2012

ANNUAL REPORT

ICI Mutual Insurance Company

A Risk Retention Group

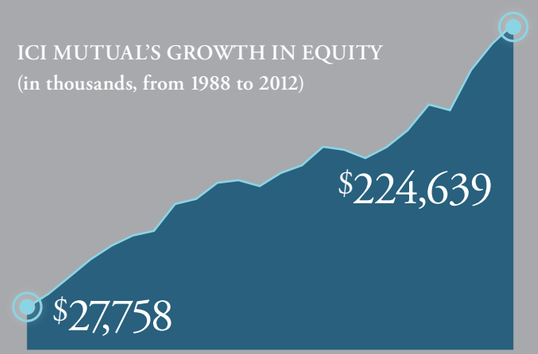
25

years of excellence

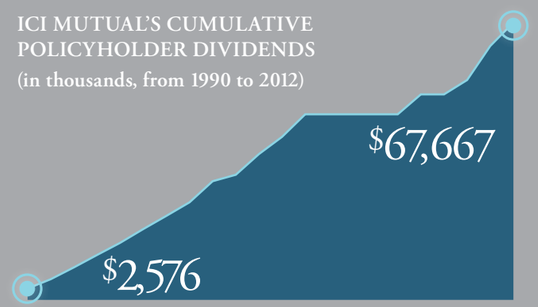
Financial Strength Rating
A M BEST
A Excellent

ICI MUTUAL *at a glance*

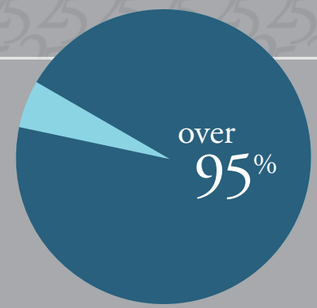
ICI MUTUAL'S GROWTH IN EQUITY
(in thousands, from 1988 to 2012)



ICI MUTUAL'S CUMULATIVE POLICYHOLDER DIVIDENDS
(in thousands, from 1990 to 2012)



Data shown here represents tabulations as of December 31, 2012.



ICI MUTUAL CLIENT RETENTION

$886 MILLION CUMULATIVE CLAIMS INCURRED

ICI MUTUAL INSUREDS REPRESENT

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:

Unequaled industry knowledge and expertise:
We help insureds identify and avoid risk at the front end. We stand behind them if problems occur.

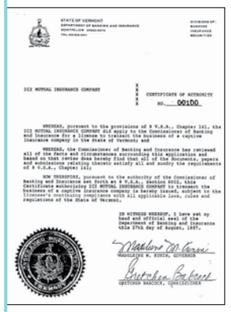
A history of stability and financial strength:
Our coverage has been available and consistent since our inception. And by reinsuring our policies, we've deliberately and prudently spread our own risk.

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

Not just a partner, a *good* partner:
We were created to serve the mutual fund industry and only the mutual fund industry. We answer only to our insureds and their needs.

25 Years of ICI Mutual

ICI Mutual is founded



STATE OF VERMONT
DEPARTMENT OF BANKING AND INSURANCE
MONTPELIER 05620-3101

DIVISION OF
BANKING
INSURANCE
SECURITIES

ICI MUTUAL INSURANCE COMPANY

CERTIFICATE OF AUTHORITY
NO. 00100

WHEREAS, pursuant to the provisions of 8 V.S.A., Chapter 141, the ICI MUTUAL INSURANCE COMPANY did apply to the Commissioner of Banking and Insurance for a license to transact the business of a captive insurance company in the State of Vermont; and

WHEREAS, the Commissioner of Banking and Insurance has reviewed all of the facts and circumstances surrounding the application and based on that review and the fact that the applicant has complied, and undertakes relating thereto satisfy all and satisfy the requirements of 8 V.S.A., Chapter 141.

NOW, THEREFORE, pursuant to the authority of the Commissioner of Banking and Insurance set forth at 8 V.S.A., Section 6002, this Certificate authorizing ICI MUTUAL INSURANCE COMPANY to transact the business of a captive insurance company is hereby issued, subject to the terms of the application and in accordance with all applicable laws, rules and regulations of the State of Vermont.

IN WITNESS WHEREOF, I have set my hand and caused the seal of the Department of Banking and Insurance this 27th day of August, 1987.

MADELINE M. KUNIN, GOVERNOR

BRUTUS N. BROWN, COMMISSIONER

ICI Mutual begins operations with two insurance products: an Investment Company Fidelity Bond and a D&O/E&O Policy with standard coverage for costs of corrections, regulatory investigations, and defense costs

ICI Mutual introduces the first of many technology-related coverages: a bond rider for voice-initiated transactions

Financial Strength Rating
A.M. BEST
A Excellent

ICI Mutual, in its first year of eligibility, earns an "A" (Excellent) rating from A.M. Best

ICI Mutual introduces bond coverages for fraudulent on-line transactions

ICI Mutual publishes its first newsletters: *Claims Trends* and *Risk Manager Alert*

ICI Mutual introduces the Independent Director Safety Net Policy

ICI Mutual publishes its first of 19 Risk Management Studies: *Managing Risk in Processing Corporate Actions*

ICI Mutual introduces the Independent Director Liability Policy

ICI Mutual launches www.icimutual.com and converts to an RRG structure

ICI Mutual publishes its on-line Litigation Notebook and introduces SDDI coverage

ICI Mutual expands Independent Director coverage

$12.5 trillion

INDUSTRY ASSETS UNDER MANAGEMENT

$13 trillion
$12 trillion
$11 trillion
$10 trillion
$9 trillion
$8 trillion
$7 trillion
$6 trillion
$5 trillion
$4 trillion
$3 trillion
$2 trillion
$1 trillion
$0

1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

message from the president and chairman

2012 marks ICI Mutual's 25th anniversary.

Since the Company was founded in 1987, it has been the predominant provider of D&O/E&O liability insurance and fidelity bonding for the mutual fund industry, now insuring over 60% of the industry's assets under management.

Michael J. Downer, Chairman and Lawrence R. Maffia, President

In order to mark this significant milestone, we have asked ICI Mutual's founding president, David Silver, to share his recollections (on page 14) about the formation of the Company and its role in assisting industry leaders and fund directors to achieve effective insurance and risk management solutions.

We are pleased to report that ICI Mutual continued to thrive in 2012. The Company reported net income after dividends and taxes of $9.4 million. Equity grew by 5.9% to reach $224.6 million. In December, the Board of Directors declared a dividend to Participating Members in the amount of $5 million. Management's detailed discussion of 2012's operating results can be found on pages 10 and 11.

2012 in Review

THE INSURANCE MARKET

The market for mutual fund insurance continued to be competitive throughout 2012. While commercial insurers sought to raise primary insurance rates on their existing clients, an over-supply of capacity tended to dampen premium increases. Given ICI Mutual's strategy to maintain stable premium rates, the vast majority of the Company's insureds renewed their coverage at expiring rates. ICI Mutual's client retention rate of over 95% is a testament to its strategy of stable premiums.

