REPORT ON EXAMINATION AS TO THE CONDITION OF

ARI MUTUAL INSURANCE COMPANY

NEWTOWN, PENNSYLVANIA 18940

AS AT DECEMBER 31, 2010

N.A.I.C. GROUP CODE 0848

N.A.I.C. COMPANY CODE 13900

FILED

June 26, 2012

Commissioner
Department of Banking &
Insurance

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State of New Jersey
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF SOLVENCY REGULATION
PO BOX 325
TRENTON, NJ 08625-0325

TEL (609) 292-5350
FAX (609) 292-6765

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

KENNETH E. KOBYLOWSKI
Acting Commissioner

May 11, 2012

Honorable Kenneth E. Kobylowski
Acting Commissioner of Banking and Insurance
State of New Jersey
Trenton, New Jersey 08625

Commissioner:

In accordance with the authority vested in you by the Revised Statutes of New Jersey, an examination has been made of the assets and liabilities, method of conducting business and other affairs of the:

ARI Mutual Insurance Company
NEWTOWN, PENNSYLVANIA
N.A.I.C. GROUP CODE 0848
N.A.I.C. COMPANY CODE 13900

a domestic insurer duly authorized to transact the business of insurance in the State of New Jersey. Hereinafter, the ARI Mutual Insurance Company will be referred to in this report as the "Company" or "ARI Mutual".

SCOPE OF EXAMINATION

The New Jersey Department of Banking and Insurance, hereinafter referred to as "NJDOBI" have performed a full scope risk focused examination of ARI Mutual Insurance Company.

This risk focused 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, 2010, and addressed the three-year period from December 31, 2007, the date of the last examination. During this three-year period under examination, the Company's assets decreased from $71,073,015 to $59,455,163. Liabilities decreased from $41,515,839 to $28,210,207 and its surplus to policyholders increased from $29,557,176 to $31,244,956.

NJDOBI conducted our examination in accordance with the 2009 edition of the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook (the "NAIC Handbook"). The NAIC Handbook requires that NJDOBI plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company. In order to meet these objectives, NJDOBI obtained information regarding the Company's corporate governance environment, identified and assessed inherent risks to which it is exposed and evaluated its system of internal controls and procedures used to mitigate those risks identified. The examination also included 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.

According to the NAIC Handbook, "One of the increased benefits of the enhanced risk focused approach is to include … consideration of other than financial risks that could impact the insurer's future solvency. By utilizing the enhanced approach, the examiner reviewed the "financial" and "enterprise" risks that existed at the examination "as of" date and will be positioned to assess "financial" and "enterprise" risks that extend or commence during the time the examination was conducted and "prospective" risks which are anticipated to arise or extend past the point of examination completion. Using this approach, examiners will be better positioned to make recommendations for appropriate future supervisory plans (i.e., earlier statutory exams, limited-scope exams, key areas for financial analysts to monitor, etc.) for each insurer."

The Company has adopted an Enterprise Risk Management ("ERM") framework for proactively addressing and mitigating risks, including prospective business risks. The Company's Corporate Governance was found to be effective, contributing to its entity level (or monitoring level) controls, including prospective risks.

For years 2008 and 2009, the Certified Public Accounting (CPA) firm of Brown Schultz Sheridan & Fritz provided an unqualified audit opinion on the fair presentation of the Company's year-end financial statements based on statutory accounting principles. For the year 2010, the Certified Public Accounting (CPA) firm of EisnerAmper provided an unqualified audit opinion on the fair presentation of the Company's year-end financial statements based on statutory accounting principles. Relevant work performed by the CPA

firm, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

All accounts and activities of the Company were considered in accordance with the risk focused examination process. The examination report only addresses regulatory information revealed by the examination process in accordance with the NAIC Handbook. All other financial matters were reviewed and determined not to be material for discussion in this report.

COMPLIANCE WITH PRIOR EXAMINATION REPORT RECOMMENDATIONS

Continuity of Operations

2007 Examination Report Recommendation
It is recommended that the company continue to work on upgrading the recovery process of all their important systems and that they continue developing and testing a full Business Continuity Plan.

Company's Response
The Company will continue developing and testing the co-office business continuity strategy as outlined. This plan includes all mission critical applications and procedures.

2010 Examination Review
The Company complied with the recommendation of developing a full Business Continuity Plan but were not able to produce the testing results of the Business Continuity Plan from the Company outside third party vendor - Blue Cod Technologies, Inc.

Other Expenses

2007 Examination Report Recommendation
It is recommended that the Company include insurance fraud assessments in their future accruals.

Company's Response
The Company will include the Fraud Assessments in future accruals.

2010 Examination Review
The Company did comply with this recommendation.

HISTORY AND KIND OF BUSINESS

The Company was chartered by a special act of the Legislature of the State of New Jersey on December 4, 1879, under the name, “Farmer’s Mutual Insurance Company of New Jersey”.
An amendment to the Certificate of Incorporation, dated July 30, 1984, was filed with the Commissioner of Insurance of the State of New Jersey on November 1, 1984 changing the name of the corporation to the “American Reliance Insurance Company” (Mutual).

On June 30, 1993 the Company, in collaboration with the American Reliance Casualty Company (Casualty), sold the bulk of their business written to VIK Brothers Insurance,

Inc. and affiliates pursuant to an Asset Purchase Agreement dated February 12, 1993 and approved by the New Jersey Department of Banking and Insurance on June 12, 1993. At that point the Company operated in a runoff status, retaining the responsibility for claims in the State of Florida, for New Jersey personal automobile policies and for all policies issued before January 1, 1989. The Company also sold the right to market the name "American Reliance".

On February 28, 1994 the Company submitted a Form D filing to the New Jersey Department of Banking and Insurance requesting approval of an "Exchange Agreement" whereby all of its common stock in ARI Holdings, Inc. (1,359,656 shares) are to be transferred to the American Reliance Casualty Company in exchange for 100% of Casualty's issued and outstanding common stock. Prior to such a transfer, Casualty would declare and pay an extraordinary dividend to ARI Holdings, Inc. equal to the difference between the value of the Casualty Common Stock and the value of the ARI Common Stock beneficially held by Mutual.

