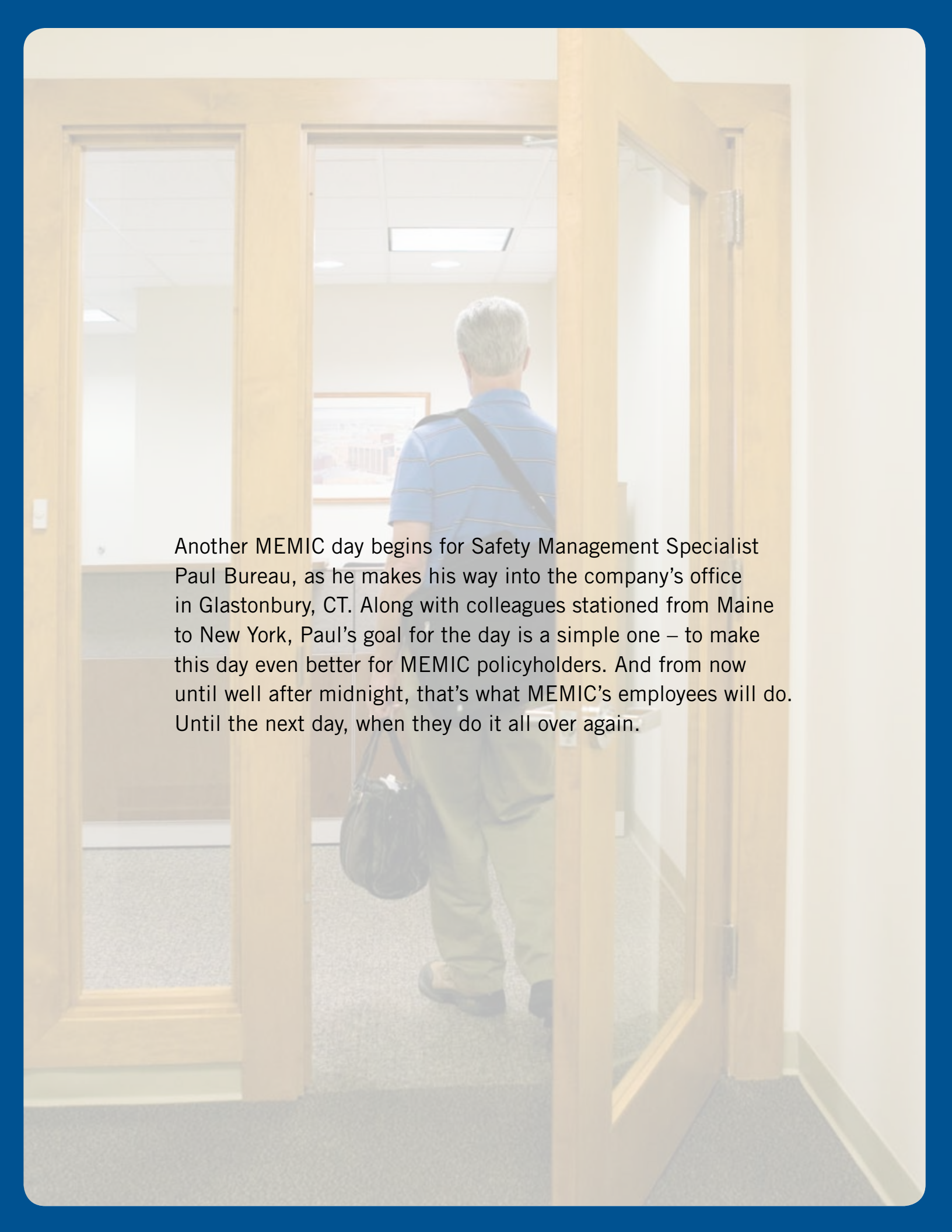




**Every Day. Even Better.**

2007

THE MEMIC GROUP  
ANNUAL REPORT

A man with short grey hair, wearing a blue polo shirt with thin horizontal stripes and khaki pants, is walking away from the camera through a glass door into an office. He has a black bag slung over his shoulder and is carrying a black bag in his right hand. The office interior is visible through the glass, showing a desk, a framed picture on the wall, and a fluorescent light fixture on the ceiling. The scene is brightly lit, suggesting a well-lit office environment.

Another MEMIC day begins for Safety Management Specialist Paul Bureau, as he makes his way into the company's office in Glastonbury, CT. Along with colleagues stationed from Maine to New York, Paul's goal for the day is a simple one – to make this day even better for MEMIC policyholders. And from now until well after midnight, that's what MEMIC's employees will do. Until the next day, when they do it all over again.

## Dear policyholder:

As we look back at 2007 for your workers' compensation insurance company, we can honestly say it was a year of tremendous success for our organization and, in turn, for the customers we serve.

Not only did we grow in our geographic reach, we also grew the size of the policyholder dividend for members of our mutual company to \$14 million, a record amount once again.

How did we manage this success in an ever-more-competitive market? The answer is in the title of this year's annual report: "Every day. Even better." As those simple words indicate, we look at every day as an opportunity to succeed in new ways and to improve upon what we did yesterday. It is my pledge to you, on behalf of our Board of Directors and all of my fellow employees at MEMIC, that we will continue that effort this year and beyond.



In 2007, we wrote premium of approximately \$185 million. That reflected solid growth from our MEMIC Indemnity Company and a relatively steady performance by the parent company, MEMIC.

The growth of MEMIC Indemnity Company makes us especially proud. It wrote more than \$36 million in premium, a record total for the nimble, entrepreneurial subsidiary. Better yet, it is now authorized to write workers' compensation in 42 states. That puts our goal of writing in all available U.S. jurisdictions within reach.

While the potential markets have grown, MEMIC Indemnity's focus in 2007 was in southern New England and upper New York state. To that end, we opened field offices in Glastonbury, CT and Albany, NY during 2007. These new locations give us an important presence in these communities helping bolster our relationships with agents and customers. We're finding, as we had predicted, that people in these areas are responding positively to our entry into those markets. We expect them to continue to grow for the next few years.

At the parent company, we continue to execute on the mission of providing top flight safety services and compassionate claims management at the lowest possible cost. While injury rates remain more than 30 percent below the rate at which they occurred before we came into existence, we still put approximately 40 safety professionals in the field every day to help our customers reduce injuries even further.

We continue to pride ourselves on the efficient and fair treatment of injured workers. With the work of our case managers and claims handlers, we helped hundreds return to work after a significant injury in 2007 while we once again helped lead the industry in making prompt payments to workers who were due them.

In total, The MEMIC Group grew to more than \$730 million in total assets with a policyholder surplus of \$226 million. Those numbers are clearly indicative of a company that is built for the long haul.

As the competitive market continues to develop, we know that our competitors will try to squeeze service out of their offerings to customers. We will not follow this foolish path. Rather, look for MEMIC to continue to offer you the superior customer service that you expect and deserve. We know that success will come to those companies who help policyholders succeed, earning your business with each and every interaction.

We'll continue to move ahead with the same methods that have helped us to the achievements above. By serving you, we'll continue to make sure that we make every day an opportunity to be even better.

Sincerely,

A handwritten signature in black ink that reads "John T. Leonard".

John T. Leonard, President and CEO

6:49  
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## Five steps in four hours

Jared Payton likes talking workers' comp. In fact, he likes talking, period. But as a director within MEMIC's Claims Department, one of Jared's assignments is to lead educational workshops for policyholders. That's where his enthusiasm comes in handy.

Whether he's doing a workshop or not, Jared is an early-arrival at MEMIC's Portland offices. On workshop days, he gets ready: Coffee in one hand, and a 32-ounce bottle of water in the other. At the door of the MEMIC Safety Academy, Jared greets representatives from policyholder customers who have come to learn the ins and outs of dealing with a workers' comp injury.

After getting everyone signed in and settled, it's time to start the show. Jared estimates that he's done this workshop more than 50 times but it's still a part of the job he loves. "I like being in front of policyholders, sharing with them what we do, and why," he says. "It's nice to be able to show them how they can use us to make it all work better."



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## “This is what I’m looking for.”

“This is what I’m looking for.” says Ed Hayes. “We need this.” Ed is the safety manager for Creed Monarch, a metal components manufacturer in New Britain, CT. Before he met Paul Bureau of MEMIC, Ed didn’t have customized programs to help him train his employees on lockout /tagout procedures.

Paul is a MEMIC Safety Management Specialist whose job is to help policyholders develop and improve their safety program. Paul works from MEMIC’s Glastonbury, Connecticut office, but rarely will you find him occupying a desk there. He spends his days (and sometimes nights) traveling to visit MEMIC policyholders to provide assistance.

During his recent visit to Creed Monarch’s facility, Paul followed up on newly-implemented safety procedures identified in his past plant tours, and talked with Ed about creating the customized training that he wanted. With Paul’s inspiration and the assistance of a digital camera, Creed Monarch’s employees will literally see themselves in the training materials. Taking the extra step for a customer makes all the difference. Says Paul: “The bottom line is, we both want the presentation to have the greatest impact on the employees. One of the ways to achieve this is to make the training as home grown as possible.”



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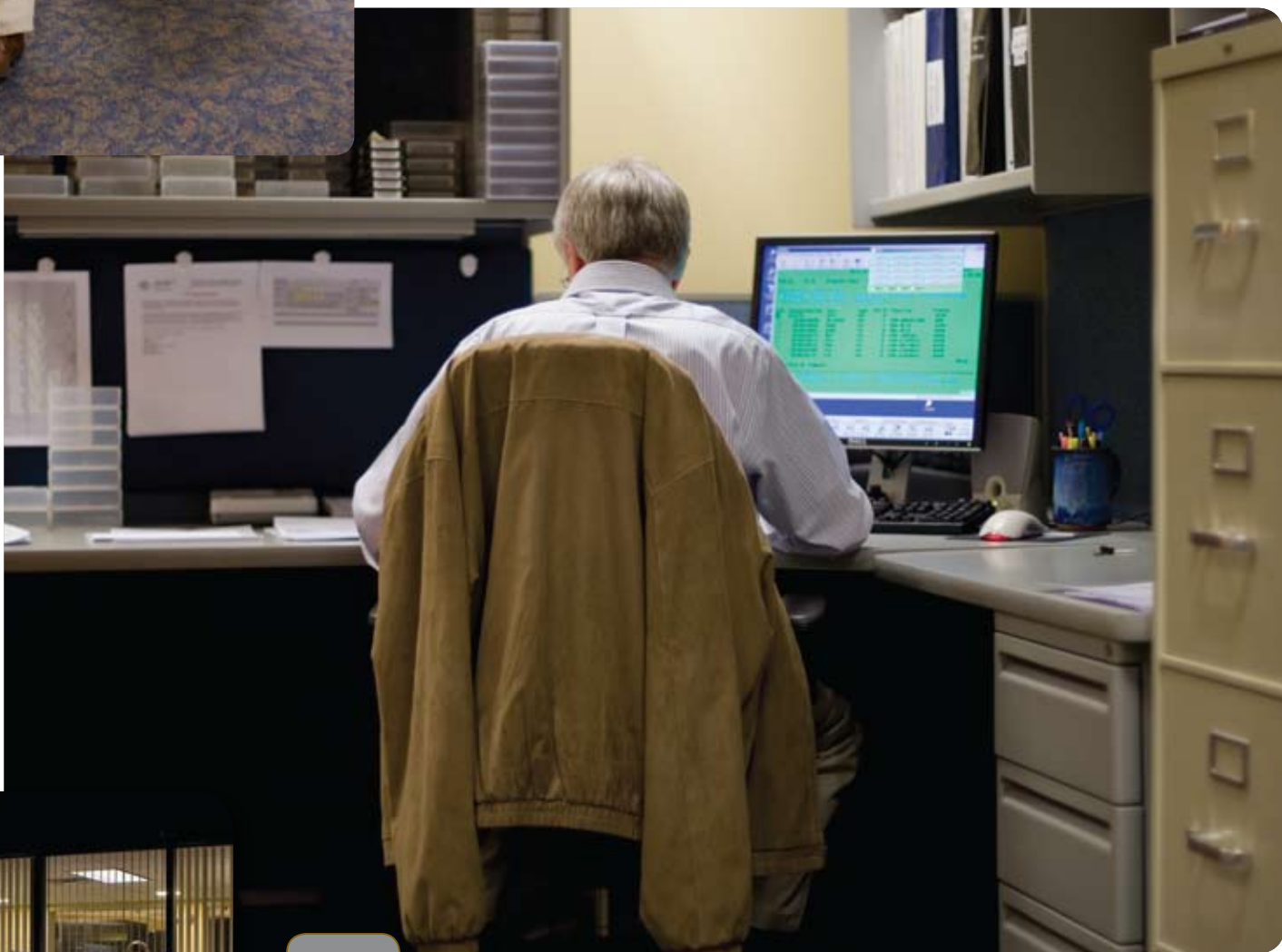
## “Five seconds changed my life.”

