

On even keel 2010



GEM

Annual Report 2010



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Letter from the Chairman and the President

A ship in harbor is safe,
but that is not what ships
are built for.

—William Shedd



John M. Foehl, Jr.,
President and Chief
Executive Officer



Allen Hatten,
Chairman

Our annual report this year draws from a nautical theme “On Even Keel,” sailing terminology for when a ship’s keel is perfectly horizontal to the water line. Interestingly, this typically only exists when a ship is in port. Once on open water a ship is normally trimmed by the stern to allow for steerage. Sailing, like reinsurance, involves a degree of risk. Blue water sailing carries a higher degree of risk than shore sailing. Wind and ocean conditions will dictate how much sail can be carried safely. Occasionally sailors will be faced with heavy weather where only a well-reefed ship, properly handled, makes it through the storm.

Storm conditions can be measured using the Beaufort scale, which is an empirical measure of wind speeds based on sea conditions. Force 10, on a scale of twelve, is known as a “whole gale” and is characterized by very high waves with overhanging crests, large patches of foam, and airborne spray. Wave heights may reach 35-40 feet. This is a useful analogy for the conditions that captives involved in writing business in the public entity market faced in 2010.

Intense competition and excess surplus allowed commercial insurance rates to drift lower for most of the year. Pricing, depending on the line of business, fell between five and ten percent during 2010 for most commercial insureds. This, after similar price declines in 2009 and 2008. At the same time, public entities were struggling with a severe contraction in revenue. Since the start of the recession, states closed more than \$400 billion in cumulative budget gaps. Some of that came through reduced revenue sharing with cities and towns. For our members, no expense—including the cost of insurance, was exempt from possible cutbacks.

As we noted in last year’s Annual Report, public entity captives such as GEM, operate best when capacity is constrained and prices are rising for commercial insurance buyers. That is because these captives were created to provide stable reinsurance pricing. During prolonged soft market periods, such as the last three years, GEM’s pricing structure is not as competitive as the pricing structures provided by the commercial carriers. 2010 saw these pressures coupled with the need by public entities to reduce costs in order to balance budgets. As a result, GEM saw net written premiums fall by 6.4% for the year. For comparison purposes, the Insurance Information Institute estimates that commercial lines net written premiums for the U.S. property/casualty industry declined by 2.0%.

As any sailor will attest, when you are in the middle of a gale, the first question is, “How long before this blows itself out?” The same question can be asked concerning the soft market conditions that have continued unabated for the last three years. The following information is all drawn from a presentation by Dr. Robert Hartwig of the Insurance Information Institute at the NAMIC Personal Lines Seminar on April 22, 2011.

During the 30 years from 1980 to 2009, the world averaged 615 annual natural catastrophes resulting in approximately \$23 billion in insured losses per event. In 2010, 950 events occurred with an average loss per event of \$37 billion. While commercial lines and reinsurance combined ratios deteriorated in 2010, rates of return on surplus remained positive. Hard markets tend to result only after surplus has eroded. So, while losses have climbed, insurers are still able to pay for these losses out of earnings. Therefore, while commercial rates may have bottomed out in 2010, there is nothing on the horizon to suggest that the storm clouds are lifting any time soon.

I find the great thing in this world is not so much where we stand, as in what direction we are moving - we must sail sometimes with the wind and sometimes against it - but we must sail, and not drift, nor lie at anchor.

—Oliver Wendell Holmes, Jr.

Even while being buffeted by squalls, GEM kept sailing as well. On January 1st, 2010, GEM officially converted to a protected cell captive corporation in the District of Columbia. The conversion allows GEM to optimize the financing of certain risks with the benefit of legally separating the assets and liabilities of those risks. Participants within a cell are protected from the liabilities and creditors of other cells. In October 2010, the Board of Directors provisionally approved the creation of GEM’s first cell for the benefit of an existing captive insurer. A decision on the actual formation of the cell will not occur until the third or fourth quarter of 2011.

At the July 2010 Board meeting, management previewed a new risk model that had been developed in consultation with Milliman. The model provides the Board with a snapshot of GEM’s risk profile as measured against a risk-based capital benchmark. In this regard, it allows the Board to understand how different reinsurance structures, retention levels, and changes in membership impact GEM’s capital position. The Board also approved setting time aside at each February Board meeting to review the model output and discuss long-term strategy for GEM.

While it is never pleasant to have to report an operational loss for the year, GEM is still a relatively young reinsurance company and reinsurance, by its nature, is volatile. Even given the loss, the Company remains strongly capitalized and well-positioned to continue to assist its membership. We don’t know how long the commercial market disturbance is likely to continue, but we are confident that GEM is on an even keel.

Finally, we would like to acknowledge the efforts of the membership, the Board, and staff in 2010. Your continued support is instrumental to GEM’s success.