On December 29, 1994 the Company submitted a Form D filing to the New Jersey Department of Banking and Insurance requesting approval of an assumption reinsurance agreement whereby the company would assume all of the business of American Reliance Indemnity Company, hereinafter referred to as "Indemnity". Indemnity would pay an extraordinary dividend to the Company in an amount such that Indemnity's capital and surplus would be reduced to the minimum required level. The New Jersey Department of Banking and Insurance approved both Form D filings on July 17, 1995.

On August 7, 1995 an Assumption Reinsurance Agreement was executed between Indemnity and the Company whereby the Company assumed all of the rights, liabilities and obligations relating to all insurance policies issued by Indemnity as of August 31, 1995. Also on August 7, 1995 the "Exchange Agreement" between the Company and Casualty was consummated and Casualty declared an extraordinary dividend in the amount of $4,030,173 payable to ARI Holdings, Inc.

On September 6, 1995 the Company filed an amended Form B (Holding Company Registration Filing) with the New Jersey Department of Banking and Insurance reflecting the changes discussed above.

Effective December 18, 1995 the corporate name was changed to "ARI Mutual Insurance Company" (ARI Mutual).

The Company's amended Certificate of Authority dated December 18, 1995 authorizes the Company to transact the kinds of insurance specified under paragraphs "a", "b", "d", "e", "f", "g", "i", "j", "k", "l", "m", "n" and "o-1", "o-2" and "o-3" of <u>N.J.S.A.</u> 17:17-1 <u>et. seq.</u> and Health Insurance as defined in the Life and Health Insurance Code <u>N.J.S.A.</u> 17B:17-4.

In 1996 the Company developed a detail feasibility study and plan for recommencement of operations. This plan was filed with the State of New Jersey with the request that the Company be permitted to recommence writing insurance. The State of New Jersey approved the Company's request in August of 1996. In March 1997 the Company recommenced issuing insurance policies in the State of New Jersey.

On February 1, 1996 the Company moved its principal office and operations to 133 Franklin Corner Road, Lawrenceville, New Jersey. The registered agent upon whom process may be served is the Company itself.

On February 19, 1999 the New Jersey Department of Banking and Insurance approved a capital contribution from the Company to ARI Casualty in the amount of $2,000,000.

The contribution was made by the Company in the form of a transfer of 709,220 shares of ARI Indemnity common stock with a statement value of $2.82 per share.

The Company's amended Certificate of Authority dated November 6, 2000 authorizes the Company to transact the kinds of insurance specified under paragraphs "a", "b", "e", "f", "g", "i", "j", "k", "l", "m", "n" and "o" of N.J.S.A. 17:17-1 et. seq.

ARI Indemnity Company was sold in the year 2005.

ARI Mutual Insurance Company was issued a Surplus Note on December 15, 2005 totaling $3,000,000. The Company re-paid the surplus debenture in the amount of $3,000,000 on December 15, 2010.

The principal office of the Company is located at 125 Pheasant Run, Newtown, PA 18940, which was moved on April 11, 2011. The agent in charge upon whom process may be served is Coughlin Duffy LLP.

STATUTORY DEPOSIT

As of December 31, 2010, the Company maintained two securities on deposit with the State of New Jersey, in trust for the benefit and security of all of the policyholders of ARI Mutual Insurance Company.

State	Security	Par Value / Number of Shares
New Jersey	F.H.L.B. BONDS, 2.75%, due August 19, 2013	$1,000,000.00
New Jersey	GOLDMAN SACHS ILA FEDERAL PORTFOLIO	13,750.34
Total		$1,013,750.34

TERRITORY AND PLAN OF OPERATION

A review of the Company's Schedule T indicated the Company is licensed and authorized to write business in the States of Delaware, Maryland, New Jersey, Pennsylvania, and Virginia as of December 31, 2010.

The Company conducted its business operations from its home office at 133 Franklin Corners Road, Lawrenceville, New Jersey, 08648 as of December 31, 2010. The Company moved its business operations to the new home office located at 125 Pheasant Run, Newtown, PA 18940 on April 11, 2011.

All underwriting and administrative business is conducted at this office; and all accounting books of record are maintained at this office. The Company has no other locations of business.

The Company intends to concentrate on mono-line auto rather than an entire account basis. The Company's concentration is on smaller "mom and pop" businesses with a small percentage of riskier businesses (vehicles over 20,000 pounds).

The Company markets its products exclusively through approximately 180 independent agents and brokers.

The Company places reinsurance through one reinsurance intermediary broker, AON Re Inc. AON Re Inc. began as the Company's Intermediary on August 15, 2005. The Intermediary is authorized to act in the State of New Jersey under N.J.S.A. 17:22E-2.

A summary of direct premiums written over the past three years is summarized below:

Year	Direct Premiums Written
2008	$30,759,934
2009	$26,970,686
2010	$19,497,486

Direct premiums written in 2010 were allocated among the following lines of business:

Line of Business Written	Direct Premiums Written
Commercial Auto Liability	17,004,555
Auto Physical Damage	2,303,883
Other Liability-Occurrence	189,098
Total	$19,497,486

The Company's accounting, claim, underwriting and administrative functions are conducted at the Company's home office.

ARI Mutual Insurance Company maintains two service agreements with Blue Cod Technologies who is not affiliated with the Company. These two service agreements are summarized below:

- **Master Processing Service Agreement – This agreement, entered into by both parties on March 30, 2007, allows Blue Cod Technologies to provide Processing Services for the Company that include policy services, claim services, billing services, extracts/interfaces with the processing system and management reports. Blue Cod Technologies also provides Hosting Services, Support Services, Security that allows Blue Cod to provide reasonable security to prevent unauthorized access to the data and the processing system of the Company and other various services.**

- **Non-Binding Memorandum of Understanding Level I - CUSTOMER PARTNER - Purchase The Complete Set Of Components - This Non-Binding Memorandum, entered into on June 8, 2007, Blue Cod Technologies and the Company will seek to mutually agree upon the set of subsystems, modules, components and the like comprising the Blue Cod Alternate Insurance Policy Information System.**

CORPORATE RECORDS

Minutes of meetings held by the Board of Directors revealed adequate approval of the Company's transactions and events including the review and approval of the prior statutory financial examination report.

