EXAMINATION REPORT
on
NORTHERN NECK INSURANCE COMPANY
Irvington, Virginia
as of
December 31, 2008

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE

P.O. BOX 1157
RICHMOND, VIRGINIA 23218
TELEPHONE: (804) 371-9741
TDD/VOICE: (804) 371-9206
http://www.state.va.us/scc

STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Northern Neck Insurance Company as of December 31, 2008, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed to the original the seal of the Bureau at the City of Richmond, Virginia this 3rd day of March, 2010

Alfred W. Gross

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
December 18, 2009

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by authority of § 38.2-1317 of the Code of Virginia, a financial condition examination of the

NORTHERN NECK INSURANCE COMPANY

Irvington, Virginia,

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a mutual assessment property and casualty insurer and was last examined by representatives of the Virginia State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2005. The current examination covers the three year period from January 1, 2006 through December 31, 2008.

HISTORY

The Company was originally chartered by a special Act of the Legislature of Virginia on March 4, 1896 (Chapter 742, Acts of 1896). The original charter provided that the Company's capital should not be more than $10,000, divided into shares of $100 each. The charter also provided that the Company should have the power to insure, on the mutual plan, properties against loss by fire and lightning.

The Company operated from the beginning on an assessment basis; however, control was not vested in its members but in the holders of the outstanding capital shares, each having one vote.

A meeting of the board of directors was held on March 13, 1954, for the purpose of considering the advisability of qualifying the Company as a mutual assessment fire association as provided by § 13-231.1 of the Code of Virginia, which permitted the conversion of certain stock fire insurance companies to non-stock corporations. Pursuant to action taken by the board at this meeting, a special meeting of the holders of the outstanding capital shares was held on March 26, 1954. At this meeting a motion was approved to take the necessary steps to bring the Company in compliance with § 13-231.1 so that it could qualify under current Chapter 25, Title 38.2 of the Code of Virginia.

The charter was amended effective June 19, 1987, to change the Company's name from The Northern Neck Mutual Fire Association of Virginia to Northern Neck Insurance Company. This amendment also restated the purpose of the Company as follows:

> The corporation shall be a Mutual Assessment Property and Casualty insurer as defined in § 38.2-2501 of the Code of Virginia, as the same may be amended from time to time. It may write all the classifications of insurance specified in § 38.2-2503 of the Code of Virginia as amended from time to time, and may further engage in any other incidental or related business. The corporation shall have all powers as set forth in § 13.1-826 of the Code of Virginia as amended from time to time.

The Company amended its Articles of Incorporation May 23, 1997, to provide for the indemnification of directors and officers against all claims, liabilities, judgments, settlements, costs, and expenses, including all attorney's fees, imposed upon or reasonably incurred by him or her in connection with or resulting from any action, suit, proceeding or claim to which he or she may be a party by reason of being or having been an officer or director of the Company, except an indemnity against his or her willful misconduct or a knowing violation of the criminal law.

MANAGEMENT AND CONTROL

Management of the Company is vested in a board of at least 8 voting directors but not more than ten voting directors, each of whom shall be a member of the Company, and shall include the chairman, vice chairman and president. A quorum at any meeting shall consist of a majority of the members of the board. A majority of such quorum shall decide any question that may come before the meeting.

The bylaws state that the officers of the Company shall be a chairman, a vice chairman, a president, a secretary, and a treasurer, and may include one or more vice presidents, assistant vice presidents, assistant secretaries and assistant treasurers as may be elected by the board.

Directors and officers of the Company at December 31, 2008 were as follows:

Directors	Principal Occupation
Elizabeth A. Crowther	President Rappahannock Community College Glenns, Virginia
Thomas A. Gosse	President and Chief Executive Officer Northern Neck Insurance Company Irvington, Virginia
Benjamin H. Hubbard, III	Partner Hubbard, Terry & Kopcsak, Attorneys Irvington, Virginia
John H. Hunt, II	Executive Vice-President, Chief Financial Officer and Corporate Secretary Chesapeake Bank Kilmarnock, Virginia
Ronald L. Mihills	Managing Director Research & Engineering Council Irvington, Virginia
Julien G. Patterson	Chairman Omniplex World Services Corporation Chantilly, Virginia
William F. Shumadine, Jr.	Former President Central Fidelity Bank Richmond, Virginia
R. Lee Stephens, Jr.	Senior Vice-President Spotts Fain Consulting, LC, Attorneys Irvington, Virginia
Douglas G. Stewart	Managing Partner Cary Street Partners, Investment Managers Fredericksburg, Virginia

