurrence limit	\$3,000,000
	Personal & advertising injury	\$3,000,000
	Products & Comp. Operations	\$3,000,000
	Aggregate limit	\$3,000,000
Directors & Officers Liability	General Aggregate limit	\$3,000,000
	Policy aggregate limit, Including defense costs	\$5,000,000
	Security claims	\$250,000
	All other claims	\$250,000
	Employment practices	\$100,000
Financial Institution Bond	Fidelity	\$1,000,000
	Forgery or alteration	\$1,000,000
	Securities	\$1,000,000
	Computer systems	\$1,000,000

### **EMPLOYEE WELFARE AND PENSION PLANS**

The Company has no employees and, therefore, has no retirement, deferred compensation, or other post retirement benefit plan liabilities.

All employees are employed directly by BICUS Services Corporation, a wholly owned subsidiary of Mercer Insurance Company. BICUS provides management services to all of the insurance companies.

### **STATUTORY DEPOSITS**

The Company maintained, as confirmed with the respective custodian, one special deposit as of December 31, 2004:

Certificate of Deposit 3.68%, due November 8, 2006, held by the Commissioner of Banking and Insurance of the State of New Jersey	<u>\$100,000</u>
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## **POLICY FORMS AND UNDERWRITING GUIDELINES**

MICNJ, through its parent Mercer Insurance Group, Inc., maintains an Underwriting Guide. A review of the underwriting guideline manual indicated that MICNJ writes their personal and commercial lines by evaluating each risk with consistently applied standards. The Company maintains information on all aspects of their business, which is regularly reviewed to determine product line profitability.

MICNJ through the Mercer Insurance Group, Inc. group of Companies maintains access to numerous underwriters, who generally specialize in either personal or commercial lines, and have many years of experience as underwriters. Specific information is monitored with regard to individual insureds to assist the Company in making decisions about policy renewals or modifications. New risks are frequently inspected to insure they are as desirable as suggested by the application process.

The Company relies on information provided by independent agents. Subject to certain guidelines, producers also pre-screen policy applicants. The producers have the authority to sell and bind insurance coverages in accordance with pre-established guidelines.

Producers' results are continuously monitored. On occasion, producers with historically poor loss ratios have had their binding authority removed until more profitable underwriting results were achieved. Continued poor loss ratios often result in agency termination.

## **TERRITORY AND PLAN OF OPERATION**

The Company is licensed only in New Jersey. Schedule T reflects premiums written only in the state of New Jersey. The Company is located at 10 North Highway 31, Pennington, NJ 08534. The Company's accounts and data are maintained at this address.

A review of the Underwriting and Investment Exhibit indicates the Company wrote only the lines of business for which it was authorized. Operations are focused on writing homeowners and commercial lines coverages, including workers' compensation, commercial automobile and a religious institution package policy. Commercial products target mercantile, light manufacturing business owners, artisans and contractors coverage.

The Company uses independent agents to write their business and is not Producer controlled. Broker and agents commissions are authorized in accordance with their respective agreements.

## **ADVERTISEMENT MATERIALS**

A review of the Company's advertisements indicated that it is in compliance with **N.J.S.A.** 17:18-10.

## **TREATMENT OF POLICYHOLDERS**

The Company maintains a complaint register, which is in general compliance with **N.J.S.A. 17:29B-4(10)**.

## **REINSURANCE**

In the ordinary course of business the Company seeks to limit its exposure to loss on individual claims and from the effects of catastrophes by entering into reinsurance contracts with other insurance companies. Reinsurance is ceded on excess of loss and on a pro rata basis with the Company's retention not exceeding \$500,000 per occurrence for year ending 12-31-04.

Effective January 1, 2002 Mercer Insurance of New Jersey, Inc., (MICNJ), Franklin Insurance Company, (FIC) and Mercer Insurance Company, (MIC) are parties to a reinsurance pooling agreement whereby Mercer Insurance Company of New Jersey, Inc. and Franklin Insurance Company each cede 100% of their business to Mercer Insurance Company. In turn Mercer Insurance Company retro-cedes a percentage of business back to the Companies based upon each Company's prior year surplus.