Management Team

GEM Board of Directors



Allen Hatten
Chairman
Washington State
Transit Insurance Pool



Greg Womack
Vice Chair
Texas Council Risk
Management Fund



Brett Davis
Secretary
Park District Risk
Management Agency



Michael Rhyner
Michigan Municipal
Risk Management
Authority



Parker Chambers
Texas Water Conservation
Association Risk
Management Fund



Michael Hammond
Miami Valley Risk
Management Association



Dean Boes
Wisconsin Municipal
Mutual Insurance
Company



Robin Johnson
California Transit
Insurance Pool



Richard Lee
Delaware Valley
Insurance Trust



Alan Hulse
Montana Municipal
Interlocal Authority

GEM Board of Directors & President



GEM Officers



GEM Staff

John M. Foehl, Jr.
President and
Chief Executive Officer

Bridget Rogier, Esquire
Vice President of
Member Services & Claims

Joel Kress, ARE
Underwriting Manager

Diane Caley
Executive Services & Operations

Carol MacDougall
Staff Assistant

Marietherese D'Agostino
Treasurer

Kathy Tremblay
Staff Assistant

Melanie McDonough
Claims Adjustor

2010 Management Discussion and Analysis

of Financial Conditions and Results of Operations

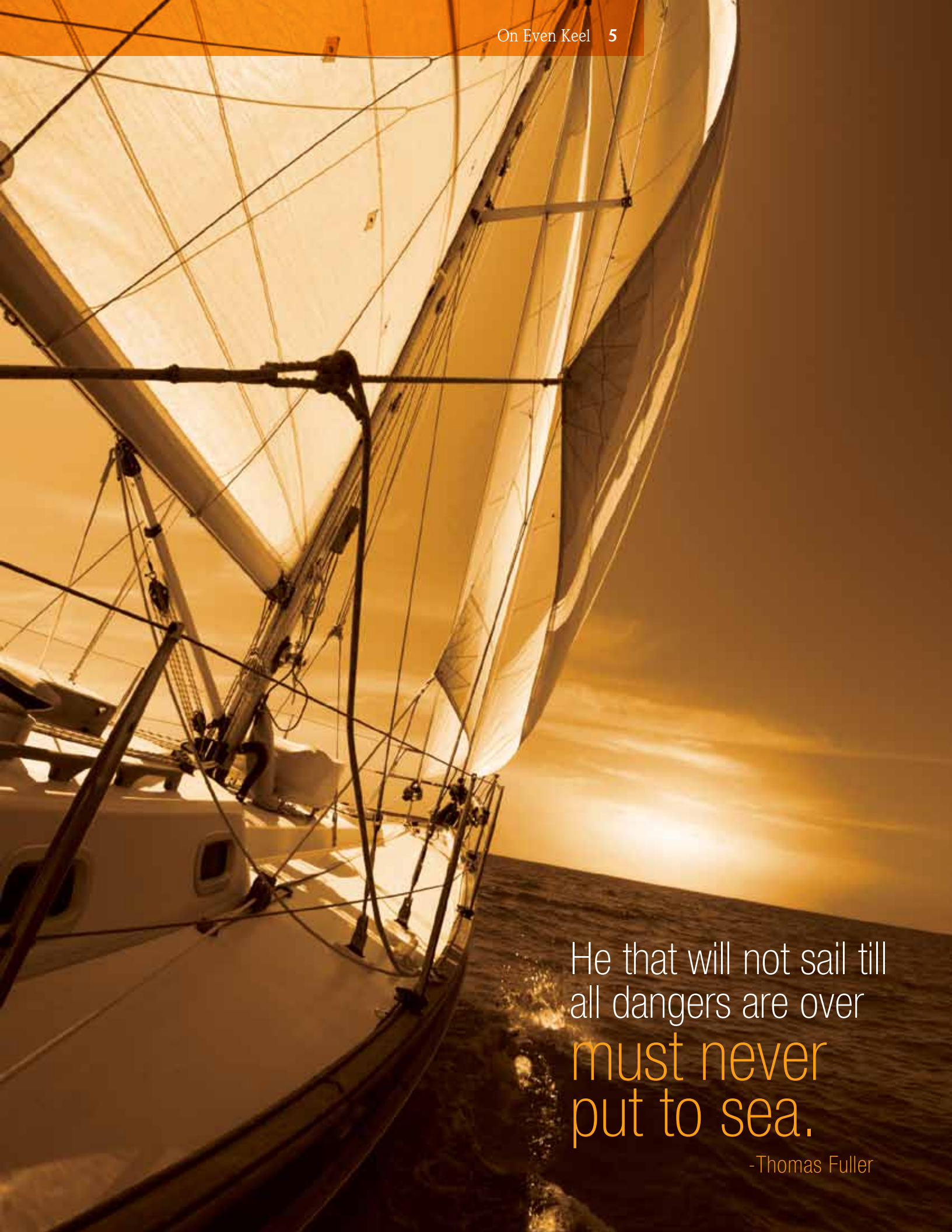
December 31, 2010

Government Entities Mutual, Inc. (“GEM” or the “Company”) was organized as a mutual insurance company in 2002 under the captive statutes of the District of Columbia as an association sponsored captive. GEM is a non-profit corporation dedicated to serving the insurance needs of public entity self-insurance pools and public entity insurance companies. The Company commenced operations on January 1, 2003 and is able to write casualty, workers’ compensation, auto physical damage and property insurance and reinsurance. The Company has received a Section 115 letter ruling from the Internal Revenue Service that GEM is exempt from federal income taxes based on its submitted plan of operations.

In December 2009, the Company’s Board of Directors approved amendments to the Company’s Articles of Incorporation to convert the Company to a protected cell captive insurer under the District of Columbia Insurance Department’s captive insurance laws. GEM converted to a Protected Cell Corporation (PCC) as of January 1, 2010. To date the Company has not formed any cells within the PCC.

The Company has two classes of membership; Founding or Premiere members and Associate members. All members are required to make an initial capital contribution to GEM when they are accepted for membership. Members enter into a written membership agreement that includes a minimum commitment of five years. This commitment helps assure the financial stability of the Company and promotes a long-term approach to risk financing. GEM currently has sixteen (16) Founding or Premiere members and one (1) Associate member. The Company is non-assessable.

GEM derives its income principally from premiums on the reinsurance contracts it writes for casualty, workers’ compensation and property and secondarily from net investment income. Since GEM is organized as a non-profit company, the Company does not build a profit margin into its underwriting guidelines. Therefore, its profitability depends primarily on its ability to generate investment income and maintain its combined ratio near 100%.

A photograph of a sailboat with white sails on a sunset sea. The sun is low on the horizon, creating a golden glow over the water and the sky. The sailboat's rigging and masts are visible in the foreground, and the water is dark with some whitecaps.

He that will not sail till
all dangers are over
must never
put to sea.

-Thomas Fuller

Critical Accounting

➤ The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the accounting period. Actual results could differ from these estimates.

GEM has identified the estimates inherent in the valuation of investments and reserves (including reserves for unreported claims—IBNR) as critical in that they involve a higher degree of judgment and are subject to a significant degree of variability. In developing these estimates management makes subjective and complex judgments that are inherently uncertain and subject to material change as facts and circumstances develop. Although variability is inherent in these estimates, management believes the amounts provided are appropriate and conservative based upon the facts available as of the date of the financial statements.



Estimates

Investments

One significant estimate inherent in the valuation of investments is the evaluation of fair value and other than temporary impairment (OTTI). The determination of OTTI is a quantitative and qualitative process, which is subject to judgment in the determination of whether declines in the fair value of investments are other than temporary.

The cost basis of fixed maturity investments is adjusted for impairments in value, deemed to be other than temporary, with the associated realized loss reported in net income. Factors considered in evaluating whether a decline in value is other than temporary include:

[1] the magnitude of the decline in value; [2] current economic conditions and the financial condition and near-term prospects of the issuer; [3] the amount of time that the fair value has been less than cost; and [4] the estimated period over which the security is expected to recover and whether GEM's cash or working capital requirements and contractual or regulatory requirements may indicate a need to sell the security before its forecasted recovery.

Loss Reserves

Property/casualty reserves are estimates of losses and loss development and as such will differ from the ultimate results. Therefore, one of the critical accounting estimates is the proper amount of reserves to be set aside to meet future liabilities of the current in-force business. Changes in or deviations from the assumptions used to develop the loss reserves can significantly affect GEM's reserve levels and related future operations. Assumptions include company methodology for underwriting and claims handling, as well as current estimates of the inflation rate, legal and social environments.

Annually, GEM retains an outside independent actuary to provide a loss reserve opinion and establish a range for GEM's loss reserves. GEM's policy is to book reserves to the point estimate issued by the actuary. This estimate includes reserves for claims incurred but not yet report (IBNR). There are two components of IBNR reserves. The first is the provision for claims that have occurred but for which the insurance company is not aware (so called pure IBNR). The second part of IBNR reserves is for claims that have been reported to the insurer but the ultimate value of the claim has not yet been established. In this instance the IBNR provides a cushion against adverse development of known claims.

Results of Operations

OPERATING RESULTS FOR YEARS ENDED DECEMBER 31

(\$ THOUSANDS)	2010	2009	% CHANGE
Revenues:			
■ Net earned premiums	\$7,559	\$7,975	-5.2%
■ Investment income, net	\$1,890	\$1,849	2.2%
■ Realized gains on investments	\$727	\$303	***
TOTAL REVENUES	\$10,176	\$10,127	0.5%
Expenses:			
■ Loss and loss adjustment expenses	\$9,013	\$6,831	31.9%
■ General and administrative expenses	\$1,384	\$1,408	-1.7%
■ Underwriting expenses incurred	\$225	\$157	43.3%
TOTAL EXPENSES	\$10,622	\$8,396	26.5%
NET (LOSS) INCOME	(\$446)	\$1,731	***
Other Comprehensive Income			
■ Unrealized holding gain on available for securities	\$1,058	\$2,191	-51.7%
■ Reclassification adjustments for realized gains (losses) included in net income (loss)	(\$727)	(\$303)	***
	\$331	\$1,888	***
COMPREHENSIVE (LOSS) INCOME	(\$115)	\$3,619	***

*** Percentage change exceeds 100% or is negative

Anyone can hold the helm
when the sea is calm.

-Syrus Publius

Net Loss from Operations

GEM reported a net loss from operations for the year ended December 31, 2010 of \$446 thousand or a decrease of \$2,177 thousand as compared to the prior year end net income of \$1,731 thousand. The loss was primarily driven by a large increase in loss and loss adjustment expenses incurred for 2010 of \$2,182 thousand, coupled with a minor decrease in net earned premiums of \$416 thousand. The loss was partially offset by an increase of \$465 thousand in net investment income, including realized gains, to \$2,617 thousand at December 31, 2010.