COVERAGE ENHANCEMENTS

On July 1, 2012, ICI Mutual introduced several policy enhancements that fortified insurance protections for independent directors. The enhancements, which were added to policies at no cost to insureds:

1) provide additional assurance to independent directors regarding their ability to receive advancements of defense costs, and
2) address the concerns of independent directors over their potential personal exposure to deductible risk.

These enhancements reflect ICI Mutual's commitment to meeting the needs of mutual fund directors and grew out of a series of management interviews with independent directors and the outside counsel who advise them.

SUPPORTING INSUREDS

Personalized service remains an essential component of ICI Mutual's dedication to supporting the needs of the mutual fund industry. In 2012, ICI Mutual staff members visited with over half of the Company's client base and were featured as guest speakers or panelists at a number of industry conferences and events. Meeting with insured fund directors, advisers, and their outside counsel helps ICI Mutual gain a deeper understanding of the risks and issues of greatest concern to insureds and provides ICI Mutual staff with opportunities to share the wealth of knowledge they have accumulated from underwriting and serving the claim needs of well over one hundred insured fund complexes. If you would like ICI Mutual staff to meet with your fund board, please contact your ICI Mutual underwriter or Larry Maffia.

Recognizing the range of individuals who have a significant role in the decision to purchase liability insurance, ICI Mutual expanded its outreach efforts on the world wide web in order to connect with all stakeholders, as described on the next page.

In 2012, ICI Mutual introduced a new outreach program designed especially for outside counsel to funds, their directors, and advisers. Regional luncheon sessions, featuring an introduction/overview regarding mutual fund D&O/E&O insurance presented by members of the Company's legal and underwriting departments and a facilitated roundtable discussion during which counsel are invited to share their insights and ask questions of ICI Mutual's staff, were held in Washington, DC and Boston and attracted over 50 participating attorneys. Additional sessions in New York and other major cities are planned for 2013.

RISK MANAGEMENT SERVICES

ICI Mutual regularly expands its library of risk management publications through its annual *Claims Trends* newsletter and new Risk Management Studies. In 2012, the Company published *Risk Management in the Digital Age: Mobile Computing, Cloud Computing and Social Media*, which focuses on a number of recent developments in technology. This Study provides an introduction to:

1) mobile computing, cloud computing, and social media,
2) the financial, legal, and reputational risks associated with their use, and
3) approaches that fund groups may employ to manage the risks presented by these technologies.

a new look for WWW.ICIMUTUAL.COM

In February 2013, ICI Mutual launched its redesigned website. Along with an updated, clean, easy-to-read look, there are a number of other features designed to make a visit to the website more intuitive, interactive, and productive. Passwords are no longer required in order to view ICI Mutual's Risk Management Studies, *Claims Trends* newsletters, or other intellectual property. The new site has special sections devoted to each of ICI Mutual's key constituencies: Independent Fund Directors, Fund Management, Outside Counsel, Risk Managers, and Brokers. These sections provide answers to the questions most frequently asked by each constituency and direct users to the resources most pertinent to their particular needs and interests. ICI Mutual plans additional enhancements to the site throughout 2013, including opening access to its *Litigation Notebook* to all users.

ICI Mutual's forthcoming Study, a primer on Independent Director Liability (IDL) Insurance, will be published in 2013. Designed as a guide for independent directors and their insurance advisers, the Study provides an introduction and commentary on various considerations related to the purchase of IDL insurance. A complete list of all ICI Mutual Risk Management Studies can be found on page 23.

CLAIMS

2012 was a relatively benign year for new claims. Claim frequency was at the lower end of the historical range of annual claim notices received by ICI Mutual. This was due, in part, to the positive legal precedents that have emerged from court rulings during the past several years. The nature of new claims made during 2012, in general, was less severe as well. No new prospectus liability or excessive fee lawsuits, the most costly claim types, were reported to ICI Mutual. However, the cost of previously reported prospectus liability and fee lawsuits continued to grow.

The most significant claim development over the past two years has been the level of regulatory actions, in particular by the SEC. Enforcement actions against investment advisers and investment companies represented 20% of all SEC enforcement actions, the highest category for the second year in a row. A summation of claims incurred by ICI Mutual over its 25-year history is located on page 13.

Outlook for 2013

As of the date of this letter, ICI Mutual's outlook is that 2013 will see a continuation of the trends experienced in 2012. We expect that commercial insurers will continue their push to increase premium rates to improve their underwriting results across their entire book of business and to offset the continued low returns earned on fixed income investment portfolios. In contrast, ICI Mutual intends to continue to pursue its strategy of maintaining stable premiums and coverage terms. Absent some unanticipated dramatic event, we expect that most insureds will see modest changes in premium rates unless their particular underwriting profile warrants an adjustment. With regard to coverage terms, ICI Mutual will continue to offer the same core coverages it always has; to the extent opportunities arise to enhance coverage terms for all insureds, the Company will seek to do so.

With regard to claims, we expect regulatory actions will continue as the SEC examines areas such as portfolio valuation, omnibus account oversight and the related fees, and fund governance. Other areas ICI Mutual is monitoring for potential claim exposures include the CFTC's new role with regard to mutual funds and their advisers, the outcome of Dodd-Frank rules yet to be written, and resolution of the debate over the $1.00 net asset value offered by money market mutual funds.

On the service front, this past year ICI Mutual staff invested a significant amount of research and development time to create electronic versions of the Company's insurance applications. The "electronic app" is an Adobe Acrobat PDF file which allows multiple people to complete the app, hides those sections and questions that are not applicable to an insured's particular circumstances, and allows documents to be attached to the app and electronically sent to ICI Mutual. The focus group of insureds that tested the new app confirmed our hope that the electronic app will simplify the application process. ICI Mutual began sending the new app to insureds in March. Please use the new electronic format and send us any suggestions or comments you have for how the app can be improved.

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 asset management industry, we strive to be your insurer of choice and partner for many years to come.

Lawrence R. Maffia
President

Michael J. Downer
Chairman of the Board of Directors

POSTSCRIPT *from the president*

As many of you know, I have decided to retire in September of 2013 after a 31 year career in the mutual fund industry, the last seven of which I've spent as president of ICI Mutual. I am looking forward to traveling with my wife, spending time with my two grandchildren, and becoming involved in a volunteer effort here in Washington, DC.

On November 15, 1982, I joined Stein Roe & Farnham as the CFO of its mutual fund family. On that date, the Dow closed at 1021.43 and the yield on the 30-year Treasury was 10.52%. At the end of 1982, mutual fund industry assets were approximately $297 billion and ICI Mutual did not exist. While the scale and complexity of the industry has vastly changed since late 1982, the standards of care I see industry professionals use to serve investors remain at the highest levels. One of the most enjoyable parts of my career has been working with colleagues at fund organizations. I've always marveled at the fact that strong competitors could come together under the umbrella of the Investment Company Institute (ICI) and work together to improve the mutual fund structure for investors.

I have especially enjoyed my tenure at ICI Mutual. Working with the Company's insureds, staff, Board of Directors, and global reinsurance partners has been a wonderful experience and is the part of the job I will miss the most. From a distance, I plan to watch ICI Mutual continue to prosper for its insureds.

