

REPORT ON EXAMINATION

OF THE

AMERICAN ASSOCIATION OF INSURANCE SERVICES, INC.

AS OF

DECEMBER 31, 2005

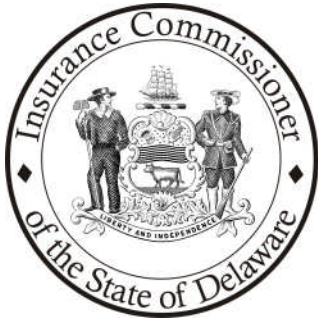
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

AMERICAN ASSOCIATION OF INSURANCE SERVICES, INC.

is a true and correct copy of the document filed with this Department.

ATTEST BY: *Antoinette Handy*

DATE: 18 JUNE 2007



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 18TH DAY OF JUNE 2007.

Matthew Denn
Insurance Commissioner

REPORT ON EXAMINATION
OF THE
AMERICAN ASSOCIATION OF INSURANCE SERVICES, INC.
AS OF
December 31, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.



MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 18TH Day of JUNE 2007.

TABLE OF CONTENTS

	<u>Page</u>
SALUTATION	1
SCOPE OF EXAMINATION	2
HISTORY	3
CAPITALIZATION	3
MANAGEMENT AND CONTROL	
Membership	3
Board of Directors	3
Officers	5
Committees	6
Conflict of Interest	7
ORGANIZATIONAL STRUCTURE	7
TRANSACTIONS WITH AFFILIATES	8
TRANSACTIONS WITH OUTSIDE SERVICE PROVIDERS	8
TERRITORY AND PLAN OF OPERATION	9
ACCOUNTS AND RECORDS	10
FINANCIAL STAMENTS	11
Balance Sheet	13
Income Statement	14
POLICY FORMS AND RATE FILING ANALYSIS	15
STATISTICAL INFORMATIOAN FILING ANALYSIS	15
RECOMMENDATIONS	16
CONCLUSION	16

March 5, 2007

Honorable Matthew Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Building
Dover, Delaware, 19901

Dear Commissioner:

In compliance with instructions contained in Certificate of Authority No. 06.035, an examination has been made of the affairs, financial condition and management of

AMERICAN ASSOCIATION OF INSURANCE SERVICES, INC.

hereinafter referred to as "AAIS" or "the Association", a domestic non-stock, non-profit corporation. The Company's registered office in Delaware is c/o The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware. The examination was conducted pursuant to the Delaware Revised Insurance Statutes Title 18 Chapter 25 Section 2524, at the main administrative office of the Company located at 1745 Naperville Road, Wheaton, Illinois 60187 – 8132.

The report of such examination is respectfully submitted herewith.

SCOPE OF EXAMINATION

This examination of AAIS covers the period for January 1, 2001 through December 31, 2005. Business activities subsequent to the year-end 2005 were reviewed where deemed necessary.

The primary focus of this report is to determine the accuracy and reliability of the Association's statistical, policy forms and rate filing process. Therefore, this examination will consist of a general review and testing of methods employed by the Association in compiling and submission of statistical, policy forms, and rate filing data to the States, Territories, and Commonwealths of the United States of America on behalf of its membership and non-membership subscribers. This report will not analyze the financial aspects of the Company's operations because it does not underwrite or assume insurance risk, and therefore is not subject to any specific statutory financial reporting requirements. This report also will not contain an analysis of any relativity factors, credibility factors, or other items of an actuarial nature.

The format of this report is designed to explain the procedures employed on the examination and any findings. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

In addition to items hereinafter incorporated as part of the written report, the following were analyzed, but only made a part of the workpapers of this examination:

- Corporate Records
- Corporate Insurance
- Federal and State Tax Filings
- Employee Pension Plans and Welfare
- Legal Actions

HISTORY

AAIS was organized as the Transportation Insurance Rating Bureau, a non-profit trade association, in 1936. Its business operations mainly focused on rate and policy form filings involving transportation insurance risks. The Association's operations gradually evolved to encompass other property and casualty risks except automobile, workers' compensation and surety. In 1975 the name was changed to American Association of Insurance Services. In 1984 the Association incorporated in Delaware as American Association of Insurance Services, a non-profit corporation which is tax-exempt pursuant to Section 501(c) (6) of the Federal Internal Revenue Code.

