ICI MUTUAL

a risk retention group

2011

annual **report**

ICI MUTUAL ***at a glance***

THE **SAFEST DECISION** YOU CAN MAKE

Since its founding in 1987, ICI Mutual has provided investment companies—and their directors, officers, and advisers—with stable and consistent underwriting, claims handling, and risk management services. Our insureds represent more than 60% of the industry's managed assets. There are other choices for insurance coverage but, for a number of reasons, ICI Mutual stands apart:

ICI Mutual has **unequaled industry knowledge and expertise:**
We help insureds identify and avoid risk at the front end. We stand behind them if problems occur.

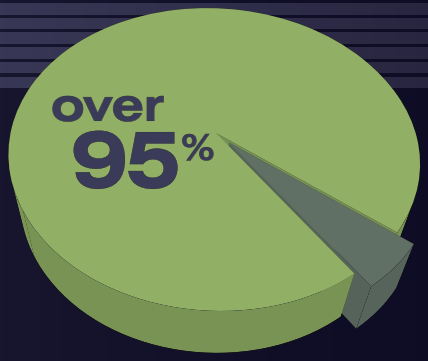
ICI Mutual has a **history of stability and financial strength:**
Our coverage has been available and consistent since our inception. We deliberately and prudently spread risk by reinsuring a portion of our policies.

ICI Mutual has the **best claims payment reputation in the industry:**
As our insureds who have faced trouble with commercial insurers will attest, we're dedicated to paying appropriate claims rather than haggling over them.

ICI Mutual is **not just a partner, we're a *good* partner:**
We were created to serve the mutual fund industry and only the mutual fund industry. We serve our insureds' needs, not the pressure of a public company share price.

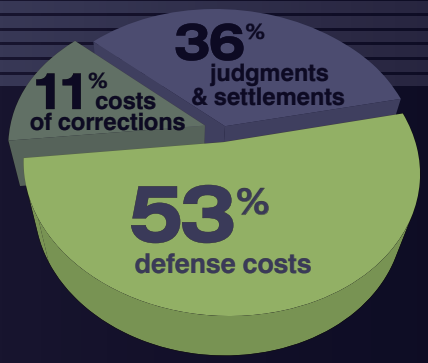
2011

ICI MUTUAL
CLIENT RETENTION



ICI MUTUAL'S **GROWTH IN EQUITY**
(in thousands, from 1990 to 2011)

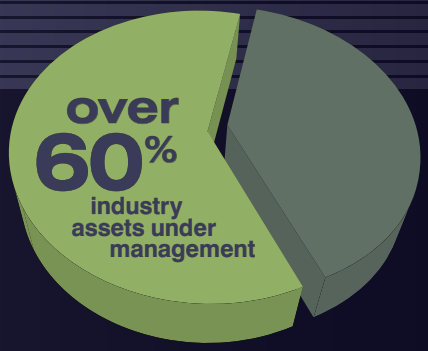
$782 MILLION PAID IN
D&O/E&O CLAIMS



(life of the Company)

ICI MUTUAL'S CUMULATIVE
POLICYHOLDER DIVIDENDS
(in thousands, from 1990 to 2011)

ICI MUTUAL
INSUREDS REPRESENT



Data shown here represents tabulations as of December 31, 2011.

We are pleased to report that 2011 was another successful year for ICI Mutual.

Lawrence R. Maffia and Ronald H. Fielding

message
from the **president** and **chairman**

The Company posted net income after dividends and taxes of $10.2 million. Equity grew by 6.4% to reach $213.1 million. In December, the Board of Directors declared a dividend to Participating Members in the amount of $5.3 million, which is approximately 8.5% of qualifying premium. Please see pages 8 and 9 for management's detailed discussion of 2011's operating results.

2011 *in Review*

THE INSURANCE **MARKET**

Historically, the commercial insurance market is volatile. Premium rates and coverage terms swing from hard to soft depending on commercial insurers' underwriting results in all lines of business. It is not so surprising, then, that the commercial insurance market in 2011 might best be described as having a split personality, with commercial insurers offering declining rates in the first half of the year, before reversing course and beginning to seek premium increases in the second. As 2011 progressed, pressure on premium rates increased as the impact of numerous physical catastrophes worked their way through commercial insurers' financial results. During fourth quarter 2011 earnings calls, executives of several commercial insurers spoke of the need to "increase rate." One comment in particular stood out. The chairman and chief executive officer of one of ICI Mutual's competitors said during his company's fourth quarter earnings call, "We are writing business at the right price the first time to bring it in the door, and then we are constantly looking to push rate once it's in the door."

ICI Mutual was formed to be the ballast to the inherent volatility of the commercial insurance market. For over 24 years, ICI Mutual has provided mutual funds, their directors, officers, and advisers with consistent coverage terms and stable, risk-related premiums that reflect the fund industry's claims experience and risk exposures. In 2011, ICI Mutual's overall premium rates were again stable, a decline of slightly less than 2% from 2010, and client retention continued to exceed 95%. We believe that ICI Mutual's premium philosophy combined with its excellent claims paying reputation and risk management assistance account for much of the Company's long-term success.

COVERAGE **ENHANCEMENTS**

During 2011, ICI Mutual implemented a number of enhancements to its D&O/E&O policies to ensure that the Company continues to provide insurance coverage that is valuable and relevant to insureds. The enhanced coverages were added at no additional cost to insureds.

The first enhancement provides up to $1 million of "first dollar" coverage, on a co-insurance basis, for costs incurred by funds (and the adviser, if covered under the policy) to investigate shareholder derivative demands. This enhancement was added to all D&O/E&O policies for registered funds to ensure that fund directors have the resources to conduct thorough derivative demand investigations, thereby reducing the risk of successful follow-on litigation. Counsel consulted by ICI Mutual have advised that the total expense of a derivative demand investigation can cost up to $2 million. The "first dollar" coverage of up to $1 million afforded by ICI Mutual thus represents a significant insurance benefit for insureds.

The second enhancement amended the "application severability" endorsement for independent directors to eliminate directors' concerns regarding a possible policy rescission.

A.M. Best Rating: On March 1, 2012, A.M. Best reaffirmed ICI Mutual's "A" (Excellent) rating—a rating the Company has maintained since it was first eligible for a rating in 1993. In its most recently published review, Best commented that "the rating reflects ICI Mutual's excellent underwriting and operating results, strong capitalization, solid risk management practices, and vast intellectual capital and expertise within the mutual fund industry."

The final enhancement provided clarification to insureds that the Dodd-Frank whistleblower rules would not be used to invoke the insured versus insured coverage exclusion. The enhancement also clarified that any "bounty" the SEC may award a whistleblower should neither increase nor decrease any insurance recovery under the policy.

RISK MANAGEMENT **SERVICES**

In 2011, ICI Mutual added to its comprehensive array of risk management services with the publication of *Managing Operational Risks of Private Accounts: A Guide for Investment Advisers.* This study explored the underlying causes of the

operational errors involving private accounts that have led to actual insurance claims over the past two decades, and discussed various risk management techniques employed by advisers to reduce and address these risks.

2011 also marked the launch of a new on-line resource for the Company's insureds—the ICI Mutual *Litigation Notebook*. It is available, at no cost, to all of ICI Mutual's insureds and

The Importance of **Indemnifiable Coverage to Independent Directors**

When considering stand-alone Independent Director Liability (IDL) insurance coverage, it is important for fund groups to recognize that not all IDL coverage is the same. In particular, traditional IDL coverage, sometimes referred to as "Side A" and sold by the commercial insurance industry, fails to protect the fund and its shareholders against the fund's liability to cover independent director costs. This is because traditional, "Side A" IDL policies cover only "non-indemnifiable" costs (i.e., those costs incurred by independent directors that their funds are unable or unwilling to indemnify). In the mutual fund industry, however, indemnification is rarely, if ever, unavailable to independent directors. Indeed, decades of industry claims experience demonstrate that funds typically are financially able and willing to indemnify their independent directors. Accordingly, traditional IDL (i.e., Side A only) policies can be expected to rarely, if ever, be called upon to cover independent directors' costs in actual claim situations.

In contrast, ICI Mutual's IDL Policy covers not only non-indemnifiable, "Side A" costs, but also those costs that claims experience shows that independent directors are most likely to incur (i.e., "indemnifiable" or Side B costs). Thus, for example, it is not unusual for independent directors to incur defense costs totaling a million dollars or more in regulatory investigations and lawsuits. However, because defense costs incurred by independent directors are typically indemnifiable, these defense costs are not eligible for coverage under traditional IDL (i.e., Side A only) policies. By contrast, the ICI Mutual IDL Policy, by including coverage for "indemnifiable" (i.e., Side B) losses, greatly enhances the protection afforded by the policy, protecting not only independent directors, but also the funds and by extension the shareholders they serve.

to their outside counsel. The on-line *Litigation Notebook* relieves users of the burden of searching for information about recent mutual fund related lawsuits and regulatory proceedings. Legal documents, procedural histories, and links to federal or state docket sheets are also provided. We encourage you to visit the *Litigation Notebook* at www.icimutual.com/litigation/notebook.php.

CLAIMS

In 2011, the major claims trends that insurers monitor—frequency and severity—continued to be relatively benign and within the norms ICI Mutual has experienced the past several years. Court decisions that emerged from the late trading and market timing events of the last decade have been generally favorable to the mutual fund industry and have served to define and narrow the available legal avenues under which the plaintiffs' bar may attempt to attack the fund industry. As a result of these decisions, major mutual fund litigation exposures are primarily focused on actions related to mutual fund fees under Section 36(b) of the Investment Company Act of 1940 and prospectus liability under the Securities Act of 1933. Over the course of the next few years, we expect that the nature of mutual fund fee litigation will be further defined as the fee lawsuits initiated after the Supreme Court's Jones v. Harris decision are concluded.

Beyond litigation, the major source of mutual fund claims relates to the myriad of regulatory issues that result from SEC rules and from rules issued by other federal regulatory agencies, FINRA, and state securities administrators. As the compliance burden faced by all mutual funds and their advisers expands, ICI Mutual expects that claims related to regulatory investigations are likely to grow. In this regard, ICI Mutual pioneered—and is still almost unique in providing—coverage for "informal" regulatory investigations as part of the Company's core D&O/E&O policy. Most insurers provide coverage only for "formal" investigations. Although the difference in these two words is only two letters, the financial implications can be very large because the vast majority of defense costs incurred in a regulatory investigation often occur in the "informal" stage.

Outlook for **2012**

As noted in the beginning of this letter, when 2012 began, the commercial insurance market was seeking to change the direction of premium rates to offset the cost of losses incurred in lines of business unrelated to mutual funds. As this report went to press, it is uncertain whether this push by commercial insurers will be successful. ICI Mutual, however, plans to continue its practice of underwriting each account based on its own risk profile and underwriting history. We expect that most insureds will see modest changes in premium unless their particular underwriting profile justifies an adjustment.