<u>Officers</u>

John H. Hunt, II	Chairman
Benjamin H. Hubbard, III	Vice Chairman
Thomas A. Gosse	President and Chief Executive Officer
Peter J. Cammarata	Executive Vice President & Chief Financial Officer
Betty B. Abbott	Senior Vice President – Claims and Secretary
Donna P. Wyatt	Treasurer
C. Randall Conner	Vice President – Product Development
Diane D. Starbuck	Vice President – Claims
Pamela L. Walker	Vice President – Information Technology
Jerry M. Wachter	Vice President – Marketing
Susan S. Abbott	Assistant Vice President – Office Administration
Eloise Wright-Hines	Assistant Vice President – Underwriting
Wendy C. Barrack	Assistant Vice President – Information Technology
Elizabeth McKinney	Assistant Vice President – Marketing

An Audit Committee consisting of the following members was elected by the board of directors and held office as of December 31, 2008:

R. Lee Stephens, Jr., Chairman
Elizabeth H. Crowther
Benjamin H. Hubbard, III
Julien G. Patterson
John H. Hunt, II, *ex officio*

The following committees were appointed by the chairman of the board of directors and held office as of December 31, 2008:

<u>Human Resource Committee</u>
Ronald L. Mihills, Chairman
Benjamin H. Hubbard III, Chairman
Susan S. Abbott, staff liaison
Peter J. Cammarata, staff liaison
Douglas G. Stewart
Thomas A. Gosse
John H. Hunt, II, *ex officio*

<u>Compensation Committee</u>
Benjamin H. Hubbard, III, Chairman
John H. Hunt, II, *ex officio*
William F. Shumadine, Jr.
Ronald L. Mihills

Nominating/Governance Committee
Elizabeth H. Crowther, Chairman
Ronald L. Mihills
Thomas A. Gosse
Julien G. Patterson
John H. Hunt, II, *ex officio*

Investment Committee
William F. Shumadine, Jr., Chairman
Douglas G. Stewart
John H. Hunt, II, *ex officio*
Thomas A. Gosse
R. Lee Stephens, Jr.
Peter J. Cammarata, staff liaison

PENSION PLAN

The Company sponsored a non-contributory defined benefit pension plan covering its employees. As of December 31, 2007, the Company terminated the defined benefit pension plan. The distribution of plan assets was finalized in March 2009. As of December 31, 2008, the fair market value of plan assets was $2,270,226.

The Company maintains a defined contribution 401(k) plan under which participants can elect a salary reduction contribution of up to 20% of compensation, subject to a ceiling amount established annually by regulations of the Internal Revenue Service. The Company contributes 100% of the first 3% of employee contributions and 50% of the next 2% of employee contributions. The Company's contribution for the plan year was $82,794, $79,058 and $57,043 in 2008, 2007 and 2006 respectively. The Company accrued $200,000 of additional discretionary contributions to the plan for 2008.

Prior to 2008 the Company entered into an unqualified supplemental retirement plan agreement with its Senior Vice President - Claims. Pursuant to the agreement, the Company is to make annual contributions based on actuarially determined present values to provide supplemental retirement income equal to 60% of the employee's average final compensation. The payment of benefits is conditioned upon continuous employment at the Company for a period of fifteen years, subject to certain exceptions and restrictions. The Company contributed $-0-, $-0- and $-0-, for 2008, 2007 and 2006, respectively. The Senior Vice President – Claims retired in April 2009 and started receiving payments in May 2009.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2008, the Company had a fidelity bond in force providing coverage in the amount of $500,000 to insure against losses arising from dishonest acts of its officers and employees. The Company had a directors' and officers' liability policy, including company reimbursement, in force at December 31, 2008. This coverage was for $2,000,000 net of retention limits. The Company also had property insurance, workers' compensation and employers' liability coverage, fiduciary liability, a business automobile policy, and electronic data processing equipment insurance in force.

TERRITORY AND PLAN OF OPERATION

The Company confines its operations to the cities and counties of the Commonwealth of Virginia where it is licensed to transact the business of a mutual assessment property and casualty insurance company.

Applications for insurance are submitted through approximately 125 agents who inspect the risks and make written applications to the Company. Commissions are paid at various rates dependent upon the line of insurance written. Additionally, agents participate in a profit sharing plan provided they have an annual production volume of at least $100,000 in premiums.

The Company writes policies for dwelling fire, lightning, extended coverage, broad forms special coverage, homeowners, including mobile homeowners and rural estate, umbrella, automobile physical damage, and automobile liability on an annual basis only. Assessment rates are charged based upon classification and location of the risks and are levied annually in advance. These assessments are not collected for periods in excess of one year.

