North Carolina Insurance Underwriting Association

Statutory Financial Statements
With Independent Auditor’s Report Thereon
September 30, 2010 and 2009

Contents

Independent Auditor's Report

To the Board of Directors
North Carolina Insurance Underwriting Association
Cary, North Carolina

We have audited the accompanying statutory statements of admitted assets, liabilities and members' surplus of North Carolina Insurance Underwriting Association (the "Association") as of September 30, 2010 and 2009, and the related statutory statements of operations and changes in members' surplus, and cash flows for the years then ended. These statutory financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these statutory 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 of the Association'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.

As described more fully in Note 1 to the statutory financial statements, the Association prepared these statutory financial statements using accounting practices prescribed or permitted by the Insurance Department of the State of North Carolina, which practices differ from accounting principles generally accepted in the United States of America. The effects on the statutory financial statements of the variances between the statutory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the statutory financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Association as of September 30, 2010 and 2009, or the results of its operations or its cash flows for the years then ended.

The Association did not prepare and include with the basic statutory financial statements the supplementary information required by accounting practices prescribed or permitted by the Insurance Department of the State of North Carolina. In our opinion, disclosure of this information is required by statutory accounting practices.

In our opinion, except for the omission of the information discussed in the preceding paragraph, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and members' surplus of the Association as of September 30, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

The Association's loss exposure has increased very rapidly in recent years due to several factors. A very severe hurricane could produce losses that would require the Association's member companies to be assessed up to $1 billion in nonrecoupable assessments, after which these companies could impose an annual catastrophe recovery charge on their residential and commercial property insurance policyholders statewide not to exceed 10% of each policy's annual premium until all losses and expenses related to the storm (or series of storms) are paid. The ability of the Association to pay claims to insureds from such storms and the timing of those payments could depend upon the timing of receipts from those member companies and any policyholder assessments to the member companies. The Association does not currently have a method of financing these losses on a short-term basis if policyholder assessments are required.

McGladrey & Pullen, LLP

Raleigh, North Carolina
March 3, 2011

North Carolina Insurance Underwriting Association

Statutory Statements of Admitted Assets, Liabilities, and Members' Surplus
September 30, 2010 and 2009

	2010	2009
Admitted Assets		
Cash and short-term investments	**$ 251,783,046**	$ 255,123,124
Bonds (Note 4)	**649,123,179**	560,081,231
Cash and invested assets	**900,906,225**	815,204,355
Interest income due and accrued	**4,863,494**	4,625,921
Net due from North Carolina Joint Underwriting Association (Note 6)	**1,420,357**	-
Other receivables, net	**386,662**	8,716,365
Data processing equipment, at cost less accumulated depreciation of $587,935 in 2010 and $573,824 in 2009	**64,903**	89,658
Total admitted assets	**$ 907,641,641**	$ 828,636,299
Liabilities and Members' Surplus		
Liabilities:		
Unpaid losses (Notes 5)	**$ 8,187,895**	$ 4,156,128
Unpaid loss adjustment expenses (Notes 5)	**919,750**	370,440
Unearned premiums	**162,818,528**	161,757,555
Remittances and items not allocated	**9,645,178**	8,392,970
Net due to North Carolina Joint Underwriting Association (Note 6)	**-**	356,680
Accounts payable and accrued expenses (Note 10)	**7,562,444**	3,994,107
Total liabilities	**189,133,795**	179,027,880
Commitments and contingencies (Notes 2, 3, 7 and 8)		
Members' surplus	**718,507,846**	649,608,419
Total liabilities and members' surplus	**$ 907,641,641**	$ 828,636,299

See Notes to Statutory Financial Statements.

North Carolina Insurance Underwriting Association

Statutory Statements of Operations and Changes in Members' Surplus
Years Ended September 30, 2010 and 2009

	2010	2009
Direct premiums written	**$ 303,258,229**	$ 295,394,182
Change in unearned premiums	**(1,060,973)**	(12,453,479)
Ceded reinsurance premiums	**(174,234,853)**	(147,205,642)
	127,962,403	135,735,061
Underwriting expenses (Notes 5, 7 and 10):		
Losses incurred	**12,823,444**	6,312,706
Loss adjustment expenses incurred	**1,754,501**	937,551
Commissions	**39,193,203**	38,149,127
Salaries and benefits	**2,526,513**	2,553,284
Insurance taxes, licenses and fees	**8,561,059**	8,348,757
Other underwriting expenses	**1,897,640**	2,192,778
Total underwriting deductions	**66,756,359**	58,494,203
Net underwriting gain	**61,206,044**	77,240,858
Investment income:		
Interest income	**24,297,987**	25,898,769
Net income	**85,504,031**	103,139,627
Members' surplus:		
Beginning	**649,608,419**	530,208,750
Distributions to members (Note 9)	**(36,591,044)**	(23,673,376)
Assessments of members (Note 9)	**19,954,877**	40,133,461
Change in additional minimum pension liability (Note 10)	**238,994**	(468,675)
Change in nonadmitted assets	**(207,431)**	268,632
Ending	**$ 718,507,846**	$ 649,608,419

See Notes to Statutory Financial Statements.