“Five seconds changed my life,” says June Gramolini. Those were the five seconds in which her right hand was crushed and burned in a 250-pound leather press. But in the weeks following her injury, June was getting better with the support and assistance of her MEMIC-assigned case handler Mary Margaret O’Dowd. Mary Margaret is a Registered Nurse whose job is to help injured workers get the care and help they need to get well and back to work once again. Like many of her fellow nurses who work for MEMIC, Mary Margaret works from her home so that she can be nearer to the workers she helps.

On a recent day Mary Margaret traveled from Downeast Maine to Bangor to meet June at a follow-up doctor’s appointment. Mary Margaret wanted to make sure all of June’s questions were answered. “Being a nurse,” says Mary Margaret, “I know what questions to ask.” At this point, there were fewer questions than in the weeks before. Arriving at the doctor’s office, June celebrated the fact that she could drive once again. And there was even better news: the skin graft that replaced the burned skin was taking hold. She was getting more movement in her hands and getting closer to returning to work.



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## Night divides the days

When most workdays are ending, Bob Boucher is just getting started. For most of his 15 years at MEMIC, Bob has been a night operator in the Information Services Department. What does a night operator do?

“My job is the equivalent of the old end-of-day closing of the books, except it is done with computers,” Boucher says. “I set up jobs that gather data to create files for the day’s business. These files are then stored and sometimes printed. They get backed up and secured for use on the next business day.” So, after he reviews the nightly reports, he starts working to make sure that checks to injured workers will be ready to go, files are transmitted and back-ups are secured. By the time he’s finished, it’s actually the start of a new day, quite literally. And soon enough, his daytime counterparts will start streaming through the doors, or arriving at customer appointments, or heading out to meet to an injured worker. As Bob gets to sleep, the rest of MEMIC’s employees will work to make this new day even better.



## Board of Directors

STANDING: Jolan E. Ippolito;  
David M. Labbe;  
John T. Leonard, President and CEO  
Ward I. Graffam, Chairman  
S. Catherine Longley  
SEATED: Katherine M. Greenleaf  
Vicki W. Mann  
Robert D. Umphrey, Jr.  
M. Jane Sheehan



8:33  
am



# Financial Highlights

	2007	2006
<b>Assets</b>		
Invested	\$653,958	\$600,361
Other	<u>\$ 79,453</u>	<u>\$ 80,196</u>
TOTAL ASSETS	\$733,411	\$680,557
<b>Liabilities</b>		
Loss and Loss Expense Reserves	\$388,939	\$361,200
Other	<u>\$117,692</u>	<u>\$116,192</u>
TOTAL LIABILITIES	\$506,631	\$487,392
<b>Policyholders' Surplus</b>	\$226,780	\$203,165
<b>Key Statistics</b>		
Dividend	\$ 14,006	\$ 12,002
Net Written Premium	\$182,576	\$182,062
Premium-to-Surplus Ratio	.81:1	.90:1
Number of Policyholders	21,541	21,909
Combined Ratio	90.79	93.84



## Senior Management Team

SEATED: Michael P. Bourque, Vice President, Corporate Marketing and Communications; Catherine F. Lamson, Vice President, Human Resources and Administration. STANDING: Donald V. Hale, Senior Vice President, Underwriting; Chief Operating Officer, MEMIC Indemnity Company; John F. Marr, Senior Vice President, Claims; Gary R. Baxter, Senior Vice President, Information Services; John T. Leonard, President and Chief Executive Officer; Robert S. McMann, Senior Vice President, Finance and Chief Financial Officer; Daniel S. Cote, Senior Vice President, Loss Control and Safety.

**Every Day. Even Better.**



2007

**Maine Employers' Mutual Insurance Company  
Financial Statements (Statutory Basis)  
December 31, 2007 and 2006**

**Maine Employers' Mutual Insurance Company**  
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**December 31, 2007 and 2006**

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## Report of Independent Auditors

To the Board of Directors of  
Maine Employers' Mutual Insurance Company

We have audited the accompanying statutory basis statements of admitted assets, liabilities and capital and surplus of Maine Employers' Mutual Insurance Company (the "Company") as of December 31, 2007 and 2006, and the related statutory basis statements of income, changes in capital and surplus, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Maine Bureau of Insurance, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Company as of December 31, 2007 and 2006, or the results of its operations or its cash flows for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and capital and surplus of the Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Supplemental Summary Investment Schedule and Investment Risks Interrogatories of the Company as of December 31, 2007 and for the year then ended are presented for purposes of additional analysis and are not a required part of the financial statements. The effects on the Supplemental Summary Investment Schedule and Investment Risks Interrogatories of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. As a consequence, the Supplemental Summary Investment Schedule and Investment Risks Interrogatories do not present fairly, in conformity with accounting principles generally accepted in the United States of America, such information of the Company as of December 31, 2007 and for the year then ended. The Supplemental Summary Investment Schedule and Investment Risks Interrogatories have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

**Maine Employers' Mutual Insurance Company**  
**Statements of Admitted Assets, Liabilities, and Capital and Surplus**  
**(Statutory Basis)**  
**December 31, 2007 and 2006**

	2007	2006
<b>Admitted Assets</b>		
Invested assets		
Bonds, at amortized cost (NAIC fair value: \$455,722,041 and \$416,348,875 at December 31, 2007 and 2006, respectively)	\$ 449,490,816	\$ 414,995,027
Common stocks, at NAIC fair value (cost: \$44,354,846 and \$45,195,528 at December 31, 2007 and 2006, respectively)	66,355,755	64,027,946
Common stocks of affiliates	49,188,684	45,057,505
Preferred stocks, at statement value (cost: \$580,442 and \$787,420 at December 31, 2007 and 2006)	580,442	787,420
Other invested assets	4,617,224	3,946,123
Cash	14,078,973	8,836,031
Total cash and invested assets	<u>584,311,894</u>	<u>537,650,052</u>
Premium balances receivable	43,886,084	44,687,042
Equities and deposits in pools and associations	58,125	-
Investment income due and accrued	5,119,792	4,573,452
EDP equipment (net of accumulated depreciation of \$1,901,970 and \$2,491,841 in 2007 and 2006, respectively)	707,106	542,907
Reinsurance recoverable on paid loss and loss adjustment expenses	1,629,475	2,134,163
Federal income tax recoverable	947,600	3,572,431
Net deferred income taxes	10,599,218	9,012,076
Due from affiliates	925,468	380,473
Total assets	<u>\$ 648,184,762</u>	<u>\$ 602,552,596</u>
<b>Liabilities</b>		
Loss reserves	\$ 300,281,527	\$ 279,534,149
Loss adjustment expense reserves	34,554,397	33,334,292
Unearned premium reserves	69,846,978	71,256,135
Reinsurance premiums payable	879,203	932,001
Commissions payable	4,445,578	4,197,590
Advance premium	686,761	1,464,072
Workers' compensation board assessment	1,485,143	1,426,175
Supplemental benefit fund assessment	1,174,721	1,159,758
Other liabilities	14,050,757	12,082,987
Total liabilities	<u>427,405,065</u>	<u>405,387,159</u>
Commitments and contingencies (Note 13)		
<b>Capital and Surplus</b>		
Capital contributions	3,220,336	3,226,708
Unassigned surplus	217,559,361	193,938,729
Total capital and surplus	<u>220,779,697</u>	<u>197,165,437</u>
Total liabilities and capital and surplus	<u>\$ 648,184,762</u>	<u>\$ 602,552,596</u>

**Maine Employers' Mutual Insurance Company**  
**Statements of Income**  
**(Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

	2007	2006
<b>Underwriting income</b>		
Premiums earned, net	\$ 147,286,652	\$ 153,163,226
<b>Loss and underwriting expenses</b>		
Losses incurred, net	89,925,577	101,396,725
Loss adjustment expenses incurred, net	12,366,833	12,314,533
Underwriting expenses	<u>30,115,936</u>	<u>29,315,563</u>
Total loss and underwriting expenses	<u>132,408,346</u>	<u>143,026,821</u>
Net underwriting income	<u>14,878,306</u>	<u>10,136,405</u>
<b>Investment income</b>		
Net investment income	20,586,500	18,684,784
Net realized capital (losses) gains, net of taxes	<u>(448,141)</u>	<u>89,225</u>
Total investment income	<u>20,138,359</u>	<u>18,774,009</u>
<b>Other (expense) income</b>		
Bad debt expense	(439,818)	(437,662)
Service fee income	86,142	88,651
Other income	<u>8,102</u>	<u>11,870</u>
Net other expense	<u>(345,574)</u>	<u>(337,141)</u>
Income before dividends and federal income taxes	34,671,091	28,573,273
Dividends to policyholders	<u>14,006,432</u>	<u>12,002,327</u>
Income after dividends, before federal income taxes	20,664,659	16,570,946
Provision for federal income taxes	<u>6,212,185</u>	<u>2,823,671</u>
Net income	<u>\$ 14,452,474</u>	<u>\$ 13,747,275</u>

**Maine Employers' Mutual Insurance Company**  
**Statements of Changes in Capital and Surplus**  
**(Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

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	2007	2006
<b>Capital and surplus, beginning of year</b>	\$ 197,165,437	\$ 173,503,825
Capital contributions returned	(6,372)	(222,833)
Net income	14,452,474	13,747,275
Increase in net deferred income taxes	2,193,261	788,334
Decrease in nonadmitted assets	524,798	1,566,762
Increase in provision for reinsurance	43,000	-
Increase in net unrealized appreciation of invested assets (net of deferred taxes of \$1,108,972 and \$2,214,504 at December 31, 2007 and 2006, respectively)	6,407,099	7,782,074
Change in capital and surplus	<u>23,614,260</u>	<u>23,661,612</u>
<b>Capital and surplus, end of year</b>	<u>\$ 220,779,697</u>	<u>\$ 197,165,437</u>

**Maine Employers' Mutual Insurance Company**  
**Statements of Cash Flows**  
**(Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

	2007	2006
<b>Cash from operations</b>		
Premiums collected, net	\$ 145,945,020	\$ 153,647,572
Investment income received, net	21,717,215	20,165,685
Other expenses	<u>(345,574)</u>	<u>(337,142)</u>
Cash provided from operations	<u>167,316,661</u>	<u>173,476,115</u>
Benefit and loss related payments	(68,673,512)	(76,091,156)
Commissions and expenses paid	(39,357,680)	(38,807,574)
Dividends paid to policyholders	(14,006,432)	(12,002,327)
Federal income taxes paid	<u>(3,346,049)</u>	<u>(6,489,540)</u>
Cash used in operations	<u>(125,383,673)</u>	<u>(133,390,597)</u>
Net cash provided from operations	<u>41,932,988</u>	<u>40,085,518</u>
<b>Cash from investments</b>		
Proceeds from investments sold, matured or repaid		
Bonds	68,846,237	55,411,503
Common and preferred stocks	<u>2,194,754</u>	<u>4,197,225</u>
Total investment proceeds	<u>71,040,991</u>	<u>59,608,728</u>
Costs of investments acquired		
Bonds	(105,072,130)	(80,090,535)
Common and preferred stocks	(1,783,491)	(14,472,113)
Other invested assets	<u>(38,875)</u>	<u>(120,000)</u>
Total cost of investments acquired	<u>(106,894,496)</u>	<u>(94,682,648)</u>
Net cash used in investments	<u>(35,853,505)</u>	<u>(35,073,920)</u>
<b>Cash from financing and miscellaneous sources</b>		
Capital contributions returned	(6,372)	(222,833)
Other applications	<u>(830,169)</u>	<u>(1,972,373)</u>
Net cash used in financing and miscellaneous sources	<u>(836,541)</u>	<u>(2,195,206)</u>
Net change in cash	5,242,942	2,816,392
Cash, beginning of year	<u>8,836,031</u>	<u>6,019,639</u>
Cash, end of year	<u>\$ 14,078,973</u>	<u>\$ 8,836,031</u>

# **Maine Employers' Mutual Insurance Company**

## **Notes to Financial Statements (Statutory Basis)**

### **December 31, 2007 and 2006**

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#### **1. Organization**

Maine Employers' Mutual Insurance Company (the "Company") was established through a legislative action by the State of Maine on November 13, 1992 and commenced business effective January 1, 1993. The Company was established to replace the State of Maine's Workers' Compensation Residual Market Pool. The Company is a mutual insurance company and is not a state agency or instrument of the State of Maine for any purpose. The Company writes workers' compensation insurance and employers' liability insurance incidental to and written in connection with workers' compensation coverage for employers in four New England states. The Company writes its business primarily through independent agents and brokers. Approximately 99% of premium written during 2007 was for Maine policies.