ICI Mutual's Board of Directors carefully considered the qualities and capabilities the next President would need to lead the Company. A significant factor in the Board's decision in selecting my successor was the feedback from insureds and reinsurers who were unanimous in their view that the mission, culture, knowledge, and service ethic of ICI Mutual are critical to the continued success of the Company. In my view, the Board's selection of Daniel Steiner to succeed me certainly fits with the view of insureds and reinsurers. Dan, the Company's Executive Vice President and General Counsel, has been deeply involved in the success of ICI Mutual since the Company was formed in 1987. Over the next several months, I will be working closely with Dan to facilitate a seamless transition. I am confident that the Company will continue to flourish under Dan's leadership. Please join me in wishing Dan and the entire ICI Mutual staff much success in the years ahead.

2012 ICI Mutual financial overview

2012 marks the twenty-fifth anniversary of ICI Mutual Insurance Company and the eighth consecutive year that the Company recorded an underwriting profit. ICI Mutual was created by the mutual fund industry to continuously provide relevant insurance coverage to mutual funds, and their directors, officers, and advisers, at prices that reflect mutual fund insurance risks. Management and the Board consider a wide range of factors in their strategic planning and decision making; attaining an underwriting profit in order to maintain the Company's financial strength, as evaluated by A.M. Best, is a key goal. In 2012, the Company recorded an underwriting profit of $5.6 million, of which $5 million will be returned to owner insureds in the form of a dividend credit against their 2013 renewal premiums.

Direct premiums written declined 4.4% to $84.7 million for the year ended 2012. The decline was due primarily to two factors; first, certain policies written in 2011 did not renew in 2012 as a few insureds restructured their insurance programs and others purchased non-recurring tail policies; second, there were policy extensions that resulted in premiums being recognized in 2011 that would otherwise have been recognized in 2012. The decline in premium was partially offset by new business written in 2012, which was on par with prior years. ICI Mutual does not adjust premiums based on cyclical changes in the commercial insurance market. The Company relies on its comprehensive underwriting approach that seeks to charge premiums that are reflective of the underlying risks presented by an insured. In 2012, most insureds renewed their coverage at expiring rates and coverage terms. Those insureds that had improved underwriting results received modest premium decreases, while insureds with deteriorating underwriting results experienced rate increases. Overall, ICI Mutual's renewal premium rates increased less than one percent in 2012.

The decline in direct premiums written was also reflected in net earned premiums (the amount of premium the Company retains after paying for reinsurance to protect the Company against adverse developments in claim frequency and severity). Net earned premiums declined 4.3% to $29.8 million from 2011 levels.

The claims environment for the Company was generally benign in 2012. Net loss and loss adjustment expenses incurred in 2012 amounted to $13.5 million which yielded a loss ratio of 45.3% (loss and loss adjustment expenses divided by earned premiums). 2012's losses incurred were higher than the $11.9 million experienced in 2011, reflecting a modest uptick in claim severity. However, 2012's losses incurred were below the Company's long-term average and well within the range anticipated when the Company prices its products.

The Company's combined ratio for 2012 was 81.1%, before dividends to participating policyholders, and 97.8% after dividends to participating policyholders.

Net investment income equaled $8.1 million in 2012 and $8.3 million in 2011, as the continuing low interest rate environment for the assets the Company typically invests in (high grade fixed income securities—"AA" average quality) offset the additional earnings from the increase in the assets available for investment. The 2012 results also include $3.6 million of net gains on securities as compared to $0.5 million in 2011.

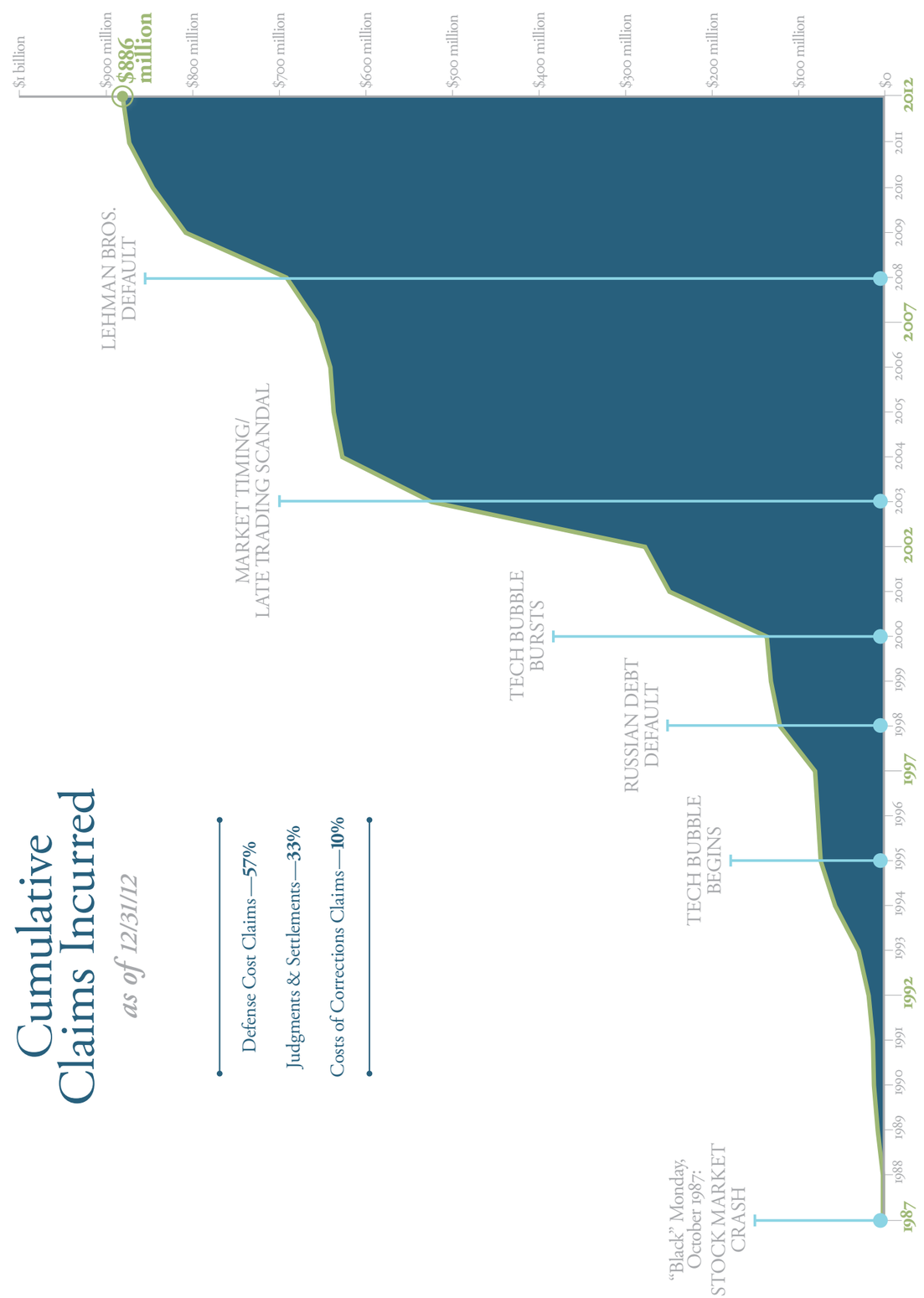
Total equity increased 5.9% to $224.6 million after the inclusion of $9.4 million net income and $3.9 million of net unrealized appreciation on investments, less $0.8 million of other changes, all net of tax. ICI Mutual's primary focus is on meeting the insurance needs of its insureds. As a result, the Board and management continue to believe that maintaining equity at levels in excess of what would be required to support the business it writes is prudent and consistent with the conservative manner in which the Company manages its finances.