Net Earned Premiums

Net earned premiums decreased by \$416 thousand or 5.2% to \$7,559 thousand at December 31, 2010. The decrease was the result of several factors. First, from a general operating environment, soft market conditions for commercial insurance rates continued into 2010 with rates falling between 5%-10% on a year-over-year basis. Second, GEM serves the public entity market which has experienced significant revenue pressures of its own as a consequence of the general nationwide recession. As a result, GEM saw members increase their net retentions or seek rate relief, which together eroded net earned premiums.

Net Investment Income Including Realized Gains

Net investment income of \$2,617 thousand at December 31, 2010 was 21.6% or \$465 thousand higher than the same period during 2009. The increase resulted from a management decision to harvest some capital gains during the latter half of the year as rates started to increase. The gains capture program generated approximately \$500 thousand in additional investment income. The investment portfolio is comprised primarily of high-grade investment debt securities with a small allocation to equities. During 2010, the portfolio was managed very tightly to its benchmark given the uncertainty in the direction of interest rates.

Loss and Loss Adjustment Expenses

Loss and loss adjustment expenses rose to \$9,013 thousand for the year ended December 31, 2010 versus \$6,831 thousand for December 31, 2009. The increase of \$2,182 thousand was attributable to two things. The property program experienced several catastrophic losses for the year, resulting in significantly higher loss reserves and the casualty program had a limits loss early in 2010. Management also adopted new Reinsurance Association of America (RAA) loss development factors and increased limits factors that caused an increase in prior years' reserves of approximately 5%. Management updates RAA factors on a bi-annual basis in order to maintain a conservative position for loss reserves.

General, Administrative, and Underwriting Expenses

Other underwriting expenses were \$1,609 thousand and \$1,565 thousand, respectively, for the years ended December 31, 2010 and 2009. The 2.8% increase in underwriting expenses was attributable to the addition of a new claims adjustor staff position in 2009 and an increase in commission expense associated with the property program.

Other Comprehensive Income

Other comprehensive income, which for GEM is composed solely of change in fair value of the investment portfolio, was \$331 thousand at December 31, 2010. This was down significantly from the December 31, 2009 figure of \$1,888 thousand, when the markets rallied off of significant price declines in 2008. Therefore, GEM's surplus position declined by \$115 thousand for the year ended December 31, 2010.

GEM's Financial Position

ASSETS FOR YEARS ENDED DECEMBER 31

(\$ THOUSANDS)	2010	2009	% CHANGE
<i>Invested Assets</i>			
■ Cash and cash equivalents	\$3,670	\$1,742	***
■ Certificates of deposit	\$0	\$1,503	***
■ Investments, available for sale, fair value	\$53,175	\$47,149	12.8%
TOTAL INVESTED ASSETS	\$56,845	\$50,394	12.8%
<i>Other Assets</i>			
■ Premiums receivable	\$1,558	\$1,044	49.2%
■ Reinsurance recoverable, gross paid and unpaid	\$18,278	\$13,378	36.6%
■ Prepaid reinsurance	\$2,176	\$1,734	25.5%
■ Other assets	\$837	\$607	37.9%
TOTAL ASSETS	\$79,694	\$67,157	18.7%

*** Percentage change exceeds 100% or is negative

LIABILITIES FOR YEARS ENDED DECEMBER 31

(\$ THOUSANDS)	2010	2009	% CHANGE
<i>Loss reserves</i>			
■ Losses	\$50,130	\$39,807	25.9%
■ Loss adjustment reserves	\$370	\$310	19.4%
TOTAL LOSS RESERVES	\$50,500	\$40,117	25.9%
<i>Other Liabilities</i>			
■ Accrued expenses	\$1,950	\$124	***
■ Unearned premiums	\$4,739	\$4,283	10.6%
■ Other Liabilities	\$58	\$71	***
TOTAL LIABILITIES	\$57,247	\$44,595	28.4%

*** Percentage change exceeds 100% or is negative

Invested Assets

Total invested assets for the year ended December 31, 2010 increased to \$56,845 thousand or a 12.8% increase over the December 31, 2009 balance of \$50,394 thousand. The increase in invested assets was attributable to two factors. First, the capital markets improved substantially from the lows reached at the end of 2008 with a resulting increase in the price of assets. Second, free cash flow from operations was invested into the portfolio, predominantly into bonds, with a corresponding increase in cash. For the year ended December 31, 2010 GEM did not have any securities within its portfolio subject to OTTI.

Other Assets

Other assets as of December 31, 2010 included premiums receivable of \$1,558 thousand, reinsurance recoverables of \$18,278 thousand and prepaid reinsurance of \$2,176 thousand. Premiums receivable increased by 49.2% from \$1,044 thousand at December 31, 2009 primarily due to the addition of a new member to the GEM property program at December 1, 2010. The increase in prepaid reinsurance of \$442 thousand was also attributable to the new property program since GEM purchases substantial reinsurance for property. The increase in reinsurance recoverables at December 31, 2010 of \$4,900 thousand has two main causes. First, the GEM property program experienced a significant loss in 2010. Second, there was adverse development in several accident years that required strengthening reserves.

Loss Reserves

Loss reserves for unpaid loss and loss adjustment expenses increased to \$50,500 thousand, or 25.9%, at December 31, 2010 versus \$40,117 thousand for the same point in time in 2009. As noted previously, approximately 5% of the increase in loss reserves is due to the change in RAA loss development and increased limits factors at year-end. Another 6% of the increase is due to adverse development on one claim for the 2008 accident year as a result of a trial verdict. The remaining increase is due to the re-estimation of loss reserves for the remainder of the accident years on GEM's books. To date the Company has not closed any accident years.

Other Liabilities

The major components of other liabilities at December 31, 2010 were accrued expenses of \$1,950 thousand and unearned premiums of \$4,739 thousand. The increase in accrued expenses was attributable to reinsurance premiums payable for the new property program member. Unearned premiums occur because GEM writes policies on a twelve month basis with inception dates that attach throughout the calendar year. The majority of policies written have inception dates of 1/1 or 7/1 however, there are different effective dates as well.

Capital and Surplus

GEM's capital and surplus at December 31, 2010 was \$22,447 thousand, a decrease of \$115 thousand from the December 31, 2009 balance of \$22,562 thousand. The decrease resulted from the loss from operations of \$446 thousand, partially offset by an increase in the market value of invested assets. At December 31, 2010, GEM had paid-in capital from its members' of \$14,512 thousand and unassigned surplus of \$5,683 thousand. GEM is seeking to increase its capital and surplus position to \$25,000 thousand by December 31, 2013.

Members' Equity

(\$ Thousands)

Cash Flow

(From Operations)