The Company's adherence to its Certificate of Incorporation, Certificate of Authority and By-laws was validated without exception.

MANAGEMENT AND CONTROL

Mutual Policyholder Members

Mutual policyholder meetings shall be held at such place and at such time as the Board of Directors shall determine from time to time.

Ten members shall constitute a quorum for the transaction of any business. Each member is entitled to one vote.

The election of the Board of Directors is accomplished through a majority of votes cast by the Members at the annual meeting of policyholders.

Directors

In accordance with the Company's By-laws, the business and affairs of the Company are governed under the management of the Board of Directors.

The By-laws indicate the number of Directors serving the Company should be no less than three or more than seven. Directors are to remain in office for a term of three years except

in the case of death, resignation or removal. Directors are divided into three classes of Directors and the term of each Director is staggered so that one class of Directors expires each year. A majority of Directors shall constitute a quorum on any business transactions.

The following Directors were serving as of December 31, 2010:

Director	**Current Occupation**
George L. Bielitz, Jr.	**Independent Financial Consultant** **Chairman of the Board**
Barry W. Blank	**Commercial Banking Consultant**
William G. Vowteras	**President and Full Partner of Fraser Brothers, Inc. an independent insurance agency**
Karen S. Fulton	**President & Chief Executive Officer of ARI Companies**

In accordance with N.J.S.A. 17:27A-4(d)(3) the Company is required to maintain 1/3 outside directors. All Directors other than Karen S. Fulton are outside directors.

In accordance with the By-laws the Company is required to maintain an audit committee consisting of Directors who are neither Officers nor employees of the Company. The audit committee shall perform the following functions:

- **Annually arrange an audit of the Company's books by an independent public accountant.**
- **Review the annual report and present the report and its finding to the Board of Directors.**
- **Access to the accounts, books and records of the Company and the cooperation and assistance of the Officers maintaining such corporate and accounting records.**

Directors of the audit committee serving as of December 31, 2010 were as follows:

George Leonard Bielitz Jr.
William George Vowteras
Barry William Blank

In accordance with the Company By-laws, the Board of Directors may create additional committees and appoint Directors to serve on them. Under this resolution the Board of Directors created a Compensation Committee comprised of the following Directors:

George Leonard Bielitz Jr.
William George Vowteras
Barry William Blank

As indicated above, all Directors serving on both the audit and compensation committees are considered outside directors. As indicated in N.J.S.A. 17:27A-4(d)(4), any committee

selecting and reviewing the work performed by the Company's CPA auditors, nominating candidates for director, or evaluating the performance and determining the compensation of Company officers, shall be comprised solely of outside Directors. Both the compensation and audit committee encompass such functions.

Officers

As designated in the Company's By-laws, the Officers of the Company shall be a President, a Secretary, a Treasurer and additional Officers as designated by the Board. Officers are annually elected and hold one-year terms.

Officers serving the Company as of December 31, 2010 are indicated below:

Karen S. Fulton – President
John T. Ericson – Secretary
David A. Gerth -- Treasurer
Patrick Cusack -- Senior VP Claims

Corporate Governance

The Company has adopted an ERM framework for proactively addressing and mitigating risks, including prospective business risks. Exhibit M of the NAIC Handbook was utilized as guidance for assessing corporate governance. Overall, it was determined that the Company's corporate governance structure is effective.

Management has an effective approach to identifying and mitigating risks across the Company, including prospective business risks. The Company deals proactively with its areas of risk and is knowledgeable about mitigation strategies. Management discusses the significant issues and reacts to changes in the environment with a clear commitment to address risk factors and manage the business accordingly. The Company's overall risk management process is well-defined and takes a proactive approach to identifying, tracking, and dealing with current significant and emerging risk factors.

The Company outsources its Internal Audit function to a third party as per the Company's Internal Audit Charter. The third party for the 2010 audit year was SMART Business Advisory and Consulting, LLC (Smart and Associates). Smart and Associates mission is to provide reasonable assurance as to the effectiveness and efficiency of the overall internal control environment for ARI Insurance Companies. In that regard Smart and Associates will play a significant role in identifying and assessing the priority of business risks.

Smart and Associates primary objective is to provide independent assurance over the internal controls established by Senior Management over all its company operations. Smart and Associates assessment of internal controls will focus on the achieving the following objectives:

- **Effective and efficient operations;**
- **Reliable financial reporting;**
- **Compliance with legal and regulatory requirements, and**

- **Best industry practices including the Committee of Sponsoring Organizations ('COSO') requirements. COSO identifies five components of the internal control process that need to be in place and integrated: control environment, risk assessment, control activities, information and communication, and monitoring.**

Smart and Associates will focus on verifying the effectiveness of the key controls that minimize the more significant risks identified in the Annual Risk Assessment.

Smart and Associates will also:

- **Provide management with advice and recommendations on controls over their business operations and processes: the objective is that controls minimize the potential for significant risks that are unintended or unknown by the Board of Directors and Management;**

- **Provide management with advice and recommendations to improve the reliability, integrity and security of management and financial information;**

- **Consult with the external auditors to ensure key risks are addressed and to ensure audit duplication is avoided whenever possible;**

- **Assist management in ascertaining the extent of compliance with laws and regulation to which the company is subject or will be subject, and**

- **Communicate the principles of the risk-based audit approach and the basis of the Audit Plan to management.**

Smart and Associates has a direct reporting relationship to the Audit Committee and administratively to the Chief Financial Officer of the ARI Insurance Companies.

SMART Business Advisory and Consulting, LLC changed their name to WeiserMazars in 2011.

Due to the size of the Company and the cost associated with employing a sufficient number of employees to establish an effective set of internal control procedures that provide for a clear segregation of duties, the examination team did not evaluate internal controls of the Company.