North Carolina Insurance Underwriting Association

Statutory Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	2010	2009
Cash Flows From Operations		
Premiums collected net of reinsurance	**$ 129,127,219**	$ 147,479,091
Losses and loss adjustment expenses paid	**(9,996,868)**	(10,842,220)
Net interest income	**24,060,415**	24,938,531
Underwriting expenses paid	**(49,269,825)**	(52,834,425)
Net cash provided by operations	**93,920,941**	108,740,977
Cash Flows From Investments		
Cost of long-term investments acquired:		
Bonds and other debt instruments	**(248,297,975)**	(213,191,879)
Proceeds from investments sold, matured or repaid:		
Bonds and other debt instruments	**159,256,027**	97,129,998
Net cash used in investments	**(89,041,948)**	(116,061,881)
Cash Flows From Financing and Miscellaneous Sources		
Member assessments	**28,371,973**	31,716,365
Member distributions	**(36,591,044)**	(23,673,376)
Net cash (used in) provided by financing and miscellaneous sources	**(8,219,071)**	8,042,989
Net increase (decrease) in cash and short-term investments	**(3,340,078)**	722,085
Cash and short-term investments:		
Beginning	**255,123,124**	254,401,039
Ending	**$ 251,783,046**	$ 255,123,124
Supplemental Disclosure of Noncash Investing and Financing Activities		
Accounts receivable for members' assessments	**$ -**	$ 8,417,096

See Notes to Statutory Financial Statements.

Note 1. Nature of Organization and Significant Accounting Policies

North Carolina Insurance Underwriting Association (the "Association") was formed August 15, 1969 as an association of insurance companies ("Members") mandated by North Carolina law authorized to write fire, extended coverage and vandalism and malicious mischief coverage in the State of North Carolina. The purpose of the Association is to assist applicants in securing adequate property insurance in the coastal areas of North Carolina when not obtainable in the customary insurance market. The majority of the Association's policies are submitted by independent producers, who remit premiums directly to the Association. In recent years the number of policies issued has increased substantially, resulting in greatly increased exposure levels. During 2009, the North Carolina General Assembly made several changes to the method of operation of the Association through legislation (see Note 2).

The Association is administered by a Board of Directors elected by the Members and is subject to the supervision of the Commissioner of Insurance of the State of North Carolina. The manager of the Association is appointed by the Board of Directors.

A summary of the Association's significant accounting policies is as follows:

Risk and uncertainties: Certain risks and uncertainties are inherent in the Association's day to day operations and to the process of preparing its statutory financial statements. The more significant of those risks and uncertainties are presented below and throughout the notes to the statutory financial statements.

Estimates: The preparation of the statutory financial statements 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 statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Loss reserves: The Association estimates loss and loss adjustment expenses subsequent to consultation with the Association's independent actuary net of deductions of amounts for reinsurance ceded. Actual results could differ from these estimates.

Investments: The Association is exposed to risks that issuers of securities owned by the Association will default or that interest rates will change and cause a decrease in the value of the Association's investments. With mortgage-backed securities, the Association is exposed to prepayment risk. As interest rates decline, the rate at which these securities pay down principal will generally increase. Management mitigates these risks by conservatively investing in high-grade securities and by matching maturities of its investments with the anticipated payouts of its liabilities.

Basis of presentation: At the direction of the Commissioner of Insurance of the State of North Carolina, the Association presents its financial statements on the basis of accounting practices prescribed or permitted by the North Carolina Department of Insurance. The State of North Carolina has adopted the National Association of Insurance Commissioners' ("NAIC") statutory accounting practices ("SAP") as the basis of its statutory accounting practices.

In addition, the Commissioner of the North Carolina Department of Insurance has the right to permit other specific practices that may deviate from prescribed practices. There is no deviation from the NAIC Accounting Practices and Procedures Manual.

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

Accounting practices and procedures of the NAIC as prescribed or permitted by the insurance department of the applicable state of domicile comprise a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (“GAAP”). The more significant differences are as follows:

Investments in bonds and other debt instruments are generally reported at amortized cost, unless required to be reported at market value by NAIC regulations. Under GAAP, investments in debt securities are designated at purchase as held-to-maturity, trading securities, or available-for-sale. Held to maturity debt securities are reported at amortized cost, less applicable valuation allowances, and other debt securities are reported at fair value under GAAP. For debt securities designated as trading, unrealized holding gains and losses are reported in operations and for those designated as available-for-sale, unrealized holding gains and losses are reported as a separate component of equity, under GAAP.

Beginning with the Association’s fiscal year that began October 1, 2009, for loan-backed and structured securities, if the Association determines that they intend to sell a security or no longer have the ability and intent to retain the investment for a period of time sufficient to recover the amortized cost, that security shall be written down to fair value. For statutory purposes, if the Association subsequently changes its assertion, and now believes it does not intend to sell the security and has the ability and intent to retain the investment for a period of time sufficient to recover the amortized cost, that security will continue to be carried at the lower of cost or market with any future decreases in fair value charged through operations until the security is disposed. For GAAP purposes, once the Association alters its assertion, the securities’ amortized cost basis will not be decreased for future reductions in fair value unless an other than temporary impairment is determined to have occurred.