\$22,447



\$5,492



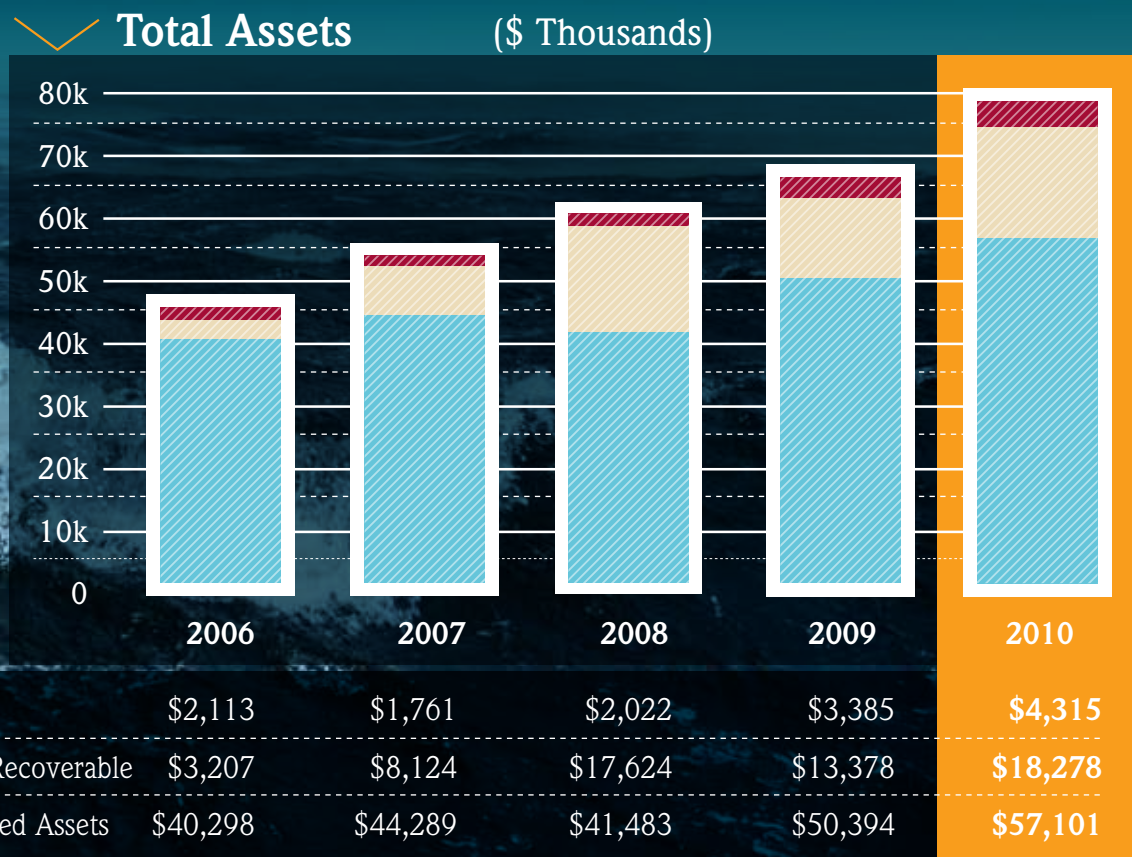
■ 2006
 ■ 2007
 ■ 2008
 ■ 2009
 ■ 2010

Liquidity Sources and Requirements

GEM's two primary liquidity sources are cash flows from premiums and investment income from its investment portfolio. For 2010, GEM generated a positive cash flow from operations for the year ended December 31, 2010 of \$5,492 thousand as compared against a positive cash flow of \$6,660 thousand in 2009.

A secondary source of liquidity is the investment portfolio which is primarily invested in high quality bonds that are readily marketable. During 2010, GEM generated \$26,659 thousand of proceeds from investments sold or matured and used \$30,162 thousand to acquire new bonds and common stock. Overall cash flow from investment activities was a negative \$3,563 thousand as invested assets increased in 2010.

Cash and cash equivalents, defined as short-term investments or long-term investments with a maturity under one year, increased to \$3,671 thousand at December 31, 2010 from \$1,742 thousand at December 31, 2009, which is the difference between the positive cash flow from operations and the cash consumed by investment activities.



Enterprise Risks

Liquidity Risk

Liquidity risk is the risk that GEM will not have access to sufficient funds to meet its liabilities when due. GEM's liquidity management consists of policies and procedures to ensure that adequate liquidity is available at all times. The liquidity position is assessed on a monthly basis and both normal and stressed market conditions are considered as part of this process. Where liquidity gaps exist, they are primarily more than three years in the future since GEM's invested assets have a duration of approximately 3.7 years while its liabilities have longer durations due to the type of insurance risk.

Market Risk

GEM has exposure to market risk arising from its insurance operations and investment activities. Market risk can be defined as the risk of potential fluctuation in earnings, cash flows and fair value of its assets and liabilities due to changes in the level of market rates and prices. Since GEM is a regulated entity, market risk can also arise from changes in the political or regulatory landscape that impact GEM as a captive reinsurance company or impact GEM's members as public entity risk pools.

Interest Rate Risk

GEM's exposure to interest rate changes results from its significant holdings of fixed rate investments. GEM manages its interest rate risk through the use of investment managers and investment consultants. GEM consults with its investment manager and investment consultant in order to ensure that the construction of its investment portfolio is designed to specifically satisfy the cash flow needs from its insurance activities on an on-going basis. The investment portfolio is constrained in terms of quality of investments and the maturity and duration of the securities in order to make sure that GEM is not subject to undue interest rate risk.

Other Required Disclosures

Off-Balance Sheet Arrangements – None

Participation in High Yield Financings, Highly Leveraged Transactions or Non-Investment Grade Loans and Investments – None

Preliminary Merger and Acquisition Negotiations – None



The pessimist complains about the wind;
the optimist expects it to change;
the realist adjusts the sails.

-William A. Ward

Independent Auditors' Report

Board of Directors
Government Entities Mutual, Inc.
Washington D.C.

We have audited the accompanying balance sheets of Government Entities Mutual, Inc. (the "Company") as of December 31, 2010 and 2009, and the related statements of operations and comprehensive income (loss), changes in members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness on the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Brown Smith Wallace, L.L.C.

St. Louis, Missouri
April 21, 2011

BALANCE SHEETS – DECEMBER 31, 2010 AND 2009

ASSETS	2010	2009
▪ Cash and cash equivalents	\$3,670,608	\$1,741,968
▪ Certificates of deposit	—	1,503,697
▪ Investments, available for sale, at fair value	53,174,771	47,148,618
▪ Receivable for securities	255,669	—
▪ Accounts receivable	—	97
▪ Premiums receivable	1,558,097	1,043,567
▪ Reinsurance recoverable, gross paid and unpaid	18,278,044	13,377,918
▪ Prepaid reinsurance	2,176,017	1,734,473
▪ Deferred policy acquisition costs	10,658	9,612
▪ Prepaid expenses and other assets	47,964	135,597
▪ Accrued interest receivable	428,647	384,858
▪ Fixed assets, net of accumulated depreciation of \$264,801 and \$221,529 in 2010 and 2009, respectively	93,229	76,414
TOTAL ASSETS	\$79,693,704	\$67,156,819
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
▪ Unpaid losses and loss adjustment expenses	\$50,499,735	\$40,116,974
▪ Unearned premiums	4,739,133	4,283,277
▪ Premium taxes payable	25,934	25,823
▪ Accrued expenses	1,949,532	124,325
▪ Employee benefits payable	32,588	44,471
TOTAL LIABILITIES	57,246,922	44,594,870
MEMBERS' EQUITY		
▪ Members' contributions	14,512,369	14,512,369
▪ Accumulated other comprehensive income	2,251,696	1,920,577
▪ Retained earnings	5,682,717	6,129,003
TOTAL MEMBERS' EQUITY	22,446,782	22,561,949
TOTAL LIABILITIES AND MEMBERS' EQUITY	\$79,693,704	\$67,156,819

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

Note A *Operations*

Government Entities Mutual, Inc. (the "Company") is an association sponsored reinsurance captive domiciled in the District of Columbia. The Company received its certificate of authority on December 19, 2002, and commenced operations on January 1, 2003. The Company is controlled and capitalized by Member public entity risk pools. The Company provides reinsurance to its Members on an excess of loss or quota share basis for liability, workers' compensation, auto physical damage and property.

In December 2009, the Company's Board of Directors approved amendments to the Company's articles of incorporation to convert the Company to a protected cell captive insurer under the captive insurance laws of the District of Columbia. The change to a protected cell captive insurer became effective January 2010. As of December 31, 2010, the Company has not created any segregated cells.

Note B *Significant Accounting Policies***Basis of Presentation**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America that differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities (Note F).

Use of Estimates

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

Cash and Cash Equivalents

For financial statement purposes, the Company considers all short-term investments with an original maturity of three months or less from the date of purchase to be cash equivalents. For these short-term investments, the carrying amount is an estimate of market value. At December 31, 2010 and 2009, the Company did not hold short-term investments classified as cash equivalents.