REINSURANCE

The Company had the following reinsurance in force as of December 31, 2010:

Business Type and Contract	**Reinsurance Limits**
Commercial Auto Liability	
1st Excess of Loss – Section A - Exhibit A	**$800,000 in excess of $200,000.**
2nd Excess of Loss – Section A – Exhibit C	**$4,000,000 in excess of $1,000,000.**
Aggregate Limitation 2nd Excess of Loss – Section A – Exhibit C	**100% of 12,000,000 per year on Commercial Auto Liability during any one Agreement year.**
Commercial Auto Physical	
1st Excess of Loss – Section B - Exhibit B	**If Commercial Auto Liability loss is in excess of $200,000 and there is also a Commercial Auto Physical Damage including Collision loss – the reinsurer limit is $75,000 on the Commercial Auto Physical Damage Collision loss.**
1st Layer Excess of Loss Catastrophe	**95% in excess of $350,000 of any catastrophe loss, up to a limit of $1,000,000 on Commercial Auto Physical Damage Comprehensive Coverage Only.**
Aggregate Limitation – 1st Layer	**95% of 1,300,000 per year on Commercial Auto Physical Damage Comprehensive Coverage Only during the 12 month term of the Agreement.**
2nd Layer Excess of Loss Catastrophe	**95% of $5,500,000 in excess of $1,000,000 on Commercial Auto Physical Damage Comprehensive Coverage Only.**
Aggregate Limitation – 2nd Layer	**95% of 11,000,000 per year on Commercial Auto Physical Damage Comprehensive Coverage Only during the 12 month term of the Agreement.**
Commercial Excess and Umbrella	
1st Layer Excess	**95% of 1,000,000 each occurrence, each policy, plus proportional share of loss expense.**
2nd Layer Excess	**$4,000,000 in excess of $1,000,000 each occurrence, each policy, plus proportional share of loss expense.**

Once the above reinsurance is calculated, the Company accounts as if it assumes 100% of ARI Casualty Company's net loss exposures under an Inter-Company Reinsurance Pooling Treaty. ARI Mutual will then cede 35% of the total net consolidated losses of the combined Companies back to ARI Casualty Company under an Inter-Company Quota Share Reinsurance Treaty. These inter-company agreements are explained in detail under the examination report section titled <u>Inter-Company Agreements</u>. This is done through two reinsurance contracts.

In addition to the above mentioned reinsurance, the Company is also a participant in mandatory Pools and Associations. The Company assumes reinsurance from the National Workers Compensation Pool and the New Jersey Commercial Automobile Insurance Procedure and cedes reinsurance to the New Jersey Unsatisfied Claim and Judgment Fund.

The Company did report reinsurance in dispute of $27,000 as of December 31, 2010.

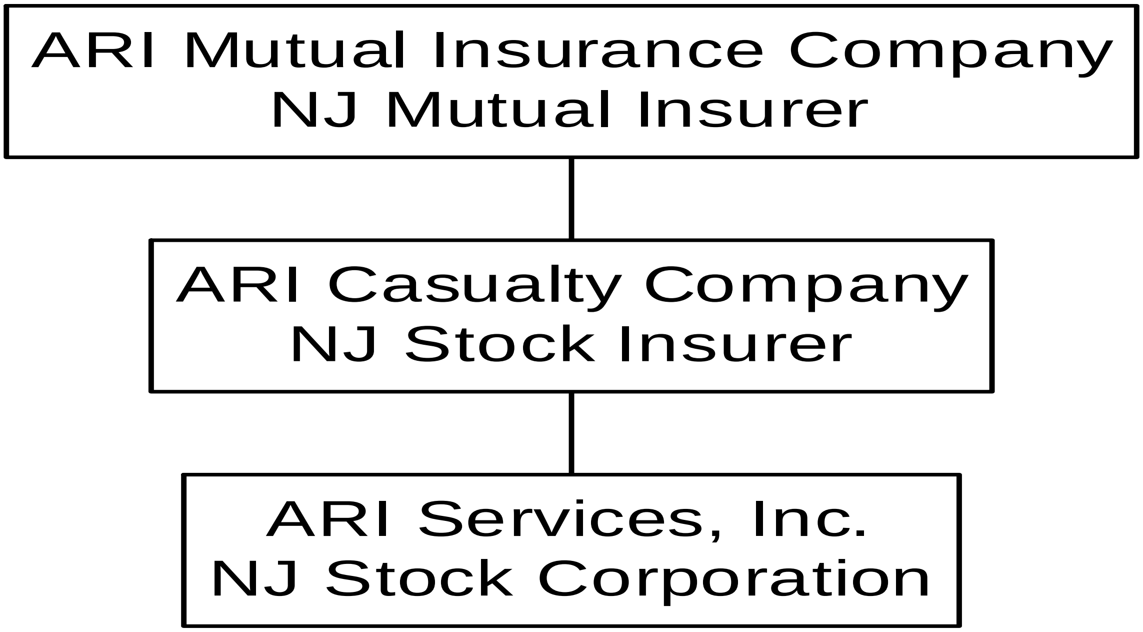
The Company wrote-off $34,536 of additional reinsurance balances due from insolvent/commuted companies in 2010. The amount is shown below by reinsurer:

Reinsurer	Amount
Constellation Reinsurance	963
Dominion Insurance	7,580
Fireman's Fund	3,398
Northeastern Insurance	4,764
Pine Top	1,572
Universal Reinsurance	16,259
Total	$34,536

Reinsurance Agreements were reviewed to ensure contracts had acceptable clauses and conditions.

REGULATION OF INSURANCE HOLDING COMPANY SYSTEMS

The Company is a member of a holding company system as defined within N.J.S.A. 17:27A-1. The Company is the ultimate Parent of the Companies within the holding company system as illustrated below:



A review indicated that the holding company filings were made for the period under examination by ARI Mutual Insurance Company as registrant to the requirements and standards under N.J.S.A. 17:27A-3.