The combination of strong underwriting results, a strong balance sheet, and the ongoing conservative financial management of the Company has resulted in A.M. Best Company once again assigning the Company its "A" (Excellent) Financial Strength Rating during 2012.

mutual fund claims environment: YOUTH vs. MATURITY

The graph on the opposite page depicts the cumulative claims incurred (i.e., claim payments plus current loss reserves) by ICI Mutual throughout its history. After 25 years, ICI Mutual has incurred $886 million of claims on behalf of insureds. The growth in claims follows two distinct paths. The first half of ICI Mutual's life, 1987 through 1999, was a relatively benign period for mutual fund claims, during which approximately $130 million (or only 15%) of total claims were incurred. Since 2000, the mutual fund claims environment has changed dramatically, with $756 million of claims incurred. It would be easy to speculate that the upward trajectory is due to claims incurred early in the 2000s as a result of late trading and market timing. However, less than one-half of the $756 million is attributable to these events. Defense costs and settlement payments related to litigation from the bursting of the technology bubble early in the last decade and the credit crisis late last decade, combined with legal costs associated with defending insureds involved in a range of regulatory investigations, have helped to drive the dramatic change in the trajectory of claims. As a further indication of the change in the claims environment, the average claim paid by ICI Mutual post-2000 has been three times larger than the average claim paid pre-2000, despite the substantial growth in insurance deductibles assumed by funds, their directors, officers, and advisers.

Insureds frequently ask what drives the cost of insurance. The answer can be found on the accompanying chart. 57% of claims incurred by ICI Mutual have been to reimburse insureds for legal and other costs of defense, while only 33% have been incurred to reimburse insureds for judgments and settlements. The remainder of incurred claims has been to reimburse insureds for the cost of correcting operational errors. In a highly regulated industry such as the fund industry, regulatory oversight and investigations are a fact of life. ICI Mutual's standard policies provide coverage for both formal and informal regulatory investigations. Indeed, ICI Mutual pioneered coverage for informal regulatory investigations, and even today is unique in the breadth of coverage it provides for these types of claims.



an interview with ICI Mutual's founder

David Silver, a former President of the Investment Company Institute (ICI) *(1977–1991)* and the first President of ICI Mutual *(1987–2001),* met recently with Daniel T. Steiner, ICI Mutual's Executive Vice President and General Counsel, to discuss the conditions that led to the Company's formation and the role of the Company in assisting industry leaders and fund directors to achieve effective insurance and risk management solutions.

DAN: It's a pleasure to speak with you, Dave, as we celebrate ICI Mutual's 25th anniversary. Did you ever envision, back in 1987, that the fund industry and ICI Mutual would experience such growth and success?

DAVE: Twenty-five years ago, many of us at the ICI and in the industry expected a period of substantial growth. We were likewise confident that newly formed ICI Mutual, as an insurer created, owned, and operated by the fund industry, would capture significant market share. As it turned out, right from the beginning, ICI Mutual proved highly successful, and today the Company remains the predominant provider of liability insurance for the fund industry. What ICI Mutual has achieved, in terms of growth and percentage of industry assets covered, has been very gratifying to me.

DAN: You were a chief architect in the fund industry's creation of ICI Mutual. What were the precipitating events that led to the Company's formation?

DAVE: Two events stand out. The first was the savings and loan crisis of the mid-1980s. The crisis resulted in an extraordinary increase in the level of premiums charged by commercial insurers, unrelated to mutual fund industry claims, and some fund groups were having difficulty in securing insurance coverage at any price. This situation highlighted the importance to our industry of having a stable, long-term source of liability insurance at prices that reflected mutual fund risks.

The second event was a growing "disconnect" between the type of corporate liability coverage offered by most commercial insurance companies to financial companies, and the coverage needs of the fund industry. This disconnect reflected a failure by commercial insurers to understand that the mutual

fund industry, as the "new kid on the block," had very different risk exposures than traditional financial institutions. Industry leaders realized the importance of having an insurer with the knowledge and ability to rapidly develop and offer appropriate coverages to meet the evolving risks to which mutual funds, their directors, officers, and advisers were subject.

***DAN:** As part of its mission, the Company has always sought to serve as a ballast to shield the fund industry from the extreme cycles to which commercial insurance markets have historically been subject. As a long-time student of both the fund industry and the liability insurance markets, do you believe that this part of ICI Mutual's mission has continued relevance today?*

DAVE: No one can pretend that ICI Mutual, or any other single insurance company, can completely insulate an industry from the impact of swings in interest rates, influxes of industry-specific claims, and cycles of insurance availability. That being said, ICI Mutual, even as it remains dedicated to pursuing its business along sound commercial lines, has also always been cognizant that the risks and insurance needs of the fund industry are different from those of other segments of the financial industry. By focusing on pricing that reflects mutual fund risks, and by keeping its premiums reasonable and stable during "harder" market cycles, ICI Mutual has, I think, played an important role in assisting the fund industry to avoid the often drastic swings in premium rates to which liability insurance markets have traditionally been subject.

ICI Mutual has been successful due its fund expertise. This expertise and its ability to recognize and evaluate fund industry risks have enabled ICI Mutual to establish enormous credibility with the reinsurance markets, which has been of significant assistance in promoting stability of insurance pricing, as well as in winning acceptance for coverage innovations. Through its continued relationships with the reinsurance markets, ICI Mutual has maintained its reputation as the authoritative source of reliable information for reinsurers about the fund industry. In my view, being the leading provider of responsive coverage at risk-related prices, and serving as the link between the fund industry and the worldwide insurance and reinsurance markets, has continuing relevance.

***DAN:** As part of its mission, ICI Mutual has also focused substantial effort on implementing insurance coverages that are tailored to the insurance needs of funds, and their directors, officers, and advisers. ICI Mutual has also sought to provide its insureds with fair and prompt claims handling. Some might argue that in today's competitive mutual fund insurance market, where many fund complexes turn to professional insurance brokers and other insurance advisers for advice and assistance, ICI Mutual's role as an innovator of new insurance coverages and as a claims-oriented insurer is less important than it may once have been. What is your reaction to that argument?*

DAVE: First, with regard to ICI Mutual as an innovator of new coverages, it is true that the commercial insurance industry is better situated to write all forms of liability insurance coverage than it was twenty-five years ago. In part, this is because the commercial insurance industry has been able to tag along and make available some of the coverage innovations that were pioneered by ICI Mutual. Even so, some specialized coverages long provided by ICI Mutual—coverage for informal regulatory investigations, for example—have, even today, not been generally adopted by the commercial insurance industry. Meanwhile, I've watched ICI Mutual continue to address new needs of the fund industry, including, most recently, by introducing coverage for shareholder derivative demand investigations and specialized enhancements to buttress insurance protections for fund independent directors. The Company's focus on the fund industry, and the experience and expertise of its staff and Board of Directors, place ICI Mutual in a unique position to develop and implement sensible coverage solutions for its insureds as the fund industry's innovations and legal developments create new insurance issues.