Cash and cash equivalent balances maintained at banks are insured by the Federal Deposit Insurance Corporation (FDIC). The Company maintains deposits in excess of the FDIC insurance limits from time to time, in the normal course of business. Deposits are secured by an irrevocable letter of credit issued by the Federal Home Loan Bank of Pittsburgh to cover amounts in excess of FDIC limits.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2010 AND 2009

REVENUES	2010	2009
▪ Net earned premiums	\$7,558,572	\$7,974,872
▪ Investment income, net	1,890,076	1,848,998
▪ Realized gains on investments	726,741	302,864
TOTAL REVENUES	10,175,389	10,126,734
EXPENSES		
▪ Losses and loss adjustment expenses	9,012,801	6,831,266
▪ General and administrative expenses	1,383,961	1,408,418
▪ Underwriting expenses incurred	224,913	156,519
TOTAL EXPENSES	10,621,675	8,396,203
NET INCOME (LOSS)	(446,286)	1,730,531
OTHER COMPREHENSIVE INCOME		
▪ Unrealized holding gain on available for sale securities	1,057,860	2,191,666
▪ Reclassification adjustments for realized gains (losses) included in net income (loss)	(726,741)	(302,864)
TOTAL OTHER COMPREHENSIVE INCOME	331,119	1,888,802
COMPREHENSIVE INCOME (LOSS)	\$(115,167)	\$3,619,333

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

STATEMENTS OF CHANGES IN MEMBERS' EQUITY
YEARS ENDED DECEMBER 31, 2010 AND 2009

	MEMBERS' CONTRIBUTIONS	ACCUMULATED OTHER COMPREHENSIVE INCOME	RETAINED EARNINGS	TOTAL
BALANCE AT DECEMBER 31, 2008	\$14,362,369	\$31,775	\$4,398,472	\$18,792,616
NET INCOME	–	–	1,730,531	1,730,531
▪ Members' contributions	150,000	–	–	150,000
▪ Other comprehensive income	–	1,888,802	–	1,888,802
BALANCE AT DECEMBER 31, 2009	14,512,369	1,920,577	6,129,003	22,561,949
NET LOSS	–	–	(446,286)	(446,286)
▪ Other comprehensive income	–	331,119	–	331,119
BALANCE AT DECEMBER 31, 2010	\$14,512,369	\$2,251,696	\$5,682,717	\$22,446,782

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

Note B *Significant Accounting Policies (continued)***Certificate of Deposits**

Certificate of deposits are carried at cost, which approximates fair value.

Investments

The Company accounts for its investments in accordance with Financial Accounting Standards Board ("FASB") ASC 320, Investments – Debt and Equity Securities. Management determines the appropriate classification of its investments at the time of purchase and reevaluates such determination at each balance sheet date (Note D).

All of the Company's investments at December 31, 2010 and 2009 were classified as available for sale. Available for sale securities may be sold prior to maturity and are carried at fair value. Unrealized gains and losses relating to available for sale securities are reported in a separate component of members' equity as accumulated other comprehensive income (loss).

Realized investment gains and losses on investments sold, determined on a specific identification basis, are included in income.

Other-Than-Temporary Impairments on Investments

When a decline in fair market value is deemed to be other-than-temporary, a provision for impairment is charged to earnings, included in net realized investment losses, and the cost basis of that investment is reduced accordingly (Note C).

Premiums Receivable

Premiums receivable are stated at the amount the Company expects to collect from balances outstanding at year-end. Based on management's assessment of the credit history with policyholders having outstanding balances and current relationships with them, it has concluded that realization of losses on balances outstanding at year-end will be insignificant.

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2010 AND 2009		
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME (LOSS)	\$(446,286)	\$1,730,531
<i>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</i>		
▪ Depreciation	43,273	21,067
▪ Amortization of fixed maturity securities	34,836	17,151
▪ Realized gains	(726,741)	(302,864)
<i>Changes in assets and liabilities:</i>		
▪ Reinsurance recoverable	(4,900,126)	4,246,460
▪ Prepaid reinsurance	(441,544)	(145,693)
▪ Deferred policy acquisition costs	(1,046)	30,692
▪ Premiums receivable	(514,433)	(1,043,664)
▪ Receivable for securities	(255,669)	49,300
▪ Prepaid expenses and other assets	87,633	(102,834)
▪ Accrued interest receivable	(40,092)	(98,224)
▪ Unpaid losses and loss adjustment expenses	10,382,761	2,089,171
▪ Unearned premiums	455,856	259,250
▪ Premium taxes payable	111	(2,619)
▪ Accrued expenses	1,825,207	(101,300)
▪ Employee benefits payable	(11,883)	13,784
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,491,857	6,660,208
CASH FLOWS FROM INVESTING ACTIVITIES:		
▪ Purchases of investments	(30,162,417)	(30,547,746)
▪ Purchases of certificates of deposit	–	(1,500,000)
▪ Proceeds from sales of investments	26,659,288	17,098,898
▪ Purchases of fixed assets	(60,088)	(77,536)
NET CASH USED IN INVESTING ACTIVITIES	(3,563,217)	(15,026,384)
CASH FLOWS FROM FINANCING ACTIVITIES:		
▪ Contributions received from Members	–	150,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	–	150,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,928,640	(8,216,176)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,741,968	9,958,144
CASH AND CASH EQUIVALENTS, END OF YEAR	\$3,670,608	\$1,741,968

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

Note B *Significant Accounting Policies (continued)***Fixed Assets**

Fixed assets, consisting of computer equipment, software, furniture and fixtures, are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Depreciation expense for the years ended December 31, 2010 and 2009 was \$43,273 and \$21,067, respectively.

Deferred Policy Acquisition Costs

Policy acquisition costs, representing commissions and premium taxes, are deferred and expensed over the term of the related policies. Amortization of acquisition costs amounted to \$224,913 and \$156,519 for the years ended December 31, 2010 and 2009, respectively, and is included in underwriting expenses incurred within the statements of operations and comprehensive income (loss).

Premium Deficiency

The Company recognizes premium deficiencies when there is a probable loss on an insurance contract. Premium deficiencies are recognized if the sum of expected losses and loss adjustment expenses, expected dividends to policyholders, and maintenance costs exceed unearned premiums and anticipated investment income. There were no premium deficiencies as of December 31, 2010 and 2009.

Recognition of Premium Revenues

Premiums written are earned on a pro-rata basis over the related policy period. The portion of premiums that will be earned in the future is deferred and reported as unearned premiums.

Federal Income Taxes

The Company is exempt from federal taxes in accordance with Section 115(1) of the Internal Revenue Code.

Effective January 1, 2009, the Company implemented the accounting guidance for uncertainty in income taxes using the provisions of FASB ASC 740, Income Taxes. The adoption of FASB ASC 740 did not have a material impact on the Company's financial statements. The Company has concluded that there are no significant uncertain tax positions requiring disclosure. Tax years that remain subject to examination are the years ended December 31, 2007, 2008 and 2009. The Company continues to evaluate its tax exempt status in relation to FASB ASC 740.

Reinsurance

In the normal course of business, the Company seeks to reduce its loss exposure by reinsuring certain levels of risk with reinsurers. Reinsurance is accounted for in accordance with FASB ASC 944, Financial Services - Insurance. Ceded premiums are expensed over the period that coverage is provided. Prepaid reinsurance premiums are calculated on a pro-rata basis for the unexpired term of the policy in force. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsurance policies.

Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses includes estimates for reported losses, plus supplemental amounts calculated based upon loss projections utilizing actuarial studies of a similar group of insureds and industry data. In establishing the liability for losses and loss adjustment expenses, the Company utilizes the findings of an independent consulting actuary. Management believes that its aggregate liability for unpaid losses and loss adjustment expenses at year end represents its best estimate, based upon available data, of the amount necessary to cover the ultimate cost of losses; however, because of the limited population of insured risks and the limited historical experience, it is not presently possible to determine whether actual loss experience will conform to the assumptions used in determining the estimated amounts for such liability and the related reinsurance recoverable at the balance sheet dates. Accordingly, the ultimate liability and recoverable could be significantly in excess of or less than the amount indicated in the financial statements. As adjustments to these estimates become necessary, such adjustments will be reflected in current operations.

Comprehensive Income (Loss)

The Company reports comprehensive income (loss) in accordance with FASB ASC 220, Comprehensive Income. Comprehensive income is a measurement of certain changes in members' equity that result from transactions and other economic events other than transactions with Members. For the Company, these events consist of changes in unrealized gains and losses on the investment portfolio, which are used to adjust net income (loss) to arrive at comprehensive income (loss). The cumulative amount of these changes is reported in the balance sheets within accumulated other comprehensive income.

Subsequent Events

The Company has evaluated all subsequent events through April 21, 2011, the date the financial statements were available to be issued.

Note C *Investments*

The Company invests in mutual funds and fixed maturity securities. Mutual bond funds are classified as equity securities in accordance with FASB ASC 320.

The investments classified as available for sale and carried at fair value as of December 31, 2010, are as follows:

INVESTMENTS CLASSIFIED AS AVAILABLE FOR SALE AND CARRIED AT FAIR VALUE AS OF DECEMBER 31, 2010				
	ORIGINAL OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
Corporate and foreign debt securities	\$16,892,072	\$788,368	\$(54,391)	\$17,626,049
U.S. government obligations	8,012,703	121,694	(98,550)	8,035,847
U.S. states, territories, and possessions	953,429	30,565	(14,046)	969,948
U.S. political subdivisions of states, territories, and possessions	2,672,198	85,431	(12,655)	2,744,974
U.S. special revenue and special assessment	1,214,248	27,748	–	1,241,997
All other governments	244,826	12,889	–	257,714
Mortgage and asset backed securities	19,094,039	920,732	(48,540)	19,966,231
Total fixed maturities	49,083,515	1,987,427	(228,182)	50,842,760
Equity securities	1,839,559	492,452	–	2,332,011
TOTAL	\$50,923,075	\$2,479,878	\$(228,182)	\$53,174,771

The investments classified as available for sale and carried at fair value as of December 31, 2009, are as follows:

INVESTMENTS CLASSIFIED AS AVAILABLE FOR SALE AND CARRIED AT FAIR VALUE AS OF DECEMBER 31, 2009				
	ORIGINAL OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
Corporate and foreign debt securities	\$12,788,011	\$587,619	\$(4,375)	\$13,371,255
U.S. government obligations	10,760,611	304,580	(7,493)	11,057,698
Mortgage and asset backed securities	20,117,895	875,279	(3,176)	20,989,998
Total fixed maturities	43,666,517	1,767,478	(15,044)	45,418,951
Equity securities	1,561,524	168,143	–	1,729,667
TOTAL	\$45,228,041	\$1,935,621	\$(15,044)	\$47,148,618

The following table shows the amortized cost and fair value of debt securities at December 31, 2010, by contractual maturity. 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 AND FAIR VALUE OF DEBT SECURITIES AT DECEMBER 31, 2010		
	AMORTIZED COST	FAIR VALUE
Less than one year	\$1,615,784	\$1,639,896
One year through five years	11,941,000	12,376,227
Five through ten years	12,265,568	12,659,764
More than ten years	4,167,124	4,200,642
Mortgage and asset backed securities	19,094,039	19,966,231
TOTAL	\$49,083,515	\$50,842,760

As of December 31, 2010 and 2009, the Company held 43 and 14 securities having unrealized losses, respectively. Since the Company has the ability and intent to hold these securities until a recovery of amortized cost, which may be at maturity, and because the unrealized losses were primarily due to significant increases in prepayments received on mortgage backed and asset backed securities during the year, the Company does not consider these securities to be other than temporarily impaired.

The following table shows the investments' gross unrealized loss and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010:

INVESTMENT	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
Corporate and foreign debt securities	\$2,023,150	\$(33,428)	\$372,211	\$(20,963)
U.S. government obligations	4,901,206	(98,550)	–	–
U.S. states, territories, and possessions	260,955	(14,046)	–	–
U.S. political subdivisions of states, territories, and possessions	1,098,573	(12,655)	–	–
Mortgage and asset backed securities	4,012,277	(48,450)	–	–
TOTAL	\$12,296,161	\$(207,219)	\$372,211	\$(20,963)

Note C *Investments (continued)*

The following table shows the investments' gross unrealized loss and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009:

INVESTMENT	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
Corporate and foreign debt securities	\$1,505,820	\$(4,375)	\$-	\$-
Mortgage and asset backed securities	1,731,573	(7,493)	-	-
Equity securities	994,116	(3,176)	-	-
TOTAL	\$4,231,509	\$(15,044)	\$-	\$-

The Company monitors its investment securities to identify impairments in value. The Company evaluates factors such as financial condition of the issuer, payment performance, the length of time and the extent to which the estimated fair value has been below amortized cost, general market conditions, intent and ability to hold securities, and various other subjective factors. Based on management's judgment, securities with other-than-temporary impairment in value are written down to management's estimate of fair value. No impairment loss on investment securities was recorded for the years ended December 31, 2010 and 2009.

Proceeds from sales of investments, including maturing certificates of deposits, amounted to \$26,659,288 and \$17,098,898 in 2010 and 2009, respectively. The gross losses realized on sales were \$80,145 and \$56,782 for 2010 and 2009, respectively. The gross gains realized on sales were \$806,886 and \$359,646 for 2010 and 2009, respectively.

Note D *Fair Value Measurements*

Certain financial assets and liabilities are valued using market prices from active markets (level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily-observable inputs of the instrument. Level 3 instrument valuations are done primarily with unobservable inputs which are significant to the fair value measurement. As of December 31, 2010 and 2009, the Company did not have any assets with valuations without observable market values or other inputs that would require a high level of judgment to determine fair value (level 3 instruments).

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2010 and 2009, respectively.

Bonds: Valued at quoted market prices in less active markets; quoted market prices for similar instruments, and pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data.

Mutual funds: Valued at the net asset value of shares held by the Company at year end.

Certificates of deposit: Valued at the principal deposited, plus accrued interest.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Note D *Fair Value Measurements (continued)*

FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2010				
DECEMBER 31, 2010	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
<i>Fixed maturity securities</i>				
▪ Corporate and foreign debt securities	\$ –	\$17,626,049	\$ –	\$17,626,049
▪ U.S. government obligations	–	8,035,847	–	8,035,847
▪ U.S. states, territories, and possessions	–	969,948	–	969,948
▪ U.S. political subdivisions of states, territories, and possessions	–	2,744,974	–	2,744,974
▪ U.S. special revenue and special assessment	–	1,241,997	–	1,241,997
▪ All other governments	–	257,714	–	257,714
▪ Mortgage and asset backed securities	–	19,966,231	–	19,966,231
TOTAL FIXED MATURITY SECURITIES	–	50,842,760	–	50,842,760
<i>Equity securities</i>				
▪ Mutual funds	2,332,011	–	–	2,332,011
TOTAL INVESTMENTS	\$2,332,011	\$50,842,760	\$–	\$53,174,771

FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2009				
DECEMBER 31, 2009	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
<i>Fixed maturity securities</i>				
▪ Corporate and foreign debt securities	\$ –	\$13,371,255	\$ –	\$13,371,255
▪ U.S. government obligations	–	11,057,698	–	11,057,698
▪ Mortgage and asset backed securities	–	20,989,998	–	20,989,998
Total fixed maturity securities	–	45,418,951	–	45,418,951
<i>Equity securities</i>				
▪ Mutual funds	1,729,667	–	–	1,729,667
▪ Certificates of deposit	1,503,697	–	–	1,503,697
TOTAL INVESTMENTS	\$3,233,364	\$45,418,951	\$ –	\$48,652,315

Note E *Insurance Activity*

The Company reinsures on an excess of loss or quota share basis for liability, workers' compensation, auto physical damage and property coverage of its Members. The policies are written on either a per occurrence basis, or claims made basis. The Members retain various self-insured retentions ("SIR"). The Company then offers gross limits of coverage that vary by policy.