In 1996, the Company obtained approval from the Maine Bureau of Insurance (the "Insurance Department") and established a wholly-owned subsidiary, MEMIC Services Inc. ("MEMIC Services"), which sells loss control and managed care services to the Company and to other unrelated companies.

In 1998, the Company obtained approval from the Insurance Department to assume business from other insurance carriers only when the business is related to the business written in the State of Maine.

In 1999, the Company obtained approval from the Insurance Department of the State of New Hampshire to form a subsidiary, MEMIC Indemnity Company ("MEMIC Indemnity") to write workers' compensation insurance in New Hampshire. MEMIC Indemnity commenced writing business September 1, 2000 and is licensed in 42 states with approximately 95% of premium written in the States of Connecticut, New Hampshire, Massachusetts and Vermont.

During 2007, the Company obtained approval from the Insurance Department to write employment practices liability insurance for State of Maine policies only. The Company did not write any premium for this new line of business during 2007.

#### **2. Summary of Significant Accounting Policies**

##### **Basis of Presentation**

The financial statements are prepared in conformity with statutory accounting practices of the National Association of Insurance Commissioners ("NAIC") as prescribed or permitted by the Maine Bureau of Insurance.

Statutory accounting practices differ in certain respects from accounting principles generally accepted in the United States of America ("GAAP"). The effects of such differences on the accompanying financial statements, which could be significant, have not been determined. The most significant differences generally include the following:

- a. Statutory accounting requires that policy acquisition costs such as commissions, premium taxes and other items be charged to current operations as incurred. Under GAAP, policy acquisition costs would be deferred and then amortized ratably over the periods covered by the policies;

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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- b. The statutory provision for federal income taxes represents estimated amounts currently payable based on taxable income or loss reported in the current accounting period. Deferred income taxes are provided in accordance with SSAP 10, *Income Taxes* ("SSAP 10") and changes in deferred income taxes are recorded through surplus. The realization of any resulting deferred tax asset is limited based on certain criteria in accordance with SSAP 10. The GAAP provision would include a provision for taxes currently payable, as well as deferred taxes, both of which would be recorded in the income statement.
- c. Under statutory accounting, certain assets designated as "nonadmitted assets" (principally premiums receivable over 90 days past due, deferred income taxes and office furniture and equipment) are charged directly to surplus. GAAP would require the Company to maintain a reserve for doubtful accounts based on amounts deemed to be uncollectible. Office furniture and equipment would be capitalized and depreciated over the estimated useful lives;
- d. Statutory results of MEMIC Indemnity are reflected on the statutory equity method. Investment in MEMIC Services is accounted for under GAAP equity adjusted to a statutory basis which resulted in a net liability on the Company's statements of admitted assets, liabilities, capital and surplus. Adjustments include nonadmitted deferred tax assets, receivables over 90 days past due and furniture and equipment. The results of operations of these subsidiaries are recorded directly in surplus. Under GAAP, the subsidiary would be consolidated and such amounts would be reported in the financial statements on a consolidated basis;
- e. Under statutory accounting, investments in debt securities are generally carried at amortized cost. Under GAAP, debt securities classified as trading or available-for-sale are valued at fair value, and debt securities classified as held-to-maturity are valued at amortized cost;
- f. Reinsurance balances relating to unpaid loss and loss adjustment expenses are presented as offsets to reserves; under GAAP, such amounts would be presented as reinsurance recoverable; moreover, under statutory accounting, a liability is established for recoverable balances from reinsurers which are not authorized and for overdue paid loss recoverables;
- g. Under GAAP, the inclusion of a statement of comprehensive income, detailing the income effects of unrealized gains and losses, foreign exchange transactions, and pension liability adjustments is required;
- h. For cash flow purposes, included as cash and cash equivalents are short-term investments which mature within one year as opposed to three months;
- i. A reconciliation of cash flows to the indirect method is not provided under statutory accounting;

**Management Estimates**

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

# Maine Employers' Mutual Insurance Company

## Notes to Financial Statements (Statutory Basis)

### December 31, 2007 and 2006

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#### **Investments**

Invested assets are valued in accordance with the statutory basis of valuation prescribed by the NAIC. Bonds are generally stated at amortized cost. Bonds with an NAIC rating of "3" or higher are carried at the lower of amortized cost or fair value. The Company utilizes the prospective adjustment methodology to value mortgage-backed bonds. Common stocks and preferred stocks are generally stated at the NAIC fair value. Short-term investments are stated at cost which, together with accrued interest thereon, approximates fair value.

Investments in affiliates at December 31, 2007 and 2006 are stated at the net asset value of the affiliate determined on a statutory basis excluding surplus notes issued (Note 10). Changes in net asset value of affiliates are charged or credited directly to unassigned surplus.

Declines in the fair value of investments which are determined to be other than temporary, are recorded as realized losses is equal to the difference between the fair value and cost basis of the investment. Subsequent fluctuations in fair value which are determined to be temporary are recorded as unrealized gains or losses.

Investment income is recorded on an accrual basis. Realized capital gains or losses are reported in operating results based on the specific identification of investments sold. Unrealized capital gains and losses from the valuation of investments at fair value are credited or charged directly to unassigned surplus, net of federal income taxes.

#### **Premiums and Unearned Premium Reserves**

Direct and assumed premiums, net of amounts ceded to other insurance companies, are earned on a monthly pro rata basis over the in-force period. Accordingly, unearned premium reserves are established for the pro rata portion of premiums written which are applicable to the unexpired terms of the policies in force, net of reinsurance. Premium adjustments resulting from retrospective rating plans and/or audit adjustments are immediately recorded as written and earned premiums once such amounts can be reasonably estimated.

#### **Equities and Deposits in Pools**

The Company is required to participate in involuntary pools in several states where it writes workers compensation business. The Company participates in underwriting results, including premiums, losses, expenses and other operations of involuntary pools, based on the Company's proportionate share of similar business written in the state. Underwriting results are accounted for on a gross basis whereby the Company's portion of premiums, losses, expenses and other operations of the pool are recorded separately in the financial statements rather than netted against each other.

#### **Loss and Loss Adjustment Expense Reserves**

Losses and loss adjustment expenses are recorded as incurred so as to match such costs with premiums over the contract periods. Loss reserves are established for losses and loss adjustment expenses based upon claim evaluations and include an estimated provision for both reported and unreported claims incurred and related expenses. The assumptions used in determining loss and loss adjustment expense reserves have been developed after considering the experience of the Company, industry experience and projections by independent actuaries. The ultimate loss and loss adjustment expense reserves may vary from the amounts reflected in the accompanying financial statements. The methods utilized in estimating and establishing the reserves are continually reviewed and updated and any adjustments are reflected in current operating results. Allowances for subrogation recoveries are included in the Company's estimate of loss reserves. See the summary of reserve development in Note 6.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**Nonadmitted Assets**

The following nonadmitted assets were excluded from the balance sheet as of December 31, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
Premium balances receivable 90 days past due	\$ 1,276,279	\$ 1,367,678
Deferred income taxes	12,933,157	13,436,010
Accrued retrospective premiums	7,078	12,199
Fixed assets, net of accumulated depreciation	2,324,115	2,199,206
Other assets	<u>776,912</u>	<u>827,246</u>
Total nonadmitted assets	<u>\$ 17,317,541</u>	<u>\$ 17,842,339</u>

Depreciation expense on nonadmitted fixed assets was \$553,273 and \$583,568 in 2007 and 2006, respectively.

**Federal Income Taxes**

The Company files a consolidated tax return with MEMIC Indemnity and MEMIC Services. Under this tax sharing agreement, the provision for federal income taxes is recorded based upon amounts expected to be reported as if the Company filed a separate federal income tax return. Additionally, under this agreement, the Company will be reimbursed for the utilization of tax operating losses, tax credits and capital loss carryforwards to the extent the Company would have utilized these tax attributes on a separate return basis.

The provision for federal income taxes includes amounts currently payable or recoverable and deferred income taxes, computed under the asset/liability method, which results from temporary differences between the tax basis and the book basis of assets and liabilities.

**EDP Equipment**

EDP equipment is stated at cost, net of accumulated depreciation. Depreciation is computed principally using the straight-line method based on the estimated useful lives of assets, which is generally three years. Depreciation expense for the years ended December 31, 2007 and 2006 was \$363,353 and \$317,578, respectively. Expenditures for maintenance and repairs relating to EDP equipment and certain fixed assets which are nonadmitted are charged to expense as incurred. When property is sold or retired, the cost of the property and the related accumulated depreciation are removed from the statement of admitted assets, liabilities and capital and surplus and any gain or loss on the transaction is reflected in current operating results.

**3. Capital Contributions**

As authorized by specific provisions of Maine state law, the Company was established as a special purpose workers' compensation insurer without any initial capital or surplus. To provide capital, the Company's policyholders were required to make capital contributions based upon a percentage of their final audited premiums for policies with effective dates prior to January 1, 1996. Capital contributions were based on the estimated annual premium and are subsequently adjusted, as necessary, based upon cancellations and premium audits. Cumulative capital contributions as of December 31, 2007 and 2006 amounted to \$3,220,336 and \$3,226,708, respectively.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
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The Maine Bureau of Insurance recognizes only statutory accounting practices prescribed or permitted by the State of Maine for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under the Maine Insurance Laws. The NAIC Accounting Practices and Procedures Manual ("NAIC SAP") has been adopted as a component of prescribed or permitted practices by the State of Maine. Prescribed Maine Laws can and do deviate from NAIC SAP and, further, the Commissioner of Insurance has the right to permit other specific practices which deviate from prescribed practices.

In 1998, the Company received approval from the Insurance Department to return capital contributions to the extent authorized by the Board of Directors and the Insurance Department. The Company returned \$3,834 and \$221,337, of capital contributions in 2007 and 2006, respectively, net of related write-offs.

**4. Dividend Restrictions**

The Company is subject to regulatory limitations with respect to statutory surplus levels and dividends. Under these regulations, annual dividends cannot exceed the greater of 10% of the insurer's surplus as of the prior year end or the net gain from operations for the twelve month period ended in the prior year. The maximum amount of dividends which can be paid by insurers to policyholders without prior approval of the Superintendent of Insurance during 2007 and 2008 is \$19,716,544 and \$22,077,970, respectively. Dividends to policyholders amounted to \$14,006,432 and \$12,002,327 in 2007 and 2006, respectively.

**5. Income Taxes**

The components of net deferred tax assets as of December 31, 2007 and 2006 was as follows:

	<b>2007</b>	<b>2006</b>
Total of deferred tax assets	\$ 31,489,684	\$ 29,212,917
Total of deferred tax liabilities	<u>(7,957,309)</u>	<u>(6,764,831)</u>
Net deferred tax asset	23,532,375	22,448,086
Deferred tax assets nonadmitted	<u>(12,933,157)</u>	<u>(13,436,010)</u>
Net admitted deferred tax asset	<u>\$ 10,599,218</u>	<u>\$ 9,012,076</u>
Decrease in nonadmitted asset	<u>\$ 502,853</u>	<u>\$ 1,781,367</u>

There are no deferred tax liabilities that have not been recognized in the Company's financial statements.