All perils contain a deductible clause with the exception of liability coverages.

GROWTH OF THE COMPANY

The following data, obtained from annual statements filed with the Bureau and from examination reports, indicates the growth of the Company for the ten-year period ended December 31, 2008:

Year	Admitted Assets	Liabilities	Unassigned Funds
1999	$46,146,474	$16,115,341	$30,031,133
2000	46,678,402	17,926,758	28,751,644
2001	44,995,735	22,166,140	22,829,595
2002	42,214,310	22,457,573	19,756,737
2003	47,312,706	26,583,110	20,729,596
2004	52,217,657	27,158,393	25,059,264
2005	56,622,117	27,453,717	29,168,400
2006	62,768,036	29,057,538	33,710,498
2007	66,644,406	31,501,721	35,142,685
2008	55,150,871	30,883,471	24,267,400

Year	Premiums Earned	Incurred Loss and Loss Adjustment Expenses	Other Underwriting Expenses	Net Underwriting Gains or (Losses)
1999	$17,730,383	$12,903,858	$5,174,453	($347,928)
2000	19,499,358	15,497,139	7,187,928	(3,185,709)
2001	21,145,768	13,324,839	8,738,822	(917,893)
2002	22,463,964	15,958,971	8,598,965	(2,093,972)
2003	23,777,887	17,680,835	9,941,511	(3,844,459)
2004	26,552,561	13,571,406	10,279,818	2,701,337
2005	26,886,710	11,778,282	10,887,977	4,220,451
2006	27,905,308	13,616,764	12,181,311	2,107,233
2007	30,103,524	16,797,907	13,520,411	(214,794)
2008	32,177,392	19,223,324	13,708,061	(753,993)

REINSURANCE

The Company had the following reinsurance agreements in force at December 31, 2008:

Ceded:

Type of Agreement	Line of Business	Company's Retention	Reinsurers' Limits
Property Excess of Loss	Section One: Property	$225,000 of ultimate net loss any one risk, each loss occurrence	$175,000 of ultimate net loss any one risk, each loss occurrence; $525,000 of ultimate net loss any one loss occurrence
	Section Two: Property	$400,000 of ultimate net loss any one risk, each loss occurrence	$600,000 of ultimate net loss any one risk, each loss occurrence; $1,200,000 of ultimate net loss any one loss occurrence
	Section Three: Property	$1,000,000 of ultimate net loss any one risk, each loss occurrence	$500,000 of ultimate net loss any one risk, each loss occurrence; $1,000,000 of ultimate net loss any one loss occurrence; $1,500,000 all occurrences
Casualty Excess of Loss	Section One: Casualty	$225,000 any one loss occurrence	$175,000 any one loss occurrence
	Automobile Casualty	$125,000 any one loss occurrence	$275,000 any one loss occurrence
	Section Two: Casualty	$400,000 any one loss occurrence	$600,000 any one loss occurrence

Type of Agreement	Line of Business	Company's Retention	Reinsurers' Limits
	Section Three: Casualty	$1,000,000 any one loss occurrence	$500,000 any one loss occurrence

In the event of a loss involving a combination of the casualty business and property business subject to the above agreements, further reinsurance is provided when the Company's combined retention under these two agreements, resulting from one occurrence exceeds $225,000. In regard to such a combination loss, the Company will retain the first $225,000 of its combined retention each occurrence and the Reinsurer will reimburse the Company for the amount in excess of $225,000 subject to a maximum reimbursement under this provision of $225,000 for each occurrence.

Type of Agreement	Line of Business	Company's Retention	Reinsurers' Limits
Facultative	Property	$1,500,000	$1,500,000; subject to a limit of $7,500,000 combined on all risks involved on one occurrence
First Catastrophe Excess of Loss	Property	$2,000,000 any one loss occurrence	$1,500,000 any one loss occurrence; $3,000,000 during any contract year
Second Catastrophe Excess of Loss	Property	$3,500,000	100% of $3,500,000 in excess of $3,500,000 loss per occurrence; $7,000,000 with respect to all loss occurrences
Third Catastrophe Excess of Loss	Property	$7,000,000	100% of $4,000,000 in excess of $7,000,000 loss per occurrence; $8,000,000 with respect to all loss occurrences
Fourth Catastrophe Excess of Loss	Property	$11,000,000	100% of $6,000,000 in excess of $11,000,000 loss per occurrence; $12,000,000 with respect to all loss occurrences