The Company purchases retrocession coverage on liability and property with U.S. and Bermuda domiciled reinsurers rated A+ (Superior) by A.M. Best Company. The following tables provide information on Member SIR's, the Company's gross and net retentions and the limits ceded to reinsurers for years ended December 31, 2010 and 2009, respectively.

	MEMBER SIR (000 OMITTED)	GROSS LIMITS (000 OMITTED)	RETROCEDED LIMITS (000 OMITTED)	NET LIMITS (000 OMITTED)
DECEMBER 31, 2010				
Liability (per occurrence)	\$300 – 10,000	\$600 – 5,000	\$4,000	\$600 – 2,000
Workers' Compensation (per occurrence)	400 – 1,500	500 – 1,500	–	500 – 1,500
Property (per occurrence)	100 – 500	700 – 350,000	349,000	500 – 900
Property (aggregate)	300 – 4,750	350,000	349,500	500

	MEMBER SIR (000 OMITTED)	GROSS LIMITS (000 OMITTED)	RETROCEDED LIMITS (000 OMITTED)	NET LIMITS (000 OMITTED)
DECEMBER 31, 2009				
Liability (per occurrence)	\$200 – 10,000	\$600 – 5,000	\$4,000	\$600 – 2,000
Workers' Compensation (per occurrence)	400 – 1,500	500 – 1,500	–	500 – 1,500
Property (per occurrence)	100 – 500	500 – 350,000	349,000	500 – 900
Property (aggregate)	300 – 4,750	350,000	349,500	500

Note E *Insurance Activity (continued)*

The reinsurance contracts reduce the exposure to large losses by permitting recovery of a portion of the losses and loss adjustment expenses. The reinsurance contracts do not relieve the Company from its primary obligations to its policyholders. Additionally, failure of a reinsurer to honor its obligations for claims incurred in prior years and reported in the current or future years could result in significant losses to the Company.

Premiums assumed and the related reinsurance amounts for the years ended December 31, 2010 and 2009 were as follows:

PREMIUMS ASSUMED AND RELATED REINSURANCE AMOUNTS				
	2010		2009	
	WRITTEN	EARNED	WRITTEN	EARNED
Assumed	\$11,526,266	\$11,070,410	\$11,475,858	\$11,163,796
Ceded	(3,953,382)	(3,511,838)	(3,387,500)	(3,188,924)
NET	\$7,572,884	\$7,558,572	\$8,088,358	\$7,974,872

The Company recorded reinsurance recoveries of \$6,226,608 and (\$947,508) in 2010 and 2009, respectively, which is reflected as a decrease (increase) in losses and loss adjustment expenses incurred in the statements of operations and comprehensive income (loss).

Activity in the liability for losses and loss adjustment expenses is summarized as follows for the years ended December 31, 2010 and 2009, respectively (in thousands):

LIABILITY FOR LOSSES AND LOSS ADJUSTMENT EXPENSES	2010	2009
BALANCE AT JANUARY 1,	\$40,117	\$38,028
Less: reinsurance recoverable (unpaid losses)	(12,160)	(15,551)
NET BALANCE AT JANUARY 1	27,957	22,477
<i>Incurred related to:</i>		
▪ Current year	7,919	6,527
▪ Prior years	1,094	304
TOTAL INCURRED	9,013	6,831
<i>Paid related to:</i>		
▪ Current year	(211)	–
▪ Prior years	(4,561)	(1,351)
TOTAL PAID	(4,772)	(1,351)
NET BALANCE AT DECEMBER 31	32,198	27,957
ADD: REINSURANCE RECOVERABLE (UNPAID LOSSES)	18,302	12,160
BALANCE AT DECEMBER 31,	\$50,500	\$40,117

Reinsurance recoverable on paid losses for the years ended December 31, 2010 and 2009 were \$84,836 and \$1,218,303, respectively, and are included in total reinsurance recoverable reported on the balance sheets.

For the year ended December 31, 2010 and 2009, incurred losses and loss adjustment expenses increased by approximately \$1,094,000 and \$304,000, respectively. The increase in incurred losses and loss adjustment expenses for 2010 and 2009 was primarily due to the unfavorable loss development and increase in reported losses sustained in prior years.

Note F *Members' Equity*

There are three classifications of membership with the Company: Founding, Premiere and Associate Members. The Board has adopted a Surplus Contribution and Withdrawal Policy that establishes the surplus requirements for each of the membership classes. Founding Members are those who made a surplus contribution prior to October 1, 2003. Premiere Members are eligible entities that made the required surplus contribution after October 1, 2003. Associate Members are those eligible entities who purchase reinsurance from the Company. Associate Members are required to make a minimum surplus contribution of \$20,000 at the time of initial membership and additional surplus contributions of \$20,000 on each policy renewal date for the next four years, for a total contribution of \$100,000, in accordance with the Member Surplus Contribution and Withdrawal Policy.

The Company is a non-assessable mutual insurance company. However, the Board may request additional surplus contributions, in such amounts and at such times as may be deemed necessary and appropriate by the Board, in order to maintain adequate surplus to premium ratios for the safe and sound operation of the Company.

Note F *Members' Equity (continued)*

Founding and Premiere Members shall have one vote for each \$100,000 of the Member's allocated surplus account balance. Associate Members will receive one vote once the total surplus contribution of \$100,000 is attained.

If a Member ceases to obtain insurance from the Company, it can either withdraw its surplus account or maintain the account. If the Member elects to withdraw the account, such withdrawal will be completed, at the sole discretion of the Board and approval by the District of Columbia Department of Insurance Securities and Banking (the Department), no later than five years from the date of notice of withdrawal. If the Member withdraws from the Company within a five year period of becoming a Member it will forfeit all surplus.

Following is a schedule of Member surplus contributions as of December 31, 2010 and 2009 :

MEMBER SURPLUS CONTRIBUTIONS AS OF DECEMBER 31, 2010 AND 2009			MEMBER SURPLUS CONTRIBUTIONS AS OF DECEMBER 31, 2010 AND 2009		
FOUNDING MEMBERS	2010	2009	FOUNDING MEMBERS	2010	2009
▪ PDRMA	\$2,400,000	\$2,400,000	▪ VTLP	500,000	500,000
▪ NH PRIMEX	2,250,000	2,250,000	▪ WMMIC	500,000	500,000
▪ MMRMA	1,144,795	1,144,795	▪ TASBRMF	500,000	500,000
▪ ENDURIS	975,708	975,708	PREMIERE MEMBERS:		
▪ DVIT	926,866	926,866	▪ CALTIP	655,000	655,000
▪ MMIA	750,000	750,000	▪ TWCARMF	500,000	500,000
▪ WSTIP	750,000	750,000	ASSOCIATE MEMBERS:		
▪ WCIA	750,000	750,000	▪ SCCPLT	25,000	25,000
▪ MVRMA	750,000	750,000	▪ SDRMA	5,000	5,000
▪ TCRMF	625,000	625,000	▪ AMLJIA	5,000	5,000
▪ MPR	500,000	500,000	TOTAL	\$14,512,369	\$14,512,369

Statutory Capital

District of Columbia captive insurance statutes require \$500,000 minimum unimpaired paid-in capital and surplus be maintained by an association sponsored reinsurance captive. The Company has filed its annual statement with the Department on a statutory basis.