With regard to policy terms, ICI Mutual expects to continue to offer the same core coverages it always has and not to take advantage of a potential "hardening" of the commercial insurance

market to restrict policy terms and conditions. On the contrary, the Company is evaluating opportunities to enhance core coverages for independent fund directors, in particular in the area of potential exposures in which directors may be at risk to personally satisfy certain costs before insurance coverage takes effect.

The 2012 claims outlook is somewhat clouded by the numerous SEC, CFTC, and Federal Reserve rulemaking initiatives that are works-in-progress. New rules, combined with a visibly more aggressive enforcement posture at the SEC, suggest that 2012 could see an increase in claims activity related to regulatory investigations.

Finally, on the service front, the staff expects to issue its next risk management study, entitled *Risk Management in the Digital Age: An Overview for Investment Advisers* in 2012. We also plan to reevaluate the Company's insurance applications with the goal of streamlining the number of questions and documentation requests and to evaluate possible uses of technology to enable us to create a tailored application that reflects each insured's requested scope of coverage.

On behalf of the management, staff, and Board of Directors, we appreciate your continuing support of ICI Mutual. As the only insurance company created by and for the mutual fund and investment management industry, we strive to be your insurer of choice for many years to come.

Lawrence R. Maffia
President

Ronald H. Fielding
Chairman of the Board of Directors

Postscript *from the President*

This June, Ron Fielding will step down as ICI Mutual's Chairman. It has been my distinct pleasure to work with Ron in his role as Chairman of the Board during the past two years. Ron joined ICI Mutual's Board in 1995, serving for multiple terms on the Board's Investment Committee as a member and as the committee chairman. Ron also served as the Company's Vice Chairman from 2008–2010, before assuming the position of Chairman.

I'd like to thank Ron for his leadership and support. During his tenure, Ron has been generous in sharing his expertise and insights with all of us on the ICI Mutual staff. The Company is fortunate that Ron will continue on the Board of Directors after his term as Chairman is complete. The institutional knowledge he brings to the Company is invaluable.

2011 ICI Mutual financial overview

2011 marked the seventh consecutive year that ICI Mutual experienced an underwriting profit and is reflective of the Company's dedication to only writing business it fully understands and at prices that recognize the underlying risks being assumed.

ICI Mutual's comprehensive underwriting process, which is unique in that it has been developed in conjunction with leading members of the mutual fund industry, allows it to charge premiums that are established at levels that reflect the underlying risk to be assumed and are not subject to the inconsistent pricing that has traditionally been available in the commercial marketplace.

Gross written premiums declined a very modest 1.6% to $88.6 million for the year ended 2011. This compares favorably to the overall marketplace where the Company's competitors experienced price declines of 5%–10%. Net earned premiums, the amount of the premium the Company retains after paying for the reinsurance it purchases to protect the Company against both an unexpected increase in the number of claims it may experience in a given year (frequency), as well as protection from any unusually large claims (severity), equaled $31.1 million, an amount that approximated the previous year's amount.

The claims environment for the Company's insureds continued to be relatively benign in 2011, which resulted in net loss and loss adjustment expenses incurred of $11.9 million for the year, resulting in a loss ratio (losses and loss expenses incurred divided by earned premiums) of 38%.

While losses incurred in 2011 are up from the $3.3 million of losses incurred in 2010, the 2010 losses benefited from the release of $10 million of reserves that were established for certain prior year (2003–2004) claims that ultimately proved unnecessary. Without this reserve release, the 2010 loss ratio would have been 43%.

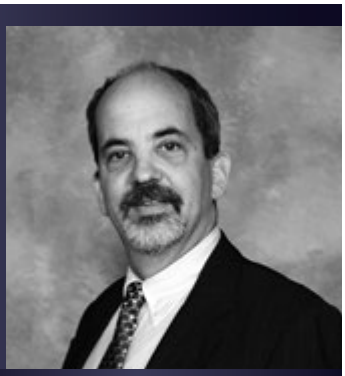
The Company's 2011 combined ratio was 69% before dividends to policyholders and 86% after dividends. The comparable industry averages for property and casualty companies in 2010, the latest year for which industry data is available, was approximately 102%. A combined ratio of under 100% indicates an underwriting profit. ICI Mutual once again returned a significant portion of the 2011 underwriting profit to participating policyholders in the form of a $5.3 million dividend.

The Company's net income for the year equaled $10.2 million ($8.5 million in 2010). Total equity now stands at $213.1 million at December 31, 2011.

The continued positive underwriting results combined with the Company's conservative management approach and solid balance sheet was recognized once again by A.M. Best which reaffirmed the Company's "A" (Excellent) Strength Rating, a rating it has maintained since 1993, the first year it was eligible to receive a rating.

view from the inside

Three ICI Mutual executives provide a snapshot of operations from their own perspectives.



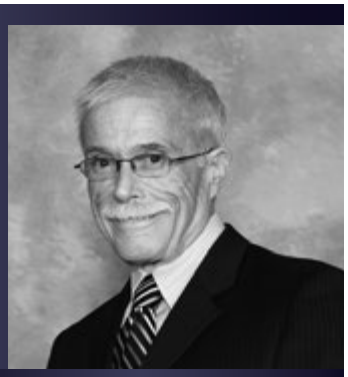
Daniel T. **Steiner**

EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL

The four in-house attorneys in ICI Mutual's legal department bring more than 70 years of combined investment management and insurance-related legal experience to our work for the Company and its insureds. Among the department's chief responsibilities is claims handling, where we seek to ensure that all insurance claims submitted by our clients are approached in an even-handed, rational, and prompt fashion—an approach that is mandated both by the Company's mission and by its position as the dedicated insurer owned by and operated for the mutual fund industry.

From the initial receipt of a claim notice to the claim's final resolution, we view claims handling to be a collaborative, rather than an adversarial, process between ICI Mutual and its insureds. In all claims, big and small, we work to develop and foster open lines of communication with appropriate representatives of insureds (and with their counsel), and we encourage them to engage with us in ongoing discussions, both with regard to the litigation or regulatory matters underlying their claims, and any associated insurance coverage issues. ICI Mutual's nearly 25 years of fund industry claims experience—during which time we have made more than $780 million in claims payments to our insureds—evidences that this close attention to pending claims benefits both insureds and the Company, by reducing the potential for misunderstandings or surprises to interfere with the claims handling process, and by assisting the Company and its insureds to achieve claims resolutions that can be viewed as timely and fair by all concerned. Indeed, we are particularly proud of the fact that most insureds continue to remain with ICI Mutual long after their insurance claims are resolved, which we believe to be a convincing test of good claims handling.

Outside the claims handling context, the work of the legal department is probably most visible to insureds through the publications that we author for the Company. These include (1) our annual *Claims Trends* newsletter, which provides a general overview of the fund industry's claims and litigation environment; (2) our on-line *Litigation Notebook*, which tracks specific developments in a broad selection of lawsuits and public regulatory proceedings involving funds, fund directors and officers, and fund advisers; (3) our guide on *What to Expect in the Claims Process*, which describes the steps involved in making and resolving insurance claims; and (4) our risk management studies (numbering 18 to date), which provide in-depth research and analysis on such topics as prospectus liability, D&O/E&O liability insurance, and private advisory risks. (A list of risk management studies authored or co-authored by the Company's attorneys over the past decade is included on page 19.) These publications—together with our regular speaking engagements to individual fund boards and advisers, and at industry conferences and gatherings—provide us with a forum to share insights on fund industry claims and risks, derived from the Company's unique position as the industry's dedicated insurer.



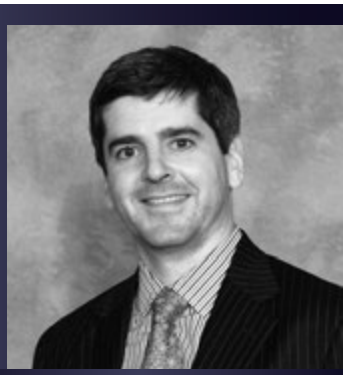
Charles W. **Behr**

SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

As ICI Mutual's CFO since 1997, my responsibilities include oversight of the finance department and its accounting, investment, regulatory compliance, and reporting functions, as well as the oversight of ICI Mutual's information technology (IT) infrastructure and staff. Over the past five years, there have been several major system enhancements to improve work-flow efficiency. For example, the IT staff has implemented a data capture and analysis process from Morningstar that eliminates a significant portion of the upfront manual data collection employed to underwrite an account; assisted finance with a wide range of data integration projects that eliminate the need to reenter data; deployed a document management system to store and organize the data; and digitized hard copy documents associated with the underwriting and claims handing processes.

The IT staff is also responsible for management of the Company's Business Continuity Site (BCS) located in Sterling, Virginia. ICI Mutual established the BCS in 1999 to ensure that the Company's core operations would continue without interruption in the event that the main office in Washington, DC became inoperable or inaccessible. Over the past few years, the BCS has been transformed into a "hot site" to which critical data is replicated nightly. The BCS also supports fail-over voice capabilities. This technology proved useful when Hurricane Irene disrupted telephone service at our Washington, DC location; calls were seamlessly re-routed through the BCS, allowing ICI Mutual's staff to communicate with clients without interruption.

My duties also include supervising the staff of ICI Mutual Insurance Brokers, Inc. (Brokers), a wholly-owned subsidiary of ICI Mutual. Brokers was founded in 1990 to assist ICI Mutual's insureds with obtaining certain types of insurance coverage not offered by ICI Mutual, but which are necessary for our investment adviser insureds, such as ERISA fidelity bonds, non-mutual fund investment adviser insurance products, and lost instrument bonds. Brokers understands the practical business needs and the regulatory requirements of the mutual fund industry and works with a number of highly-rated commercial insurance partners to develop tailored and meaningful coverages for ICI Mutual's insureds.



John T. **Mulligan**

VICE PRESIDENT—UNDERWRITING

In the highly competitive marketplace for professional liability and bond insurance, ICI Mutual's underwriting team stands apart from the crowd, with fund industry experience and expertise that no other insurer can match. We possess over 75 years of combined experience, which makes a difference for our clients, especially when it comes to understanding their risks, tailoring their coverages, and setting premiums for their policies. It also translates to consistency and stability in an area of insurance noted for its volatility and cyclical nature.

Unlike most underwriters in the financial institutions category, our underwriting team concentrates exclusively on fund industry risks and insurance requirements. We have a clear mandate to understand deeply the legislative, regulatory, and legal environments impacting funds, their boards, and their service providers. We pay close attention to trends and developments, and we do so with strategic oversight and bi-annual input from the Risk Prevention and Underwriting Committees of ICI Mutual's Board of Directors, comprised of fund industry independent directors and senior executives.