INTER-COMPANY AGREEMENTS

The Company is operating under a number of inter-company agreements, which are described below:

Inter-Company Quota Share Reinsurance Pooling Agreements **- The Company and ARI Casualty Company participate in two reinsurance pooling agreements. Under the Agreements ARI Casualty cedes 100% of its premiums and losses to ARI Mutual. ARI Mutual combines this business with its own premiums and losses and cedes 35% of it back to ARI Casualty. Prior to March 1, 1997, ARI Mutual assumed 40% and ARI Casualty assumed 60% of the combined premiums and losses. Please see examination report section titled Subsequent Events for termination of these agreements in 2011.**

Management Agreement **- ARI Mutual has a management agreement with ARI Casualty Company. Under this Agreement, ARI Mutual provides use of the following:**

- **Executive, management, administrative and other employee services**
- **Office facilities**
- **Data processing systems and services**
- **Equipment, supplies, communications and other systems**

In exchange ARI Casualty is to share in the cost of such services through the same respective prorated percentage (35%) as indicated in the Pooling Agreement.

Tax Allocation Agreement **- ARI Mutual files a consolidated income tax return with both ARI Casualty Company and ARI Services Inc. The Agreement stipulates ARI Mutual should account for all tax payments and tax refunds and share all payments and refunds based upon Casualty's proportionate share of tax liability (including credit for tax losses) as if each Company filed independently.**

POLICY ON CONFLICT OF INTEREST

The Company maintains a "Code of Conduct" policy statement for all employees of ARI regardless of position. The Code of Conduct stipulates the various conditions and actions that are and or may be deemed by the Company to be inappropriate, potential conflicts of interest and or violations of said policy statement.

In addition all conflict of interest questionnaires are reviewed by the Company President, with the results of the review being presented to the Board of Directors.

EMPLOYEE WELFARE AND PENSION PLANS

The ARI Mutual Insurance Company provides several benefit programs for its employees. Some benefit programs require contributions from employees, but most are fully funded by the Company.

A general summary of the various plans available to the Company employees are as follows:

- **401K Saving Plan**
- **Life Insurance & Disability Insurance**
- **Health Insurance Coverage**
- **Dental Care Program**
- **Short-term Incentive Plan**

The Company also offers a Long-term Incentive Plan. The Long-term Incentive Plan is administered by the Board of Directors. The Board of Directors shall select Participants from among those directors and employees of the Company who occupy positions which afford them the opportunity to make a substantial contribution to the success of the Company. In making this selection and in determining the form and amount of Awards, the Board of Directors shall consider any factors it deems relevant, including the individual's functions, responsibilities, value of services to the Company, and past and potential contributions to the Company's profitability and sound growth. The Board of Directors may establish performance criteria for the granting of Awards for the Long-term Incentive Plan.

FIDELITY BOND AND OTHER INSURANCE COVERAGES

The Company maintains insurance coverage designed to protect its assets from losses arising out of various risks. The following summary shows the types and amounts of coverage that were in force as at December 31, 2010:

ARI Mutual Insurance Company Only:

Umbrella Coverage	
General Aggregate Limit (Other than Products - Completed Operations, Bodily Injury By Disease and Automobile)	10,000,000
Products - Completed Operations Aggregate Limit	10,000,000
Bodily Injury By Disease Aggregate Limit	10,000,000
Each Occurrence Limit	10,000,000
Retention – Each Occurrence	10,000
Employers' Liability	
Each accident (by accident)	1,000,000
Policy limit (by disease)	1,000,000
Each employee (by disease)	1,000,000
Commercial Auto Liability - written to include all owned, non-owned and hired autos, except Owned Auto	
Single Liability Limit - Each accident	1,000,000
Split Liability Limits - Bodily injury each person	
Bodily injury each accident	
Property damage each accident (Owned Auto)	
Commercial General Liability	
Each occurrence limit	1,000,000
Personal and advertising injury limit	1,000,000
General aggregate limit(other than products completed operations)	2,000,000
Products-completed operations aggregate limit	2,000,000
Employee Benefits Liability	
Each Claim Limit	1,000,000
Aggregate Limit	2,000,000
Fiduciary Liability Insuring Agreement	
Limit of Liability – Each Policy Year	1,000,000
Retention – Each Claim	2,500
Workers Compensation	
Bodily Injury By Accident-Each Accident	1,000,000
Bodily Injury By Disease -Each Employee	1,000,000
Bodily Injury By Disease -Policy Limit	1,000,000

ARI Insurance Companies Group:

Employment Practices Liability Insurance	
Each Claim	**5,000,000**
Annual Aggregate	**5,000,000**
Retention – Each Claim	**10,000**
Insurance Company Professional Liability	
Each Claim	**5,000,000**
Annual Aggregate	**5,000,000**
Deductibles Each Claim	**100,000**
Directors and Officers Liability	
For Each Claim	**5,000,000**
Aggregate	**5,000,000**
Deductibles Each Claim	**150,000**

At December 31, 2010, the Company, along with its affiliates ARI Casualty Company and ARI Services Inc. (collectively the ARI Group), are the named insured's on a Financial Institution Bond which is underwritten by St. Paul Fire and Marine Insurance Company. The fidelity bond provides the ARI Group with a single loss limit of liability of $2,000,000 with a single loss deductible of $25,000 for various risks covered under the policy. This policy also covers Restoration Costs of Electronic Information with a single loss limit of liability of $2,000,000 with a deductible of $25,000. The amount of fidelity coverage carried on this policy meets the suggested minimum amount of fidelity coverage as measured on a group basis using the NAIC's formula and exposure index.

POLICY FORMS AND UNDERWRITING PRACTICES

The Company filed its rates, rules and forms filings with the New Jersey Department of Banking and Insurance for their commercial automobile liability, commercial automobile physical damage, commercial business owners and commercial general liability. The Company uses Insurance Services Office (ISO) Forms for all lines of business. All commercial line filings for rates, rules and forms have been determined to be in compliance with N.J.S.A. 17:29AA-1 et. seq. and in accordance with N.J.A.C. 11:13-2.1. The Company also writes their own underwriting guidelines for all commercial lines of business.