Second, with regard to ICI Mutual as a claims-oriented insurer, this is an area in which the Company has excelled. From the very beginning, ICI Mutual's understanding of the fund industry's operations and legal structure, and of the interplay of duties and obligations between and among advisory companies, funds, and fund independent directors, has been unique among insurers. This has enabled ICI Mutual to evaluate and settle claims with both understanding and objectivity, against the most relevant backdrop of similar claims liabilities, in ways that commercial insurers ordinarily cannot.

***DAN:** At ICI Mutual, we are seeing independent fund directors become more involved in, and more knowledgeable about, insurance decisions and associated issues. What are your thoughts on the considerations that independent directors, and their insurance advisers, may wish to take into account with regard to insurance coverage for themselves and their funds?*

DAVE: Independent directors must maintain vigilance over every significant aspect of the business activities of their funds. Meanwhile, the management of these funds is mostly in the hands of separate advisory organizations. The law governing the relative obligations and responsibilities of fund independent directors, on the one hand, and advisory organizations, on the other, remains murky. For this reason, among others, I would expect that independent directors will continue to find themselves operating in a legal environment with few bright lines for guidance, and where their actions may be susceptible to unforeseen challenges, which may result in costly and protracted litigation.

Under such circumstances, it is obviously important for fund independent directors to focus attention on securing appropriate and adequate insurance for themselves and their funds. Price is one factor among many to be considered by fund directors in insurance selection. But in reaching business judgments on insurance, it is entirely appropriate, in my view, for directors to assign substantial value to the stability and qualitative benefits offered by insurers, like ICI Mutual, who have specialized industry knowledge, who have a demonstrated, long-standing commitment to providing sensible and robust coverage and to crafting special provisions when needed, and who have an outstanding record of fair claims settlements.

***DAN:** On behalf of ICI Mutual and its insureds, I want to thank you for your time today, Dave, and for a most interesting discussion.*

aligned with the industry

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

ICI Mutual 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, 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

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 acknowledged as 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 specific 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 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 ongoing, 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 23, 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 online *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*

2012 *Risk Management in the Digital Age: Mobile Computing, Cloud Computing and Social Media*

FORTHCOMING RISK MANAGEMENT PUBLICATION

2013 *Independent Directors Liability (IDL) Insurance: A Guide for Fund Independent Directors and their Insurance Advisers*

This study will provide a general introduction to independent directors liability (IDL) insurance, as well as commentary on related topics. The publication will include an overview of fundamental liability protections commonly provided to fund independent directors, detail how IDL policies are structured, describe the two basic types of IDL policies and how they differ, and highlight some of the key questions that fund boards may wish to consider in evaluating IDL insurance options.

financial stability

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

For 25 years, ICI Mutual has been the acknowledged and trusted presence 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 25 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.

company information

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Morgan Stanley

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Pioneer Investment Management USA, Inc.

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B of A Global Capital Management

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DWS Funds (Independent Director)

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Saturna Investment Trust (Independent Trustee)

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American Century Investments

Robert F. Gunia
Prudential Funds (Interested Trustee)

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Investment Company Institute

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Investment Company Institute

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Franklin Resources, Inc.

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Eaton Vance Management

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Lord, Abbett & Co. LLC

Les M. Kratter
Franklin Resources, Inc.

Thomas P. Lemke
Legg Mason, Inc.

Mark N. Polebaum
MFS Investment Management Company

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Standing: John F. Cogan, Jr., Ronald H. Fielding, Dawn-Marie Driscoll, Barry Fink, Kevin M. Carome, David Oestreicher
Seated: Lawrence R. Maffia, Michael J. Downer, William V. Healey; *Not pictured:* Paul Schott Stevens

This page (left to right),
standing: Les M. Kratter, Stefanie Chang Yu, Paul S. Kulig;
seated: David M. Pfeffer, Mark E. Carver

Opposite page (left to right),
standing: Michael D. Strohm, Robert F. Gunia, Kenneth C. Eich, Alison Taunton-Rigby, James H. Bodurtha, Lawrence H. Kaplan, Jeffrey L. Steele;
seated: Thomas P. Lemke, Richard D. Carpenter, Diana P. Herrmann

Not pictured: Jeffrey R. Coleman, James J. McMonagle, Brian K. Reid, Maureen A. Gemma, Mark N. Polebaum

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Director, Data Analytics

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Lizabeth Hurst
Corporate Communications

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Swenitha Nalli
Underwriting Analyst

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Assistant Controller

Margaret Sullivan
Senior Underwriter

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Krystal Thomas
Policy Coordinator

Julia Ulstrup
Associate Counsel

Jinhua Zhang
Director, Corporate Reporting

Committees

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Capital Research & Management Company

William V. Healey, *Vice Chairman*
Allianz Global Investors U.S. LLC

James H. Bodurtha
BlackRock Funds

Jeffrey L. Steele
Washington Management Corporation

Michael D. Strohm
Waddell & Reed, Inc.

selected financial HIGHLIGHTS

dollar amounts in thousands	*for the years ended* 2012	2011
Gross Written Premiums	$ 84,707	$ 88,581
Net Earned Premiums	$ 29,752	$ 31,101
Net Investment Income	$ 8,096	$ 8,276
Net Loss and Loss Adjustment Expenses	$ 13,464	$ 11,918
Net Underwriting Profit	$ 5,633	$ 9,829
Dividends to Policyholders	$ 4,969	$ 5,300
Net Income	$ 9,404	$ 10,233
Total Equity	$ 224,639	$ 212,116
COMBINED RATIO		
Loss and General Expense Ratio	81%	69%
Policyholder Dividends	17%	17%
Combined Ratio including Policyholder Dividends	98%	86%

ICI Mutual | *the safest decision you can make*

Unequaled industry knowledge and expertise:
We help insureds identify and avoid risk at the front end. We stand behind them if problems occur.

A history of stability and financial strength:
Our coverage has been available and consistent since our inception. And by reinsuring our policies, we've deliberately and prudently spread our own risk.

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

Not just a partner, *good* partner:
We were created to serve the mutual fund industry and only the mutual fund industry. We answer only to our insureds and their needs.