ICI Mutual requires its underwriters to know which risks matter and to ask relevant risk-related questions. We focus on arbiters of risks at fund groups, namely independent directors, investment risk managers, compliance officials, in-house and outside counsel, and the regulatory framework that protects investors. Our application for insurance probes the "processes" that mitigate risks. We ask about prospectus development, fair valuation, compliance systems, and other areas where actual claims arise. We speak with clients every day about risks and controls and we establish risk-related, consistent premiums for policies.

Our continued dialogue with our insureds gives us an edge in the market. We do not react blindly to headline risks. For instance, as the credit crisis unfolded, many of our competitors predicted dire insurance consequences for all financial institutions, including funds and their service providers, and several increased rates and restricted terms as a result. In contrast, ICI Mutual recognized that fund complexes differed from the financial institutions that manufactured, sold, and warehoused exotic securities. We understood that fund complexes, as investors, would be impacted; however, our conviction in the industry's inherent protections for investors allowed us to enforce stability in insurance rates and terms for funds.

ICI Mutual's underwriters are entrusted with a significant responsibility to maintain the Company's excellent reputation for knowledgeable and timely service. As a result, we spend time with each client to understand the intricacies of their businesses and to develop long-term relationships. This has resulted in core client retention rates of over 95% each and every year.

aligned with the industry

ICI Mutual is the only insurance source created by and for the mutual fund industry.

The Company was founded in 1987 in response to the industry's need for comprehensive, specialized insurance coverage at risk-related prices and fair claims handling. Since the commercial insurance market was, at times, unwilling or unable to fulfill this need, mutual fund leaders collaborated with the Investment Company Institute (ICI), the industry's trade association, to form ICI Mutual, the industry's own dedicated insurance company.

As an insurance company owned and operated by and for the fund industry, ICI Mutual offers what no other insurance carrier can: an exclusive focus on the unique liability needs of mutual funds and their directors, officers, and advisers.

Mutual fund leaders serve on the Company's Board of Directors, bringing their in-depth knowledge and experience in the industry to direct the development of products and services that meet the particular needs of funds, their directors, officers, and advisers. Their involvement with the Company ensures that ICI Mutual is operated for the long-term benefit of its insureds.

ICI Mutual's structure and orientation—unique in the industry—result in a number of distinct advantages for our clients: a stable source of insurance in all market cycles, tailored coverage that is individually priced to reflect each client's risk profile, control over long-term insurance costs, access to specialized risk management services, and the potential for dividends. Now in its third decade, ICI Mutual is an established, trusted presence and the top provider of insurance for the mutual fund industry.

knowledge and expertise

More detailed descriptions of ICI Mutual's coverages may be found online at: www.icimutual.com/coverages.php

ICI Mutual has the ability to craft custom coverage for its insureds when their needs fall outside of the Company's standard policies. This may include coverage for trust company services, personal financial planning services, and administrative services for in-house and third-party plans.

Because ICI Mutual was formed by the mutual fund industry to serve the mutual fund industry, it occupies a unique position. Our people work in the mutual fund world and are the acknowledged industry experts—even by our competition. By interacting with the Board of Directors and other leading industry professionals, our staff gains invaluable insights that facilitate the development of appropriate insurance coverages and risk management educational materials. We are able to help clients identify and avoid risk at the front end…and we stand behind them with robust coverage and claims support if problems occur.

Coverages

ICI Mutual's core products are designed specifically to address the unique risk financing needs of funds, fund directors and officers, and advisers.

Directors and Officers/Errors and Omissions Liability Policy protects individuals and their insured companies against the financial impact of judgments, settlements, and legal defense costs incurred in shareholder lawsuits and regulatory investigations, and the cost of correcting errors.

Investment Company Blanket Bond meets the basic fidelity bonding required under the Investment Company Act of 1940, plus it offers protection against specified losses caused by employee theft, third-party fraud, and various other types of events. In addition, ICI Mutual's Bond (unlike many fidelity bonds generally) expressly insures legal liability for direct compensatory damages resulting from a covered loss.

Independent Directors Liability Policy offers comprehensive coverage tailored to meet the unique concerns and needs of fund independent directors.

Services

UNDERWRITING

Because ICI Mutual's underwriters focus exclusively on the mutual fund industry, they have deep insight into its unique risks and challenges. Each insured is assigned a dedicated underwriter who collaborates closely with them to develop a thorough understanding of their particular business, processes, and procedures. This enables ICI Mutual to structure coverage and offer limits that appropriately reflect the insured's risk profile.

CLAIMS HANDLING

ICI Mutual is highly regarded for its balanced, prompt, and knowledgeable claims handling—an approach mandated by the Company's position as the investment management industry's dedicated insurer. Each claim submitted undergoes a thorough analysis of the facts, circumstances, and applicable coverage language, with insureds kept informed throughout this process.

RISK MANAGEMENT

ICI Mutual's specialized knowledge and close connection with the industry is unmatched—as are the Company's efforts to provide on-going, pertinent information and risk management assistance to its insureds. ICI Mutual is committed to providing practical guidance to help insureds identify and manage industry risks through a number of publications and other media. The Company's Risk Management Studies, as listed on page 19, provide in-depth research and analysis of the fund industry's unique liability exposures and are designed to help insureds improve their organizations' risk profiles. *Claims Trends* and the on-line *Litigation Notebook* explain new and emerging areas of regulatory and litigation exposure and their implications for insurance claims and coverage. All of these publications and other materials can be readily accessed by insureds on the Company's website: www.icimutual.com.

At ICI Mutual's annual Risk Management Conference, industry experts and guest speakers present information on a wide array of risk management topics and facilitate discussion among insureds. ICI Mutual's professional staff is always available to meet with insureds and their boards of directors to discuss underwriting, claims, and emerging risks, and respond directly to an organization's specific insurance concerns.

A History of Our Risk Management Publications

2001 *Managing Risk in Processing Corporate Actions*

2002 *Investment Management Compliance Risks*

2002 *Understanding Bond Fund Risks*

2003 *Computer Security Lite*

2004 *Managing Defense Costs*

2005 *Fair Valuation Study—An Introduction* (co-authored with ICI and IDC)

2006 *Fair Valuation Study—The Role of the Board* (co-authored with ICI and IDC)

2006 *The Two Faces of Identity Theft*

2006 *Independent Director Litigation Risk*

2007 *Preparing for a Pandemic*

2007 *What to Expect in the Claims Process*

2008 *Managing Risks in Trade Allocation*

2008 *Outsourcing by Advisers and Affiliated Service Providers*

2009 *Mutual Fund D&O/E&O Insurance: A Guide for Insureds*

2010 *Mutual Fund Prospectus Liability: Understanding and Managing the Risk*

2010 *ERISA Liability: A Guide for Investment Advisers and Their Affiliates*

2011 *Managing Operational Risks of Private Accounts: A Guide for Investment Advisers*

FORTHCOMING RISK MANAGEMENT PUBLICATION

2012 *Risk Management in the Digital Age: An Overview for Investment Advisers*

This study will focus on new and emerging technology-related risks. The publication will explore risks associated with wireless and other electronic communications, digital data, and the use of social media, and will review various risk management techniques employed by insureds to address these risks.

financial stability

ICI Mutual is acknowledged as the trusted and leading insurer within the fund industry.

For nearly 25 years, ICI Mutual has been acknowledged as the trusted and leading insurer within the fund industry, with our insureds representing more than 60% of the industry's managed assets. ICI Mutual's success can be attributed to its philosophy of secure, conservative financial management, in every aspect of business. From underwriting to portfolio management and administration, the Company strives to use its resources wisely, invest prudently, and manage risk carefully. The result is uninterrupted long-term financial strength and stability to meet the needs of our insureds, unmatched by commercial competitors. These practices have enabled ICI Mutual to stand behind our insureds through significant financial market and industry-wide events and to prosper through all types of economic and insurance cycles over the past 24 years. The Company's strong network of reinsurance partners allows ICI Mutual to provide the full limits of coverage required by insureds and to promote stable premium rates and coverage terms, regardless of challenging economic environments. As a part of the mutual fund industry, ICI Mutual offers investment companies, their directors, officers, and advisers confidence that insurance coverage will always be available at risk-related prices in all kinds of markets.

Board of **Directors**

Ronald H. Fielding, *Chairman*
Saturna Investment Trust
(Independent Director)

Michael J. Downer, *Vice Chairman*
Capital Research & Management Company

James H. Bodurtha
BlackRock Funds
(Independent Director)

Kevin M. Carome
Invesco Ltd.

Richard D. Carpenter
The Vanguard Group, Inc.

Mark E. Carver
UBS Global Asset Management (Americas), Inc.

Jeffrey R. Coleman
B of A Global Capital Management

Dawn-Marie Driscoll
DWS Funds (Independent Director)

Kenneth C. Eich
Davis Selected Advisers, L.P.

Barry Fink
American Century Investments

Maureen A. Gemma
Eaton Vance Management

William V. Healey
Allianz Global Investors of America L.P.

Diana P. Herrmann
Aquila Investment Management LLC

Lawrence H. Kaplan
Lord, Abbett & Co. LLC

Les M. Kratter
Franklin Resources, Inc.

Paul S. Kulig
Kulig & Sullivan, P.C.

Thomas P. Lemke
Legg Mason, Inc.

Lawrence R. Maffia
ICI Mutual Insurance Company

James J. McMonagle
Selected Funds (Independent Director)

David M. Pfeffer
OppenheimerFunds, Inc.

Mark N. Polebaum
MFS Investment Management Company

Paul Schott Stevens
Investment Company Institute

Alison Taunton-Rigby
Columbia Funds
(Independent Director)

Gregory Johnson, *Ex-officio*
Franklin Resources, Inc.

DIRECTORS ON **SABBATICAL**

Stefanie Chang Yu
Morgan Stanley

John F. Cogan, Jr.
Pioneer Investment Management USA, Inc.

David Oestreicher
T. Rowe Price Associates, Inc.

Jeffrey L. Steele
Washington Management Corporation

Michael D. Strohm
Waddell & Reed, Inc.

company information

Executive **Committee**

Standing: Kenneth C. Eich, William V. Healey, Dawn-Marie Driscoll, Barry Fink, Lawrence H. Kaplan
Seated: Lawrence R. Maffia, Ronald H. Fielding, Michael J. Downer Not pictured: Paul Schott Stevens

Below, ***standing***: James H. Bodurtha, Alison Taunton-Rigby, Jeffrey R. Coleman, David M. Pfeffer, Kevin M. Carome, Thomas P. Lemke, James J. McMonagle, Les M. Kratter, John F. Cogan, Jr.