As of December 31, 2004 the Mercer Insurance Company retro-ceded 19% and 8% back to Mercer Insurance Company of New Jersey and Franklin Insurance Company respectively. The following summary identifies the various coverages by treaty;

<b><u>Treaty</u></b>	<b><u>Coverage</u></b>
Multi-Line Excess	500,000 x 500,000 per occurrence All lines except umbrella Property Occurrence Limit: \$1,500,000
WC First Excess	3,000,000 X 1,000,000 per occurrence
WC Second catastrophe Excess	6,000,000 X 4,000,000 per occurrence
WC Byrne Agency Quota Share Reinsurance Program	100% up to \$100,000 per occurrence J. Byrne Agency premium
Property Per Risk	3,000,000 X 1,000,000 per occurrence Occurrence Limit: \$6,000,000
First Excess Catastrophe	100 % of 3,000,000 X 2,000,000 Mercer 2.5% participation
Second Excess Catastrophe	100 % of 5,000,000 X 5,000,000 Mercer 2.5% participation

Third Excess Catastrophe	100 % of 10,000,000 X 10,000,000 Mercer 2.5% participation
Fourth Excess Catastrophe	100 % of 12,000,000 X 20,000,000 Mercer 2.5% participation
First Casualty Contingency Excess of Loss	1,000,000 X 1,000,000 per occurrence
Second Casualty Contingency Excess of Loss	2,000,000 X 2,000,000 per occurrence
Commercial Umbrella Excess	90% of 1,000,000 100% of \$4,000,000 X \$1,000,000 Add'l w/ approval
Personal Umbrella Excess	90% of 1,000,000 100% of \$2,000,000 X \$1,000,000 Add'l \$2,000,000 w/ approval
American Re Facultative	Excess of \$4,000,000 subject to American Re approval.
Boiler & Machinery Quota Share	100% of Boiler and Machinery Premiums, Losses and LAE
Terrorism Excess of Loss	\$6,000,000 X \$1,000,000 in the aggregate WC MAOL : \$1,000,000

Reinsurance contracts were reviewed for contract coverage, period covered, reporting and settling requirements, reinsurance premiums and ceded commissions.

In accordance with **N.J.S.A.** 17:18-9 (Risk Limitations), “No insurance company transacting business in this State shall expose itself to any loss on any one risk or hazard in an amount exceeding ten per centum (10%) of its net assets as of December 31 next preceding, ...”, EXCEPT that for the kind of business specified in subsection “e” of **N.J.S.A.** 17:17-1, the exposure shall not exceed five per centum (5%) of the insurer’s net assets as of December 31 next preceding.” MICNJ is in compliance with **N.J.S.A.** 17:18-9 on Risk Limitations.

The Company maintains two reinsurance intermediaries-brokers, AON RE Inc. and Benefield Inc. as liaisons between the Company and its reinsurers. The reinsurance intermediaries are authorized to transact business in the State of New Jersey under **N.J.S.A.** 17:22E-2(b). The Company maintains agreements with Benefield Inc. and AON

RE Inc. conforming to the reinsurance intermediary contract requirements as stipulated in and in accordance with **N.J.S.A.** 17:22E-6.

### **CONTINUITY OF OPERATIONS**

The Company, as part of the Mercer Insurance Group, Inc. group of companies, has developed and maintains a formal disaster recovery plan for the purpose of continuing its business operations in the event of a natural or man made disaster. The plan provides for and each department has an individual department preparation plan identifying its responsibility.

The information systems plan requires a complete backup of data each night. The most recent backup tape is taken off-site by a designated IS employee. Each week the prior week's backup tapes are stored off-site in a bank deposit box. Plans are in place to replicate data between the Lock Haven, Pennsylvania and Pennington, New Jersey offices as much as possible.

The Company's disaster recovery Emergency Team meets semi-annually to review the plan and is responsible for the Company becoming operational and conducting business as efficiently as possible under the circumstances.

It was noted that the disaster recovery plan has not been tested and or the Company has not performed a mock recovery drill so as to identify any potential deficiencies, which could potentially impede the process necessary to establish either a basic or critical systems restoration and the specific recovery time associated with each critical system restoration.

It is recommended the Company perform a mock disaster recovery test to further identify and document essential deficiencies that might exist which could potentially impede the process necessary to establish either a basic or critical systems restoration and the specific recovery time associated with each critical system restoration.