Also, beginning with the 2009 fiscal year, for GAAP purposes other-than-temporary impairment losses (related to non loan-backed and structured securities) related to debt securities are bifurcated between credit and non-credit, where for statutory purposes the total other-than-temporary impairment loss is reported in earnings.

Commissions, premium taxes and other costs relating to the acquisition, issuance and renewal of policies are charged to operations as incurred, rather than being deferred and amortized over the term of the policy.

Certain assets, described as nonadmitted, are excluded from the balance sheet by direct charges to surplus. In accordance with GAAP, such assets are recorded on the balance sheet, net of valuation allowances.

Comprehensive income is not determined for SAP; whereas for GAAP, such income is determined.

The defined benefit pension and postretirement obligations are determined excluding nonvested employees. Under GAAP, nonvested employees are included in the valuations.

If the accumulated benefit obligation exceeds the fair value of the defined benefit pension plan's assets, a minimum pension liability is required and recorded through surplus in the current year under SAP. Under GAAP, the funded status (plan assets less than benefit obligations) of the Plan is recognized on the balance sheet as an asset or liability with a corresponding charge or credit to accumulated other comprehensive income.

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

Assets and liabilities related to insurance and reinsurance activities are netted in financial statements prepared on the basis of SAP. Under GAAP, those assets and liabilities would be reported at their gross amounts.

Under SAP, cash and short-term investments represent cash balances and investments with an initial maturity of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents include cash balances and investments with an initial maturity of three months or less.

Cash and short-term investments: Cash constitutes a medium of exchange that a bank will accept for deposit and allow an immediate credit to the depositor's account. Also classified as cash for financial statement purposes, although not falling within the above description of cash, are cash equivalents which include savings accounts and certificates of deposit in banks and other similar institutions with maturity dates of one year or less from the date of acquisition. At times cash deposits with a financial institution may exceed federally insured limits. The Association has not experienced any credit losses related to such deposits and its management is not aware of any events or circumstances which would raise doubt about the ongoing solvency of the institution.

Investments with remaining maturities of one year or less at the time of acquisition (excluding those investments defined as cash equivalents above) are considered short-term investments. From time to time the Association holds investments in money market instruments that are reported in accordance with the guidance in the NAIC *Purposes and Procedures of the Securities Valuation Office ("SVO"),* which is generally the reported net asset value.

Investments: Bonds are reported at amortized cost in the accompanying statutory financial statements. Prepayment assumptions for asset-backed securities were obtained from broker dealer survey values or internal estimates. Realized gains and losses on sales of investments are recognized in the statutory statements of operations on a specific-identification basis. Declines in fair value that are considered other-than-temporary are charged to realized losses and the cost of the investment is adjusted to estimated fair value in the period when the determination is made. In determining whether these losses are expected to be temporary, the Association considers severity of impairment, duration of impairment, forecasted market price recovery, and the intent and ability of the Association to hold the investment until the market price has recovered.

For the Association's fiscal year beginning October 1, 2009, for loan-backed or structured securities, factors considered by management in determining whether an other-than-temporary impairment exists include the Association's stated intent to not sell, the Association's ability to hold such investments until the fair value recovers, and the discounted cash flows of the security based on the yield at the date of acquisition. If the Association intends to sell or if the Association does not have the ability and intent to hold the security for a period of time sufficient to recover its amortized cost basis, an other-than-temporary impairment exists, and the security is written down to fair value with the amount of the write-down recorded as a realized loss. If the Association does not intend to sell the security and has the ability and intent to hold the security for a period of time sufficient to recover the amortized cost basis, the Association calculates the cash flows expected to be collected. In this calculation, the Association compares the present value of cash flows expected to be collected, discounted at the security's effective interest rate at date of purchase, to the amortized cost basis. If the present value of cash flows is less than the amortized cost basis, a realized loss is recorded for the difference. The present value of cash flows then becomes the new cost basis.

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

Accrued investment income: The Association nonadmits investment income due and accrued if amounts are over 90 days past due. As of September 30, 2010 and 2009, the Association had no income due or accrued over 90 days past due.

Premiums in course of collection: The Association records premiums in course of collection at total unpaid balance, which approximates estimated fair value, net of any nonadmitted receivables. The Association determines past due status of individual accounts receivable based on the effective date of the policy and generally does not charge interest on past due amounts. Premiums that management believes to be ultimately not collectible are written off upon such determination. Any premiums considered to be past due 90 days or more are nonadmitted.

Advanced premiums: When the Association receives premium payments from policyholders prior to the effective date of the related policy, the Association records an Advance Premiums liability. On the policy effective date, the Association reduces the advance premium liability and records the premiums as revenue.

Data processing equipment: Data processing equipment is carried at cost less accumulated depreciation. The Association provides for depreciation on these assets using the straight-line method over three to five years. Depreciation expense was $149,058 and $187,317 for the years ended September 30, 2010 and 2009, respectively. Maintenance and repairs are charged to expense as incurred.