CAPITALIZATION

The Articles of Incorporation do not give the Association authority to issue capital stock.

MANAGEMENT AND CONTROL

Membership:

Insurers that utilize the services of AAIS and organized groups of such insurers can become members of the Association. Those that choose to become Association members have voting rights and can participate in the management of the Association by appointing representatives to serve on the Board of Directors and its Committees. Members may also be liable for the actions of the Association. The corporate bylaws require an annual Membership meeting to be held on the second Monday in April to, among other things, elect members to the Board of Directors. The Association currently has about 180 members.

Board of Directors:

There are currently ten membership representatives serving on the Association's Board of Directors. The number has remained the same since the Association's incorporation, although

American Association of Insurance Services Inc.

the amended bylaws allow the Board to adjust the number of positions by resolution. The bylaws currently also state the following:

- The Board of Directors must be comprised of:
 - The Association President
 - At least seven Association member representatives
 - Up to two non-member representatives
- Each elected representative serves a three-year term
- Association member representatives can be re-elected to the Board for two additional terms, non-member representatives can be re-elected for one additional term. The term restriction does not apply to the Association President.
- The powers and duties of the Board cannot extend to any matters relating to the pricing of insurance in any State or jurisdiction.
- The annual meeting of the Board must take place after the annual membership meeting.

Currently the terms of the Board representatives are staggered so that one-third of the representation is elected each year at the annual Membership meeting. The following individuals, elected by unanimous vote, constitute the current Board of Directors as of December 31, 2005:

<u>Name</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
Kenneth T. Stover	Executive Vice President Western National Insurance Group	2008
James W. Sullivan	President and CEO Co-Operative Insurance Companies	2006
Judy S. Jackson	President and CEO NLC Insurance Companies	2008
Darin L. Kath	President Jewelers Mutual Insurance Company	2006
Paul A. Baiocchi	President and Secretary American Association of Insurance Services	2007

American Association of Insurance Services Inc.

Thomas E. Claude	Vice President and Secretary Pharmacists Mutual Insurance Company	2008
Jack M. Rader	Executive Vice President and COO Farmers Alliance Companies	2007
Christopher P. Taft	Executive Vice President Preferred Mutual Insurance Company	2006
Richard J. Zick	President and CEO Utica First Insurance Company	2006
Roy R. Bubeck	President and CEO Badger Mutual Insurance Company	2007

Officers:

The amended bylaws differentiate between Board officers and Corporate officers. Board officers must consist of at least a Board Chairman and Vice-Chairman, other office positions may be created as required. Board officers are elected from among the representatives serving the Board of Directors for two-year terms. The representatives currently serving as Board officers are:

<u>Name</u>	<u>Title</u>
Kenneth T. Stover	Chairman
James W. Sullivan	Vice-Chairman

Corporate officers must consist of at least a President and Secretary, other office positions may be created as required. Corporate officers are elected by the Board of Directors for one-year terms and do not have to be Board members. One individual can hold several office titles. Those individuals currently serving as corporate officers are:

American Association of Insurance Services Inc.