ACCOUNTS AND RECORDS

Financial information needed in conjunction with the verification of assets and the determination of liabilities was made available in detail and summary form. The general ledger system was tested and reconciled to the annual statement. The Company's accounting books and records are maintained at the Company's home office. The general books of account are maintained on a Freedom general ledger software package (Freedom).

The Company uses Freedom to record accounts payable, which has a direct feed into the general ledger package.

Premium billing and accounts receivable are recorded using the Company's Phoenix System. Approximately 70% of all premium receipts by volume are received in a lock box or paid on line and are deposited directly in the bank. The bank issues detail to the Company and the Company records the deposits daily through the Phoenix System. The remaining 30% of receipts are received by the Company directly. Premiums billed are recorded in Phoenix, and are interfaced with Freedom and posted to the general ledger. Written premiums are manually recorded (through journal entries) into Freedom and posted to the general ledger on a monthly basis through reports generated by Phoenix. Commissions are recorded in the same manner with commission payments fully automated and the recording of commissions manually recorded on a monthly basis.

Claim reserves and payments are entered in the Company's Phoenix System on a daily basis and recorded manually (through journal entries) onto Freedom and posted to the general ledger.

Investment transactions are recorded through the use of Excel spreadsheets. The Company records the activity to their investment accounts on a monthly basis. All reconciled monies are then posted to the general ledger through journal entries.

ADVERTISING AND SALES MATERIAL

A review of the Company's advertising and sales materials disclosed that the Company is in compliance with N.J.S.A. 17:18-10 and that there were no material inconsistencies between the Company's sales material and the Company's policies.

TREATMENT OF POLICYHOLDERS

The Company's complaint log for complaints filed with the New Jersey Department of Banking and Insurance for the years 2008 through 2010 were reviewed. The review of these complaint logs determined that the treatment of complainants, the record keeping of complaints and the response time by the Company was in compliance with N.J.S.A. 17:29B-4(10) (Complaint Handling Procedures).

CONTINUITY OF OPERATIONS

A business continuity plan is necessary to help ensure the Company can adequately recover from a system failure or business interruption in a timely fashion and without the loss of significant data. Management should assess how the Company's reputation and financial status would be impacted in the event of a major processing disruption and, based on this assessment, develop an appropriate continuity plan that would help to ensure the Company can adequately recover from a system failure or business disruption in a timely fashion.

The Company's comprehensive Business Continuity Plan was reviewed by the New Jersey DOBI insurance examination team. There were no exceptions noted or recommendations made.

The Company has made provisions for the succession of officers in its By-laws.

GROWTH OF COMPANY

The direct premiums written to surplus as regards policyholders ratio for the period under examination are found below:

Year Ending	Direct Premiums Written	Surplus as Regards Policyholders	Ratio
2008	30,759,934	30,069,939	1.023
2009	26,970,686	32,890,247	0.820
2010	19,497,486	31,244,956	0.624

FINANCIAL STATEMENTS AND OTHER EXHIBITS

Exhibit A **Balance Sheet as at December 31, 2010**

Exhibit B **Summary of Operations for the Three-Year Period Ending December 31, 2010**

Exhibit C **Capital and Surplus Account for the Three-Year Period Ending December 31, 2010**

ARI MUTUAL INSURANCE COMPANY
BALANCE SHEET AT DECEMBER 31, 2010

	Current Examination at 12/31/10	Balance per Company at 12/31/10	Examination Change	Note Number
Assets				
Bonds and Stocks	$41,944,211	$47,398,660	($5,454,449)	1
Real Estate:				
Properties Occupied by the Company	2,082,641	2,082,641	0	
Cash & Short-term Investments	1,031,041	1,031,041	0	
Investment Income Due and Accrued	379,664	379,664	0	
Premiums and Considerations:				
In Course of Collection	887,928	887,928	0	
Booked but Deferred and Not Yet Due	3,175,081	3,175,081	0	
Reinsurance:				
Amounts Recoverable from Reinsurers	2,480,342	2,480,342	0	
Other Amounts Receivable under Reinsurance Contracts	309,939	309,939	0	
Current Federal and Foreign Income Taxes Recoverable	41,036	41,036	0	
Net Deferred Tax Asset	600,405	600,405	0	
Guaranty Funds Receivable or on Deposit	726,921	726,921	0	
Electronic Data Processng Equipment and Software	17,776	17,776	0	
Receivable from Parent, Subsidiaries and Affiliates	323,729	323,729	0	
Total Admitted Assets	$54,000,714	$59,455,163	($5,454,449)	
Liabilities				
Losses and Loss Adjustment Expenses	$21,037,288	$19,250,138	$1,787,150	2
Reinsurance Payable on Paid Losses and Loss Adjustment Expenses	41,068	41,068	0	
Commissions Payable, Contingent Commissions and Other Similar Charges	223,830	223,830	0	
Other Expenses	735,029	735,029	0	
Taxes, Licenses and Fees	406,260	406,260	0	
Unearned Premiums	5,402,634	5,402,634	0	
Advance Premium	3,386	3,386	0	
Ceded Reinsurance Premiums Payable	2,068,247	2,068,247	0	
Amounts Withheld or Retained by Company	68,815	68,815	0	
Provision for Reinsurance	10,800	10,800	0	
Total Liabilities	$29,997,357	$28,210,207	$1,787,150	
Surplus and Other Funds				
Unassigned Funds (Surplus)	24,003,357	31,244,956	(7,241,599)	
Surplus as Regards Policyholders	$24,003,357	$31,244,956	($7,241,599)	3
Total Liabilities, Surplus and Other Funds	$54,000,714	$59,455,163	($5,454,449)	