Below, ***seated***: Richard D. Carpenter, Paul S. Kulig, Maureen A. Gemma, Mark E. Carver, Diana P. Herrmann

Not pictured: Stefanie Chang Yu, David Oestreicher, Mark N. Polebaum, Jeffrey L. Steele, Michael D. Strohm

Officers

Lawrence R. Maffia, President
Daniel T. Steiner, Executive Vice President and General Counsel
Charles W. Behr, Senior Vice President and Chief Financial Officer
John T. Mulligan, Vice President, Underwriting
Paul S. Kulig, Secretary-Treasurer
Rodolfo C. Sinon, Assistant Secretary

Staff

William Akishev
Director of Information Technology

Virginia Barry
Assistant Counsel

Meloney Burrell
Staff Accountant

Joseph Costello
Underwriter

Catherine Dalton
Senior Underwriter

Briana Davis
Lead Broker

John Driggers
Software Analyst/ Developer

Michael Heiser
Controller

Sarah Hunt
Associate Broker

Carolyn Julia
Executive Assistant

Matthew Link
Senior Underwriter

Swenitha Nalli
Underwriting Analyst

Colin Rouse
Assistant Controller

Lizabeth Staursky
Corporate Communications

Margaret Sullivan
Senior Underwriter

David Thomas
Associate Counsel

Krystal Thomas
Policy Coordinator

Julia Ulstrup
Associate Counsel

Jinhua Zhang
Director, Corporate Reporting

Committees

EXECUTIVE COMMITTEE

Ronald H. Fielding, *Chairman*
Saturna Investment Trust

Michael J. Downer, *Vice Chairman*
Capital Research & Management Company

Dawn-Marie Driscoll
DWS Funds

Kenneth C. Eich
Davis Selected Advisers, L.P.

Barry Fink
American Century Investments

William V. Healey
Allianz Global Investors of America L.P.

Lawrence H. Kaplan
Lord, Abbett & Co. LLC

Lawrence R. Maffia
ICI Mutual Insurance Company

Paul Schott Stevens
Investment Company Institute

AUDIT COMMITTEE

Kenneth C. Eich, *Chairman*
Davis Selected Advisers, L.P.

Richard D. Carpenter
The Vanguard Group, Inc.

Jeffrey R. Coleman
B of A Global Capital Management

Paul S. Kulig
Kulig & Sullivan, P.C.

Alison Taunton-Rigby
Columbia Funds

INVESTMENT COMMITTEE

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Capital Research & Management Company

Richard D. Carpenter
The Vanguard Group, Inc.

Mark E. Carver
UBS Global Asset Management (Americas), Inc.

Diana P. Herrmann
Aquila Investment Management LLC

Lawrence R. Maffia
ICI Mutual Insurance Company

James J. McMonagle
Selected Funds

David M. Pfeffer
OppenheimerFunds, Inc.

UNDERWRITING COMMITTEE

William V. Healey, *Chairman*
Allianz Global Investors of America L.P.

Kevin M. Carome
Invesco Ltd.

Richard D. Carpenter
The Vanguard Group, Inc.

Dawn-Marie Driscoll
DWS Funds

Maureen A. Gemma
Eaton Vance Management

James J. McMonagle
Selected Funds

Mark N. Polebaum
MFS Investment Management Company

Paul Schott Stevens
Investment Company Institute

RISK PREVENTION COMMITTEE

Lawrence H. Kaplan, *Chairman*
Lord, Abbett & Co. LLC

James H. Bodurtha
BlackRock Funds

Barry Fink
American Century Investments

Les M. Kratter
Franklin Resources, Inc.

Thomas P. Lemke
Legg Mason, Inc.

Lawrence R. Maffia
ICI Mutual Insurance Company

David M. Pfeffer
OppenheimerFunds, Inc.

Alison Taunton-Rigby
Columbia Funds

NOMINATING COMMITTEE

Ronald H. Fielding, *Chairman*
Saturna Investment Trust

Michael J. Downer, *Vice Chairman*
Capital Research & Management Company

James H. Bodurtha
BlackRock Funds

Thomas P. Lemke
Legg Mason, Inc.

Mark N. Polebaum
MFS Investment Management Company

2011
consolidated **financial statements**

ICI MUTUAL

a risk retention group

ICI Mutual Insurance Company, a Risk Retention Group
Index
December 31, 2011 and 2010

Report of Independent Auditors

To the Board of Directors and Members of
ICI Mutual Insurance Company, a Risk Retention Group:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in equity and of cash flows present fairly, in all material respects, the financial position of ICI Mutual Insurance Company, a Risk Retention Group, and its subsidiaries (together, the "Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

April 25, 2012

PricewaterhouseCoopers LLP, 125 High Street, Boston, MA 02110
T: (617)530 5000, F: 617)530 5001, www.pwc.com/us

ICI Mutual Insurance Company, a Risk Retention Group
Consolidated Balance Sheets
December 31, 2011 and 2010 (in 000's)

	2011	2010
Assets		
Cash and cash equivalents	$ 30,528	$ 5,022
Investments		
Debt securities, at fair value (amortized cost of $213,783 and $222,482, respectively)	225,390	226,829
Equity securities, at fair value (cost of $19,105 and $15,954, respectively)	24,150	22,358
Money market funds	3,115	21,722
Total cash and investments	283,183	275,931
Prepaid expenses	497	450
Prepaid income taxes	2,513	503
Deferred policy acquisition costs	4,143	4,128
Premiums receivable	8,755	8,405
Interest receivable	1,922	1,938
Reinsurance recoverables	127,827	294,363
Prepaid reinsurance premiums	39,314	38,754
Other amounts receivable under reinsurance contracts	1,270	2,372
Furniture and fixtures, net	447	579
Deferred income taxes	2,691	3,832
Investment securities receivable and other assets	1,424	1,319
Total assets	$ 473,986	$ 632,574
Liabilities and Equity		
Reserve for losses and loss adjustment expenses	$ 184,935	$ 360,353
Unearned premiums	52,996	51,880
Reinsurance premium payable	9,305	8,290
Premium taxes payable	524	412
State income taxes payable	-	64
Accounts payable and other liabilities	2,964	3,015
Benefits payable	4,520	3,598
Dividends payable	5,599	4,778
Total liabilities	260,843	432,390
Contingencies (Note 10)		
Contributed surplus	21,621	21,885
Accumulated other comprehensive income	8,950	5,894
Accumulated earnings	182,572	172,405
Total equity	213,143	200,184
Total liabilities and equity	$ 473,986	$ 632,574

The accompanying notes are an integral part of these consolidated financial statements.

ICI Mutual Insurance Company, a Risk Retention Group
Consolidated Statements of Operations
Years Ended December 31, 2011 and 2010 (in 000's)

	2011	2010
Revenues		
Net premiums written	$ 31,657	$ 30,943
Change in net unearned premiums	(556)	131
Net premiums earned	31,101	31,074
Net investment income	8,276	8,704
Net realized gains (losses) on securities	474	(5,429)
Reinsurance profit-sharing income (loss)	344	(323)
Other income	304	296
Total revenues	40,499	34,322
Expenses		
Net loss and loss adjustment expenses	11,918	3,353
Underwriting, general and administrative expenses	9,800	10,503
Total expenses	21,718	13,856
Income before dividends to policyholders and provision for income taxes	18,781	20,466
Dividends to policyholders	5,300	7,694
Income before provision for income taxes	13,481	12,772
Provision for income taxes	3,314	4,242
Net income	10,167	8,530
Other comprehensive income, net of tax, net of reclassification adjustments	3,056	9,024
Comprehensive income	$ 13,223	$ 17,554
Net realized gains (losses) on securities		
Other-than-temporary impairment losses	$ -	$ (4,569)
Other-than-temporary impairment losses transferred to other comprehensive income	-	3,214
Other net realized investment gains (losses)	474	(4,074)
Net realized gains (losses) on securities	$ 474	$ (5,429)

The accompanying notes are an integral part of these consolidated financial statements.

ICI Mutual Insurance Company, a Risk Retention Group
Consolidated Statements of Changes in Equity
Years Ended December 31, 2011 and 2010 (in 000's)

	Contributed Surplus	Accumulated Other Comprehensive Income (Loss)	Accumulated Earnings	Total Equity
Balance at December 31, 2009	$ 22,285	$ (3,130)	$ 163,875	$ 183,030
Net income	-	-	8,530	8,530
Other comprehensive income, net of tax, net of reclassification adjustments	-	9,024	-	9,024
Distributions of contributed surplus	(400)	-	-	(400)
Balance at December 31, 2010	$ 21,885	$ 5,894	$ 172,405	$ 200,184
Net income	-	-	10,167	10,167
Other comprehensive income, net of tax, net of reclassification adjustments	-	3,056	-	3,056
Distributions of contributed surplus	(264)	-	-	(264)
Balance at December 31, 2011	$ 21,621	$ 8,950	$ 182,572	$ 213,143

The accompanying notes are an integral part of these consolidated financial statements.

ICI Mutual Insurance Company, a Risk Retention Group
Consolidated Statements of Cash Flows
Years Ended December 31, 2011 and 2010 (in 000's)

	2011	2010
Cash Flows from Operating Activities		
Net income	$ 10,167	$ 8,530
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of premium	640	419
Deferred income taxes	(506)	(1,818)
Furniture and fixtures, net	214	201
Net realized gains on sale of securities	(474)	5,429
Investment securities and other receivables	(932)	(570)
Benefits payable	549	652
Changes in operating assets and liabilities		
Prepaid expenses	(47)	15
Prepaid income taxes	(2,010)	870
Deferred policy acquisition costs	(15)	73
Premiums receivable	(350)	68
Interest receivable	16	(94)
Reinsurance recoverables	166,536	(108,074)
Prepaid reinsurance premiums	(560)	4,017
Other amounts receivable under reinsurance contracts	1,102	2,238
Reserve for losses and loss adjustment expenses	(175,418)	98,364
Unearned premiums	1,116	(4,140)
Reinsurance premium payable	1,015	(2,810)
Premium taxes payable	112	(1,537)
Income taxes payable	(64)	40
Accounts payable and other liabilities	(51)	(946)
Dividends payable	821	1,528
Net cash provided by operating activities	1,861	2,455
Cash Flows from Investing Activities		
Proceeds from sales of investments available for sale	62,591	92,410
Proceeds from maturities of investments available for sale	3,310	2,646
Purchases of furniture and fixtures	(82)	(43)
Payments for purchases of investments available for sale	(60,517)	(82,638)
Change in money market funds	18,607	(21,058)
Net cash provided by (used in) investing activities	23,909	(8,683)
Cash Flows from Financing Activities		
Distributions of contributed surplus	(264)	(400)
Net cash used in financing activities	(264)	(400)
Net increase (decrease) in cash and cash equivalents	25,506	(6,628)
Cash and cash equivalents at beginning of year	5,022	11,650
Cash and cash equivalents at end of year	$ 30,528	$ 5,022

The accompanying notes are an integral part of these consolidated financial statements.