**Maine Employers' Mutual Insurance Company**  
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The change in net deferred income taxes is comprised of the following:

	December 31,		
	2007	2006	Change
Total deferred tax assets	\$ 31,489,684	\$ 29,212,917	\$ 2,276,767
Total deferred tax liabilities	<u>(7,957,309)</u>	<u>(6,764,831)</u>	<u>(1,192,478)</u>
Net deferred tax asset	<u>\$ 23,532,375</u>	<u>\$ 22,448,086</u>	1,084,289
Tax effect of change in net unrealized gains and losses			<u>1,108,972</u>
Change in net deferred income taxes			<u>\$ 2,193,261</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2007 and 2006 are as follows:

	2007	2006
Deferred tax assets		
Discounting on loss and LAE reserves	\$ 19,595,629	\$ 18,317,576
Unearned premium reserves	4,889,289	4,987,929
Deferred compensation costs	2,843,248	2,135,972
Investment writedowns	1,751,071	1,311,303
Nonadmitted assets	1,451,288	1,505,029
Foreign investment company tax	666,362	587,321
Other	<u>292,797</u>	<u>367,787</u>
Total deferred tax assets	31,489,684	29,212,917
Nonadmitted deferred tax assets	<u>(12,933,157)</u>	<u>(13,436,010)</u>
Admitted deferred tax assets	<u>18,556,527</u>	<u>15,776,907</u>
Deferred tax liabilities		
Unrealized investment gains	(7,700,318)	(6,591,346)
Bond market discounts	(193,931)	(124,376)
Other	<u>(63,060)</u>	<u>(49,109)</u>
Total deferred tax liabilities	<u>(7,957,309)</u>	<u>(6,764,831)</u>
Net admitted deferred tax asset	<u>\$ 10,599,218</u>	<u>\$ 9,012,076</u>

The provision for current income taxes for the years ended December 31, 2007 and 2006 consists of the following components:

	2007	2006
Federal income tax	\$ 6,212,185	\$ 2,823,671
Capital gains tax	<u>(241,305)</u>	<u>111,496</u>
Current income taxes incurred	<u>\$ 5,970,880</u>	<u>\$ 2,935,167</u>

**Maine Employers' Mutual Insurance Company**  
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The provision for federal income taxes differs from tax expense computed at the prevailing federal tax rate applied to pretax income for the year ended December 31, 2007 for the following reasons:

Tax provision (before capital gains tax) at statutory rate	\$ 7,148,174
Dividends received deduction	(250,605)
Tax-exempt interest	(2,826,832)
Change in deferred tax on nonadmitted assets	7,681
Nondeductible expense	119,121
Provision to prior year return	(70,169)
Cumulative adjustment to prior year deferred tax	(373,618)
Other	23,867
	<u>\$ 3,777,619</u>
Federal income taxes incurred	\$ 5,970,880
Change in deferred income taxes	(2,193,261)
	<u>\$ 3,777,619</u>
Total statutory income taxes	<u>\$ 3,777,619</u>

**6. Liabilities for Loss Reserves and Loss Adjustment Expense Reserves**

Activity in the liabilities for loss reserves and loss adjustment expense reserves for the years ended December 31, 2007 and 2006 is summarized as follows:

	<b>2007</b>	<b>2006</b>
Balance at January 1	\$ 351,665,759	\$ 328,875,731
Less reinsurance recoverables	38,797,318	44,071,570
Net balance at January 1	<u>312,868,441</u>	<u>284,804,161</u>
Incurred related to		
Current year	107,839,546	114,053,955
Prior years	(5,547,136)	(342,697)
Total incurred	<u>102,292,410</u>	<u>113,711,258</u>
Paid related to		
Current year	22,061,510	24,382,132
Prior years	58,263,417	61,264,846
Total paid	<u>80,324,927</u>	<u>85,646,978</u>
Net balance at December 31	334,835,924	312,868,441
Plus reinsurance recoverables	28,813,741	38,797,318
Balance at December 31	<u>\$ 363,649,665</u>	<u>\$ 351,665,759</u>

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
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The liabilities for loss and loss adjustment expense reserves are based upon assumptions which consider the experience of the Company, industry experience, and projections by independent actuaries. However, the reserve process is inherently subjective, and the ultimate loss and loss adjustment expense reserves may vary from the amounts recorded in the financial statements.

During 2007, the Company's incurred losses related to prior years decreased by \$5,547,136 due to favorable loss development on the 1993 through 2006 accident years.

During 2006, the Company's incurred losses related to prior years decreased \$342,697, as a result of favorable loss development on the 1993 through 2005 accident years.

**7. Reinsurance**

The Company assumed risks from another insurance company through a quota share reinsurance agreement which was terminated effective for 2005 policy years. Amounts added loss reserves and loss adjustment expenses for reinsurance assumed were as follows:

	<b>2007</b>	<b>2006</b>
Loss and loss adjustment expenses incurred	\$ 94,954	\$ 965,466
Loss and loss adjustment expense reserves	2,392,611	3,158,795
Premiums receivable, net of ceding commissions	15,611	16,051

The Company pledged securities with a fair value in the amount of \$2,949,210 and \$4,937,456 as collateral for a letter of credit provided to an insurance company for assumed risks as of December 31, 2007 and 2006, respectively.

In 2007, the Company wrote policies in the State of New Hampshire and Massachusetts and is required to participate in the National Workers' compensation Reinsurance pool and the Massachusetts Reinsurance Pool (the "Pools") as it relates to those states. Participation requires that the Company share in the losses and expenses of the Pool. Pool results are accounted for on a gross basis whereby the company's portion of premium, losses, expenses and other operations of the Pool are recorded separately in the financial statements. All amounts are recorded as assumed business. Amounts added to premiums, reserves and expense for reinsurance assumed from pools are as follows:

Premiums earned	\$ 37,500
Loss and loss adjustment expenses incurred	28,125
Unearned premiums	37,500
Loss and loss adjustment expense reserves	28,125
Premium receivable	58,125
Underwriting expenses incurred	16,375

The Company reinsures portions of risks with other insurance companies through excess of loss reinsurance agreements. Such agreements serve to limit the Company's maximum loss on catastrophes and large losses. To the extent that any reinsurer might be unable to meet its obligations, the Company would be liable for such defaulted amounts.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
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Under the Company's excess of loss agreement, the Company's net retention for losses is \$5,000,000 for 2007 and 2006 with reinsurance coverage up to \$50,000,000 in excess of its net retention.

The Company also has aggregate excess of loss coverage for policies effective 1998 to 2002 whereby the Company can recover losses exceeding 71% of direct workers' compensation premiums earned but not exceeding 86% of direct workers' compensation premiums earned.

Amounts deducted from premiums, reserves and expenses for reinsurance ceded to other companies were as follows:

	2007	2006
Premiums earned	\$ 2,937,282	\$ 4,291,621
Loss and loss adjustment expenses incurred	3,151,037	240,386
Loss and loss adjustment expense reserves	28,813,741	38,797,318
Premiums payable	879,203	932,001

Of the 2007 and 2006 ceded loss and loss adjustment expense reserves above, 100% of the balances are comprised of amounts with five reinsurance carriers.

The Company had unsecured reinsurance recoverables from reinsurers that exceeded 3% of capital and surplus at December 31, 2007 as follows:

General Reinsurance Corp.	\$ 26,608,000
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The Company has no reinsurance contracts that contain the following features (a) a contract term longer than two years and that is noncancellable by the reporting entity during the contract term; (b) a limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer; (c) aggregate stop loss reinsurance coverage; (d) an unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party; (e) a provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or (f) payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Additionally, the Company has not ceded any risk under any reinsurance contract where (a) the written premiums ceded to the reinsurer represents 50% or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statements or (b) 25% or more of the written premium ceded to the reinsurer has been retroceded back to the Company. Accordingly, the Company has not included the supplemental schedule of reinsurance disclosures as is required under paragraph 72 of SSAP 62.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**8. Premiums Written and Earned**

During the years ended December 31, 2007 and 2006, direct, assumed and ceded premiums were as follows:

	2007		2006	
	Written	Earned	Written	Earned
Direct	\$ 148,743,670	\$ 150,189,915	\$ 154,003,944	\$ 157,451,443
Assumed	71,519	34,019	3,404	3,404
Ceded	<u>(2,937,282)</u>	<u>(2,937,282)</u>	<u>(4,291,621)</u>	<u>(4,291,621)</u>
Net premiums	<u>\$ 145,877,907</u>	<u>\$ 147,286,652</u>	<u>\$ 149,715,727</u>	<u>\$ 153,163,226</u>

**9. Statutory Deposits**

Various regulatory authorities require that securities be placed on deposit. At December 31, 2007 and 2006, fixed income securities on deposit have a carrying value of \$1,882,946 and \$1,897,455, respectively.

**10. Investments**

The cost and NAIC fair value, of investments in equity securities, including investments in affiliates, were as follows:

	Cost	Gross Unrealized Gains	Losses	NAIC Fair Value
At December 31, 2007				
Preferred stocks	\$ 580,442	\$ -	\$ -	\$ 580,442
Common stocks	44,354,846	23,051,996	(1,051,088)	66,355,755
Common stocks of affiliates	46,223,529	2,965,155	-	49,188,684
Other invested assets	4,206,740	710,575	(300,091)	4,617,224
At December 31, 2006				
Preferred stocks	787,420	-	-	787,420
Common stocks	45,195,528	19,036,387	(203,969)	64,027,946
Common stocks of affiliates	46,223,529	-	(1,166,024)	45,057,505
Other invested assets	3,776,326	430,100	(260,303)	3,946,123

The Company owns 100% of the common stock of MEMIC Services at a cost of \$223,529. As a result of MEMIC Services' net deficit position, the Company recorded its investment in MEMIC Services included in other liabilities of \$1,339,763 and \$1,315,479 as of December 31, 2007 and 2006, respectively. Such amounts have been charged directly to unassigned surplus.

The Company owns 100% of the common stock of MEMIC Indemnity at a cost of \$46,000,000 as of December 31, 2007 and 2006, respectively.

**Maine Employers' Mutual Insurance Company**  
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During 2004 MEMIC Indemnity issued \$6 million of surplus notes that were recorded as an increase to capital and surplus at December 31, 2004. The Company's common stock investment in MEMIC Indemnity recorded in the December 31, 2007 and 2006 statements of admitted assets, liabilities and capital and surplus excludes the \$6 million of surplus notes issued by MEMIC Indemnity during 2004.

Summary financial data for MEMIC Indemnity is as follows:

	<b>2007</b>	<b>2006</b>
Admitted assets	\$ 135,196,686	\$ 123,442,358
Liabilities	80,008,002	72,384,853
Capital and surplus	55,188,684	51,057,505
Statutory net income	4,456,405	3,234,841

The carrying value and NAIC fair values of bonds at December 31, 2007 and 2006 are as follows:

<b>2007</b>	<b>Carrying Value</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>NAIC Fair Value</b>
U.S. Government and government agencies and authorities	\$ 13,503,162	\$ 330,113	\$ (10,852)	\$ 13,822,423
States, territories and possessions	95,350,962	2,269,263	(238,816)	97,381,409
Political subdivisions of states	157,020,259	3,823,603	(37,934)	160,805,928
Industrial and miscellaneous	50,125,433	665,988	(447,413)	50,344,008
Asset backed securities	133,491,000	1,032,396	(1,155,122)	133,368,273
Total bonds	<u>\$ 449,490,816</u>	<u>\$ 8,121,363</u>	<u>\$ (1,890,137)</u>	<u>\$ 455,722,041</u>
<b>2006</b>	<b>Carrying Value</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>NAIC Fair Value</b>
U.S. Government and government agencies and authorities	\$ 18,038,639	\$ 24,025	\$ (269,180)	\$ 17,793,484
States, territories and possessions	88,729,568	2,026,221	(368,272)	90,387,517
Political subdivisions of states	119,892,046	3,035,335	(180,640)	122,746,741
Industrial and miscellaneous	57,491,205	509,823	(1,250,014)	56,751,014
Asset backed securities	130,843,569	251,126	(2,424,576)	128,670,119
Total bonds	<u>\$ 414,995,027</u>	<u>\$ 5,846,530</u>	<u>\$ (4,492,682)</u>	<u>\$ 416,348,875</u>

Bonds with a NAIC rating of three or higher have been recorded at the lower of cost or fair value in accordance with statutory accounting.