<u>Name</u>	<u>Title</u>
Paul A. Baiocchi	President and Secretary
Robert Guevara	Vice-President, Marine Programs
William E. Stripp	Vice-President, Technical Services
Joyce M. Tignino	Vice-President, Marketing and Industry Relations
Deborah L. Summerlin	Vice-President, Insurance Lines

Committees:

Executive Committee:

The bylaws require the existence of an Executive Committee. The Executive Committee is to be comprised of the Chairman of the Board, the Vice-Chairman of the Board, and the President of the Corporation. The Executive Committee has the authority to exercise the powers and authority of the Board of Directors in the management of the business and affairs of the Association during the interval periods between Board meetings. During the period currently under review, the meetings of the Board of Directors and the Executive Committee were held at the same time. Those individual currently serving on the Executive Committee are:

Kenneth T. Stover
James W. Sullivan
Paul A. Baiocchi

Advisory Committees:

The Board of Directors may, by resolution, establish advisory committees as may be deemed necessary and establish the purpose of each committee and the rules and procedures under which such committee is to operate. During the period currently under review, the Association's Board of Directors established the following advisory committees:

Nominating Committee – seeks out and nominates Board representatives and corporate officers.

Personnel Committee – advises on management and employee annual salary adjustments.

American Association of Insurance Services Inc.

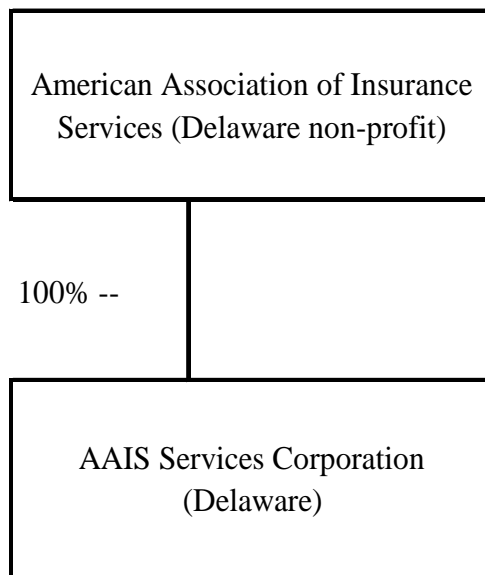
Conflict of Interest:

The Association does not currently have in place a formal procedure that requires management personnel and other key employees to disclose potential or perceived conflicts of interest. Therefore,

It is recommended the Association develop formal conflict of interest procedures in the near future.

ORGANIZATIONAL STRUCTURE

The Association currently wholly owns 100% of the outstanding shares of AAIS Services Corporation, which owns and manages the building currently being used by the Association as its principle administrative headquarters. The following chart illustrates the current existing organizational structure:



TRANSACTIONS WITH AFFILIATES

The Association rents office space from AAIS Service Corporation for \$15 per square foot. In 2005 it paid AAIS Service Corporation \$237,326 to rent office space. The Association also has made a series of loans to AAIS Services Inc. to construct the office building. In June 2003, the loaned amounts were consolidated into one \$2,450,000 promissory note. Two subsequent modifications to the note the following year increased the principal amount loaned to \$2,648,745. The note bears an interest rate of 5.5% and is to be paid off in equal monthly installments over a thirty-year period. The loan produced \$146,887 of interest income in 2005. As of year-end 2005 the outstanding balance on the loan is \$2,648,746.

TRANSACTIONS WITH OUTSIDE SERVICE PROVIDERS

The Association has not entered into any written management or service agreements involving the handling of daily business matters. However, it does utilize the services of outside entities for some functions. The Association uses outside entities to perform the following:

- prepare, distribute, and otherwise administrate the payroll;
- oversee and administrate the employee retirement plans;
- prepare and file its income tax forms.

As of the 2005 calendar year-end, the Association paid \$272,949 to outside organizations for audit, legal, and other services provided; and \$36,619 for pension administration services provided.

TERRITORY AND PLAN OF OPERATION

Territory:

The Association is licensed to transact business in all fifty states and Commonwealths, the District of Columbia, and in Puerto Rico. Testing performed during this examination indicates that all State corporate license renewals are current.