ICIMutual
The safest decision you can make

ICI Mutual Insurance Company
A Risk Retention Group

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2012

consolidated financial STATEMENTS

ICI Mutual Insurance Company

A Risk Retention Group

ICI Mutual Insurance Company, a Risk Retention Group
Index
December 31, 2012 and 2011

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of ICI Mutual Insurance Company, a Risk Retention Group and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, of changes in equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ICI Mutual Insurance Company, a Risk Retention Group and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

April 25, 2013

ICI Mutual Insurance Company, a Risk Retention Group
Consolidated Balance Sheets
December 31, 2012 and 2011 (in 000's)

	2012	2011
Assets		
Cash and cash equivalents	$ 6,099	$ 30,528
Investments		
Debt securities, at fair value (amortized cost of $230,603 and $213,783, respectively)	244,385	225,390
Equity securities, at fair value (cost of $27,734 and $19,105, respectively)	36,606	24,150
Money market funds	2,058	3,115
Total cash and investments	289,148	283,183
Prepaid expenses	477	497
Prepaid income taxes	3,611	2,513
Deferred policy acquisition costs	2,637	2,563
Premiums receivable	15,306	8,755
Interest receivable	1,978	1,922
Reinsurance recoverables	110,903	127,827
Prepaid reinsurance premiums	39,179	39,314
Other amounts receivable under reinsurance contracts	2,455	1,270
Furniture and fixtures, net	387	457
Deferred income taxes	235	3,244
Investment securities receivable and other assets	313	1,424
Total assets	$ 466,629	$ 472,969
Liabilities and Equity		
Reserve for losses and loss adjustment expenses	$ 167,922	$ 184,935
Unearned premiums	51,454	52,996
Reinsurance premium payable	8,600	9,305
Premium taxes payable	363	524
Accounts payable and other liabilities	3,070	2,974
Benefits payable	5,465	4,520
Dividends payable	5,116	5,599
Total liabilities	241,990	260,853
Contingencies (Note 10)		
Contributed surplus	21,527	21,621
Accumulated other comprehensive income	12,163	8,950
Accumulated earnings	190,949	181,545
Total equity	224,639	212,116
Total liabilities and equity	$ 466,629	$ 472,969

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, 2012 and 2011 (in 000's)

	2012	2011
Revenues		
Net premiums written	$ 28,346	$ 31,657
Change in net unearned premiums	1,406	(556)
Net premiums earned	29,752	31,101
Net investment income	8,096	8,276
Net realized gains on securities	3,584	474
Reinsurance profit-sharing income	-	344
Other income	307	304
Total revenues	41,739	40,499
Expenses		
Net loss and loss adjustment expenses	13,464	11,918
Underwriting, general and administrative expenses	10,655	9,698
Total expenses	24,119	21,616
Income before dividends to policyholders and provision for income taxes	17,620	18,883
Dividends to policyholders	4,969	5,300
Income before provision for income taxes	12,651	13,583
Provision for income taxes	3,247	3,350
Net income	9,404	10,233
Other Comprehensive Income		
Net unrealized gains on securities:		
Net unrealized gains arising during the period, net of tax	6,231	4,144
Reclassification adjustment for gains realized in net income, net of tax	(2,330)	(308)
Net actuarial unrealized losses on employee benefit plans, net of tax	(688)	(780)
Other comprehensive income, net of tax, net of reclassification adjustments	3,213	3,056
Comprehensive income	$ 12,617	$ 13,289
Net realized gains (losses) on securities		
Other-than-temporary impairment losses	$ (157)	$ -
Other net realized investment gains	3,741	474
Net realized gains on securities	$ 3,584	$ 474

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, 2012 and 2011 (in 000's)

	Contributed Surplus	Accumulated Other Comprehensive Income	Accumulated Earnings	Total Equity
Balance at December 31, 2010	$ 21,885	$ 5,894	$ 172,405	$ 200,184
Cumulative effect of adjustment on January 1, 2011 to initially apply new accounting guidance, net of tax	-	-	(1,093)	(1,093)
Net income	-	-	10,233	10,233
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	$ 181,545	$ 212,116
Net income	-	-	9,404	9,404
Other comprehensive income, net of tax, net of reclassification adjustments	-	3,213	-	3,213
Distributions of contributed surplus	(94)	-	-	(94)
Balance at December 31, 2012	$ 21,527	$ 12,163	$ 190,949	$ 224,639

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, 2012 and 2011 (in 000's)

	2012	2011
Cash Flows from Operating Activities		
Net income	$ 9,404	$ 10,233
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of premium	1,324	640
Deferred income taxes	1,278	(468)
Depreciation and amortization of furniture and fixtures	183	202
Net realized gains on sale of securities	(3,584)	(474)
Investment securities and other receivables	485	(932)
Benefits payable	513	549
Changes in operating assets and liabilities		
Prepaid expenses	20	(47)
Prepaid income taxes	(1,098)	(2,010)
Deferred policy acquisition costs	(74)	(117)
Premiums receivable	(6,551)	(350)
Interest receivable	(56)	16
Reinsurance recoverables	16,924	166,536
Prepaid reinsurance premiums	135	(560)
Other amounts receivable under reinsurance contracts	(1,185)	1,102
Reserve for losses and loss adjustment expenses	(17,013)	(175,418)
Unearned premiums	(1,542)	1,116
Reinsurance premium payable	(705)	1,015
Premium taxes payable	(161)	112
Income taxes payable	-	(64)
Accounts payable and other liabilities	96	(41)
Dividends payable	(483)	821
Net cash (used in) provided by operating activities	(2,090)	1,861
Cash Flows from Investing Activities		
Proceeds from sales of investments available for sale	68,477	62,591
Proceeds from maturities of investments available for sale	6,024	3,310
Purchases of furniture and fixtures	(113)	(82)
Payments for purchases of investments available for sale	(97,690)	(60,517)
Change in money market funds	1,057	18,607
Net cash (used in) provided by investing activities	(22,245)	23,909
Cash Flows from Financing Activities		
Distributions of contributed surplus	(94)	(264)
Net cash used in financing activities	(94)	(264)
Net (decrease) increase in cash and cash equivalents	(24,429)	25,506
Cash and cash equivalents at beginning of year	30,528	5,022
Cash and cash equivalents at end of year	$ 6,099	$ 30,528

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"), now the Vermont Department of Financial Regulation ("VDFR"). 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 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 VDFR.

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 2012 or 2011.

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 underwriter compensation, fees and premium taxes associated with the successful acquisition and underwriting of new and renewal insurance business. As further explained in Note 1J below, on January 1, 2012, the Company adopted ASU 2010-26, which clarified acquisition costs to be capitalized. 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 2012 or 2011.

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, 2012 and 2011.

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. For the treaty years ending March 31, 2012 and 2013, the Company retains an additional $2.5 million in excess of the first $15 million recoverable. 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, 2012, ceded losses under all of the open treaty years were well below the respective treaty caps. 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, 2012, 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 $0 and $344 in profit commission gain as a result of these features in 2012 and 2011, 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 $158 and $178 for 2012 and 2011, respectively. Accumulated depreciation totaled $1,012 and $877 at December 31, 2012 and 2011, respectively.