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The carrying value and NAIC fair value of bonds by contractual maturity at December 31, 2007 are as follows:

<b>Maturity</b>	<b>Carrying Value</b>	<b>NAIC Fair Value</b>
One year or less	\$ 8,647,739	\$ 8,654,823
Over one year through five years	74,822,658	76,135,827
Over five years through ten years	94,892,582	96,941,829
Over ten years through twenty years	131,465,787	134,321,713
Over twenty years	6,171,050	6,299,576
	<u>315,999,816</u>	<u>322,353,768</u>
Asset backed securities (principally ten through twenty years)	<u>133,491,000</u>	<u>133,368,273</u>
	<u>\$ 449,490,816</u>	<u>\$ 455,722,041</u>

Bonds subject to early or unscheduled prepayments have been included above based upon their contractual maturity dates. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from the sales of investments in debt and equity securities and the gross realized gains and losses on those sales for the years ended December 31, 2007 and 2006, are summarized as follows:

	<b>Proceeds From Sales</b>	<b>2007</b>	
		<b>Gross Realized Gains</b>	<b>Losses</b>
Bonds	\$ 68,846,237	\$ 107,855	\$ (160,904)
Preferred and common stock	2,194,754	584,549	(1,220,946)
	<u>\$ 71,040,991</u>	<u>\$ 692,404</u>	<u>\$ (1,381,850)</u>
	<b>Proceeds From Sales</b>	<b>2006</b>	
		<b>Gross Realized Gains</b>	<b>Losses</b>
Bonds	\$ 55,411,503	\$ 215,962	\$ (398,173)
Preferred and common stock	4,197,225	600,909	(217,977)
	<u>\$ 59,608,728</u>	<u>\$ 816,871</u>	<u>\$ (616,150)</u>

The Company recorded other than temporary investment writedowns of \$1,220,860 and \$122,757 in 2007 and 2006, respectively, primarily in the banking and finance sector.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
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The fair value and gross unrealized loss of investment securities and the amount of time the security has been in an unrealized loss position as of December 31, 2007 is as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Bonds (NAIC 1-2)	\$ 21,625,620	\$ (150,991)	\$ 100,661,813	\$ (1,739,146)	\$ 122,287,433	\$ (1,890,137)
Bonds (NAIC 3-6)						
Common stocks - unaffiliated	5,200,160	(732,706)	3,197,982	(318,382)	8,398,142	(1,051,088)
	<u>\$ 26,825,780</u>	<u>\$ (883,697)</u>	<u>\$ 103,859,795</u>	<u>\$ (2,057,528)</u>	<u>\$ 130,685,575</u>	<u>\$ (2,941,225)</u>

Unrealized losses on investment grade securities (NAIC 1-2) principally relate to changes in interest rates.

As of December 31, 2007 and 2006, there were no gross unrealized losses in preferred stocks.

The major categories of net investment income are summarized as follows:

	2007	2006
Bonds	\$ 20,190,481	\$ 18,629,534
Common and preferred stocks	1,263,680	1,006,352
Cash and short-term investments	648,584	404,966
Other income	156,277	197,300
Total investment income	<u>22,259,022</u>	<u>20,238,152</u>
Less: Investment expenses	<u>(1,672,522)</u>	<u>(1,553,368)</u>
Net investment income	<u>\$ 20,586,500</u>	<u>\$ 18,684,784</u>

**11. Fair Value of Financial Instruments**

The following methods and assumptions were used by the Company to determine the fair values of financial instruments:

Fair values of publicly traded fixed income securities are obtained from the Securities Value Office ("SVO") of the NAIC or an independent pricing service. Fair values for equity securities including common stocks and preferred stocks are based on the SVO or quoted market prices from an independent pricing service.

The carrying amounts in the balance sheet for cash and short-term investments approximate their respective fair values.

**Maine Employers' Mutual Insurance Company**  
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The carrying value and fair value of the Company financial instruments as of December 31, 2007 and 2006 were as follows:

	2007		2006	
	Admitted Value	Fair Value	Admitted Value	Fair Value
Financial assets				
Cash	\$ 14,078,973	\$ 14,078,973	\$ 8,836,031	\$ 8,836,031
Bonds	449,490,816	455,722,041	414,995,027	416,348,875
Common stocks - unaffiliated	66,355,755	66,355,755	64,027,946	64,027,946
Common stocks - affiliated	49,188,684	49,188,684	45,057,505	45,057,505
Preferred stocks	580,442	580,442	787,420	787,420

**12. Employee Benefit Plans**

The Company has a qualified defined contribution pension 401(k) and profit-sharing plan (the "Plan") covering substantially all full-time employees of the Company and its subsidiaries who meet the Plan's eligibility requirements. Pension contributions are determined as 6% of the covered employee's annual compensation plus an additional allocation for employee's earnings in excess of the taxable wage base. Employees become eligible to participate upon completion of three months of service and are fully vested in the Plan after three years of service. The amount expended for the pension-related portion of the Plan was approximately \$576,000 and \$363,000 in 2007 and 2006, respectively. The 401(k) and profit-sharing portion of the Plan provides for a tax deferred profit-sharing contribution by the Company and an employee elective contribution with a Company matching provision. In 2007 and 2006 with respect to the 401(k) component of the Plan, the Company contributed an amount equal to 100% of the employee's 401(k) contributions up to 5%. An employee's contribution may not exceed the greater of 10% of their annual salary or the maximum amount allowed as determined by the Internal Revenue Code. The Company incurred approximately \$413,000 and \$318,000 of expense related to the 401(k) component of the Plan in 2007 and 2006, respectively. With respect to the profit-sharing component of the Plan, each eligible participant may receive a profit-sharing contribution in an amount to be approved by the Board of Directors. The Company incurred approximately \$562,000 and \$416,000 of expense related to the profit-sharing component of the Plan in 2007 and 2006, respectively.

The Company sponsors a nonqualified, deferred compensation plan (the "Compensation Plan") and trust for certain key executives providing for payments upon retirement, death or disability. The Compensation Plan permits eligible officers to defer a portion of their compensation. The Compensation Plan provides that, in the event of liquidation of the Company, all assets of the Compensation Plan will be available to meet the obligations of the Company. Included in both other invested assets and other liabilities are amounts of \$4,443,441 and \$3,771,426, respectively, at December 31, 2007 and 2006, related to the Compensation Plan. In accordance with statutory accounting, the Company records changes in the market value of the invested assets of the compensation plan as compensation (income) expense. The Company incurred approximately \$567,300 and \$673,800 of expense related to the Compensation Plan in 2007 and 2006, respectively.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
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The Company also maintains an Incentive Compensation Plan (the "ICP") for certain members of senior management which awards "surplus shares" at the discretion of the Executive Committee of the Board of Directors. The value of each surplus share is determined based on excess capital and surplus as defined in the ICP. Shares become fully vested over a ten-year period or a shorter period, under certain conditions. At December 31, 2007, a total of 2,660 unexpired Class A shares, 3,300 Class B shares, 2,000 Class C shares and 800 Class D shares were awarded and outstanding. At December 31, 2006, a total of 2,960 Class A shares, 3,300 Class B shares, 2,000 Class C shares and 800 Class D shares were awarded and outstanding under the ICP. During 2007 and 2006, the Company paid \$2,050,265 and \$2,226,274, respectively, to certain shareholders for shares exercised. The Company has accrued \$3,504,938 and \$2,365,265 related to the ICP at December 31, 2007 and 2006, respectively.

A new Long Term Incentive Plan (LTIP) was established by the Compensation Committee of the Board of Directors (the Committee), effective January 1, 2007 for certain members of management and highly compensated individuals (participants). Participants are granted a fixed dollar base award (the "Award") contingent upon the anticipated growth of imputed surplus. The final Award is based on the actual growth levels of imputed surplus and is calculated upon imputed surplus as compared to Target, Threshold and Maximum Growth levels for an applicable performance period, generally three years. The actual earned amount of the Award can range from Zero to 150% of the fixed dollar base Award. Participants vest in the plan over three years, or a shorter period, under certain established conditions. The Company has incurred and accrued approximately \$166,700 of expense related to the LTIP as of December 31, 2007.

**13. Commitments and Contingent Liabilities**

The Company leases office space and various office equipment and vehicles under lease arrangements. Future minimum lease payments under operating leases at December 31, 2007 are as follows:

2008	\$ 774,038
2009	754,152
2010	746,954
2011	728,379
2012	728,379
Thereafter	<u>485,586</u>
Total future minimum lease payments	<u>\$ 4,217,488</u>

Total rent and lease expense was \$998,378 and \$1,000,187 for the years ended December 31, 2007 and 2006, respectively.

From time to time the Company may purchase annuities to settle claims. Certain types of annuities provide annuitants with recourse against the Company in the event that the insurer fails to pay under the annuities as agreed. Under these arrangements, the Company remains contingently liable to the annuitant.

The Company is involved in litigation with respect to claims arising with regard to insurance, which is taken into account in establishing loss and loss adjustment expense reserves. In relation to these claims, the Company carries on a continuing review of its overall position and its reserving

# Maine Employers' Mutual Insurance Company

## Notes to Financial Statements (Statutory Basis)

### December 31, 2007 and 2006

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techniques and reinsurance. The Company's management believes the resolution of such litigation is not expected to have a material adverse effect on the financial position or the operating results of the Company.

The Company is subject to guaranty fund and other assessments in New Hampshire and Massachusetts. The Company accrued a liability for guaranty fund and other assessments of approximately \$38,184 in 2007. This represents management's best estimate based on information received from these two states where the Company writes business and may change due to factors including the Company's share of the ultimate cost of insolvencies.

#### **14. Workers' Compensation Board Assessments**

The State of Maine Workers' Compensation Board (the "Board") assesses insurance companies, associations, and self-insured employers amounts based upon their written premium levels. At December 31, 2007 and 2006, the assessment was 2.11% and 1.86%, respectively, of written premium. To fund this amount, the Company is required to assess its policyholders these amounts and submit amounts collected to the Board on a quarterly basis. The balance of \$1,483,255 and \$1,426,175 represents amounts due to the Board as of December 31, 2007 and 2006, respectively.

#### **15. Supplemental Benefits Fund Assessments**

In 2002, the State of Maine created the Supplemental Benefits Fund for the purpose of reimbursing insurance companies and self-insurers for supplemental indemnity benefits not originally provided for in rates covering prior years' premiums. Insurance companies are assessed based upon their written premium levels. To fund these amounts, the Company is required to assess its policyholders and submit amounts collected to the Supplemental Benefits Oversight Committee on a quarterly basis. At January 1, 2007 and 2006, the assessment rate was .79% and .83%, respectively, of standard policy premium. The balance of \$1,174,721 and \$1,159,758 represents amounts due to the Fund for amounts billed but uncollected as of December 31, 2007 and 2006, respectively.

#### **16. Related Party Transactions**

The Company is charged by MEMIC Services for loss control and managed care services. In turn, the Company charges MEMIC Services for certain administrative and overhead expenses. The net of these charges amounted to \$5,348,048 and \$6,063,645 for 2007 and 2006, respectively. As of December 31, 2007 and 2006, the Company recorded a (payable to)/receivable from MEMIC Services of \$143,821 and \$(251,726), respectively.

In accordance with a management agreement, the Company charges MEMIC Indemnity Company for certain administrative and overhead expenses incurred on their behalf. These charges amounted to \$2,383,556 and \$2,020,902 for 2007 and 2006, respectively. In addition, the Company pays certain operating expenses on behalf of MEMIC Indemnity and in turn charges MEMIC Indemnity for reimbursement. MEMIC Indemnity also charges MEMIC for certain claims and premium audit services. These charges amounted to \$211,270 and \$158,887 during 2007 and 2006, respectively. The Company recorded a receivable from MEMIC Indemnity of \$781,647 and \$632,198 at December 31, 2007 and 2006, respectively.

**Maine Employers' Mutual Insurance Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**17. Subprime Mortgage Related Risk Exposure**

The Company considers direct exposure in all mortgage-backed securities with underlying subprime exposure as potential subprime mortgage risks. At December 31, 2007, the Company held the following mortgage backed securities with underlying subprime exposure:

	<b>Book/Adjusted Carrying Value</b>	<b>Fair Value</b>	<b>OTTI Recognized in 2007</b>
Residential mortgage-backed securities	<u>\$ 8,145,348</u>	<u>\$ 7,965,002</u>	<u>\$ -</u>

The above residential mortgage-backed securities are AAA or AA rated as of December 31, 2007.

The Company does not have any investments in collateralized debt obligations, structured securities, equity investments in subsidiary, controlled or affiliated entities with significant subprime mortgage related risk exposure, and subprime mortgage loans. Also, the Company does not provide mortgage guaranty or financial guaranty insurance coverage.