Nonadmitted assets: Certain assets designated as nonadmitted assets have been charged directly to surplus. Amounts related to nonadmitted assets are as follows:

	2010	2009
Furniture and equipment, less accumulated depreciation of $649,134 in 2010 and $566,008 in 2009	**$ 127,456**	$ 208,385
Prepaid expenses	**139,514**	111,760
Accounts receivable, assessments	**962**	721
Insolvent member companies receivable	**(83,763)**	(344,128)
	$ 184,169	$ (23,262)

Depreciation on nonadmitted assets (furniture and equipment) is computed by applying the straight-line method over the estimated useful lives of the related assets. Estimated lives are three to five years for furniture and equipment. This depreciation expense is reflected in the statements of operations with a corresponding credit to surplus.

Reserves for losses and loss adjustment expenses: Unpaid losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and, while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed and any adjustments are reflected in the period determined.

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

Establishing liabilities for claims is subject to significant uncertainties that make reserve estimation difficult. Legal decisions have tended to expand insurance coverage beyond the Association's intent of the original policies. The disposition of such requires lengthy and costly litigation. In establishing liabilities for claims, the Association considers all pertinent information as it becomes available and establishes incurred but not reported reserves where appropriate. Although the reserves are deemed adequate to cover all probable claims, there is a reasonable possibility that adverse development from prior accident years could occur in the future.

Estimates for catastrophic events are inherently more uncertain than those for non-catastrophic losses due to the unique circumstances involving a catastrophe. Due to the low frequency of historical catastrophic events, standard actuarial loss development methods are difficult to apply and may result in a wider range of estimates of ultimate catastrophic losses. Therefore, material changes to estimates related to these events are reasonably possible in the near term after these events occur and are reflected in operations as more information becomes available.

Reinsurance: Reinsurance premiums and liabilities related to reinsurance ceded are accounted for on a basis consistent with that used in accounting for the original policies issued by the Association and the terms of the reinsurance contracts. Premiums and losses on reinsurance ceded are reported as reductions of premiums earned and losses and loss adjustment expenses incurred, respectively, in the statutory statements of operations and changes in surplus.

Member participation: Each member's participation of any fiscal year is in proportion to that member's North Carolina insurance writings for the affected lines of business in the preceding calendar year. Participation percentages vary from year to year. Assessments of members related to each fiscal year are based on their participation.

Premiums and related commissions: Premiums are earned over the periods covered by the policies on a pro-rata basis. Unearned premium reserves are established to cover the unexpired portion of premiums written. Expenses incurred related to the acquisition of new insurance business, including such acquisition costs as commissions, premium taxes and other underwriting expenses, are charged to expense when incurred.

Income taxes: In 1992, the Association received correspondence from the Internal Revenue Service ("IRS") indicating that it is tax-exempt under Section 501(c)(6) of the Internal Revenue Code, and has relied on that correspondence for tax years after 1992. See Note 13.

Newly adopted pronouncements: In May 2009, the NAIC Working Group adopted as revisions to SSAP 9, *Events After the Balance Sheet Date*, based on the new guidance issued by the Financial Accounting Standards Board. This guidance was related to general standards of accounting for, and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new guidance requires disclosure of the date through which an entity has evaluated subsequent events. The guidance was effective December 31, 2009. The Association adopted this guidance without a material impact on the statutory financial statements.

Newly issued pronouncements (not yet adopted): In 2009, the NAIC adopted SSAP No. 100, Fair Value Measurements. SSAP No. 100 defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value. This statement is effective for December 31, 2010 annual statutory financial statements. The Association anticipates the adoption of SSAP No. 100 will not have a material effect on the statutory financial statements.

Note 2. Legislative Changes to the Plan

Effective August 26, 2009, the North Carolina General Assembly made substantial changes to the statutes that govern the operations of the Association. Among those changes that were effective upon enactment in late August 2009 were:

1. The Plan, formerly known as the Beach Plan, was renamed the Coastal Property Insurance Pool.
2. All Association members, which consist of all insurers authorized to write and engage in writing in North Carolina, on a direct basis, essential property insurance, except town and county mutual insurance associations and assessable mutual companies as defined in the North Carolina General Statutes and those insurers that only write in North Carolina on property exempted from taxation, are required to participate in nonrecoupable assessments levied by the Association upon the occurrence of a deficit event (an event in which losses and expenses to the Association exceed available surplus, reinsurance, and other sources of funding of Association losses). A nonrecoupable assessment is an assessment payable by members of the Association that is not directly recoverable from policyholders. The Association is authorized to issue a nonrecoupable assessment upon its members in accordance with its Plan of Operation. Member assessments may not exceed $1 billion for losses incurred from any event or series of events that occur in a given calendar year, regardless of when such assessments are actually levied on or collected from member companies. Each member of the Association must participate in the nonrecoupable assessments levied by the Association in the proportion that its net direct premium written in North Carolina during the preceding calendar year for residential and commercial properties outside of the beach and coastal areas bears to the aggregate net direct premiums written in North Carolina during the preceding calendar year for residential and commercial properties outside of the beach and coastal areas by all member of the Association, as certified to the Association by the North Carolina Commissioner of Insurance. All member companies receive credit each year for essential property insurance, farmowners insurance, homeowners insurance, and the property portion of commercial multiple peril policies voluntarily written in the beach and coastal areas in accordance with guidelines and procedures submitted to the North Carolina Commissioner of Insurance for approval. Such credits also apply to any nonrecoupable assessments levied by the Association. The participation of each member company in the nonrecoupable assessments levied by the Association shall be reduced accordingly. However, no credit is given where coverage for the peril of wind has been excluded. Upon a determination by the Association that a deficit event has occurred, the Association shall determine, in its discretion, the appropriate means of financing the deficit, which may include, but is not limited to, the purchase of reinsurance, arranging lines of credit, or other forms of borrowing or financing.