J. Recent Accounting Pronouncements

Recently Adopted Accounting Standards

In October, 2010, the FASB issued ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, which amended FASB ASC Topic 944, Financial Services—Insurance. ASU 2010-26 clarifies the definition of acquisition costs that are eligible for deferral. Acquisition costs are to include only those costs that are directly related to the successful acquisition or renewal of insurance contracts; incremental direct costs of contract acquisition that are incurred in transactions with either independent first parties or employees; and advertising costs meeting the capitalization criteria for direct-response advertising. The determination of deferability must be made on a contract-level basis.

This guidance is effective for fiscal years beginning after December 15, 2011. This guidance may be applied prospectively upon the date of adoption, with retrospective application permitted, but not required. The Company adopted this guidance retrospectively on January 1, 2012, resulting in a write down of the Company's deferred acquisition costs of $1.6 million, as of the date of adoption, relating to those costs which no longer meet the revised guidance as summarized above.

Retrospective application of accounting principles should be applied as if the change had been made as of the beginning of the earliest period presented, in this case for the year ended December 31, 2011. The cumulative effect of the retrospective adoption of this guidance reduced total equity by $1.1 million, net of tax, as of January 1, 2011.

K. Reclassifications

Certain amounts in prior years' Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2012 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, 2012 and through the date the financial statements were available to be issued of April 25, 2013. 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, 2012. 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, 2012			
Debt securities available for sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government, agencies and authorities securities	$ 44,002	$ 1,637	$ (109)	$ 45,530
Mortgage-backed	65,723	3,560	(39)	69,244
All other corporate bonds	120,878	9,244	(511)	129,611
Total debt securities	$ 230,603	$ 14,441	$ (659)	$ 244,385

	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

Included in the above fair value amounts at December 31, 2012 and 2011 is approximately $47,249 and $56,496, 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, 2012, 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	$ 5,651	$ 5,807
Due after one year through five years	32,325	34,464
Due after five years through ten years	88,085	93,451
Due after ten years	104,542	110,663
Total debt securities	$ 230,603	$ 244,385

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

	December 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Common stock	$ 27,734	$ 8,872	$ -	$ 36,606

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

At December 31, 2012 and 2011, the net unrealized gain or (losses) on investments in debt and equity securities of $14,725 and $10,824, respectively, have been reflected in the Consolidated Balance Sheets as a component of accumulated other comprehensive income, net of deferred taxes of $7,929 and $5,828, 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, 2012				
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	$ 12,672	$ (109)	$ -	$ (109)	5
Mortgage-backed	4,011	(8)	(31)	(39)	6
All other corporate bonds	12,762	(94)	(417)	(511)	17
Total securities	$ 29,445	$ (211)	$ (448)	$ (659)	28

	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	(5)	(258)	(263)	8
All other corporate bonds	13,320	(89)	(1,536)	(1,625)	24
Total securities	$ 15,118	$ (94)	$ (1,794)	$ (1,888)	34

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 $157 and $0 in 2012 and 2011, 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 and maturities of debt securities and the associated gross realized gains and gross realized losses are as follows:

	Proceeds from Sales and Maturities	Gross Realized Gains	Gross Realized Losses
For the year ended December 31, 2012	$ 74,501	$ 3,892	$ (308)
For the year ended December 31, 2011	$ 65,901	$ 1,718	$ (1,244)

The Company did not sell any equity securities in 2012 or 2011.

Net investment income is calculated as follows:

	2012		
Debt securities available for sale	Gross Investment Income	Investment Expenses	Net Investment Income
U.S. Government, agencies and authorities securities	$ 909	$ (47)	$ 862
Mortgage-backed	2,130	(110)	2,020
All other corporate bonds	4,712	(243)	4,469
Equity securities	785	(40)	745
Total	$ 8,536	$ (440)	$ 8,096

	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

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 $36,606.

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.

Pricing Level 3: Valuation is derived from techniques such as broker quotes, pricing matrices and internal calculations. The Company did not hold any Level 3 securities as of December 31, 2012.

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, 2012	Quoted Prices (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment in debt securities	$ 244,385	$ 39,036	$ 205,349	$ -
Investment in equity securities	36,606	36,606	-	-
Total	$ 280,991	$ 75,642	$ 205,349	$ -

	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

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, 2012, 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 2012. 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, 2012 are summarized as follows:

	Balance at 1/1/2012	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 12/31/2012
ABS	$ 85	$ -	$ -	$ -	$ (85)	$ -
CMO	107	-	-	-	(107)	-
RMBS	-	-	-	-	-	-
CMBS	-	-	-	-	-	-
Corporate bonds	-	-	-	-	-	-
Preferred stocks	-	-	-	-	-	-
	$ 192	$ -	$ -	$ -	$ (192)	$ -

	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

4. Deferred Policy Acquisition Costs

The deferred policy acquisition costs at December 31, 2012 and 2011 are comprised of the following:

	2012	2011
Beginning balance	$ 2,563	$ 2,446
Additional costs capitalized		
Underwriting expenses	1,376	1,185
Royalty fees (Note 7)	847	885
Premium taxes	2,118	2,214
	4,341	4,284
Less current year amortization		
Underwriting expenses	1,249	1,107
Royalty expense (Note 7)	862	873
Premium taxes	2,156	2,187
	4,267	4,167
Ending balance	$ 2,637	$ 2,563

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, 2012 and 2011, $3,250 and $3,344, respectively, related to reserve premiums for terminated policies which were included in contributed surplus. Of the premiums written, 32.1% and 31.3% were attributable to Non-Participating Members during the years ended December 31, 2012 and 2011, respectively.

6. Provision for Income Taxes

The provision for income taxes consists of the following:

	2012	2011
Current provision	$ 1,969	$ 3,818
Deferred provision	1,278	(468)
Provision for income taxes	$ 3,247	$ 3,350

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

	2012	2011
Expected tax provision at 35%	$ 4,428	$ 4,754
Tax exempt income from municipal bonds	(309)	(401)
State income taxes	34	109
Dividend received deduction	(164)	(105)
Reconciling tax adjustment	(592)	(899)
Provision to return adjustments	(183)	(120)
All other, net	33	12
Actual provision for income taxes	$ 3,247	$ 3,350

During 2012 and 2011, the Company identified the need to record reconciling tax adjustments that were primarily related to accounting differences between book and tax that had accumulated over prior periods. The reconciling adjustment recorded in its 2012 and 2011 financial statements resulted in a $592 and $899 reduction in the provision for income taxes, respectively.

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 $3,000 and $5,701 in 2012 and 2011, respectively.

The deferred income tax amounts reflected in the consolidated balance sheets at December 31, 2012 and 2011 are comprised of the following items:

	2012	2011
Net unearned premiums	$ 878	$ 958
Discounting of loss reserves	1,719	1,902
Deferred policy acquisition costs	(923)	(897)
Net unrealized gains on investments	(7,929)	(5,828)
Post-retirement employee benefits	2,692	2,139
Bond discount accretion	(126)	(637)
Other than temporarily impaired securities	1,459	1,413
Nondeductible portion of policyholder dividend	1,790	1,960
Nondeductible capital loss carry forward	165	1,708
Other	510	526
	$ 235	$ 3,244

The Company believes that as of December 31, 2012, there were no material uncertain tax positions that would require disclosure under GAAP. As of December 31, 2012, the Company's 2011, 2010, and 2009 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 2012 and 2011 were $853 and $856, 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 $765 and $768 for 2012 and 2011, respectively.