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**MEMIC Indemnity Company**  
**Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

**MEMIC Indemnity Company**  
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## Report of Independent Auditors

To the Board of Directors of  
MEMIC Indemnity Company

We have audited the accompanying statutory basis statements of admitted assets, liabilities, and capital and surplus of MEMIC Indemnity Company (the "Company") as of December 31, 2007 and 2006, and the related statutory basis statements of income and changes in capital and surplus, and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the New Hampshire Insurance Department, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Company as of December 31, 2007 and 2006, or the results of its operations or its cash flows for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of the Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended on the basis of accounting described in Note 2.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Supplemental Summary Investment Schedule and Investment Risks Interrogatories of the Company as of December 31, 2007 and for the year then ended are presented for purposes of additional analysis and are not a required part of the financial statements. The effects on the Supplemental Summary Investment Schedule and Investment Risks Interrogatories of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. As a consequence, the Supplemental Summary Investment Schedule and Investment Risks Interrogatories do not present fairly, in conformity with accounting principles generally accepted in the United States of America, such information of the Company as of December 31, 2007 and for the year then ended. The Supplemental Summary Investment Schedule and Investment Risks Interrogatories have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

**MEMIC Indemnity Company**  
**Statements of Admitted Assets, Liabilities, and Capital and Surplus**  
**(Statutory Basis)**  
**December 31, 2007 and 2006**

	2007	2006
<b>Admitted Assets</b>		
Invested assets		
Bonds, at amortized cost (NAIC fair value: \$110,718,944 and \$98,876,864 at December 31, 2007 and 2006, respectively)	\$ 109,502,284	\$ 99,074,272
Common stocks, at NAIC fair value (cost \$4,232,452)	3,947,320	-
Preferred stock, at statement value (cost \$694,641 and \$411,742 at December 31, 2007 and 2006, respectively)	682,861	419,592
Other invested assets	100,747	100,756
Cash	4,602,044	8,173,758
Total cash and invested assets	<u>118,835,256</u>	<u>107,768,378</u>
Premium balances receivable	11,846,129	11,538,814
Equities and deposits in pools and associations	608,350	827,581
Investment income due and accrued	1,211,061	1,054,669
EDP equipment (net of accumulated depreciation of \$88,367 and \$73,031 at December 31, 2007 and 2006, respectively)	77,939	17,772
Reinsurance recoverable on paid loss and loss adjustment expenses	38,719	75,187
Net deferred income taxes	2,579,232	2,159,957
Total assets	<u>\$ 135,196,686</u>	<u>\$ 123,442,358</u>
<b>Liabilities</b>		
Loss reserves	\$ 46,938,644	\$ 42,285,777
Loss adjustment expense reserves	7,164,536	6,045,574
Unearned premium reserves	18,783,292	17,802,140
Reinsurance premiums payable	340,951	613,213
Other liabilities	2,761,041	2,145,762
Commissions payable	1,134,899	1,150,145
Due to parent	781,647	632,198
Federal income tax payable	2,102,992	1,710,044
Total liabilities	<u>80,008,002</u>	<u>72,384,853</u>
Commitments and contingencies (Note 14)		
<b>Capital and Surplus</b>		
Surplus notes (Note 16)	6,000,000	6,000,000
Common stock, 100,000 shares issued, 100,000 shares outstanding, \$20.00 par value	2,000,000	2,000,000
Gross paid-in and contributed surplus	44,000,000	44,000,000
Unassigned surplus (deficit)	3,188,684	(942,495)
Total capital and surplus	<u>55,188,684</u>	<u>51,057,505</u>
Total liabilities and capital and surplus	<u>\$ 135,196,686</u>	<u>\$ 123,442,358</u>

**MEMIC Indemnity Company**  
**Statements of Income**  
**(Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

	2007	2006
<b>Underwriting income</b>		
Premiums earned, net	\$ 35,716,522	\$ 31,466,105
<b>Loss and underwriting expenses</b>		
Losses incurred, net	17,825,429	16,777,215
Loss adjustment expenses incurred, net	4,763,807	4,296,573
Underwriting expenses	<u>11,056,818</u>	<u>8,626,720</u>
Total loss and underwriting expenses	<u>33,646,054</u>	<u>29,700,508</u>
Net underwriting income	<u>2,070,468</u>	<u>1,765,597</u>
<b>Investment income</b>		
Net investment income	4,188,095	3,590,846
Net realized capital gains (losses), net of taxes	<u>195,466</u>	<u>(232,326)</u>
Total investment income	<u>4,383,561</u>	<u>3,358,520</u>
<b>Other expenses</b>		
Bad debt expense	(18,227)	(36,592)
Other expense	<u>(92)</u>	<u>-</u>
Total other expenses	<u>(18,319)</u>	<u>(36,592)</u>
Income before federal income taxes	6,435,710	5,087,525
Federal income tax expense	<u>1,979,305</u>	<u>1,852,684</u>
Net income	<u>\$ 4,456,405</u>	<u>\$ 3,234,841</u>

**MEMIC Indemnity Company**  
**Statements of Changes in Capital and Surplus**  
**(Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

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	<b>2007</b>	<b>2006</b>
<b>Capital and surplus, beginning year</b>	\$ 51,057,505	\$ 47,629,292
Net income	4,456,405	3,234,841
Increase in net deferred income taxes	398,699	561,344
Decrease in nonadmitted assets	(526,172)	(373,308)
Change in net unrealized appreciation of invested assets (net of deferred taxes of \$(106,482) as of December 31, 2007 and \$2,873 as of December 31, 2006)	(197,753)	5,336
Change in capital and surplus	<u>4,131,179</u>	<u>3,428,213</u>
<b>Capital and surplus, end of year</b>	<u>\$ 55,188,684</u>	<u>\$ 51,057,505</u>

**MEMIC Indemnity Company**  
**Statements of Cash Flows (Statutory Basis)**  
**Years Ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Cash from operations</b>		
Premiums collected, net	\$ 36,815,165	\$ 30,780,704
Investment income received, net	4,586,010	3,747,531
Other expense	<u>(18,319)</u>	<u>(36,592)</u>
Cash provided from operations	<u>41,382,856</u>	<u>34,491,643</u>
Benefit and loss related payments	13,136,095	12,792,352
Commissions and expenses paid	14,224,851	10,848,326
Federal income taxes paid	<u>1,691,608</u>	<u>2,121,398</u>
Cash used in operations	<u>29,052,554</u>	<u>25,762,076</u>
Net cash provided from operations	<u>12,330,302</u>	<u>8,729,567</u>
<b>Cash from investing activities</b>		
Cash provided by investments		
Proceeds from bonds sold, matured or repaid	50,573,130	60,138,109
Proceeds from stocks sold	-	379,950
Cost of bonds acquired	(61,254,196)	(69,553,463)
Cost of stocks acquired	<u>(4,515,352)</u>	<u>(787,618)</u>
Net cash used in investing activities	<u>(15,196,418)</u>	<u>(9,823,022)</u>
<b>Cash from financing and miscellaneous sources</b>		
Other cash (applied)		
Other (applications)	<u>(705,598)</u>	<u>766,310</u>
Net cash (used in) provided from financing and miscellaneous sources	<u>(705,598)</u>	<u>766,310</u>
Net change in cash	(3,571,714)	(327,145)
Cash, beginning of year	<u>8,173,758</u>	<u>8,500,903</u>
Cash, end of year	<u>\$ 4,602,044</u>	<u>\$ 8,173,758</u>

# MEMIC Indemnity Company

## Notes to Financial Statements (Statutory Basis)

### December 31, 2007 and 2006

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#### 1. Organization

MEMIC Indemnity Company (the "Company"), a wholly-owned subsidiary of Maine Employers' Mutual Insurance Company ("MEMIC"), was incorporated on February 24, 2000. MEMIC has contributed \$46,000,000 to capitalize and fund operations of the Company. The Company is licensed to write workers' compensation insurance in 42 states with approximately 95% of premium written in the States of Connecticut, New Hampshire, Massachusetts and Vermont. The Company writes its business primarily through independent agents and brokers in the State of New Hampshire.

#### 2. Summary of Significant Accounting Policies

##### Basis of Presentation

The financial statements of the Company are prepared in conformity with statutory accounting practices of the National Association of Insurance Commissioners ("NAIC") as prescribed or permitted by the New Hampshire Insurance Department ("statutory accounting").

Statutory accounting practices differ in certain respects from accounting principles generally accepted in the United States of America ("GAAP"). The effects of such differences on the accompanying financial statements, which could be significant, have not been determined. The most significant differences generally include the following:

- (a) Statutory accounting requires that policy acquisition costs such as commissions, premium taxes and other items be charged to current operations as incurred. Under GAAP, policy acquisition costs would be deferred and then amortized ratably over the periods covered by the policies;
- (b) The statutory provision for federal income taxes represents estimated amounts currently payable based on taxable income or loss reported in the current accounting period. Deferred income taxes are provided in accordance with SSAP 10, *Income Taxes* ("SSAP 10") and changes in deferred income taxes are recorded through surplus. The realization of any resulting deferred tax asset is limited based on certain criteria in accordance with SSAP 10. The GAAP provision would include a provision for taxes currently payable, as well as deferred taxes, both of which would be recorded in the income statement;
- (c) Under statutory accounting, certain assets designated as "nonadmitted assets" (principally premiums receivable over 90 days past due, deferred income taxes and office furniture and equipment) are charged directly to surplus. GAAP would require the Company to maintain a reserve for doubtful accounts based on amounts deemed to be uncollectible. Office furniture and equipment would be capitalized and depreciated over the estimated useful lives;
- (d) Under statutory accounting, investments in debt securities are generally carried at amortized cost. Under GAAP, debt securities classified as trading or available-for-sale are valued at fair value, and debt securities classified as held-to-maturity are valued at amortized cost;
- (e) Reinsurance balances relating to unpaid loss and loss adjustment expenses are presented as offsets to reserves; under GAAP, such amounts would be presented as reinsurance recoverable; moreover, under statutory accounting, a liability is established for recoverable balances from reinsurers which are not authorized and for overdue paid loss recoverables;

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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- (f) Under GAAP, the inclusion of a statement of comprehensive income, detailing the income effects of unrealized gains and losses, foreign exchange transactions, and pension liability adjustments is required;
- (g) For cash flow purposes, included as cash and cash equivalents are short-term investments which mature within one year as opposed to three months; and
- (h) A reconciliation of cash flows to the indirect method is not provided under statutory accounting.

**Management Estimates**

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

**Investments**

Invested assets are valued in accordance with the statutory basis of valuation prescribed by the NAIC. Bonds are generally stated at amortized cost. Bonds with an NAIC rating of "3" or lower are carried at the lower of amortized cost or fair value. Short-term investments are stated at cost which, together with accrued interest thereon, approximates fair value. Other invested assets consist of an investment in surplus notes that is recorded at amortized cost. Common stocks are stated at the NAIC fair value. Preferred stocks without mandatory sinking funds are stated at the NAIC fair value. Preferred stocks with mandatory sinking funds are carried at amortized cost. Cash represents amounts of cash on hand and amounts on deposit with banks.

Investment income is recorded in an accrual basis. Realized capital gains or losses are reported in operating results based on the specific identification of investments sold. Unrealized gains and losses from the valuation of investments at fair value are credited or charged directly to unassigned surplus, net of federal income taxes.

Declines in the fair value of investments which are determined to be other than temporary are recorded as realized losses equal to the difference between the fair value and cost basis of the investment. Subsequent fluctuations in fair value which are determined to be temporary are recorded as unrealized gains or losses.

**Premiums and Unearned Premium Reserves**

Direct and assumed premiums, net of amounts ceded to other insurance companies, are earned on a monthly pro rata basis over the in-force period. Accordingly, unearned premium reserves are established for the pro rata portion of premiums written which are applicable to the unexpired terms of the policies in force, net of reinsurance. Premium adjustments resulting from audits are immediately recorded as written and earned premiums once such amounts can be reasonably estimated.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**Equities and Deposits in Pools**

The Company is required to participate in involuntary pools in several states where it writes workers compensation business. The Company participates in underwriting results, including premiums, losses, expenses and other operations of involuntary pools, based on the Company's proportionate share of similar business written in the state. Underwriting results are accounted for on a gross basis whereby the Company's portion of premiums, losses, expenses and other operations of the pool are recorded separately in the financial statements rather than netted against each other.

**Loss and Loss Adjustment Expense Reserves**

Losses and loss adjustment expenses are recorded as incurred so as to match such costs and premiums over the contract periods. Loss reserves are established for losses and loss adjustment expenses based upon claim evaluations and include an estimated provision for both reported and unreported claims incurred and related expenses. The assumptions used in determining loss and loss adjustment expense reserves have been developed after considering the experience of the Company, industry experience and projections by independent actuaries. The ultimate loss and loss adjustment expense reserves may vary from the amounts reflected in the accompanying financial statements. The method utilized in estimating and establishing the reserves are continually reviewed and updated and any adjustments resulting therefrom are reflected in current operating results. The immaturity of the Company's book of business may result in an increased level of variability within the historical loss data. Allowances for subrogation recoveries are included in the Company's estimate of loss reserves. See the summary of reserve development in Note 7.