   Once the member companies have paid $1 billion in nonrecoupable assessments for losses and expenses incurred in any given year, the Association may authorize member companies to impose a catastrophe recovery charge on their residential and commercial property insurance policyholders statewide. Catastrophe recovery charges are charged as a uniform percentage of written premiums as prescribed by the North Carolina Commissioner of Insurance and shall not exceed an aggregate amount of 10% of the annual policy premium on any one policy of insurance. The catastrophe recovery charge amount shall continue until financing of the deficit event has been paid in full. Any charge amounts collected by the Association, the North Carolina Joint Underwriting Association, or the member companies that exceed amounts necessary for payment of the debt shall be remitted to the North Carolina Insurance Underwriting Association and added to its surplus for the purposes of offsetting future Association losses or expenses.

Note 2. Legislative Changes to the Plan

3. The accumulated surplus of the Association must be retained from year to year and used to pay losses, reinsurance costs, and other operating expenses of the Association as necessary. No member company shall be entitled to the distribution of any portion of the Association's surplus, except pursuant to judgments entered prior to the effective date of the revised state Statute. The North Carolina Department of Insurance has prescribed that surplus amounts accumulated prior to the 2009 legislation effective date not be segregated from amounts accumulating after the 2009 legislation effective date.
4. Coverage for an insurance policy was limited to a maximum of $750,000 on habitational property. This limit applies to the value of buildings only. Contents of habitational property can be insured up to 40% of the building value. Insurance issued by the Association for commercial property shall not exceed $3,000,000 on any freestanding structure or any building unit within multiple firewall divisions, provided the aggregate insurance on structures with multiple firewall divisions shall not exceed $6,000,000 on all interest at one risk. If the value of the property exceeds the maximum coverage limits, the Association shall not issue coverage without the insured's purchase of excess coverage to the full value of the property insured.
5. The Association's rates shall be the North Carolina Rate Bureau Manual Rates plus a surcharge of 5% of the applicable North Carolina Rate Bureau Rate for wind and hail coverage and a surcharge of 15% of the applicable North Carolina Rate Bureau Rate for homeowners' insurance including wind and hail coverage. It is the intent of the North Carolina General Assembly that these surcharges ensure the Coastal Property Insurance Pool is the market of last resort over and above the manual rate.
6. The Association shall offer a deductible for named storm wind and hail losses of 1% of the insured value of the property for all policies and may offer any other deductible options provided by the North Carolina Rate Bureau, so long as the deductible is not lower than 1% of the insured value of the property applicable to named storm wind and hail losses.
7. The Association shall file no later than May 1, 2010, a schedule of credits for policyholders based on the presence of mitigation and construction features and on the condition of buildings that it insures. The Association shall develop rules applicable to the operation of the schedule and the mitigation program with the approval by the North Carolina Insurance Commissioner.
8. The Association shall file not later than May 1, 2010, with the North Carolina Insurance Commissioner an installment plan for premium payments and shall accept other methods of payment that are the same as those filed by the North Carolina Rate Bureau. The Association shall collect an installment fee if premiums are paid other than on an annual basis.
9. The Association shall consider the purchase of reinsurance each calendar year in order to maintain the ability to pay losses and expenses from a named storm or combination of named storms.

Currently the Association has not obtained any financing for funding losses above the $1 billion nonrecoupable assessment limit on a short-term basis. The Association is currently examining its options for the funding of losses that exceed available surplus and reinsurance. The 2009 statutory changes did not have a material impact on the operations or financial statements for the years ended September 30, 2010 and 2009.

Note 3. Significant Increased Exposure to Coastal Properties

As many insurers have lessened their voluntary writings of policies covering North Carolina coastal properties over the past few years, and as pricing of policies has become much less competitive for coverages in coastal areas, the Association has seen an unprecedented increase in exposure. Amplifying this exposure is the fact that during this period of time market prices for coastal properties have also substantially increased. The Association currently estimates it has approximately $68 billion of exposure along the North Carolina coast.

Management estimates that a very severe hurricane could produce losses that would require the Association to assess amounts totaling several billion dollars. The ability of the Association to pay claims to insureds from such a storm and the timing of those payments would depend upon receipts of those assessments from the member companies (see Note 2).