### **ACCOUNTS AND RECORDS**

The Company's accounting, investment, policy and claim records are available at the Company's administrative office.

The Company utilizes the Allenbrook Phoenix system for policy and claims processing, including premium rate calculation, policy packet generation and accounting activities. Phoenix is a client/server, Windows application and utilizes an Oracle database back-end.

The Company uses the Platinum for Windows general ledger accounting system developed by Best Software, Inc. The system is a Windows based on-line, real time general ledger accounting system, which maintains proper audit trails for journal entries down to the line item level.

## **AUDITED FINANCIALS**

Pursuant to **N.J.A.C.** 11:2-26.4 an annual audit was performed by the CPA firm of KPMG LLP, located at 1601 Market Street Philadelphia, Pa. 19103-2499 and an audited financial CPA report was filed with the Commissioner of Banking and Insurance of the State of New Jersey.

The report contains a synopsis of the major audit activities and the results of these activities on the Company's financial statements.

## **FINANCIAL STATEMENTS AND OTHER EXHIBITS**

The financial statements consist of the following exhibits and notes to financial statements showing the financial condition as of December 31, 2004, as shown in the annual statement:

EXHIBIT A: Comparative Statement of Assets, Liabilities, Surplus, and Other Funds at December 31, 2004 and December 31, 2000.

EXHIBIT B: Summary of Operations for the Four-Year Period Ending December 31, 2004.

EXHIBIT C: Capital and Surplus Account for the Four-Year Period Ended December 31, 2004.

The financial statements, schedules, and other exhibits shown in the following pages are based upon the annual statements as reported by the Mercer Insurance Company of New Jersey, Inc. Failure of items to add to the totals in certain schedules is due to rounding.

**EXHIBIT A**

**MERCER INSURANCE COMPANY OF NEW JERSEY, INC.**  
**COMPARATIVE STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND**  
**OTHER FUNDS AT DECEMBER 31, 2004 AND DECEMBER 31, 2000**

	Current Examination	Previous Examination @ 12/31/00	Increase (Decrease)	Note No.
<b><u>Assets</u></b>				
Bonds	\$21,099,639	\$ 9,882,998	\$11,216,641	
Stocks:				
Preferred	1,788,520	754,447	1,034,073	
Common	841,808	769,358	72,450	
Cash and Short-Term Investments	6,093,871	146,539	5,947,332	1
Receivable For Securities	5,404	0	5,404	
Investment Income Due and Accrued	201,588	156,115	45,473	
Premiums and Considerations:				
Premiums and agents' balances in course of collection	4,312,879	3,586	4,309,293	2
Agents' balances booked but deferred and not yet due	8,412,950	293,956	8,118,994	
Reinsurance: Amounts Recoverable From Reinsurers	362,276	12,401	349,875	
Net Deferred Tax Asset	558,920	0	558,920	
Receivables From Parent, Subsidiaries and Affiliates	2,321,021	0	2,321,021	
Aggregate Write-ins for Other Than Invested Assets	0	35,000	(35,000)	
<b>Total Admitted Assets</b>	<b><u>\$45,998,876</u></b>	<b><u>\$12,054,400</u></b>	<b><u>\$33,944,476</u></b>	
<b><u>Liabilities</u></b>				
Losses	\$ 5,451,155	\$2,430,194	\$3,020,961	3
Reinsurance Payable On Paid Loss and LAE	1,307,923	9,734	\$1,298,189	
Loss Adjustment Expenses	812,060	449,500	\$362,560	
Commissions Payable	111,041	5,379	\$105,662	
Other Expenses	0	3,143	(3,143)	4
Taxes, Licenses and Fees	130,506	12,614	117,892	
Current Federal and Foreign Income Taxes	243,522	254,917	(11,395)	
Unearned Premiums	6,162,500	838,572	5,323,928	
Ceded Reinsurance Premiums Payable	15,777,837	0	15,777,837	
Amounts Withheld or Retained By Company For				
Account of Others	365,424	120,017	245,407	
Excess of Statutory Reserves Over Statement Reserves	0	103,000	(103,000)	
Payable To Parent, Subsidiaries and Affiliates	0	302,266	(302,266)	
<b>Total Liabilities</b>	<b><u>\$30,361,968</u></b>	<b><u>\$4,529,336</u></b>	<b><u>\$25,832,632</u></b>	
<b><u>Surplus and Other Funds</u></b>				
Common Capital Stock	\$ 3,500,000	\$ 3,500,000	\$ 0	
Gross Paid In and Contributed Surplus	6,196,657	600,000	5,596,657	
Unassigned Funds (Surplus)	<u>5,940,251</u>	<u>3,425,064</u>	<u>2,515,187</u>	
Surplus as Regards Policyholders	<u>15,636,908</u>	<u>7,525,064</u>	<u>8,111,844</u>	5
<b>Total Liabilities, Surplus and Other Funds</b>	<b><u>\$45,998,876</u></b>	<b><u>\$12,054,400</u></b>	<b><u>\$33,944,476</u></b>	