Type of Agreement	Line of Business	Company's Retention	Reinsurers' Limits
Fifth Catastrophe Excess of Loss	Property	$17,000,000	100% of $8,000,000 in excess of $17,000,000 loss per occurrence; $16,000,000 with respect to all loss occurrences
Sixth Catastrophe Excess of Loss	Property	$25,000,000	100% of $20,000,000 in excess of $25,000,000; $40,000,000 with respect to all loss occurrences
Seventh Catastrophe Excess of Loss	Property	$45,000,000	$12,000,000 any one loss occurrence; $24,000,000 during any contract year
Quota Share and Excess of Loss	Personal Umbrella and Farm Personal Umbrella Liability	10% of the first $1,000,000 each occurrence	90% of first $1,000,000 each occurrence; 100% of the difference between the policy limit and the first $1,000,000 each occurrence, not to exceed $2,000,000 each occurrence

The Company also cedes 100% of its business written for identity recovery coverage and equipment breakdown coverage for homeowners.

All agreements contain an insolvency clause and, where applicable, a reinsurers' guarantee of the intermediaries credit. At the request of the Company, any portion of the reinsurance credits for outstanding losses and loss adjustment expenses recoverable provided by the aforementioned agreements that is placed with unauthorized reinsurers shall be funded by the unauthorized reinsurer by a letter of credit or a cash advance.

Assumed:

The Company participates in a reciprocal catastrophe pool administered by the Mutual Reinsurance Bureau (MRB). Rights and obligations associated with participation in this pool are set forth in a contract between MRB and insurers specified in the interests and liabilities agreements. Pool participants agree to reinsure MRB for losses under any of its aggregate and catastrophic excess contracts, known as "original agreements." The Company has assumed a 4.4% share of the interests and liabilities of the pool contract.

MRB cedes to the Company its proportionate share of premiums received on each original agreement subject to the pool contract.

The Company is liable for its pro rata share of each and every loss occurring on the business covered by the pool agreement, not to exceed a maximum of $30,000,000 on any one original agreement. The pool contract warrants that all original agreements are the top layers of each respective program. MRB's net liability on any one original agreement will not exceed $30,000,000 any one occurrence when the original agreement is written on an occurrence basis or $30,000,000 in the aggregate during any one agreement year when written on an aggregate basis.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2006 through December 31, 2008. Assets were verified and liabilities were established at December 31, 2008. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the National Association of Insurance Commissioners *Examiners' Handbook.* Analytical review procedures were applied for non-SRA items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History
Management and Control
Records of the Company
Fidelity Bond and Other Insurance
Conflict of Interest
Territory and Plan of Operation
Growth of the Company
Reinsurance
Accounts and Records
Financial Statements
Subsequent Events

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2008, a statement of income for the period ending December 31, 2008, a reconciliation of surplus for the period under review, and a statement of cash flow for the period ending December 31, 2008. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$20,839,476		$20,839,476
Preferred stocks	48,554		48,554
Common stocks	16,137,555		16,137,555
Mortgage loans on real estate: First liens	33,468		33,468
Real estate: Properties occupied by the company	2,815,400		2,815,400
Cash, cash equivalents and short-term investments	2,714,352		2,714,352
Other invested assets	4,950,471		4,950,471
Investment income due and accrued	311,337		311,337
Uncollected premiums and agents' balances in course of collection	361,417		361,417
Deferred premiums, agents' balances and installments booked but deferred and not yet due	4,232,372		4,232,372
Amounts recoverable from reinsurers	84,035		84,035
Other amounts receivable under reinsurance contracts	147,397		147,397
Current federal income tax recoverable and interest thereon	416,727		416,727
Net deferred tax asset	3,320,421	1,562,695	1,757,726
Guaranty funds receivable or on deposit	181,430		181,430
Electronic data processing equipment	1,393,965	1,274,811	119,154
Furniture and equipment	416,580	416,580	
Aggregate write-ins for other than invested assets	95,026	95,026	
Totals	$58,499,983	$3,349,112	$55,150,871

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		$6,880,218
Loss adjustment expenses		421,312
Commissions payable, contingent commissions and other similar charges		1,656,482
Other expenses		146,113
Taxes, licenses and fees		361,350
Unearned premiums		19,093,746
Advance premium		799,587
Ceded reinsurance premiums payable		568,175
Amounts withheld or retained by company for account of others		3,571
Aggregate write-ins for liabilities		952,917
Total liabilities		$30,883,471
Unassigned funds	$24,267,400	
Surplus as regards policyholders		24,267,400
Totals		$55,150,871

STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	$32,177,392
Deductions:	
Losses incurred	$16,631,510
Loss adjustment expenses incurred	2,591,814
Other underwriting expenses incurred	13,708,061
Total underwriting deductions	$32,931,385
Net underwriting gain	($753,993)