1. Significant Accounting Policies

A. Basis of Presentation

ICI Mutual Insurance Company ("Mutual") was incorporated on August 26, 1987 as an association captive insurance company domiciled in the State of Vermont and commenced accepting insurance risks on March 1, 1988. Mutual, together with its wholly owned subsidiaries described below, are collectively referred to as "the Company." The Company primarily writes fidelity bonds, Financial Industry Regulatory Authority ("FINRA") bonds, and directors and officers and errors and omissions insurance for Members and Associate Members of the Investment Company Institute ("ICI") and their affiliated companies on a claims-made basis. These Members primarily provide services to the regulated investment company industry.

On December 15, 2008, the participating members of Mutual voted to convert Mutual, effective January 1, 2009, from a Vermont association captive insurance company to a Vermont risk retention group ("RRG"), under the Federal Liability Risk Retention Act subject to the approval of the Vermont Department of Banking, Insurance, Securities and Healthcare Administration ("BISHCA"). Mutual received the approval of BISHCA and the change became effective on January 1, 2009. Among other things, the Act preempts certain state registration requirements and allows Mutual to solicit business and service clients in those states where it applies for admission as an RRG. The conversion to an RRG has not had a material impact on Mutual's operations or financial condition.

In 1990, ICI Mutual Insurance Brokers, Inc. ("Brokers") was formed as a wholly-owned subsidiary of Mutual. Brokers was formed to allow the Company to provide insurance brokerage services to Members of the ICI.

In 1992, ICIM Services, Inc. ("Services") was formed as a wholly-owned subsidiary of Mutual. Services provides the underwriting function for Mutual under a written agreement. This agreement provides that Mutual will reimburse Services for all reasonable expenses associated with performing the underwriting function plus a 5% fee.

The Consolidated Financial Statements include the consolidated accounts of Mutual, Brokers, and Services, with all significant intercompany amounts eliminated in consolidation. The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which are also in accordance with practices prescribed for risk retention groups by BISHCA.

GAAP requires management to make certain estimates and assumptions in the preparation of the financial statements. Therefore, actual results could differ from those estimates and assumptions.

B. Investments

The Company's debt and equity securities are classified as available-for-sale and reported at fair value as defined in Note 3. Short-term securities and money market funds are stated at amortized cost which approximates fair value.

For securities where the fair value is less than the amortized cost basis, the Company must determine whether or not an other-than-temporary impairment has occurred. See Note 2 for a detailed explanation of the procedures utilized by the Company in calculating other-than-temporary impairment losses.

The Company may utilize, to a limited extent, derivatives such as U.S. Government Treasury Note and Euro dollar futures and options to hedge certain risks within the portfolio of debt securities that are considered to be held for other than trading purposes. The return received or paid on these contracts varies in relationship to the movement in the U.S. Government Treasury Bond and Note markets. When utilized, such instruments are characterized for financial statement purposes as available-for-sale. Outstanding futures and options positions are adjusted to market and settled daily. The Company recognizes the daily mark-to-market for futures and options as a component of net realized gains (losses) on securities. Fair value of derivatives is based on a quoted market price. The Company recognizes any unrealized gains (losses) on open forward contracts as realized gains (losses) in the consolidated statement of operations. The Company did not utilize any derivatives in its portfolio during 2011 or 2010.

All debt investment transactions have credit exposure to the extent that a counterparty may default on an obligation to the Company. Credit risk is a consequence of carrying trading and investing positions. To manage credit risk, the Company focuses on higher quality fixed income securities, limits its exposure in any one investment, and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.

Interest income on debt securities is recorded on the accrual basis. Dividend income on equity securities is recorded on the ex-dividend date. Unrealized gains and losses from changes in the fair value of the Company's holdings, net of applicable federal income taxes, are reported as a separate component of equity. Realized gains and losses on the sale of the Company's securities are determined based on specific identification and are included as a separate component of operations.

C. Premiums

Net earned premiums have been computed on a semimonthly pro rata basis over the term of the underlying insurance policies. Ceded reinsurance premiums are charged against premiums earned on the same basis. Unearned premiums represent the portion of the gross premium written which is applicable to the unexpired terms of policies in force. Prepaid reinsurance premiums represent the

portion of unearned premiums ceded to reinsurers. Commissions on reinsurance premiums ceded are considered earned when due and serve to reduce ceded reinsurance premiums.

D. Deferred Policy Acquisition Costs

Acquisition costs consist primarily of fees and premium taxes associated with the acquisition and underwriting of new and renewal insurance business. These acquisition costs are being amortized over the expected policy period of related policies in proportion to the ratio of the annual earned premiums to the total premium revenue anticipated. Anticipated premium revenue was estimated using the same assumptions as those used for computing the reserve for losses and loss adjustment expenses. Expected losses, related expenses, and investment income are considered in measuring the recoverability of this asset.

E. Reserve for Losses and Loss Adjustment Expenses

The reserve for losses and loss adjustment expenses is based on management's individual case estimates of the ultimate cost of reported losses and estimates for incurred but not reported losses ("IBNR") determined in consultation with independent professional actuaries. The method of making IBNR estimates and for establishing the resulting reserves is based on actuarial assumptions as to future contingencies and as to the applicability of other data sources which the Company's independent actuaries deem to be reasonable and appropriate in the circumstances. However, given the nature of the Company's business, the ultimate amount of losses and loss adjustment expenses may vary significantly from the estimated amounts. Due to this uncertainty, the appropriateness of the current level of such estimated liability can only be determined with the passage of time.

F. Provision for Income Taxes

As required by authoritative accounting guidance, the Company uses the balance sheet method of accounting for deferred income taxes including the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. Interest and penalties are classified as other interest expense and are included in underwriting, general and administrative expenses in the Consolidated Statement of Operations. There were no interest or penalties incurred in 2011 or 2010.

Deferred income taxes arise principally from differences between the timing of expense or income recognition of deferred policy acquisition costs, loss reserve discounting, bond accretion, unrealized gains and losses, and the revenue offset for unearned premium reserves. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. No valuation allowance was deemed necessary at December 31, 2011 and 2010.

G. Reinsurance

The Company utilizes both treaty and facultative reinsurance to provide protection for claims in excess of the Company's normal retention limits ($3 million). Under the Company's annual treaty reinsurance program (which runs from April 1 to March 31), limits up to $15 million, less the Company's normal retention, are automatically assumed by the treaty participants. Maximum recoveries under the reinsurance treaties are capped at $100 million for the treaty years ending March 31, 2005 (" '04 Treaty") and subsequent, and at $120 million for the treaty years ending March 31, 2004 (" '03 Treaty"), and March 31, 2003 (" '02 Treaty"). A sub limit of $91 million is further imposed on the $7 million excess of $3 million layer for the '03 Treaty and the '02 Treaty.

A treaty year remains open until all noticed claims are paid or otherwise closed. As of December 31, 2011, ceded losses under all of the open treaty years were well below the respective treaty caps with the exception of the 2003 treaty year, where they are equal to the cap for that year. Future adverse development on any of the treaty years could result in the respective caps for such treaty years being exceeded and such excess amounts, if any, would have to be paid out of the Company's earnings and surplus. While management believes that the Company is adequately capitalized to meet its ongoing claims obligations, there can be no assurance that in the event a cap on a reinsurance treaty is exceeded, the Company's resources would be sufficient to meet all of its claims liabilities.

For those insureds that require limits in excess of $15 million on Fidelity Bonds, the Company issues additional limits of up to $5 million. For limits above $20 million on Fidelity Bonds or $15 million on D&O/E&O Policies, the Company purchases facultative (case by case) reinsurance from various other reinsurers. There is no cap on facultative reinsurance except for the actual limits reinsured. In addition, from time to time, the Company may elect to retain up to $5 million in additional limits in the excess layers.

Although reinsurance agreements contractually obligate the Company's reinsurers to reimburse it for their proportionate shares of losses, they do not discharge the primary responsibility of the Company. Thus, in the event a reinsurer did not meet its obligation under its agreement with the Company, the Company would be responsible for such amount.

The Company monitors the credit worthiness of its reinsurers and only conducts business with reinsurers that are highly rated by reputable rating agencies. As of December 31, 2011, the Company had no reason to believe that any amounts currently due from reinsurers will prove uncollectible. Accordingly, the Company has not made a separate provision for any amounts that might ultimately prove to be uncollectible from reinsurers in the future.

The '04 and '05 Treaties contain a profit-sharing feature by which the Company may recover up to 20% of the profits recognized by reinsurers on those Treaties after they have recovered any losses they may have incurred on prior treaties with the Company. The amount of the profit commission can be adjusted up or down depending on the results of the underlying treaties until such time as all

of the claims for those particular treaty years are closed. The Company recognized $344 in profit commission gain and $323 of profit commission loss as a result of these features in 2011 and 2010, respectively.

H. Cash and Cash Equivalents

The Company considers all cash on hand and deposits in banks as cash and cash equivalents for purposes of the Consolidated Statement of Cash Flows.

I. Furniture and Fixtures

Furniture and fixtures are stated at cost net of accumulated depreciation. The costs of additions and improvements, including leasehold improvements, are capitalized while expenditures for maintenance, repairs, and minor renewals are charged to expense as incurred. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation and amortization are eliminated from the accounts and any resulting gain or loss is reflected in income. Depreciation of leasehold improvements is offset by the amortization of a rent incentive allowance. Provisions for depreciation are computed using the straight-line method based on useful lives ranging from three to twelve years. Depreciation expense was $178 and $175 for 2011 and 2010, respectively. Accumulated depreciation totaled $877 and $798 at December 31, 2011 and 2010, respectively.

J. Recent Accounting Pronouncements

Recently Adopted Accounting Standards

In January 2010, the Financial Accounting Standards Board ("FASB") issued standards requiring new disclosures regarding (i) transfers in and out of Level 1 and Level 2 fair value measurements and (ii) activity in Level 3 fair value measurements. This guidance also clarifies existing disclosures regarding (i) the level of asset and liability disaggregation and (ii) fair value measurement inputs and valuation techniques. The guidance is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to provide Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010; early adoption is permitted. The adoption of this guidance, effective January 1, 2010, did not have a material effect on the Company's consolidated financial statements.

Recently Issued Accounting Standards Not Yet Adopted

In October 2010, the FASB issued guidance that specifies the accounting treatment for the costs incurred by insurance entities when acquiring new and renewal insurance contracts. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011 and should be applied prospectively upon adoption. The Company has evaluated the

impact the ultimate implementation of the amendments in this update will have on its consolidated financial statements and does not believe they will be material.

K. Reclassifications

Certain amounts in prior years' Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2011 presentation.

L. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The Company has evaluated all such events occurring subsequent to the balance sheet date herein of December 31, 2011 and through the date the financial statements were available to be issued of April 25, 2012. The effects of all subsequent events that provided additional evidence about conditions that existed at the date of the balance sheet, including estimates, if any, have been recognized in the accompanying Consolidated Balance Sheet and Consolidated Statements of Operations as of and for the twelve month period ended December 31, 2011. The Company did not recognize subsequent events that provided evidence about conditions that arose after the balance sheet date.

2. Investments

A summary comparison of amortized cost and fair value of debt securities is as follows:

	December 31, 2011			
Debt securities available for sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government, agencies and authorities securities	$ 55,581	$ 3,597	$ -	$ 59,178
Mortgage-backed	57,402	2,371	(263)	59,510
All other corporate bonds	100,800	7,527	(1,625)	106,702
Total debt securities	$ 213,783	$ 13,495	$ (1,888)	$ 225,390

	December 31, 2010			
Debt securities available for sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government, agencies and authorities securities	$ 55,855	$ 1,128	$ (1,119)	$ 55,864
Mortgage-backed	53,864	2,061	(687)	55,238
All other corporate bonds	112,763	5,215	(2,251)	115,727
Total debt securities	$ 222,482	$ 8,404	$ (4,057)	$ 226,829

Included in the above fair value amounts at December 31, 2011 and 2010 is approximately $56,496 and $79,854, respectively, invested in securities such as U.S. Treasury strips, collateralized mortgage obligations, and other corporate asset-backed securities.

The amortized cost and fair value of debt securities at December 31, 2011, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	$ 6,059	$ 6,178
Due after one year through five years	37,234	39,479
Due after five years through ten years	64,747	69,105
Due after ten years	105,743	110,628
Total debt securities	$ 213,783	$ 225,390

A summary comparison of cost and fair value of equity securities is as follows:

	December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Common stock	$ 19,105	$ 5,045	$ -	$ 24,150

	December 31, 2010			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Common stock	$ 15,954	$ 6,404	$ -	$ 22,358

At December 31, 2011 and 2010, the net unrealized gains or (losses) on investments in debt and equity securities of $10,824 and $6,988, respectively, have been reflected in the Consolidated Balance Sheets as a component of accumulated other comprehensive income, net of deferred taxes of $5,828 and $3,763, respectively.

There are three key investment risks that can impact an investment portfolio: Liquidity Risk, Credit Risk and Market Risk.

1. **Liquidity Risk**: Market conditions create a situation where liquid assets become illiquid. To offset this risk, the Company maintains significant cash balances and holdings in U.S. Treasury securities.

2. **Credit Risk**: An issuer (or counterparty) is unable to pay their claim and defaults. To offset this risk, the Company maintains a well-diversified portfolio containing high quality fixed income securities. 88% of the portfolio is rated investment grade (BBB- or higher). The portfolio is also closely monitored for downgrades on corporate bonds and cash flows on structured securities.

3. **Market Risk:** Falling market value due to changing risks in a sector or interest rate risks. The Company also maintains diversity with no more than 25% allocation to any one fixed income sector.

Unrealized loss position securities:

	December 31, 2011				
Debt securities available for sale	Fair Value	Gross Unrealized Losses < 12 months	Gross Unrealized Losses > 12 months	Total Gross Unrealized Losses	Numbers of Investment Positions
U.S. Government, agencies and authorities securities	$ 36	$ -	$ -	$ -	2
Mortgage-backed	1,762	(6)	(258)	(264)	8
All other corporate bonds	13,320	(88)	(1,536)	(1,624)	24
Total securities	$ 15,118	$ (94)	$ (1,794)	$ (1,888)	34

	December 31, 2010				
Debt securities available for sale	Fair Value	Gross Unrealized Losses < 12 months	Gross Unrealized Losses > 12 months	Total Gross Unrealized Losses	Numbers of Investment Positions
U.S. Government, agencies and authorities securities	$ 20,681	$ (398)	$ (721)	$ (1,119)	8
Mortgage-backed	11,541	(91)	(596)	(687)	20
All other corporate bonds	32,358	(606)	(1,645)	(2,251)	45
Total securities	$ 64,580	$ (1,095)	$ (2,962)	$ (4,057)	73

The Company does not have the intent to sell nor is it more likely than not that the Company will be required to sell debt securities in unrealized loss positions that are not other-than-temporarily impaired before recovery.

Other-Than-Temporary Impairment Evaluations

The Company reviews its investment securities regularly and determines whether other-than-temporary impairments have occurred. For fixed maturities, if a decline in fair value is judged by management to be other-than-temporary, and the Company does not intend to sell the security and it is not more likely than not that it will be required to sell the security prior to recovery of the security's amortized cost, the impairment is bifurcated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to interest and all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized by a charge to total other-than-temporary impairment losses in the Consolidated Statements of Operations, establishing a new cost basis for the security. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income in the Statement of Operations. The factors considered by management in its regular review include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; subordinated credit support; whether the issuer of a debt security has remained current on principal and interest payments; current expected cash flows; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions (including, in the case of fixed maturities, the effect of changes in market interest rates); and the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis.

In assessing corporate debt securities for other-than-temporary impairment, the Company evaluates the ability of the issuer to meet its debt obligations and the value of the company or specific collateral securing the debt position. When evaluating whether a mortgage-backed security is other-than-temporarily impaired, the Company examines characteristics of the underlying collateral, such as delinquency and default rates, the quality of the underlying borrower, the type of collateral in the pool, the vintage year of the collateral, subordination levels within the structure of the collateral pool, the Company's intent to sell the security and whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis. For all debt securities evaluated for other-than-temporary impairment (for which the Company does not have the intent to sell and it is not more likely than not that it will be required to sell the security before the recovery of its amortized cost basis), the Company considers the timing and amount of the cash flows.

The Company evaluates its mortgage-backed securities for other-than-temporary impairment using multiple inputs. Loan level defaults are estimated using appropriate modeling techniques. All bonds are modeled individually and each bond is assigned a custom default assumption based on projections for the mortgage pool, historical underlying collateral performance, and borrower characteristics.

Basic inputs to the model include data on:

- voluntary prepayments,
- defaults and,
- expected severity of losses in a liquidation scenario, taking into account loan size, geographic concentration, and loan to value percentages.

Additional variables are applied to each mortgage pool specific to structural elements such as triggers and financial guarantees to the extent that they exist. The cash flows generated by the collateral securing these securities are then determined with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issuer's position in the overall structure, to determine the cash flows associated with the mortgage-backed security held by the Company.

To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost, a credit loss exists, and an other-than-temporary impairment is recognized through earnings. It is reasonably possible that further declines in estimated fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further other-than-temporary impairments in the near term, which could be significant.

In addition, the Company evaluates other asset-backed securities for other-than-temporary impairment by examining similar characteristics referenced above for mortgage-backed securities. The Company evaluates U.S. Treasury securities and obligations of U.S. Government corporations, U.S. Government agencies, and obligations of states and political subdivisions for other-than-temporary impairment by examining similar characteristics referenced above for corporate debt securities.

Equity securities may experience other-than-temporary impairment in the future based on the prospects for full recovery in value in a reasonable period of time and the Company's ability and intent to hold the security to recovery. If a decline in fair value is judged by management to be other-than-temporary, a loss is recognized by a charge to total other-than-temporary impairment losses in the consolidated statements of operations. For the purpose of other-than-temporary impairment evaluations, preferred stocks are treated in a manner similar to debt securities.

Other-than-temporary impairments included in net realized losses on securities in the consolidated statements of operations were $0 and $1,355 in 2011 and 2010, respectively.

Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalance in liquidity that exist in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

Proceeds from sales of debt securities and the associated gross realized gains and gross realized losses are as follows:

	Proceeds from Sales	Gross Realized Gains	Gross Realized Losses
For the year ended December 31, 2011	$ 65,901	$ 1,718	$ (1,244)
For the year ended December 31, 2010	$ 92,372	$ 723	$ (4,797)

Proceeds from sales of equity securities and the associated gross realized gains and gross realized losses are as follows:

	Proceeds from Sales	Gross Realized Gains	Gross Realized Losses
For the year ended December 31, 2011	$ -	$ -	$ -
For the year ended December 31, 2010	$ 38	$ -	$ -

Net investment income is calculated as follows:

	2011		
Debt securities available for sale	Gross Investment Income	Investment Expenses	Net Investment Income
U.S. Government, agencies and authorities securities	$ 1,655	$ (92)	$ 1,563
Mortgage-backed	1,940	(108)	1,832
All other corporate bonds	4,667	(260)	4,407
Equity securities	502	(28)	474
Total	$ 8,764	$ (488)	$ 8,276

	2010		
Debt securities available for sale	Gross Investment Income	Investment Expenses	Net Investment Income
U.S. Government, agencies and authorities securities	$ 1,416	$ (78)	$ 1,338
Mortgage-backed	2,705	(149)	2,556
All other corporate bonds	4,685	(259)	4,426
Equity securities	406	(22)	384
Total	$ 9,212	$ (508)	$ 8,704

3. Fair Value

The valuation techniques required by the authoritative accounting guidance on fair value measurements are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market expectations. These two types of inputs create the following fair value hierarchy:

Level 1 - Quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 - Instruments where significant value drivers are unobservable.

When available, the Company utilizes quoted market prices to determine fair value and classify such items in Level 1. In some cases, quoted market prices are used for similar instruments in active markets and/or model-derived valuations where inputs are observable in active markets and classify such items in Level 2. When there are limited or inactive trading markets, the Company utilizes industry–standard pricing methodologies, including discounted cash flow models, whose inputs are based on management assumptions and available current market information. These items are classified in Level 3. Further, the Company relies upon independent pricing vendors to assist in valuing certain instruments.

The following section describes the valuation methodologies used by management to measure different financial instruments at fair value.

Investments in fixed maturities and equity securities:

Pricing Level 1: Valuation is based on quoted prices in active markets that are readily available. These securities do not entail a significant degree of judgment. This includes exchange traded mutual funds. Holdings consist of three index mutual funds with a total market value of $24,150.

Pricing Level 2: Valuation is based on quoted prices for similar assets. This would include any bonds priced by Interactive Data Corporation ("IDC"), including Treasuries and all other fixed income securities, with the exception of the four securities highlighted below.

Pricing Level 3: Valuation is derived from techniques such as broker quotes, pricing matrices and internal calculations. Holdings consist of four securities with a total market value of $192.

Priority of market value methodology:

1. Price from an independent pricing service, such as IDC
2. Market price from a broker-dealer
3. Matrix pricing

All of the prices are monitored month-over-month to highlight any significant price change. Any security with a significant price change is verified using a secondary pricing source and/or verification from a broker-dealer.