Note 4. Bonds

Amortized cost (admitted amount), aggregate market value and gross unrealized gains and losses pertaining to the portfolio of bonds as of September 30, 2010 and 2009 are as follows:

	September 30, 2010			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized (Losses)**	**Market Value**
U. S. Treasury obligations	**$ 177,124,922**	**$ 10,338,618**	**$ -**	**$ 187,463,540**
Federal agency obligations	**378,908,574**	**18,809,492**	**(426,295)**	**$ 397,291,771**
Federal agency mortgage-backed securities	**84,096,373**	**4,681,041**	**-**	**88,777,414**
Corporate debt securities	**8,993,310**	**337,000**	**-**	**9,330,310**
	$ 649,123,179	**$ 34,166,152**	**$ (426,295)**	**$ 682,863,035**

	September 30, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
U. S. Treasury obligations	$ 84,706,550	$ 3,451,450	$ -	$ 88,158,000
Federal agency obligations	351,140,474	11,605,587	(107,388)	362,637,673
Federal agency mortgage-backed securities	115,240,897	5,265,183	(49,290)	120,456,790
Corporate debt securities	8,993,310	367,310	-	9,361,870
	$ 560,081,231	$ 20,689,530	$ (156,678)	$ 580,614,333

Note 4. Bonds (Continued)

Amortized cost and aggregate market value of bonds held as of September 30, 2010, according to final contractual maturity dates, are as indicated below. Actual future maturities will differ from the maturities shown because certain issuers have the right to call or prepay obligations.

	Amortized Cost	Market Value
Amounts due in less than one year	$ 55,894,280	$ 56,218,800
Amounts due after one year through five years	242,340,252	253,093,936
Amounts due after five years through ten years	167,585,655	177,748,886
Amounts due after ten years through twenty years	183,302,991	195,801,414
	$ 649,123,179	$ 682,863,035

There were no significant sales of bonds and other debt instruments during the years ended September 30, 2010 or 2009.

The following table shows unrealized gross losses and fair value, for the Association's investments, aggregated by individual category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2010:

	12 Months or Less		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal agency obligations	$ 53,408,825	$ 276,271	$ 24,588,432	$ 150,024	$ 77,997,257	$ 426,295

The following table shows unrealized gross losses and fair value, for the Association's investments, aggregated by individual category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2009:

	12 Months or Less		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal agency obligations	$ 24,631,068	$ 107,388	$ -	$ -	$ 24,631,068	$ 107,388
Federal agency mortgage-backed securities	4,419,537	49,290	-	-	4,419,537	49,290
	$ 29,050,605	$ 156,678	$ -	$ -	$ 29,050,605	$ 156,678

Note 4. Bonds (Continued)

The Association evaluates impairment at each reporting period for each security (other than loan-backed or structured securities) where the fair value of the investment is less than its amortized cost. It is expected that the securities would not be settled at a price less than the amortized cost of the investment, as the Association has the ability and intent to hold the investment until recovery. The Association evaluated the credit ratings of these holdings, noting neither a significant deterioration since purchase nor other factors which may indicate an other-than-temporary impairment, such as the length of time and extent to which fair value has been less than cost, the financial condition and near-term prospects of the issuer as well as specific events or circumstances that may influence the operations of the issuer, and our intent and ability to hold the investment for a sufficient time in order to enable recovery of our cost.

For 2010, the Association evaluated each loan-backed and structured security for impairment where the fair value of the investment was less than its amortized cost. For those securities that the Association intends to sell or does not have the ability to hold until recovery, an impairment is recorded equal to the difference of amortized cost and fair value. For all other loan-backed and structured securities, the Association developed assumptions around prepayment speeds, expected default rates and the value of the underlying collateral. These assumptions were used to develop expected cash flows which were discounted at the effective yield at the date of acquisition (or most recent impairment). These modeled cash flows were compared against the current amortized cost basis. If the expected discounted cash flows were less than the amortized cost basis, the security was written down to the discounted cash flow amount, with the difference recorded as a realized loss.

Investment income, net of investment expenses, which are not material, for the fiscal years ending September 30, 2010 and 2009 is comprised of primarily interest on bonds and short-term investments.

Note 5. Reserve for Losses and Loss Adjustment Expenses

Activity in the reserve for losses and loss adjustment expenses is summarized as follows:

	2010	2009
Balance at October 1	**$ 4,526,568**	$ 8,118,531
Incurred related to:		
Current year	**15,683,164**	10,434,136
Prior years	**(1,105,219)**	(3,183,879)
Total incurred	**14,577,945**	7,250,257
Paid related to:		
Current year	**(8,288,234)**	(6,900,821)
Prior years	**(1,708,634)**	(3,941,399)
Total paid	**(9,996,868)**	(10,842,220)
Balance at September 30	**$ 9,107,645**	$ 4,526,568

As a result of changes in estimates related to insured events of prior years, the provision for losses and loss adjustment expenses was adjusted as indicated in the table above. The decrease in prior year incurred losses and loss adjustment expenses in 2010 and 2009 resulted from favorable development of claims on an overall basis. No individual events were responsible for a large change in prior year incurred claims.

Note 5. Reserve for Losses and Loss Adjustment Expenses (Continued)

The components of unpaid losses and loss adjustment expenses as of September 30, 2010 and 2009 are as follows:

	2010	2009
Unpaid losses:		
Case basis	$ 3,195,832	$ 1,522,063
Incurred but not reported	4,992,063	2,634,065
	$ 8,187,895	$ 4,156,128
Unpaid loss adjustment expenses:		
Case basis	$ 334,992	$ 175,836
Incurred but not reported	584,758	194,604
	$ 919,750	$ 370,440
	$ 9,107,645	$ 4,526,568

Note 6. Related Party Transactions

A related organization, North Carolina Joint Underwriting Association ("NCJUA"), shares the same facility and is operated by the same personnel as the Association. This arrangement periodically results in receivables or payables between the two associations. Shared expenses are allocated between the two parties with 71% allocated to the Association and the remainder to NCJUA, except for furniture and equipment costs which are shared equally. If this cost sharing arrangement was not in place, the actual expense amounts for the Association would vary from the amounts reported in the statutory financial statements.