**Nonadmitted Assets**

The following nonadmitted assets were excluded from the balance sheet as of December 31, 2007 and 2006 as follows:

	<b>2007</b>	<b>2006</b>
Premium balances receivable over 90 days past due	\$ 301,116	\$ 115,776
Deferred income taxes	2,512,970	2,427,064
Fixed assets, net of accumulated depreciation	391,141	134,016
Other assets	37,691	39,890
Total nonadmitted assets	<u>\$ 3,242,918</u>	<u>\$ 2,716,746</u>

Depreciation expense on nonadmitted fixed assets was \$61,223 and \$40,644 in 2007 and 2006, respectively.

**Federal Income Taxes**

The Company is a party to a tax-sharing agreement with MEMIC and an affiliate, MEMIC Services, Inc. Under this tax-sharing agreement, the provision for federal income taxes is recorded based upon amounts expected to be reported as if the Company filed a separate federal income tax return. Additionally, under this agreement, the Company will be reimbursed for the utilization of tax operating losses, tax credits and capital loss carryforwards, to the extent the Company would have utilized these tax attributes on a separate return basis.

The provision for federal income includes amounts currently payable/recoverable and deferred income taxes, computed under the asset/liability method, which results from temporary differences between the tax basis and book basis of assets and liabilities.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**EDP Equipment**

EDP equipment is stated at cost, net of accumulated depreciation. Depreciation is computed principally by use of the straight-line method based on the estimated useful lives of assets, which is generally three years. Depreciation expense for the years ended December 31, 2007 and 2006 was \$17,890 and \$8,771, respectively. Expenditures for maintenance and repairs relating to EDP equipment and certain fixed assets which are nonadmitted are charged to expense as incurred. When property is sold or retired, the cost of the property and the related accumulated depreciation are removed from the statement of admitted assets, liabilities, and capital and surplus and any gains or loss on the transaction is reflected in current operating results.

**Reclassification**

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

**3. Insurance Department Conditions**

In connection with obtaining a license to write business in the State of New Hampshire, the New Hampshire Insurance Department ("Insurance Department") placed certain conditions on the Company as follows:

- Premiums written will not exceed a ratio of 1 to 1 (writings-to-surplus);
- Reinsurance retention will be \$2,000,000 per occurrence;
- The Insurance Department will be notified, in writing and in advance of all classes of risk excluded from treaty reinsurance;
- All reinsurance must be admitted and reinsurers must be noted "A" or better by A.M. Best;
- All contracts and agreements for services and management fees shall be approved before hand by the New Hampshire Insurance Commissioner; and
- The Company shall provide \$500,000 as a special deposit to be held by the insurance department.
- The Company cannot pay dividends or transfer funds to MEMIC without prior approval of the insurance department if the dividend or fund transfer aggregate \$100,000 during the preceding twelve months.

**4. Capital and Surplus**

Total contributions from MEMIC were \$46,000,000 as of December 31, 2007 and 2006.

The Company has 1,000,000 shares of stock authorized; 100,000 shares issued and outstanding as of December 31, 2007 and 2006. The stock had a \$20 par value per share as of December 31, 2007 and 2006.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**5. Dividend Restrictions**

The Company may declare a dividend without insurance department approval so long as such dividend is not considered extraordinary. In the case of extraordinary dividends, prior approval is required. An extraordinary dividend or distribution includes any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding 12 months exceeds 10% of such insurer's capital and surplus as of December 31, limited to the prior year-end's unassigned surplus.

However, as previously mentioned in Note 3, the Company cannot pay dividends to MEMIC without prior approval of the Insurance Department if the dividend would aggregate in excess of \$100,000 during the preceding twelve months.

**6. Federal Income Taxes**

The components of net deferred tax assets as of December 31, 2007 and 2006 was as follows:

	<b>2007</b>	<b>2006</b>
Total of deferred tax assets	\$ 5,215,266	\$ 4,608,058
Total of deferred tax liabilities	<u>(123,064)</u>	<u>(21,037)</u>
Net deferred tax asset	5,092,202	4,587,021
Deferred tax assets nonadmitted	<u>(2,512,970)</u>	<u>(2,427,064)</u>
Net admitted deferred tax asset	<u>\$ 2,579,232</u>	<u>\$ 2,159,957</u>
(Decrease) increase in nonadmitted asset	<u>\$ 85,906</u>	<u>\$ 247,822</u>

The change in net deferred income taxes is comprised of the following:

	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
Total deferred tax assets	\$ 5,215,266	\$ 4,608,058	\$ 607,208
Total deferred tax liabilities	<u>(123,064)</u>	<u>(21,037)</u>	<u>(102,027)</u>
Net deferred tax asset	<u>\$ 5,092,202</u>	<u>\$ 4,587,021</u>	505,181
Tax effect of change in net unrealized gain and losses			<u>(106,482)</u>
Change in net deferred income taxes			<u>\$ 398,699</u>

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2007 and 2006 are as follows:

	<b>2007</b>	<b>2006</b>
Deferred tax assets		
Discounting on loss and LAE reserves	\$ 2,989,856	\$ 2,567,308
Unearned premium reserves	1,314,830	1,246,150
Deferred compensation costs	-	7,830
Guaranty fund and second injury assessments	414,099	390,997
Capital loss carryforward	-	278,220
Nonadmitted assets	255,482	101,389
Other	240,999	16,164
	<u>5,215,266</u>	<u>4,608,058</u>
Total deferred tax assets		
Nonadmitted deferred tax assets	<u>(2,512,970)</u>	<u>(2,427,064)</u>
Admitted deferred tax assets	<u>2,702,296</u>	<u>2,180,994</u>
Deferred tax liabilities		
Bond market discounts	(18,743)	(18,164)
Unrealized gains	(103,609)	-
Other	<u>(712)</u>	<u>(2,873)</u>
Total deferred tax liabilities	<u>(123,064)</u>	<u>(21,037)</u>
Net admitted deferred tax asset	<u>\$ 2,579,232</u>	<u>\$ 2,159,957</u>

The expense for current income taxes for the years ended December 31, 2007 and 2006 consists of the following components:

	<b>2007</b>	<b>2006</b>
Current income tax expense	\$ 1,979,305	\$ 1,852,684
Capital gains tax	105,251	(122,195)
	<u>\$ 2,084,556</u>	<u>\$ 1,730,489</u>

The expense for federal income taxes differs from tax expense computed at the prevailing federal tax rate applied to pretax income for the year ended December 31, 2007 for the following reasons:

Tax provision before capital gains tax at statutory rate	\$ 2,289,336
Tax-exempt interest	(587,468)
Dividend received deduction	(54,314)
Provision to prior year return	(51,052)
Change in deferred tax on nonadmitted asset	(154,093)
True-up of prior year deferred taxes	177,274
Other	66,174
	<u>\$ 1,685,857</u>
Federal income tax expense	\$ 2,084,556
Change in deferred income taxes	(398,699)
Total statutory income taxes	<u>\$ 1,685,857</u>

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**7. Liabilities for Loss Reserves and Loss Adjustment Expense Reserves**

Activity in the liabilities for loss reserves and loss adjustment expense reserves for the years ended December 31, 2007 and 2006 is summarized as follows:

	<b>2007</b>	<b>2006</b>
Opening balance	\$ 51,705,435	\$ 46,184,803
Less reinsurance recoverable	<u>3,374,084</u>	<u>2,897,680</u>
Net balance	<u>48,331,351</u>	<u>43,287,123</u>
Incurred related to		
Current year	28,127,628	26,145,848
Prior year	<u>(5,538,392)</u>	<u>(5,072,060)</u>
	<u>22,589,236</u>	<u>21,073,788</u>
Paid related to		
Current year	6,925,453	6,975,464
Prior year	<u>9,891,954</u>	<u>9,054,096</u>
	<u>16,817,407</u>	<u>16,029,560</u>
Net balance at December 31	54,103,180	48,331,351
Plus reinsurance recoverable	<u>3,951,520</u>	<u>3,374,084</u>
Balance at December 31	<u>\$ 58,054,700</u>	<u>\$ 51,705,435</u>

The liabilities for loss and loss adjustment expense reserves are based upon assumptions which consider the experience of the Company, industry experience, and projections by independent actuaries. However, the reserve process is inherently subjective, and the ultimate loss and loss adjustment expense reserves may vary from the amounts recorded in the financial statements.

During 2007, the Company's incurred losses related to prior years decreased by \$5.5 million as a result of favorable loss development principally in the 2002 through 2006 accident years.

During 2006, the Company's incurred losses related to prior years decreased by approximately \$5.1 million, as a result of favorable loss development principally in the 2004 and 2005 accident years.

**8. Reinsurance**

The Company assumed risks from another insurance company through a 100% quota share reinsurance agreement which was terminated effective for 2005 policy years. Amounts added to premiums, loss reserves and loss adjustment expenses for reinsurance assumed from the other company was as follows:

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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	<b>2007</b>	<b>2006</b>
Premiums earned	\$ 604	\$ 4,755
Loss and loss adjustment expenses incurred	61,812	(10,366)
Loss and loss adjustment expense reserves	827,334	1,285,172
Premiums payable, net of ceding commissions	-	(77,074)

The Company pledged securities with a fair value in the amount of \$524,995 and \$525,655 as collateral for a letter of credit provided to an insurance company for assumed risks as of December 31, 2007 and 2006, respectively.

As a condition of writing policies in the States of New Hampshire, Massachusetts, Connecticut and Vermont, the Company is required to participate in the National Workers' Compensation Reinsurance Pool and the Massachusetts Reinsurance Pool (the "Pools") as it relates to those and other states. Participation requires that the Company share in the losses and expenses of the Pool. Pool results are accounted for on a gross basis whereby the Company's portion of premiums, losses, expenses and other operations of the Pool are recorded separately in the financial statements. All amounts are recorded as assumed business. Amounts added to premiums, reserves and expenses for reinsurance assumed from pools are as follows:

	<b>2007</b>	<b>2006</b>
Premiums earned	\$ 2,596,193	\$ 3,690,206
Loss and loss adjustment expenses incurred	658,098	1,900,797
Unearned premiums	919,826	1,193,345
Loss and loss adjustment expense reserves	6,779,843	7,588,914
Premiums receivable	608,350	828,245
Underwriting expenses incurred	830,605	979,630

The Company reinsures portions of risks with another insurance company through excess of loss reinsurance agreements. Such agreements serve to limit the Company's maximum loss on catastrophes and large losses. To the extent that the reinsurer might be unable to meet its obligations, the Company would be liable for such defaulted amounts.

Under the Company's excess of loss agreement, the Company's net retention for losses is \$2,000,000 for 2007, \$1,000,000 for 2006 and \$500,000 for 2005 and 2004 with reinsurance coverage up to \$50,000,000 in excess of its net retention. For losses incurred prior to 2003, the net retention for losses is \$100,000 with coverage up to \$50,000,000 in excess of its retention.

Amounts deducted from premiums, reserves and expenses for reinsurance ceded were as follows:

	<b>2007</b>	<b>2006</b>
Premiums earned	\$ 1,642,505	\$ 2,487,154
Loss and loss adjustment expenses incurred	775,000	1,270,000
Loss and loss adjustment expense reserves	3,951,521	3,374,084

The 2007 and 2006 ceded loss and loss adjustment expense reserves above are comprised of amounts with one reinsurance carrier.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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The Company has unsecured reinsurance recoverables from a reinsurer that exceeded 3% of capital and surplus at December 31, 2007 as follows:

General Reinsurance Corp.	\$ 3,650,000
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The Company's reinsurance program was implemented in accordance with the New Hampshire Insurance Department's Consent Agreement dated March 8, 2000.

The Company has no reinsurance contracts that contain the following features (a) a contract term longer than two years and that is noncancelable by the reporting entity during the contract term; (b) a limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer; (c) aggregate stop loss reinsurance coverage; (d) an unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party; (e) a provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or (f) payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Additionally, the Company has not ceded any risk under any reinsurance contract where (a) the written premiums ceded to the reinsurer represents 50% or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statements or (b) 25% or more of the written premium ceded to the reinsurer has been retroceded back to the Company. Accordingly, the Company has not included the supplemental schedule of reinsurance disclosures as required under paragraph 72 of SSAP 62.