The following is a summary of the inputs used in valuing the Company's assets at fair value:

	December 31, 2011	Quoted Prices (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment in debt securities	$ 225,390	$ -	$ 225,198	$ 192
Investment in equity securities	24,150	24,150	-	-
Total	$ 249,540	$ 24,150	$ 225,198	$ 192

	December 31, 2010	Quoted Prices (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment in debt securities	$ 226,829	$ -	$ 226,197	$ 632
Investment in equity securities	22,358	22,358	-	-
Total	$ 249,187	$ 22,358	$ 226,197	$ 632

It is the Company's policy to recognize transfers of assets between levels of the fair value hierarchy at the end of a reporting period. For the twelve months ending December 31, 2011, there were no transfers of assets between Level 1 and Level 2 of the fair value hierarchy. No securities were transferred out of Level 2 and into the Level 3 category as a result of limited or inactive markets during 2011. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow.

The changes in the carrying value of Level 3 assets for the twelve months ended December 31, 2011 are summarized as follows:

	Balance at 1/1/2011	Total Gains and Losses included in Net Income	Unrealized in Other Comprehensive Income	Purchases, issuances, sales and settlements	Transfer in and/or out of Level 3	Balance at 12/31/2011
ABS	$ 108	$ 1	$ 7	$ (31)	$ -	$ 85
CMO	121	-	5	(19)	-	107
RMBS	-	-	-	-	-	-
CMBS	403	(268)	244	(379)	-	-
Corporate bonds	-	-	-	-	-	-
Preferred stocks	-	-	-	-	-	-
	$ 632	$ (267)	$ 256	$ (429)	$ -	$ 192

	Balance at 1/1/2010	Total Gains and Losses included in Net Income	Unrealized in Other Comprehensive Income	Purchases, issuances, sales and settlements	Transfer in and/or out of Level 3	Balance at 12/31/2010
ABS	$ 640	$ (117)	$ 222	$ (637)	$ -	$ 108
CMO	142	26	(10)	(37)	-	121
RMBS	-	-	-	-	-	-
CMBS	306	-	214	(117)	-	403
Corporate bonds	-	-	-	-	-	-
Preferred stocks	-	-	-	-	-	-
	$ 1,088	$ (91)	$ 426	$ (791)	$ -	$ 632

4. Deferred Policy Acquisition Costs

The deferred policy acquisition costs at December 31, 2011 and 2010 are comprised of the following:

	2011	2010
Beginning balance	$ 4,128	$ 4,201
Additional costs capitalized		
Underwriting expenses	3,826	4,012
Royalty fees (Note 7)	885	899
Premium taxes	2,214	2,250
	6,925	7,161
Less current year amortization		
Underwriting expenses	3,850	3,940
Royalty expense (Note 7)	873	941
Premium taxes	2,187	2,353
	6,910	7,234
Ending balance	$ 4,143	$ 4,128

5. Contributed Surplus (Mutual only)

Mutual has two classes of Members: Participating and Non-Participating. Participating Members are required to make a capital contribution ("reserve premium") equal to 100% of initial annual premium, if membership was applied for before July 31, 1987, or 125% of initial annual premium if membership was applied for after that date. The reserve premium with respect to a policy is required to be repaid to the participating member within 60 days if Mutual terminates or fails to renew the policy; in all other cases, the reserve premium generally is not required to be repaid for five years after the insured cancels, terminates, or fails to renew the policy. Non-Participating Members are not required to contribute capital. Participating Members receive dividends, share in the Company's net worth, and receive a higher proportion of votes on corporate governance matters than Non-Participating Members.

At December 31, 2011 and 2010, $3,344 and $3,300, respectively, related to reserve premiums for terminated policies which were included in contributed surplus. Of the premiums written, 31.3% and 32.5% were attributable to Non-Participating Members during the years ended December 31, 2011 and 2010, respectively.

6. Provision for Income Taxes

The provision for income taxes consists of the following:

	2011	2010
Current provision	$ 3,976	$ 6,060
Deferred provision	(662)	(1,818)
Provision for income taxes	$ 3,314	$ 4,242

Set forth below is a reconciliation of the expected and actual income tax provision:

	2011	2010
Expected tax provision at 35%	$ 4,718	$ 4,470
Tax exempt income from municipal bonds	(401)	(401)
State income taxes	109	158
Dividend received deduction	(105)	-
Reconciling tax adjustment	(899)	-
Provision to return adjustments	(120)	27
All other, net	12	(12)
Actual provision for income taxes	$ 3,314	$ 4,242

During 2011, the Company identified the need for a reconciling tax adjustment that was primarily related to accounting differences between book and tax that had accumulated over prior periods. The reconciling adjustment recorded in its 2011 financial statements resulted in a $899 reduction in the provision for income taxes as seen above.

The Company files a consolidated federal income tax return. Income tax provisions are allocated to the Company's wholly-owned subsidiaries as if they had been calculated on a separate company basis. State income taxes are paid by Mutual, Brokers and Services on a separate company basis. Net payments for federal income taxes were $5,701 and $5,000 in 2011 and 2010, respectively.

The deferred income tax amounts reflected in the consolidated balance sheets at December 31, 2011 and 2010 are comprised of the following items:

	2011	2010
Net unearned premiums	$ 958	$ 919
Discounting of loss reserves	1,902	2,509
Deferred policy acquisition costs	(1,450)	(1,492)
Net unrealized gains on investments	(5,828)	(3,763)
Post-retirement employee benefits	2,139	1,565
Bond discount accretion	(637)	(1,859)
Other than temporarily impaired securities	1,413	2,866
Nondeductible portion of policyholder dividend	1,960	1,645
Nondeductible capital loss carry forward	1,708	1,000
Other	526	442
	$ 2,691	$ 3,832

The Company believes that as of December 31, 2011, there were no material uncertain tax positions that would require disclosure under GAAP. As of December 31, 2011, the Company's 2010, 2009, and 2008 tax years were open under current Internal Revenue Service regulations and as such, potentially subject to examination.

7. Related Party Transactions

Mutual is party to a royalty agreement and a services and facilities agreement with the ICI. Under the royalty agreement, Mutual is required to pay 1% of gross annual premium as a royalty fee to the ICI, limited to a total maximum of $1,000 in any calendar year. Royalty fees paid for 2011 and 2010 were $856 and $898, respectively.

The services and facilities agreement requires the Company to reimburse the ICI for actual direct and indirect expenses incurred on behalf of the Company. Service and facility fees amounted to approximately $768 and $714 for 2011 and 2010, respectively.

Amounts payable at December 31, 2011 and 2010 under these agreements were approximately $55 and $169, respectively.

8. Reinsurance Agreements

The Company utilizes reinsurance agreements to provide protection for claims in excess of the Company's normal retention limits. In addition, the Company may utilize reinsurance agreements to provide increased limits of liability on a case-by-case basis.

The Company reports ceded reinsurance balances on a gross basis. Accordingly, the following balance sheet accounts are grossed up by the amounts noted below:

	2011	2010
Reserve for losses and loss adjustment expenses	$ 126,562	$ 288,260
Unearned premiums	$ 39,314	$ 38,754

At December 31, 2011 and 2010, reinsurance recoverable was concentrated with two third party reinsurance groups, Travelers Insurance Companies (approximately 26% and 27% respectively) and Lloyds of London (approximately 12% and 14% respectively).

Insurance risks ceded to reinsurance companies would become a liability in the event the reinsurers are unable to meet their obligations assumed under reinsurance contracts.

Premiums and losses by the Company in 2011 and 2010 have been adjusted as follows as a result of voluntary reinsurance:

	2011		2010	
Premiums	**Written**	**Earned**	**Written**	**Earned**
Direct and assumed	$ 88,581	$ 87,464	$ 89,997	$ 94,138
Ceded (net of ceding commission income)	(56,924)	(56,363)	(59,054)	(63,064)
Net	$ 31,657	$ 31,101	$ 30,943	$ 31,074

Losses and loss adjustment expenses	**2011**	**2010**
Direct	$ (10,528)	$ 129,276
Ceded	(22,446)	(125,923)
Net	$ 11,918	$ 3,353

9. Reserve for Losses and Loss Adjustment Expenses

The following table sets forth a reconciliation of beginning and ending reserve for losses and loss adjustment expenses, as shown, in the Company's consolidated financial statements for the periods indicated:

	2011	2010
Balance at January 1	$ 360,353	$ 261,989
Less reinsurance recoverable, unpaid losses	(288,260)	(185,086)
Net balance at January 1	72,093	76,903
Incurred related to		
Current year	21,251	25,198
Prior years	(9,333)	(21,845)
Total incurred	11,918	3,353
Paid related to		
Current year	244	3,356
Prior years	25,394	4,807
Total paid	25,638	8,163
Net balance at December 31	58,373	72,093
Plus reinsurance recoverable, unpaid losses	126,562	288,260
Balance at December 31	$ 184,935	$ 360,353

As a result of changes in estimates of incurred losses related to insured events of prior years, the reserve for losses and loss adjustment expenses decreased $9,333 and $21,845, in 2011 and 2010 respectively, primarily as a result of favorable developments on certain claims that arose in the 2003, 2005 and 2006 calendar years. As additional historical loss experience information is obtained, the Company will update its estimate of the reserve for losses and loss adjustment expenses.

10. Contingencies

In the normal course of its business activities, the Company may be subject to various asserted and unasserted claims and lawsuits covering a wide range of matters. The Company is not aware of any events that would give rise to a claim at December 31, 2011.

11. Policyholders' Dividend

In determining the level of dividend to declare the Board of Directors ("Board") reviews the financial results of the Company as well as the anticipated capital levels needed to fund the Company's future operations and to maintain the Company's sound financial condition. After a review of all these factors, the Board adopted a formula that resulted in a dividend of $5.3 million being declared in 2011.

The 2011 dividend will be allocated to participating members based equally on each Participating Member's share of the Company's net worth determined at December 31, 2011, before payment of the dividend, and the proportion of 2011 gross earned premium of the Company attributable to each participating member. In accordance with the by-laws of the Company, dividends will only be paid to those eligible participating members that renew a participating policy in the year after the dividend declaration. Dividends on renewed policies will be paid on or around the policy renewal date or May 15, 2012, whichever is later.

As per Title 8, Chapter 141, Section 6005 of the Vermont Statutes, the Company sought and received the approval of the Commissioner of the Department prior to the payment of these dividends.

Given the financial results of 2009 coupled with 2010 interim results, the Board elected to pay a supplemental dividend of $3 million to participating members of record on June 30, 2010. Based on the projected results and surplus level for the entire year of 2010, the Board elected to declare an additional dividend to participating members of record on December 31, 2010 in the amount of $4.7 million. $7.4 million of the total dividends declared in 2010 have been paid as of December 31, 2011, with the remaining amounts paid as of March 31, 2012.