At September 30, 2010, the Association had a net receivable from NCJUA of $1,420,357. At September 30, 2009, the Association had a net payable to NCJUA of $356,680.

Note 7. Lease Commitments

The Association and NCJUA jointly rent home office facilities under an operating lease agreement, which expires in calendar year 2014. The Association was allocated 71% of the costs under this lease agreement in 2010 and 2009. The Association's allocated share of rent expense was $242,548 in 2010 and $242,803 in 2009.

Note 7. Lease Commitments (Continued)

The Association's share of the rent commitments, based on current cost sharing provisions with NCJUA, under the terms of operating lease agreements at September 30, 2010 is as follows:

Year Ending September 30,	Amount
2011	$ 382,826
2012	340,329
2013	340,539
2014	349,540
2015	58,507
Thereafter	-
	$ 1,471,741

The Association is also required to pay a proportionate share of operating expense increases during the lease term for the building.

Note 8. Litigation

In the ordinary course of business, the Association from time to time is involved in lawsuits filed under various causes of action. Ultimate disposition of these actions will not have a material effect on the Association's financial condition.

Note 9. Assessments of and Distributions to Members

Under North Carolina law prior to the 2009 legislative changes affecting the operation of the Association (see Note 2), the Association could make assessments of its members and could also make periodic distributions to its members.

An assessment totaling $19,954,877 and a distribution totaling $36,591,044 were made in fiscal year 2010. An assessment totaling $40,133,461 and a distribution totaling $23,673,376 were made in fiscal year 2009.

There were no amounts owed to/due from Association members at September 30, 2010 or 2009.

Note 10. Employee Benefit Plans

The Association and the NCJUA are members of a multiple-employer pension trust. Plan assets are held in a single trust for all employers who participate in the Plan. Each year, assets are allocated to the Association based on its historical contributions, benefit disbursements, and share of investment return. Employees who are hired before age 60 and who are scheduled to work 1,000 hours in a 12-month period are eligible for the plan upon their date of hire. No employee contributions are required. The Association's funding policy is to make the minimum annual contributions required by applicable regulations, which are based on recommendations from the plan's actuary. For 2010 and 2009, the Association is allocated 71% of the costs and obligations associated with their participation in the plan under the current cost-sharing arrangement with the NCJUA.

The Association uses a September 30 measurement date for its plans.

Note 10. Employee Benefit Plans (Continued)

Obligations and Funded Status

	Pension Benefits	
	2010	2009
Changes in benefit obligations:		
Obligations at beginning of year	**$ 2,950,482**	$ 1,842,097
Service cost	**190,165**	131,247
Interest cost	**169,715**	158,765
Plan amendments	**-**	(523)
Participant contributions	**-**	-
Actuarial (gains) losses	**(235,782)**	630,564
Benefits paid	**(92,921)**	(79,068)
Change in cost sharing with NCJUA	**-**	267,400
Obligations at end of year	**2,981,659**	2,950,482
Changes in plan assets:		
Fair value of assets at beginning of year, primarily pooled separate accounts with insurance companies and mutual funds	**1,867,377**	1,356,275
Actual return on assets	**191,783**	221,073
Association contributions	**266,105**	172,220
Participant contributions	**-**	-
Benefits paid	**(92,921)**	(79,068)
Change in cost sharing with NCJUA	**-**	196,878
Fair value of assets at end of year, primarily pooled separate accounts with insurance companies and mutual funds	**2,232,344**	1,867,378
Funded status (plan assets less than benefit obligations) at end of years	**(749,315)**	(1,083,104)
Amounts not recognized on statutory statements of admitted assets, liabilities, and surplus before additional minimum pension liability:		
Unrecognized net loss	**578,069**	933,303
Prior service cost	**(472)**	(523)
Net amount recognized on statutory statements of admitted assets, liabilities, and surplus before additional minimum pension liability	**(171,718)**	(150,324)

Note 10. Employee Benefit Plans (Continued)

	Pension Benefits	
	2010	2009
Amounts recognized on statutory statements of admitted assets, liabilities, and surplus as:		
Accrued benefit cost	**$ (171,718)**	$ (150,324)
Adjustment to record to additional minimum liability	**(208,287)**	(468,675)
Net amount recognized on statutory statements of admitted assets, liabilities, and surplus	**$ (380,005)**	$ (618,999)
Aggregate accumulated benefit obligation for defined benefit pension plan	**$ 2,612,349**	$ 2,486,377
For pension plan with accumulated benefit obligation in excess of assets at September 30 of the respective years:		
Projected benefit obligation	**2,981,659**	2,950,482
Accumulated benefit obligation	**2,612,349**	2,486,377
Fair value of plan assets	**2,232,344**	1,867,378