Amounts payable at December 31, 2012 and 2011 under these agreements were approximately $178 and $55, 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:

	2012	2011
Reserve for losses and loss adjustment expenses	$ 110,038	$ 126,562
Unearned premiums	$ 39,179	$ 39,314

At December 31, 2012 and 2011, reinsurance recoverable was concentrated with two third party reinsurance groups, Travelers Insurance Companies (approximately 16% and 26% respectively) and Lloyds of London (approximately 14% and 12% 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 in 2012 and 2011 have been adjusted as follows as a result of voluntary reinsurance:

	2012		2011	
Premiums	**Written**	**Earned**	**Written**	**Earned**
Direct and assumed	$ 84,707	$ 86,249	$ 88,581	$ 87,464
Ceded (net of ceding commission income)	(56,361)	(56,497)	(56,924)	(56,363)
Net	$ 28,346	$ 29,752	$ 31,657	$ 31,101

Losses and loss adjustment expenses	**2012**	**2011**
Direct	$ 23,765	$ (10,528)
Ceded	(10,301)	(22,446)
Net	$ 13,464	$ 11,918

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:

	2012	2011
Balance at January 1	$ 184,935	$ 360,353
Less reinsurance recoverable, unpaid losses	(126,562)	(288,260)
Net balance at January 1	58,373	72,093
Incurred related to		
Current year	23,681	21,251
Prior years	(10,217)	(9,333)
Total incurred	13,464	11,918
Paid related to		
Current year	2,015	244
Prior years	11,938	25,394
Total paid	13,953	25,638
Net balance at December 31	57,884	58,373
Plus reinsurance recoverable, unpaid losses	110,038	126,562
Balance at December 31	$ 167,922	$ 184,935

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 $10,217 and $9,333, in 2012 and 2011 respectively. 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, 2012.

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 $5.0 million and $5.3 million being declared in 2012 and 2011, respectively. $5.2 million of the total dividends declared in 2011 have been paid as of December 31, 2012, with the remaining amounts paid as of March 31, 2013.

The 2012 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, 2012, before payment of the dividend, and the proportion of 2012 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, 2013, 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.

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, 2012 and 2011:

	2012	**2011**
Discount rate for benefit obligation	4.42%	5.23%
Discount rate for pension cost	5.23%	5.71%
Expected return on plan assets	7.00%	7.50%
Rate of compensation increase	4.00%	4.00%

Plan amounts recognized in the Consolidated Balance Sheet consist of:

	2012	2011
Assets	$ 193	$ 428

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

	2012	2011
Net loss	$ 1,537	$ 1,129

Other components of the Plan for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Projected benefit obligation	$ 8,622	$ 6,520
Fair value of plan assets	8,815	6,948
Funded status of the plan	$ 193	$ 428
Employer contributions	$ 856	$ 479
Benefits paid	$ 31	$ 31

The Plan's accumulated benefit obligation is $6,358 as of December 31, 2012 and was $4,777 as of December 31, 2011. Pension expense for the Plan equaled $465 and $321 for the years ended December 31, 2012 and 2011, 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:

	2012	2011
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 $856 and $479 to the Plan for the years ended December 31, 2012 and 2011, 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 $114 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
2013	$ 1,190
2014	$ 138
2015	$ 122
2016	$ 123
2017	$ 1,598
2018-2022	$ 2,369

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 $17.0. The Company contributed approximately $147 and $129 to this plan in 2012 and 2011, 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:

	2012	2011
Current liabilities	$ 871	$ -
Noncurrent liabilities	1,317	1,757
Total	$ 2,188	$ 1,757

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

	2012	2011
Net loss	$ 387	$ 298

Other components of the SERP for the years ended December 31, 2012 and 2011 were as follows:

	2012	2011
Benefit obligation	$ 2,188	$ 1,757
Fair value of plan assets	-	-
Funded status of the plan	$ (2,188)	$ (1,757)
Employer contributions	$ -	$ -
Benefits paid	$ -	$ -

The SERP's accumulated benefit obligation is $1,863 as of December 31, 2012 and was $1,228 as of December 31, 2011. Included in "Underwriting, general and administrative expenses" in the accompanying consolidated statements of operations at December 31, 2012 and 2011, are amounts attributable to this plan of approximately $294 and $242, 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 $66 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
2013	$ 871
2014	$ -
2015	$ -
2016	$ -
2017	$ 522
2018-2022	$ 1,545

The accrued liability included in the consolidated balance sheet for the defined contribution component of the SERP was $187 at December 31, 2012 and $158 at December 31, 2011. Amounts recognized in the consolidated statement of operations for the defined contribution component of the SERP were $29 at December 31, 2012 and $28 at December 31, 2011.

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:

	2012	2011
Liabilities	$ 2,091	$ 1,647

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

	2012	2011
Net loss	$ 638	$ 447

Other components of the plan for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Benefit obligation	$ 2,091	$ 1,647
Fair value of plan assets	-	-
Funded status of the plan	$ (2,091)	$ (1,647)
Employer contributions	$ 29	$ 38
Benefits paid	$ 29	$ 42

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

	2012	2011
Retirees	$ (761)	$ (599)
Other active participants	(1,330)	(1,048)
Accumulated postretirement benefit obligation	$ (2,091)	$ (1,647)
Weighted average assumed discount rate to determine:		
The benefit obligation	4.35%	5.17%
The net benefit cost	5.17%	5.71%

Included in "Underwriting, general and administrative expenses" in the accompanying consolidated statements of operations at December 31, 2012 and 2011, are amounts attributable to this plan of approximately $178 and $143, 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 2013 is $58.

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 $48 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
2013	$ 58
2014	$ 68
2015	$ 79
2016	$ 62
2017	$ 64
2018-2022	$ 382

For measurement purposes, a 9.0% increase in healthcare costs was assumed for fiscal year 2012, trending down to 5.0% in 2020 and thereafter. A 1% increase in this rate would increase the postretirement benefit obligation by $487 and the service and interest cost by $47. A 1% decrease in this rate would decrease the postretirement benefit obligation by $373 and the service cost and interest cost by $35.

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, 2012 and 2011 are amounts attributable to this plan of approximately $2 and $110, respectively.

13. Other Comprehensive Income

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

For the Year Ended December 31, 2012	Pretax Amount	Tax Expense or Benefit	Net of Tax Amount
Net unrealized gains on investments			
Net unrealized gains arising during the period	$ 9,586	$ 3,355	$ 6,231
Reclassification adjustment for gains realized in net income	(3,584)	(1,254)	(2,330)
Net actuarial unrealized losses on employee benefit plans	(1,058)	(370)	(688)
Other comprehensive income	$ 4,944	$ 1,731	$ 3,213

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 losses realized in net income	(474)	(166)	(308)
Net actuarial unrealized losses on employee benefit plans	(1,200)	(420)	(780)
Other comprehensive income	$ 4,701	$ 1,645	$ 3,056

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