Plan of Operation:

The Association acts as an “Advisory Organization”, a “Statistical Agent”, and an “Information Provider” for a significant number property and casualty insurance companies. Both member and non-member (subscriber) insurers can utilize the Association’s services. It currently has about 480 members and subscribers. Assessments from members and subscribers provide the Association with its operational income. Assessments amounts are based on:

- The line of business involved
- Premium volume flow (from the previous calendar year)
- The number of States the member/subscriber does business in
- Type of services provided

As an “Advisory Organization”, the Association prepares and files policy forms, manuals of rules, and rating procedures on about twenty-one (21) property and casualty lines of insurance coverages. The filings are made with State insurance regulators on behalf of only those members and subscribers that have given AAIS filing authorization. It files this information with insurance regulators in two specific ways:

- Direct Method – The submission of required policy form and rating information on for approval on appropriate State forms with required attachments.
- SERFF (System for Electronic Rates & Forms Filing) - an electronic method of filing rates with States accepting and utilizing the program. It is supported and controlled by the National Association of Insurance Commissioners (the NAIC) which standardized and defined the filing requirements.

American Association of Insurance Services Inc.

The Association also distributes information to its membership and subscribers via bulletins. These bulletins include, among other things, instructions on adopting newly filed rules, forms, and mandatory endorsements.

The Association is one of only four operating “Statistical Agents” in the nation. As a “Statistical Agent”, the Association collects insurance company data on behalf of its members and subscribers and then files this information to the State insurance regulators in a summarized manner that satisfies statutory reporting requirements. Statistical information filed reflects activity specific to each individual State broken out by specific lines of business. For comparison purposes, countrywide statistical information is also filed along with the State specific statistics.

As an “Information Provider”, the Association provides information services to reinsurers, adjusters and software vendors requesting forms, manuals, and bulletin services in order that these entities can improve services being provided.

The Association utilizes several available resources to promote its services:

- the internet
- direct mailings
- presentations at trade conventions
- member or subscriber referrals

ACCOUNTS AND RECORDS

During the course of the review of the Association’s operational and organizational controls in place were observed. In general, it appears the Association has a sufficient level of controls in place. The Association also has in place a written formal disaster recovery plan to address a potential interruption of business functions at its main administrative office.

American Association of Insurance Services Inc.

The financial affairs of the Association are subject to review by an outside CPA firm. The same independent auditing firm analyzed and reported on the Association's financial statements for each year of the period currently being reviewed. In addition the auditing firm reviewed and commented upon the employee retirement plans the Association currently has in place. The comments indicate no disagreements with how the Association accounts for its employee retirement plans.

FINANCIAL STATEMENTS

The following financial statements present the financial position of the Association as of December 31, 2005, and the results of its operations for a one year period ending December 31, 2005. The Association's management prepared these financial statements specifically for this examination, because the Association operates on a July 1, through June 30, fiscal year. As such the financial statements presented have not been audited. The reason for not specifically analyzing the financial statements during the current examination is discussed earlier in this report under the subtitle "Scope of Examination". As such these financial statements have not been reviewed for accuracy. An independent auditor reviewed the fiscal year financial statements for each year of the period currently under examination. The reports issued by the independent auditors indicate the Association's financial statements have been prepared in accordance with Generally Accepted Accounting Principals.

The financial statements indicate the Association operated in a solvent financial environment for the 2005 calendar year. Each of the audited fiscal year financial statements indicate the Association operated in a solvent financial environment for the entire period

American Association of Insurance Services Inc.

currently under review. The 2005 financial statements also indicate the following, which also appears to be true for the entire period under review:

- The majority of the Association's income comes from membership and subscriber assessments.
- The largest liability the Association has pertains to its employee retirement plans.