**9. Premiums Written and Earned**

During the years ended December 31, 2007 and 2006, direct, assumed and ceded premiums were as follows:

	<b>2007</b>		<b>2006</b>	
	<b>Written</b>	<b>Earned</b>	<b>Written</b>	<b>Earned</b>
Direct	\$ 36,016,901	\$ 34,762,230	\$ 31,486,893	\$ 30,267,807
Assumed	2,323,278	2,596,797	3,346,443	3,685,451
Ceded	<u>(1,642,505)</u>	<u>(1,642,505)</u>	<u>(2,487,154)</u>	<u>(2,487,153)</u>
Net premiums	<u>\$ 36,697,674</u>	<u>\$ 35,716,522</u>	<u>\$ 32,346,182</u>	<u>\$ 31,466,105</u>

**10. Statutory Deposits**

Various regulatory authorities require that securities be placed on deposit. At December 31, 2007 and 2006 fixed income securities on deposit have a carrying value of \$15,718,813 and \$15,281,882, respectively.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

**11. Investments**

The carrying value and NAIC fair values of bonds at December 31, 2007 and 2006 are as follows:

	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
<b>2007</b>				
U.S. Government and government agencies and authorities	\$ 21,641,991	\$ 591,185	\$ (32,410)	\$ 22,200,767
States, territories and possessions	16,097,059	182,661	(41,476)	16,238,244
Political subdivisions of states	34,623,527	513,373	(35,815)	35,101,085
Industrial and miscellaneous	8,569,562	87,172	(207,235)	8,449,499
Asset backed securities	28,570,145	294,479	(135,275)	28,729,349
Total bonds	<u>\$ 109,502,284</u>	<u>\$ 1,668,870</u>	<u>\$ (452,211)</u>	<u>\$ 110,718,944</u>
Other invested assets	<u>\$ 109,022</u>	<u>\$ -</u>	<u>\$ (8,275)</u>	<u>\$ 100,747</u>
<b>2006</b>				
U.S. Government and government agencies and authorities	\$ 18,321,428	\$ 49,993	\$ (268,167)	\$ 18,103,254
States, territories and possessions	15,606,331	128,883	(82,237)	15,652,977
Political subdivisions of states	32,816,935	333,426	(138,443)	33,011,918
Industrial and miscellaneous	6,292,472	80,810	(27,342)	6,345,940
Asset backed securities	26,037,106	62,777	(337,108)	25,762,775
Total bonds	<u>\$ 99,074,272</u>	<u>\$ 655,889</u>	<u>\$ (853,297)</u>	<u>\$ 98,876,864</u>
Other invested assets	<u>\$ 105,777</u>	<u>\$ -</u>	<u>\$ (5,021)</u>	<u>\$ 100,756</u>

The cost and NAIC fair value of equity securities were as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
<b>2007</b>				
Preferred stocks	\$ 694,641	\$ 819	\$ (19,561)	\$ 675,899
Common stocks	<u>\$ 4,232,452</u>	<u>\$ -</u>	<u>\$ (285,132)</u>	<u>\$ 3,947,320</u>
<b>2006</b>				
Preferred stock	<u>\$ 411,742</u>	<u>\$ 12,540</u>	<u>\$ -</u>	<u>\$ 424,282</u>

Bonds with an NAIC rating of three or higher have been recorded at the lower of cost or fair value in accordance with statutory accounting.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

The carrying value and NAIC fair value of bonds at December 31, 2007 by contractual maturity are as follows:

<b>Maturity</b>	<b>Carrying Value</b>	<b>NAIC Fair Value</b>
One year or less	\$ 4,104,693	\$ 4,107,587
Over one year through five years	22,190,285	22,290,739
Over five years through ten years	37,352,913	38,015,031
Over ten years through twenty years	14,028,923	14,333,030
Over twenty years	<u>3,255,325</u>	<u>3,243,208</u>
	80,932,139	81,989,595
Asset backed securities (principally ten through twenty years)	<u>28,570,145</u>	<u>28,729,349</u>
	<u>\$ 109,502,284</u>	<u>\$ 110,718,944</u>

Bonds subject to early or unscheduled prepayments have been included above based upon their contractual maturity dates. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of investments on debt securities and the gross realized gains and losses on those sales for the years ended December 31, 2007 and 2006 are summarized as follows:

	<b>Proceeds From Sales</b>	<b>2007 Gross Realized</b>	
		<b>Gains</b>	<b>Losses</b>
Bonds	\$ 50,573,130	\$ 516,522	\$ (215,806)
Preferred stock	-	-	-
	<u>\$ 50,573,130</u>	<u>\$ 516,522</u>	<u>\$ (215,806)</u>
		<b>2006 Gross Realized</b>	
		<b>Gains</b>	<b>Losses</b>
Bonds	\$ 60,138,109	\$ 325,443	\$ (684,036)
Preferred stock	379,950	4,072	-
	<u>\$ 60,518,059</u>	<u>\$ 329,515</u>	<u>\$ (684,036)</u>

During 2007 and 2006, no other than temporary investment writedowns were recorded by the Company.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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The fair value and gross unrealized loss of investment securities and the amount of time the security has been in an unrealized loss position as of December 31, 2007 is as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Bonds (NAIC 1-2)	\$ 11,526,352	\$ (261,756)	\$ 16,857,626	\$ (190,455)	\$ 28,383,978	\$ (452,211)
Bonds (NAIC 3-6)	-	-	-	-	-	-
Common stocks	3,927,399	(285,132)	-	-	3,927,399	(285,132)
Preferred stocks	577,502	(18,674)	-	-	577,502	(18,674)
	<u>\$ 16,031,253</u>	<u>\$ (565,562)</u>	<u>\$ 16,857,626</u>	<u>\$ (190,455)</u>	<u>\$ 32,888,879</u>	<u>\$ (756,017)</u>

Unrealized losses on investment grade securities (NAIC 1-2) principally relate to changes in interest rates.

At December 31, 2007 and 2006, there were no gross unrealized losses on preferred stocks.

**12. Fair Value of Financial Instruments**

The following methods and assumptions were used by the Company to determine the fair values of financial instruments:

Fair values of publicly traded fixed income and equity securities are obtained from the Securities Value Office ("SVO") of the NAIC or an independent pricing service.

The carrying amount in the balance sheet for cash and short-term investments approximate their respective fair values.

The carrying value and fair value of the Company's financial instruments as of December 31, 2007 and 2006 were as follows:

	2007		2006	
	Admitted Value	Fair Value	Admitted Value	Fair Value
Financial assets				
Cash	\$ 4,602,044	\$ 4,602,044	\$ 8,173,758	\$ 8,173,758
Bonds	109,502,284	110,718,944	99,074,272	98,876,864
Common stocks	3,947,320	3,947,320	-	-
Preferred stocks	682,861	675,899	419,592	424,282

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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The major categories of net investment income for the years ended December 31, 2007 and 2006 are summarized as follows:

	<b>2007</b>	<b>2006</b>
Bonds	\$ 4,653,029	\$ 4,050,144
Preferred stock and common	260,281	21,197
Cash and short-term investments	127,338	308,239
Total investment income	<u>5,040,648</u>	<u>4,379,580</u>
Less: Investment expenses	<u>(852,553)</u>	<u>(788,734)</u>
Net investment income	<u>\$ 4,188,095</u>	<u>\$ 3,590,846</u>

**13. Employee Benefit Plans**

The Company's parent, MEMIC, has a qualified defined contribution pension 401(k) and profit sharing plan (the "Plan") covering substantially all full-time employees who meet the Plan's eligibility requirements. Pension contributions are determined as 6% of the employee's annual compensation plus an additional allocation for employee's earnings in excess of the taxable wage base. Employees become eligible to participate upon completion of three months of service and are fully vested in the Plan after three years of service. Expenses incurred for the Plan were approximately \$64,800 and \$46,900 in 2007 and 2006, respectively. The 401(k) and profit sharing portion of the Plan provides for a tax deferred profit-sharing contribution by the Company and an employee elective contribution with a Company matching provision. In 2007 and 2006 with respect to the 401(k) component of the Plan, the Company contributed an amount equal to 100% of the employee's 401(k) contributions up to 5%. An employee's contribution may not exceed the greater of 10% of their annual salary or the maximum amount allowed as determined by the Internal Revenue Code. The Company incurred approximately \$48,300 and \$42,300 of expense related to the 401(k) component of the Plan in 2007 and 2006, respectively. With respect to the profit-sharing component of the Plan, each eligible participant may receive a profit-sharing contribution in an amount to be determined by the Board of Directors. The Company incurred approximately \$62,800 and \$48,900 of expense related to the profit-sharing component of the Plan in 2007 and 2006, respectively.

The Company's parent sponsors a nonqualified, deferred compensation plan (the "Compensation Plan") and trust for certain key executives providing for payments upon retirement, death or disability. The Compensation Plan permits eligible officers to defer portion of their compensation. The Compensation Plan provides that, in the event of liquidation of the Company, all assets of the Compensation Plan will be available to meet the obligations of the Company. The Company did not incur any direct expense related to the Compensation Plan in 2007 or 2006.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**14. Commitment and Contingent Liabilities**

The Company leases office space and various office equipment and vehicles under lease arrangements. Future minimum lease payments under operating leases at December 31, 2007 are as follows:

2008	\$ 475,980
2009	393,189
2010	389,260
2011	362,768
2012	360,093
Thereafter	<u>63,372</u>
Total future minimum lease payments	<u>\$ 2,044,662</u>

Total rent and lease expense was \$454,920 and \$227,761 for the years ended December 31, 2007 and 2006, respectively.

The Company is involved in litigation with respect to claims arising with regard to insurance, which is taken in account in establishing loss and loss adjustment expense reserves. The Company's management believes that the resolution of such litigation is not expected to have a material adverse effect of the financial position or the operating results of the Company.

The Company is subject to guaranty fund and other assessments by the states in which the Company writes business. The Company accrued a liability for guaranty fund and other assessments of approximately \$1,393,560 and \$1,117,135 as of December 31, 2007 and 2006, respectively. This represents management's best estimate based on information received from the states in which the Company writes business and may change due to factors including the Company's share of the ultimate cost of insolvencies.

**15. Related Party Transactions**

The Company is charged by an affiliate, MEMIC Services Inc. for loss control and managed care services provided. These charges amounted to \$1,879,120 and \$999,800 for 2007 and 2006, respectively.

In accordance with a management agreement, the Company is charged by MEMIC for certain administrative and overhead expenses incurred on their behalf. These charges amounted to \$2,383,556 and \$2,020,900 in 2007 and 2006, respectively, net of amounts due from MEMIC for claims and premium audit services. In addition, MEMIC pays certain operating expenses on behalf of the Company and in turn charges the Company for reimbursement. The Company recorded a payable to MEMIC of \$781,647 and \$632,198 at December 31, 2007 and 2006, respectively.

**MEMIC Indemnity Company**  
**Notes to Financial Statements (Statutory Basis)**  
**December 31, 2007 and 2006**

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**16. Surplus Notes**

Date Issued	Interest Rate	Par Value (Face Amount of Notes)	Carrying Value of Note	Principal and/or Interest Paid Current Year	Total Principal and/or Interest Paid	Unapproved Principal and/or Interest	Date of Maturity
4/30/04	LIBOR + 4%	\$ 6,000,000	\$ 6,000,000	\$ 572,639	\$ 1,716,671	\$ 67,994	4/29/2034

The surplus note of \$6,000,000 in the table above was issued pursuant to Rule 144A under the Securities Act of 1933, underwritten by Dekania Capital Management II, and administered by JP Morgan/Chase as trustee.

Interest accrues at a floating rate of 3 month LIBOR + 4%. Interest payments are due quarterly in arrears on February 15, May 15, August 15 and November 15. Each payment of interest on and principal of the surplus note may be made only with the prior approval of the Commissioner of Insurance of the State of New Hampshire and only to the extent the Company has sufficient surplus earnings to make such payment.

The Company may, at its option, on or after April 29, 2009 redeem the note in whole at any time or in part from time to time at a redemption price of 100%.

The surplus note is subordinated to all senior obligations, including all existing and future debt and guarantees, and any expense or policy claims. The note will rank equally with any future surplus note or similar obligation of the Company.

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