EXHIBIT B

ARI MUTUAL INSURANCE COMPANY
SUMMARY OF OPERATIONS FOR THE
THREE-YEAR PERIOD ENDING DECEMBER 31, 2010

UNDERWRITING INCOME	Current Examination at 12/31/10	2009	2008
Premiums Earned	$12,642,092	$15,764,083	$19,346,089
Deductions:			
Losses Incurred	$9,382,958 *	$10,130,660	$12,511,851
Loss Expenses Incurred	1,301,245	1,043,577	2,005,746
Other Underwriting Expenses Incurred	4,278,801	5,035,684	5,788,181
Total Underwriting Deductions	$14,963,004	$16,209,921	$20,305,778
Net Underwriting Gain or (Loss)	($2,320,912)	($445,838)	($959,689)
INVESTMENT INCOME			
Net Investment Income Earned	$1,097,988	$1,474,424	$1,701,385
Net Realized Capital Gains or (Losses)	91,472	94,449	60,330
Net Investment Gain or (Loss)	$1,189,460	$1,568,873	$1,761,715
OTHER INCOME			
Net Gain or (Loss) from Agents' Balances Charged Off	($75,814)	($145,390)	($143,301)
Finance and Service Charges not Included in Premium	110,682	127,501	125,928
Total Other Income	$34,868	($17,889)	($17,373)
Net Income Before Dividends to Policyholders and before Federal & Foreign Income Taxes	($1,096,584)	$1,105,146	$784,653
Dividends to Policyholders	0	0	0
Net Income Before Federal Income Taxes	($1,096,584)	$1,105,146	$784,653
Federal Income Taxes Incurred	2,917	(701)	(83,006)
Net Income	($1,099,501)	$1,105,847	$867,659

* 2010 Examination Adjustment totaling $1,787,150

ARI MUTUAL INSURANCE COMPANY
CAPITAL AND SURPLUS ACCOUNT FOR
THREE-YEAR PERIOD ENDING DECEMBER 31, 2010

	Current Examination at 12/31/10	2009	2008
NET INCOME	($1,099,501)	$1,105,847	$867,659
OTHER SURPLUS GAINS OR (-) LOSSES			
Change in Net Unrealized Capital Gains or (-) Losses	$1,480,542	$1,557,608	($112,064)
Change in Net Deferred Income Tax	(552,254)	(2,508,213)	(3,639,627)
Change in Nonadmitted Assets	(5,945,877) *	2,852,666	3,423,795
Change in Provision for Reinsurance	230,200	(178,600)	(36,000)
Change in Surplus Note	(3,000,000)	0	0
Total Other Surplus Gains or (-) Losses	($7,787,389)	$1,723,461	($363,896)
Change in Surplus as Regards Policyholders for the Year	($8,886,890)	$2,829,308	$503,763
Surplus as Regards Policyholders December 31, Previous Year	$32,890,247	$30,060,939	$29,557,176
Surplus as Regards Policyholders December 31, Current Year	$24,003,357	$32,890,247	$30,060,939

* 2010 Examination Adjustment totaling $5,454,449

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: BONDS AND STOCKS

ARI Mutual Insurance Company reported admitted assets for bonds, preferred stocks and common stocks of $27,406,818, $1,000,000 and $18,991,842 respectively at December 31, 2010.

It was determined by this examination that investments in foreign securities and investments in common stock of any non dividend-paying insurance company that exceeds 25% of the Company's surplus at year end would not be allowed as an admitted asset. However these items qualify as admitted assets under the basket clause. For further information please see the subsection titled Investment Basket Clause Provision.

Investment Basket Clause Provision

The investment "basket clause" provision allows the Company the flexibility to invest in certain securities that may not otherwise be considered permissible investments under N.J.S.A. 17:24-1. A limitation ranging from a minimum of 5% of prior year total admitted assets to a maximum of 10% of prior year total admitted assets or at some point in between. Specifically, the provision allows loans or investments (not otherwise permitted) not exceeding at any one time in the aggregate the greater of 5% of total admitted assets or 50% of the excess of total admitted assets over the sum of liabilities plus capital and surplus required to transact business but in any event not to exceed 10% of total admitted assets as of the prior year-end. This limitation is placed on the carrying value of investments that can be classified under this "basket clause" provision.

Basket Clause Provision:

Basket Clause Limit (10% of 2009 total admitted assets of $67,242,025)	**$6,724,203**
Basket Clause assets at December 31, 2010	
Bonds and Stocks:	
Basket Clause Limit (10% of 2009 total admitted assets of $67,242,025)	**$6,724,203**
Basket Clause assets at December 31, 2010	
Bonds and Stocks:	
Investments in foreign securities - N.J.S.A. 17:24-10	**998,048**
Investments in common stock of any non dividend-paying insurance company that exceeds 25% of the Company's surplus at year end - N.J.S.A. 17:24-9	**11,180,603**
Sub-total	**$12,178,651**
Over Basket Clause Provision	**$5,454,449**

Upon review, and in accordance with N.J.S.A. 17:24-1(g), it was determined by this examination that the above investments do not fall within the provisions of the investment basket clause. As such, those securities classified as foreign investments and investments in common stock of any non dividend-paying insurance company that exceeded 25% of the Company's surplus at year end should be reported as non-admitted assets under the investment basket clause provision.

It was determined by this examination that the Company should non-admit those securities classified as foreign investments and investments in common stock of any non dividend-paying insurance company that exceeds 25% of the Company's surplus at year end under the basket clause provision in the amount of $5,454,449.

It is recommended by this examination that the Company comply with N.J.S.A. 17:24-1(g) and non-admit assets which exceed the basket clause limits at year end.

NOTE 2: LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company reported a net liability for loss and loss adjustment expenses of $19,250,138 at December 31, 2010 which was $1,787,150 less than the amount determined by this examination of $21,037,288.

A review of the reserves for losses and loss adjustment expenses was completed under the direction of the Property and Casualty Actuarial Division of the New Jersey Department of Banking and Insurance. This review was supplemented with the analysis conducted by the ARI Group's Opining Actuary as of December 31, 2011. On the basis of this review, the Reserve for Loss and Loss Adjustment Expenses for the ARI Group were deficient by $2,749,462 at December 31, 2010. Since ARI Mutual Insurance Company is 65% of the 2010 pooling agreement, the deficiency for the Reserve of Loss and Loss Adjustment Expenses was $1,787,150.