**EXHIBIT B**

**MERCER INSURANCE COMPANY OF NEW JERSEY, INC.**  
**SUMMARY OF OPERATIONS FOR THE**  
**FOUR-YEAR PERIOD ENDING DECEMBER 31, 2004**

<u>UNDERWRITING INCOME</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Premiums Earned	\$10,598,919	\$10,051,352	\$8,090,835	\$1,981,838
Deductions:				
Losses Incurred	\$4,543,844	\$5,128,177	\$3,453,214	\$548,007
Loss Expenses Incurred	806,365	699,557	563,905	269,360
Other Underwriting Expenses Incurred	5,076,507	4,899,805	4,006,750	871,268
Aggregate Write-ins for Underwriting Deductions	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Deductions	<u>\$10,426,716</u>	<u>\$10,727,539</u>	<u>\$8,023,869</u>	<u>\$1,688,635</u>
Net Underwriting Gain or (Loss)	<u>\$172,203</u>	<u>(\$676,187)</u>	<u>\$66,966</u>	<u>\$293,203</u>
 <u>INVESTMENT INCOME</u>				
Net Investment Income Earned	\$633,067	\$590,594	\$550,123	\$615,608
Net Realized Capital Gains or (-) Losses	<u>19,699</u>	<u>97,781</u>	<u>136,500</u>	<u>14,829</u>
Net Investment Gain	<u>\$652,766</u>	<u>\$688,375</u>	<u>\$686,623</u>	<u>\$630,437</u>
 <u>OTHER INCOME</u>				
Net Gain or Loss (-) From Agents' Balances Charged Off	(\$36,013)	(\$42,873)	(\$9,925)	(\$37,001)
Finance or Service Charge not Included in Premium	59,938	18,378	20,276	16,534
Aggregate Write-ins for Miscellaneous Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Other Income	<u>\$23,925</u>	<u>(\$24,495)</u>	<u>\$10,351</u>	<u>(\$20,467)</u>
Net Income Before Dividends To Policyholders And Before Federal and Foreign Income Taxes	\$848,894	(\$12,307)	\$763,940	\$903,173
Dividends To Policyholders	<u>2,395</u>	<u>5,828</u>	<u>8,831</u>	<u>25,237</u>
Net Income, After Dividends to Policyholders But Before Federal and Foreign Income Taxes	\$846,499	(\$18,135)	\$755,109	\$877,936
Federal and Foreign Income Taxes Incurred	<u>245,383</u>	<u>76,706</u>	<u>568,687</u>	<u>254,998</u>
Net Income	<u>\$601,116</u>	<u>(\$94,841)</u>	<u>\$186,422</u>	<u>\$622,938</u>