INVESTMENT INCOME

Net investment income earned	$742,510
Net realized capital losses	102,103
Net investment gain	$844,613

OTHER INCOME

Aggregate write-ins for miscellaneous income	$1,797
Total other income	$1,797
Net income before federal income taxes	$92,417
Federal income taxes incurred	33,933
Net income	$58,484

RECONCILIATION OF CAPITAL AND SURPLUS FOR PERIOD UNDER REVIEW

	2006	2007	2008
Surplus as regards policyholders, December 31, previous year	$29,168,400	$33,710,499	$35,142,685
Net income	$3,709,809	$2,125,871	$58,484
Change in net unrealized capital gains or (losses)	1,182,997	(820,697)	(9,432,758)
Change in net deferred income tax	195,854	604,785	159,366
Change in nonadmitted assets	(549,561)	(477,773)	(1,660,377)
Change in provision for reinsurance	3,000		
Change in surplus as regards policyholders for the year	$4,542,099	$1,432,186	($10,875,285)
Surplus as regards policyholders, December 31, current year	$33,710,499	$35,142,685	$24,267,400

CASH FLOW

Cash From Operations

Premiums collected net of reinsurance	$32,367,263
Net investment income	889,297
Miscellaneous income	4,484
Total	$33,261,044
Benefit and loss related payments	$18,494,594
Commissions, expenses paid and aggregate write-ins for deductions	13,393,132
Federal income taxes paid	445,000
Total	$32,332,726
Net cash from operations	$928,318

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	$7,237,044
Stocks	21,583,511
Mortgage loans	6,953
Total investment proceeds	$28,827,508
Cost of investments acquired (long-term only):	
Bonds	$6,783,425
Stocks	17,897,724
Real estate	2,102,625
Other invested assets	6,122,471
Miscellaneous applications	46,888
Total investments acquired	$32,953,133
Net cash from investments	($4,125,625)
Net change in cash and short-term investments	($3,197,307)

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	$5,911,659
End of year	2,714,352
Net change in cash and short-term investments	($3,197,307)

RECOMMENDATION FOR CORRECTIVE ACTION

Management and Control

During the Examiners' review of the Company's conflict of interest statements for the period covered by this examination, it was noted that the Company did not consistently follow their prescribed policy for completing these statements. It is recommended that the Company implement a policy to ensure that a signed conflict of interest statement is obtained for all officers and board members on an annual basis and that the Company's policy is followed in a consistent manner.

SUBSEQUENT EVENT

On March 13, 2009 Peter J. Cammarata, Executive Vice President and Chief Financial Officer, was promoted to President and Chief Operating Officer while Thomas A. Goss remains as Chief Executive Officer.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, T. Bradford Earley, Jr., CFE, CPCU, AIAF, Jennifer K. Crawley, CFE, and Mario A. Cuellar, CFE, of the Bureau participated in the work of the examination.

Respectfully submitted,

Theresa C. Lewis, CFE
Senior Insurance Examiner

NORTHERN NECK
INSURANCE COMPANY
Insuring Families from the Bay to the Blue Ridge since 1896.

BUREAU OF INSURANCE
10 FEB 24 AM 8:59

February 22, 2010

David H. Smith, Chief Examiner
Bureau of Insurance
P. O. Box 1157
Richmond, VA 23218

Re: Examination Report as of December 31, 2008

Dear Mr. Smith:

We have received and reviewed the referenced examination report. Please extend to Theresa C. Lewis, Senior Insurance Examiner, our appreciation for the manner in which the examination was conducted and the professionalism extended by your entire staff.

One item was noted for corrective action under management and control.

> The Company has established, at its Board of Directors meeting on January 14, 2010, uniform and consistent procedures regarding the completion and review of signed conflict of interest statements and will ensure that the policy is followed consistently. The Company will provide a copy of the questionnaire to the members of the Board and Officers to be completed by the October Board meeting. The completed questionnaires will be furnished to the Chair of the Governance committee for review by the committee at its November meeting with a report to the Board at its next regularly scheduled meeting thereafter. Any new member of the Board or any newly elected officer of the Company must complete a questionnaire to be reported by the Secretary at the next regularly scheduled meeting of the board following such election or appointment.

Thank you for forwarding the final report for review by our Board. We would appreciate fifteen copies. If possible, we would like to share the report at the annual meeting of the directors on March 12, 2010.

Very truly yours,

Peter J. Cammarata
President & Chief Operating Officer

4981 Irvington Road Post Office Box 419 Irvington, Virginia 22480 804.438.6611 Fax: 804.438.5838 www.nnins.com