The following table reconciles the financial statements to the annual statutory statement filed with the Department for December 31, 2010 and 2009:

FINANCIAL STATEMENTS TO THE ANNUAL STATUTORY STATEMENT FILED WITH THE DEPARTMENT FOR DECEMBER 31, 2010				
DECEMBER 31, 2010:	ASSETS	LIABILITIES	MEMBERS' EQUITY	NET LOSS
As reported within audited financial statements	\$79,693,704	\$57,246,922	\$22,446,782	\$(446,286)
Deferred acquisition costs	(10,658)	–	(10,658)	(1,048)
Market value adjustment	(1,759,244)	–	(1,759,244)	–
Reclassification	(20,477,404)	(20,477,404)	–	–
Non-admitted assets	(128,047)	–	(128,047)	–
Other-	(1)	–	(1)	20
As reported within the annual statement on a statutory basis	\$57,318,350	\$36,769,518	\$20,548,832	\$(447,314)

FINANCIAL STATEMENTS TO THE ANNUAL STATUTORY STATEMENT FILED WITH THE DEPARTMENT FOR DECEMBER 31, 2009				
DECEMBER 31, 2009:	ASSETS	LIABILITIES	MEMBERS' EQUITY	NET INCOME
As reported within audited financial statements	\$67,156,819	\$44,594,870	\$22,561,949	\$1,730,531
Deferred acquisition costs	(9,612)	–	(9,612)	30,446
Market value adjustment	(1,752,472)	–	(1,752,472)	–
Reclassification	(13,894,101)	(13,869,394)	(24,707)	–
Non-admitted assets	(185,425)	–	(185,425)	–
Other-	–	–	–	(33)
As reported within the annual statement on a statutory basis	\$51,315,209	\$30,725,476	\$20,589,733	\$1,760,944

Note G *Employee Benefit Plans*

The Company has established a 401(k) employer contribution plan. The Company will provide an immediately vested contribution to this plan in the amount equal to 10% of the employee's base salary plus a percentage amount equal to the existing social security percentage on the difference between the social security wage base and the annual salary for each employee. The Company has recorded these contributions of \$57,674 and \$55,662 within the general and administrative expenses on the statements of income and comprehensive income for the years ended December 31, 2010 and 2009, respectively.

During 2010 the Company terminated its Section 457 deferred compensation plan. Plan assets were transferred to the Company's 401(k) employer contribution plan.

Note H *Related Parties*

The Company leases office space from one of its Members. The lease agreement that expired on December 31, 2008 was renewed for a five year period, expiring December 31, 2013 (Note I).

Note I *Commitments and Contingencies*

Various lawsuits against the Company have arisen in the course of business. Contingent liabilities arising from litigation and other matters are not considered material in relation to the financial position of the Company.

The Company is currently party to a land-use lawsuit that it has defended under a Reservation of Rights. At December 31, 2010 and 2009, the Company has fully reserved for the claim on both a gross and net basis. The Company's exposure to loss on this claim may be significantly less or greater than its current recorded net retention of \$1,000,000.

The Company renews an annual agreement for various accounting and financial reporting services from a third party administrator. Fees paid for services rendered for the years ended December 31, 2010 and 2009 were \$160,609 and \$136,087, respectively.

The Company leases office space from a related party under a non-cancelable operating lease agreement that expires December 31, 2013 (Note H). Annual rental payments of \$11,330 are included within the Company's general and administrative expenses on the statements of operations and comprehensive income (loss) for the years ended December 31, 2010 and 2009.

At December 31, 2010, the minimum aggregate rental commitment is as follows:

MINIMUM AGGREGATE RENTAL COMMITMENT	
YEAR ENDING DECEMBER 31	OPERATING LEASE
2011	\$11,670
2012	12,020
2013	12,380

Note J *Letter of Credit*

The Company had secured a letter of credit in the amount of \$862,000 to benefit one of its Members to collateralize the Member's reinsurance recoverable (including incurred but not reported claims and case reserves) from the Company. A reinsurance trust to benefit the Member was substituted for the letter of credit effective January 1, 2007. The value of this trust was \$986,549 and \$952,719 as of December 31, 2010 and 2009, respectively, and is included within cash and cash equivalents.

Letter of Independent Auditors' Qualification

The Board of Directors
Government Entities Mutual, Inc.
46 Donovan Street, Suite #1
Concord, NH 03301

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Government Entities Mutual, Inc. (the "Company") as of and for the years ended December 31, 2010 and 2009, and have issued our report thereon dated April 21, 2011. In connection therewith, we advise you as follows:

- A. We are independent certified public accountants with respect to the Company and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants, and the Rules of Professional Conduct of the Missouri Board of Public Accountancy.
- B. The engagement partner and engagement manager, who are certified public accountants, have over 26 years and 6 years, respectively, of experience in public accounting and are experienced in auditing insurance enterprises. Members of the engagement team, most of whom have had experience in auditing insurance enterprises and 100 percent of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.
- C. We understand that the Company intends to file its audited financial statements and our report thereon with the District of Columbia Department of Insurance and Securities Regulation and other state insurance departments in states in which the Company is licensed and that the insurance commissioners of those states will be relying on that information in monitoring the regulating and financial condition of the Company.

While we understand that an objective of issuing a report on the financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of insurance regulators. In this context, the Company and insurance commissioners should understand that the objective of an audit of financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the financial statements present fairly, in all material respects, the balance sheets, income and comprehensive income, changes in members' equity and cash flows in conformity with accounting practices prescribed or permitted by the District of Columbia Department of Insurance and Securities Regulation. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused

by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, particularly those involving concealment and falsified documentation (including forgery), a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements resulting from fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by insurance commissioners.

It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control structure that will, among other things, provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting practices prescribed or permitted by the District of Columbia Department of Insurance and Securities Regulation.

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the financial position of insurers and should not rely solely upon the independent auditor's report.

- D. We will retain the workpapers prepared in the conduct of our audit until the District of Columbia Department of Insurance and Securities Regulation has filed a Report of Examination covering 2010, but not longer than seven years. After notification to the Company, we will make the workpapers available for review by the District of Columbia Department of Insurance and Securities Regulation at the offices of the insurer, at our offices, at the insurance department or at any other reasonable place designated by the insurance commissioner. Furthermore, in the conduct of the aforementioned periodic review by the District of Columbia Department of Insurance and Securities Regulation, photocopies of pertinent audit working papers may be made (under the control of the accountant) and such copies may be retained by the District of Columbia Department of Insurance and Securities Regulation.

- E. The engagement partner has served in the capacity with respect to the Company since 2008, is licensed by the Missouri Board of Public Accountancy, and is a member in good standing of the American Institute of Certified Public Accountants.
- F. To the best of our knowledge and belief, we are in compliance with the requirements of section 7 of the NAIC's Model Rule (Regulation) Requiring Annual Audited Financial Reports regarding qualifications of independent certified public accountants.
- G. A certificate of insurance stating our professional liability coverage is attached.

This letter is intended solely for the information and use of board of directors and management of the Company and the District of Columbia Department of Insurance and Securities Regulation and other state insurance departments and is not intended to be and should not be used by anyone other than these specified parties.

Brown Smith Wallace, L.L.C.

April 21, 2011

Internal Controls Letter

**The Board of Directors
Government Entities Mutual, Inc.
46 Donovan Street, Suite #1
Concord, NH 03301**

We have audited the financial statements of Government Entities Mutual, Inc. (the "Company") for the years ended December 31, 2010 and 2009, and have issued our report thereon dated April 21, 2011. In planning and performing our audits of the financial statements of the Company, we considered internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

This letter is intended solely for filing with state regulatory authorities and for the information and use of the Board of Directors, management, and others within the organization and should not be used for any other purpose.

Brown Smith Wallace, L.L.C.

April 21, 2011





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