**EXHIBIT C****MERCER INSURANCE COMPANY OF NEW JERSEY, INC.**  
**CAPITAL AND SURPLUS ACCOUNT FOR**  
**THE FOUR-YEAR PERIOD ENDED DECEMBER 31, 2004**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Net Income	<u>\$622,938</u>	<u>\$186,422</u>	<u>(\$94,841)</u>	<u>\$601,116</u>
<b><u>OTHER SURPLUS GAINS OR (LOSSES)</u></b>				
Change in Net Unrealized Capital Gains or (Losses )	\$55,612	(\$57,364)	\$301,040	\$83,345
Change in Net Deferred Income Tax	15,575	319,430	99,450	5,498
Change in Non Admitted Assets	48,882	(84,246)	114,413	56,104
Cumulative Effect of Changes in Accounting				
Principles	241,813	0	0	0
Surplus Adjustments:				
Paid –In	0	0	5,596,657	0
Unassigned Funds	0	0	0	0
Aggregate Write-ins for Gains/Losses In Surplus	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Other Surplus Gains or (-) Losses	<u>\$361,882</u>	<u>\$177,820</u>	<u>\$6,111,560</u>	<u>\$144,947</u>
Change In Surplus as Regards Policyholders for the Year	\$984,820	\$364,242	\$6,016,719	\$746,063
Surplus as Regards Policyholders				
December 31, Previous Year	<u>\$7,525,064</u>	<u>\$8,509,884</u>	<u>\$8,874,126</u>	<u>\$14,890,845</u>
Surplus as Regards Policyholders				
December 31, Current Year	<u>\$8,509,884</u>	<u>\$8,874,126</u>	<u>\$14,890,845</u>	<u>\$15,636,908</u>

## **NOTES TO THE FINANCIAL STATEMENTS**

### **(NOTE 1) CASH AND SHORT-TERM INVESTMENTS**

It was noted that the Company inadvertently reported a long-term certificate of deposit as cash and short-term investments at year-end December 31, 2004.

It is recommended that in the future, the Company report all long-term certificates of deposit as bonds in accordance with Statement of Statutory Accounting Principle No. 26, paragraph 2 of the NAIC Accounting Practices and Procedures Manual.

### **(NOTE 2) UNCOLLECTED PREMIUMS**

A review of the Company's premiums receivable as of December 31, 2004 indicates that premiums due, regarding audit premiums, are not being aged in accordance with Statement of Statutory Accounting Principle No. 6, paragraph 7(d) of the NAIC Accounting Practices and Procedures Manual.

It is recommended that the Company change its aging method of premiums receivable to conform to the requirement of Statement of Statutory Accounting Principle No. 6, paragraph 7(d) of the NAIC Accounting Practices and Procedures Manual.

### **(NOTE 3) LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES**

MICNJ's loss and loss adjustment expense reserves, as reported by the Company totaled \$5,451,155 and \$812,060 respectively for the period ending 12-31-04.

The New Jersey Department of Banking and Insurance Actuarial Unit determined that MICNJ's overall reserves as of December 31, 2004 were reasonable and acceptable to meet future loss and loss adjustment expenses. This review was based on an actuarial analysis by the lead state, Pennsylvania.

Kevin C. McAllister, FCAS, MAAA of KPMG LLP has certified the adequacy of the Company's loss and loss adjustment expense reserves as of December 31, 2004. His review of these reserves concluded that the Company makes a reasonable provision, in the aggregate, for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements

### **(NOTE 4) OTHER EXPENSES**

Although immaterial, it was noted that the Company did not accrue for a liability, which existed for the annual statement item Other Expenses for the period ending December 31, 2004 in accordance with Statement of Statutory Accounting Principle No. 5, paragraph 3 of the NAIC Accounting Practices and Procedures Manual.

It is recommended that in the future the Company establish and report an accrual for the annual statement liability item Other Expenses when a liability exists in accordance with Statement of Statutory Accounting Principle No. 5, paragraph 3 of the NAIC Accounting Practices and Procedures Manual so as not to understate the Company's true liabilities.

#### **(NOTE 5) SURPLUS AS REGARDS POLICYHOLDERS**

MICNJ's Surplus as Regards Policyholders as determined by this examination and reported in the Company's 2004 Annual Statement, is \$15,636,908. This amount consisted of common capital stock of \$3,500,000, gross paid in and contributed surplus of \$6,196,657 and unassigned funds (surplus) \$5,940,251.

#### **EXAMINATION RECOMMENDATIONS**

##### **CONTINUITY OF OPERATIONS (Page 13)**

It was noted that the disaster recovery plan has not been tested and or the Company has not performed a mock recovery drill so as to identify any potential deficiencies, which could potentially impede the process necessary to establish either a basic or critical systems restoration and the specific recovery time associated with each critical system restoration.

It is recommended the Company perform a mock disaster recovery test to further identify and document essential deficiencies that might exist which could potentially impede the process necessary to establish either a basic or critical systems restoration and the specific recovery time associated with each critical system restoration.