Of the $2,749,462 reported deficiency for the ARI Group, over 100% of the deficiency is in the Auto Liability Bodily Injury (Auto BI) Accident Years (AYs) 2009 and 2010. Reserves for the other Lines of Business (LOBs) and other AYs of Auto BI of 2008 and prior were found slightly redundant.

The examination recommends that the ARI Group maintain gross and net loss and loss adjustment expense reserves at a level adequate to meet its ultimate loss and loss adjustment expense obligations.

The ARI Group recognized about $2.5 million in 2010 and prior AYs reserve deficiency during year end 2011 for Loss and Loss Adjustment Expense Reserves. Please see examination report section titled Subsequent Events.

The examination performed reconciliations of case reserves and paid loss totals from annual statement page 9, "Losses Paid and Incurred" and page 10, "Unpaid Losses and Loss Adjustment Expenses" to Schedule P of the Company's annual statement.

NOTE 3: SURPLUS AS REGARDS POLICYHOLDERS

Unassigned Funds (Surplus)

The Company reported surplus as regards to policyholders at December 31, 2010 of $31,244,956 which consisted of unassigned funds of $31,244,956. The examination reported surplus as regards to policyholders of $24,003,357 which was $7,241,599 less than the amount reported by the Company. This decrease is due to examination changes to certain asset and liability accounts, which ultimately affected the unassigned funds (surplus) account as follows:

Surplus as Regards Policyholders at December 31, 2010 (per Company)		**$31,244,956**
Decreases in Surplus:		
Bonds and Stocks	**$5,454,449**	
Losses and Loss Adjustment Expenses	**1,787,150**	
Total Decreases in Surplus	**$7,241,599**	
Net Decrease in Unassigned Funds (Surplus)		**$7,241,599**
Surplus as Regards Policyholders at December 31, 2010 (per Examination)		**$24,003,357**

SUBSEQUENT EVENTS

Assumption Reinsurance Agreement

An Assumption Reinsurance Agreement, effective December 1, 2011, between ARI Mutual Insurance Company (ARI Mutual) and ARI Casualty Company (ARI Casualty) terminated the Inter-Company Quota Share Reinsurance Pooling Agreements between ARI Mutual Insurance Company and ARI Casualty Company.

ARI Casualty also transfers all insurance liabilities to ARI Mutual. The insurance operations will be consolidated by ARI Mutual and they will also facilitate the cash management functions.

Extraordinary Dividend Payment

ARI Casualty Company filed a Form D requesting to issue a dividend to ARI Mutual Insurance Company. An extraordinary dividend in the amount of $12,000,000 was declared on September 14, 2011 to be paid on October 1, 2011 by ARI Mutual's subsidiary, ARI Casualty Company.

This dividend payment was approved by the New Jersey Department of Banking and Insurance Office of Solvency Regulation Financial Analysis Unit on November 21, 2011.

The actual dividend payment made by ARI Casualty Company to ARI Mutual Insurance Company was $11,623,837. The difference of $376,163 was explained by ARI Group as the payment from ARI Casualty Company to ARI Mutual Insurance Company for management fees.

The net effect to ARI Mutual Insurance Company surplus after this extraordinary dividend payment was $0.

Reserve Deficiency Recognition

The ARI Group recognized about $2.5 million in 2010 and prior Accident Year's reserve deficiency during year end 2011 for Loss and Loss Adjustment Expense Reserves. This recognition was done by ARI Group with concurrence of the Opining Actuary as of December 31, 2011.

Compliance with N.J.S.A. 17:24-9

ARI Casualty Company paid a dividend in year end 2011 so therefore ARI Mutual Insurance Company is in compliance with N.J.S.A. 17:24-9 for year end 2011.

SUMMARY OF EXAMINATION RECOMMENDATIONS

Bonds and Stocks (page 24)

It was determined by this examination that the Company should non-admit those securities classified as foreign investments and investments in common stock of any non-dividend-paying insurance company that exceeds 25% of the Company's surplus at year end under the basket clause provision in the amount of $5,454,449.

It is recommended by this examination that the Company comply with N.J.S.A. 17:24-1(g) and non-admit assets which exceed the basket clause limits at year end.

Loss and Loss Adjustment Expenses (page 24)

The Company reported a net liability for loss and loss adjustment expenses of $19,250,138 at December 31, 2010 which was $1,787,150 less than the amount determined by this examination of $21,037,288.

The examination recommends that the ARI Group maintain gross and net loss and loss adjustment expense reserves at a level adequate to meet its ultimate loss and loss adjustment expense obligations.

STATEMENT BY NEW JERSEY DEPARTMENT OF BANKING AND INSURANCE PROPERTY AND CASUALTY ACTUARY

Losses and Loss Adjustment Expenses findings in the 2010 financial condition examination report of ARI Mutual Insurance Company are the responsibility of the Property and Casualty Actuarial Unit of the Office of Solvency Regulation of the New Jersey Department of Banking and Insurance. These findings were supplemented with the analysis conducted by the ARI Group's Opining Actuary as of December 31, 2011.

/S/

Boris Privman, FCAS, MAAA

CONCLUSION

A regular statutory financial 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 ARI Mutual Insurance Company office in Newtown, Pennsylvania. The courteous assistance and cooperation of the Company's officers and employees is acknowledged.

Respectfully Submitted,

/S/

Vincent Kaighn, CFE
Examiner-in-Charge

<u>**ARI MUTUAL INSURANCE COMPANY**</u>

I, Vincent Kaighn, 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, 2010 to the best of my information, knowledge and belief.

Respectfully Submitted,

/S/

____
Vincent Kaighn
Supervising Insurance Examiner
New Jersey Department of Banking & Insurance

State of New Jersey
County of Mercer

Subscribed and sworn to before me, on this _____12th____ day of ___June______ 2012.

/S/

____
Crystal Kane
Notary Public of New Jersey

My commission expires: ___July 28, 2014______