12. Employee Benefit Plans

A. Retirement Plans

The Company has three retirement plans for its employees: a noncontributory defined benefit plan, a 401(k) defined contribution plan, and a supplemental employee retirement plan.

The noncontributory defined benefit plan ("the Plan") covers substantially all regular full-time employees. The Company uses a December 31st measurement date for the Plan. Plan assets consist of mutual funds, including various debt and equity securities.

The Plan uses the actuarial cost method and the following weighted-average assumptions to determine the benefit obligation and net periodic pension cost for the years ended December 31, 2011 and 2010:

	2011	2010
Discount rate for benefit obligation	5.23%	5.71%
Discount rate for pension cost	5.71%	6.25%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	4.00%	4.50%

Plan amounts recognized in the Consolidated Balance Sheet consist of:

	2011	2010
Assets	$ 428	$ 1,098

Plan amounts recognized in accumulated other comprehensive income, net of tax, consist of:

	2011	2010
Net loss	$ 1,129	$ 592

Other components of the Plan for the years ended December 31, 2011 and 2010, were as follows:

	2011	2010
Projected benefit obligation	$ 6,520	$ 5,359
Fair value of plan assets	6,948	6,457
Funded status of the plan	$ 428	$ 1,098
Employer contributions	$ 479	$ 811
Benefits paid	$ 31	$ 314

The Plan's accumulated benefit obligation is $4,777 as of December 31, 2011 and was $3,673 as of December 31, 2010. Pension expense for the Plan equaled $321 and $298 for the years ended December 31, 2011 and 2010, respectively, and is included in "Underwriting, general and administrative expenses" in the Consolidated Statements of Operations.

The Company determines the long-term expected rate of return on Plan assets by examining historical returns and the Plan's asset allocation. Factors such as inflation and current interest rates are also evaluated. The result is reviewed against benchmarking data to ensure that the return is a reasonable and appropriate assumption.

The Plan's asset allocation at December 31, by asset category, is as follows:

	2011	2010
Asset Category:		
Equities	60.0%	60.0%
Fixed income securities	40.0%	40.0%
Total	100.0%	100.0%

The Company's expected long-term rate of return and projected asset allocation are as follows:

	Expected Rate of Return	Guideline Asset Allocation	Expected Net Rate of Return
Asset Category:			
Equities	9.0%	60.0%	5.4%
Fixed income securities	5.0%	40.0%	2.0%
Total		100.0%	7.4%

	Guideline Allocation	Permissible Range
Asset Category:		
Equities	60.0%	+ – 1%
Fixed income securities	40.0%	+ – 1%

The Plan's assets will be invested in a prudent manner for the exclusive purpose of providing benefits to Plan participants. The Company's objective is to maximize the return on assets, over the long term, by investing a majority of assets in equities. The inclusion of additional asset classes with differing rates of return, volatility, and correlation are utilized to reduce the risk by providing diversification relative to equities. The Company's investment policy states that equities will comprise 60% of assets, and fixed income securities 40% of assets. The actual allocation will be compared to the target allocation monthly and if any fund allocation is more than one percentage point different than the target, funds will be bought or sold to bring the allocation to the target.

The Company made contributions of $479 and $811 to the Plan for the years ended December 31, 2011 and 2010, respectively, which were in excess of the minimum required ERISA contributions. The Company's funding policy is to contribute the maximum tax deductible amount and to fund at an amount equal to, or greater than 150% of the Plan's accumulated benefit obligation.

The estimated net loss and prior service cost for the Plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $71 and $37, respectively.

Benefit payments expected to be paid from the Plan over the next five years and accumulated over the five years thereafter are as follows as of December 31:

Year	Benefits
2012	$ 117
2013	$ 120
2014	$ 114
2015	$ 102
2016	$ 1,420
2017-2021	$ 3,583

The 401(k) defined contribution plan covers substantially all employees. Effective January 1, 2007, the Company contributes amounts to the plan sufficient to credit each participant's account with an amount equal to 3% of the participant's eligible compensation, subject to IRS limitations, during the plan year. In addition, the Company matches 100% of the first 1% and 50% of the next 1% of employee voluntary contributions of the participant's eligible compensation. Participants are not required to contribute to the plan. Participants may voluntarily contribute up to 50% of eligible compensation paid to the participant during the plan year up to a maximum of $16.5. The Company contributed approximately $129 and $144 to this plan in 2011 and 2010, respectively.

The Company has a supplemental employee retirement plan ("SERP") for certain key employees. The SERP provides benefits equal to what would be available under both the qualified non-contributory defined benefit plan and the 401(k) defined contribution plan, if there were no statutory limitations on the amount of compensation that could be covered by the qualified plans.

Defined Benefit Component:

SERP amounts recognized in the Consolidated Balance Sheet consist of:

	2011	2010
Liabilities	$ 1,757	$ 1,338

SERP amounts recognized in accumulated other comprehensive income, net of tax, consist of:

	2011	2010
Net loss	$ 298	$ 183

Other components of the SERP for the years ended December 31, 2011 and 2010 were as follows:

	2011	2010
Benefit obligation	$ 1,757	$ 1,338
Fair value of plan assets	-	-
Funded status of the plan	$ (1,757)	$ (1,338)
Employer contributions	$ -	$ -
Benefits paid	$ -	$ -

The SERP's accumulated benefit obligation is $1,228 as of December 31, 2011 and was $796 as of December 31, 2010. Included in "Underwriting, general and administrative expenses" in the accompanying consolidated statements of operations at December 31, 2011 and 2010, are amounts attributable to this plan of approximately $242 and $187, respectively. The Company anticipates contributing amounts equal to the benefits payable during future plan years.

The estimated net loss and prior service cost for the SERP that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $42 and $3, respectively.

Benefit payments expected to be paid from the SERP over the next five years and accumulated over the five years thereafter are as follows as of December 31:

Year	Benefits
2012	$ -
2013	$ -
2014	$ -
2015	$ -
2016	$ 1,873
2017-2021	$ 1,876

The accrued liability included in the consolidated balance sheet for the defined contribution component of the SERP was $158 at December 31, 2011 and $130 at December 31, 2010. Amounts recognized in the consolidated statement of operations for the defined contribution component of the SERP were $28 at December 31, 2011 and $27 at December 31, 2010.

B. Postretirement Benefit Plan

The Company provides health benefits to employees and retirees. The Company recognizes the expected cost of these benefits during the years in which employees render service. No assets are set aside for postretirement health benefits.

The Company has determined that any benefits to be derived under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Act") would be outweighed by the costs involved in applying for benefits under the Act. Consequently, the Company has not applied for benefits under the Act and any measures of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the Company's postretirement medical benefit plan.

Plan amounts recognized in the Consolidated Balance Sheet consist of:

	2011	2010
Liabilities	$ 1,647	$ 1,346

Plan amounts recognized in accumulated other comprehensive income, net of tax, consist of:

	2011	2010
Net loss	$ 447	$ 319

Other components of the plan for the years ended December 31, 2011 and 2010, were as follows:

	2011	2010
Benefit obligation	$ 1,647	$ 1,346
Fair value of plan assets	-	-
Funded status of the plan	$ (1,647)	$ (1,346)
Employer contributions	$ 38	$ 31
Benefits paid	$ 42	$ 32

The following table shows the plan's obligation by participant as well as assumed discount rates:

	2011	2010
Retirees	$ (599)	$ (496)
Other active participants	(1,048)	(850)
Accumulated postretirement benefit obligation	$ (1,647)	$ (1,346)
Weighted average assumed discount rate to determine:		
The benefit obligation	5.17%	5.71%
The net benefit cost	5.71%	6.25%

Included in "Underwriting, general and administrative expenses" in the accompanying consolidated statements of operations at December 31, 2011 and 2010, are amounts attributable to this plan of approximately $143 and $124, respectively.

The Company's policy is to contribute the amount required to fund postretirement benefits as they become due to retirees. The amount expected to be required in contributions to the plan during 2012 is $34.

The estimated net loss and prior service cost for the plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $32 and $0, respectively.

Benefit payments expected to be paid from the plan over the next five years and accumulated over the five years thereafter are as follows as of December 31:

Year	Benefits
2012	$ 34
2013	$ 43
2014	$ 54
2015	$ 66
2016	$ 62
2017-2021	$ 348

For measurement purposes, a 8.5% increase in healthcare costs was assumed for fiscal year 2011, increasing to 9.0% in 2012, trending down to 5.0% in 2020 and thereafter. A 1% increase in this rate would increase the postretirement benefit obligation by $341 and the service and interest cost by $29. A 1% decrease in this rate would decrease the postretirement benefit obligation by $266 and the service cost and interest cost by $22.

C. Deferred Compensation Plan

During 2010, the Company adopted a deferred compensation plan for certain key employees. The amount and timing of awards to participants is at the sole discretion of the Company and amounts remain unfunded and unvested until the employee meets all of the criteria established by the Company for payment of the awarded amounts. Included in "Underwriting, general and administrative expenses" in the accompanying consolidated statements of operations at December 31, 2011 and 2010 are amounts attributable to this plan of approximately $110 and $312, respectively.

13. Other Comprehensive Income

The Company's other comprehensive income is calculated as follows:

For the Year Ended December 31, 2011	Pretax Amount	Tax Expense or Benefit	Net of Tax Amount
Net unrealized gains on investments			
Net unrealized gains arising during the period	$ 6,375	$ 2,231	$ 4,144
Reclassification adjustment for gains realized in net income	(474)	(166)	(308)
Net unrealized losses on employee benefit plans	(1,200)	(420)	(780)
Other comprehensive income	$ 4,701	$ 1,645	$ 3,056

For the Year Ended December 31, 2010	Pretax Amount	Tax Expense or Benefit	Net of Tax Amount
Net unrealized gains on investments			
Net unrealized gains arising during the period	$ 9,371	$ 3,280	$ 6,091
Reclassification adjustment for losses realized in net income	5,429	1,900	3,529
Net unrealized losses on employee benefit plans	(918)	(322)	(596)
Other comprehensive income	$ 13,882	$ 4,858	$ 9,024

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A Risk Retention Group

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Selected Financial **Highlights**

dollar amounts in thousands	*for the years ended* **2011**	**2010**
Gross Written Premiums	$ 88,581	$ 89,997
Net Earned Premiums	$ 31,101	$ 31,074
Net Investment Income	$ 8,276	$ 8,704
Net Loss and Loss Adjustment Expenses	$ 11,918	$ 3,353
Net Underwriting Profit	$ 9,727	$ 16,895
Dividends to Policyholders	$ 5,300	$ 7,694
Net Income	$ 10,167	$ 8,530
Total Equity	$ 213,143	$ 200,184
COMBINED RATIO		
Loss and General Expense Ratio	69%	45%
Policyholder Dividends	17%	25%
Combined Ratio including Policyholder Dividends	86%	70%

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