##### **CASH AND SHORT-TERM INVESTMENTS (Page 18)**

It was noted that the Company inadvertently reported a long-term certificate of deposit as cash and short-term investments at year-end December 31, 2004.

It is recommended that in the future, the Company report all long-term certificates of deposit as bonds in accordance with Statement of Statutory Accounting Principle No. 26, paragraph 2 of the NAIC Accounting Practices and Procedures Manual.

##### **UNCOLLECTED PREMIUMS (Page 18)**

A review of the Company's premiums receivable as of December 31, 2004 indicates that premiums due, regarding audit premiums, are not being aged in accordance with Statement of Statutory Accounting Principle No. 6, paragraph 7(d) of the NAIC Accounting Practices and Procedures Manual.

It is recommended that the Company change its aging method of premiums receivable to conform to the requirement of Statement of Statutory Accounting Principle No. 6, paragraph 7(d) of the NAIC Accounting Practices and Procedures Manual.

### **OTHER EXPENSES (Page 18)**

Although immaterial, it was noted that the Company did not accrue for a liability, which existed for the annual statement liability item Other Expenses for the period ending December 31, 2004 in accordance with Statement of Statutory Accounting Principle No. 5, paragraph 3 of the NAIC Accounting Practices and Procedures Manual.

It is recommended that in the future the Company establish and report an accrual for the annual statement liability item Other Expenses when a liability exists in accordance with Statement of Statutory Accounting Principle No. 5, paragraph 3 of the NAIC Accounting Practices and Procedures Manual so as not to understate the Company's true liabilities.

### **SIGNIFICANT SUBSEQUENT EVENTS**

On October 1, 2005 Mercer Insurance Group, Inc. acquired all of the outstanding stock of Financial Pacific Insurance Group, Inc. a Wilmington, Delaware domiciled company, including its 100% owned insurance subsidiary, Financial Pacific Insurance Company. Financial Pacific Insurance Company is a property and casualty insurance company headquartered in Rocklin, California and became a participant in the reinsurance pooling arrangement with Mercer Insurance Company of New Jersey, Inc., Franklin Insurance Company and Mercer Insurance Company beginning January 1, 2006.

The Company's ultimate parent, Mercer Insurance Group, Inc. (MIG), filed an amended Insurance Holding Company System Annual Registration Statement to include the newly acquired Financial Pacific Insurance Group, Inc. (FPIG) and its 100% owned subsidiary Financial Pacific Insurance Company, (FPIC).

Effective January 1, 2006 the reinsurance pooling agreement was amended to include the Financial Pacific Insurance Company as a new participant to the reinsurance pooling arrangement.

The services allocation agreement was amended and effective October 1, 2005 to include the newly acquired Financial Pacific Insurance Group, Inc. and its group of companies.

Effective October 1, 2005, the Mercer Insurance Group, Inc., group of companies amended its consolidated tax allocation agreement to recognize the participation of the newly acquired Financial Pacific Insurance Group, Inc. and its group of companies.

**CONCLUSION**

A regular statutory condition examination was conducted by the undersigned with the assistance of fellow examiners of the New Jersey Department of Banking and Insurance examination staff.

The examination and audit was conducted at the Company's office in Pennington, New Jersey. The courteous assistance and cooperation of the Company's officers and employees afforded us during the examination is gratefully acknowledged.

Respectfully Submitted,  
/S/  
Joseph Samsel  
Joseph Samsel, AFE  
Examiner-In-Charge

**NOTARIZATION**

**MERCER INSURANCE COMPANY OF NEW JERSEY, INC.**

I, Joseph Samsel, do solemnly swear that the foregoing report of examination is hereby represented to be a full and true statement of the condition and affairs of the subject insurer as of December 31, 2004 to the best of my information, knowledge and belief.

Respectfully Submitted,

/S/

Joseph Samsel

Joseph Samsel, AFE

Examiner-In-Charge

New Jersey Department of Banking and Insurance  
Office of Solvency Regulation

State of New Jersey

County of Mercer

Subscribed and sworn to before me,  
on this 29<sup>TH</sup> day of June 2006.

/S/

Catherine M. Liptak

Notary Public of New Jersey

My commission expires January 21<sup>st</sup>, 2008