BALANCE SHEET

ASSETS

Cash *	\$153,421
Cash Equivalents *	1,807,939
Short-term investments *	2,253,403
Accounts receivable	386,552
Prepaid expenses	80,743
Inter-company receivables	<u>56,976</u>
Total Current Assets	<u>\$4,739,034</u>

Long Term Investments	<u>394,823</u>
Investment in subsidiary	61,000
Building and equipment, net of accumulated depreciation of \$1,390,486	192,403
Building loan – services	<u>2,648,745</u>
TOTAL ASSETS	<u>\$8,036,005</u>

LIABILITIES AND NET ASSETS

Accounts payable	\$ 49,822
Other current liabilities	<u>334,893</u>
Total current liabilities	<u>384,715</u>
FASB 87 additional pension liability	874,268
Total liabilities	<u>\$1,258,983</u>
Surplus reduction FASB 87	\$(791,114)
Unrestricted net assets	<u>7,568,136</u>
Total net assets	\$6,777,022
TOTAL LIABILITIES AND NET ASSETS	<u>\$8,036,005</u>

+* - The independent auditor reports disclose that in each fiscal year the Association maintained cash balance at financial institutions, which at times may significantly exceed the \$100,000 maximum amount insured by the Federal Deposit Insurance Corporation.

Any differences noted in footing are a result of rounding.

INCOME STATEMENT

UNRESTRICTED NET ASSETS

Revenues	
Members and subscribers fees and assessments	\$5,563,299
Rent	
Forms, manuals and other	203,024
Interest	270,300
Unrealized gain (loss) on investments	8,723
Realized gains from investments	0
Gains (loss) disposal of assets	<u>(180)</u>
TOTAL REVENUES	<u>\$6,045,166</u>

Expenses	
Salaries	\$3,121,269
Payroll taxes	227,571
Pension and savings plan contributions	293,207
Pension and savings plan administration fees	36,619
Group health and life insurance	146,460
Other salary related expense	66,548
Office rent	237,326
Utilities and real estate taxes	64,364
Other building related expenses	29,758
Equipment lease	1,361
Equipment maintenance	23,654
Other equipment expense	18,694
Committees	29,511
Other meetings and travel	75,131
Depreciation and amortization	99,274
Outside services, legal and audit	272,949
Marketing	67,531
Supplies, postage and telephone	47,986
Licenses, fees and subscriptions	183,584
Other operating expense	22,941
Income tax	<u>1,701</u>
TOTAL EXPENSES	<u>\$5,067,441</u>

EXCESS REVENUE OVER EXPENSES \$977,726

Any differences noted in footing are a result of rounding.

POLICY FORMS & RATE FILING ANALYSIS

The analysis of the Association's policy form and rate filing process focused on determining the following:

- That the Association is utilizing acceptable filing methods applicable to the statutory requirements of each State.
- That the filings being submitted are being approved by each State within a reasonable period of time.

The analysis concentrated on filings made during the current period under review. Because the Association operates nationally, only a few randomly selected filings were analyzed. The filings reviewed were submitted to the State of Delaware and several other States and involved various lines of insurance coverages. The States other than Delaware were randomly selected and the filings and lines of business were also randomly selected. Results of the testing indicate the Association's operational process produces and files policy forms and rates in compliance with generally accepted statutory guidelines.

STATISTICAL INFORMATION FILING ANALYSIS

Statistical information submitted to the States and Commonwealths was also analyzed to determine compliance with generally accepted statutory guidelines. Again the States where the filings were submitted and the filings themselves were randomly selected. Results of the testing indicate the Association's operational process produces and files statistical information in compliance with generally accepted statutory guidelines.

RECOMMENDATIONS

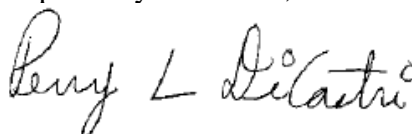
1. It is recommended the Association develop a formal procedure that requires management personnel and key employees to disclose potential or perceived conflicts of interest.

CONCLUSION

As was stated in the Scope of Examination section of this Report, the primary focus of this examination was to determine the accuracy and reliability of the Company's statistical, policy forms and rate filing process. The examination found no exceptions in this area. The Association appears to be properly performing its services in compliance with generally accepted statutory guidelines.

In addition to the undersigned, examination supervisor Max Vega, CFE participated in the examination as a reviewer.

Respectfully submitted,



Perry L. DiCastrì, CFE
Examiner-in-Charge
Delaware Insurance Examiner