Components of Net Periodic Benefit Cost and Additional Information

	Pension Benefits	
	2010	2009
Components of net periodic benefit cost:		
Service cost	**$ 190,165**	$ 131,247
Interest cost	**169,715**	158,765
Recognized actuarial loss	**60,760**	18,192
Expected return on plan assets	**(147,202)**	(121,872)
Amortization of prior service cost	**(51)**	-
Net periodic benefit cost	**273,387**	186,332
Additional information:		
Increase (decrease) in minimum liability	**(260,388)**	468,675

Assumptions

	Pension Benefits	
	2010	2009
Weighted-average assumptions used in computing ending obligations:		
Discount rate	**5.50%**	5.50%
Rate of compensation increase	**4.00**	4.00
Weighted-average assumptions used in computing net cost:		
Discount rate	**5.50**	7.25
Rate of compensation increase	**4.00**	4.00
Expected return on plan assets	**7.75**	7.75

Note 10. Employee Benefit Plans (Continued)

The expected rate of return on plan assets was determined based on the average rate of earnings expected to be earned on the current and target asset categories.

Plan Assets

The Association participates in a multiple employer pension plan called the Insurance Organizations Employees' Retirement Plan (the "Plan").

The asset allocation for the Plan at the end of the Association's fiscal year, and the ongoing target allocation, by asset category, follows:

Asset Category	Target	As of September 30, 2010	As of September 30, 2009
Equity securities	60	58 %	67 %
Debt securities	40	37	27
Cash	-	5	6
Total	100 %	100 %	100 %

The Plan's investment policy is set by the Trustees of the Insurance Organization Pension Trust. Plan assets are invested to generate a long-term investment return (net of management and administrative fees) that exceeds the Consumer Price Index ("CPI") inflation rate by at least 5.0%. Long-term investment results are measured over rolling periods of eight to ten years. During 2009, the Trustees adopted a strategy to gradually move from a 75% equity/25% debt securities allocation to a 60% equity/40% debt securities allocation over a period of 1-2 years by investing new contributions to the plan in accordance with the new target allocation rather than moving existing funds.

In addition to pension benefits, the Association and the NCJUA provide certain health care and life insurance ("postretirement") benefits for retired employees. The costs and accrued liabilities associated with these benefits are allocated between the two entities in the same proportions as for the pension plan. Retirees are eligible to continue medical coverage on a contributory basis and will continue to receive the same basic life insurance until age 65 at which time the coverage will be reduced to $5,000. Current employees and part-time employees who work at least 20 hours per week can become eligible for these life insurance benefits by retiring after meeting the age and service requirements of age 55 and 10 years of service. Medical benefit eligibility requirements are age 50 with 65 points (age plus service) or age 65 with 5 years of service. Spouses and dependent children of these retirees are also eligible to participate.

For measurement purposes, the discount rate used in 2010 in determining the accumulated postretirement benefit obligation was 5.5%, and the health care cost-trend rate was 9.0% decreasing 0.5% per year to an ultimate rate of 5.0% in 2018. A nonvested accumulated postretirement benefit obligation of $1,120,851 existed at September 30, 2010.

A nonvested pension projected benefit obligation and accumulated benefit obligation of $181,241 and $158,792, respectively, existed at September 30, 2010. A nonvested pension projected benefit obligation and accumulated benefit obligation of $154,521 and $160,864, respectively, existed at September 30, 2009.

Note 10. Employee Benefit Plans (Continued)

The Medicare Prescription Drug Improvement and Modernization Act of 2003 was enacted during 2003 (the “Act”). The Act creates Medicare Part D which could have some effect on the Association’s obligations under the postretirement health plan. Measures of the accumulated postretirement benefit obligation and the net periodic benefit cost recorded in these financial statements do not reflect any changes brought about by the Act because the employer is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

Cash Flows

The Association expects to contribute approximately $182,000 to its pension plan and approximately $26,000 to its other postretirement benefit plan in fiscal year 2011.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in fiscal years:

Year	Pension Plan
2011	108,329
2012	121,188
2013	131,329
2014	140,577
2015	150,161
2016-2020	935,700

Defined Contribution Plan

The Association also offers an Employee Savings Plan to employees working at least 1,000 hours in a year. This plan is offered through a multiple-employer arrangement with the Association matching 100% of employee contributions up to 6% of the employee's earnings. The Association's expense for the years ended September 30, 2010 and 2009 was $86,823 and $84,298, respectively.

Note 11. Fair Values of Financial Instruments

Due to their short-term maturity or settlement, the fair values of cash and short-term investments, balances due on account from insureds and others, payables, and remittances and items not allocated approximate their carrying amounts as reflected in the statutory statements of admitted assets, liabilities and surplus. The fair value and amortized cost of bonds are estimated based on quoted market prices if available, and it not, fair values are estimated using present value or other valuation techniques. These techniques are significantly affected by our assumptions, including discount rates and estimates of future cash flows. Potential taxes and other transactions costs have not been considered in estimating fair values. The fair value and amortized cost of bonds approximated $682,863,000 and $649,123,000, respectively, at September 30, 2010. The fair value and amortized cost of bonds approximated $580,614,000 and $560,081,000, respectively, at September 30, 2009.

The Association has not historically maintained financial instruments for trading purposes.

Note 12. Reinsurance Agreements

The Association, along with the North Carolina Joint Underwriting Association (collectively, the "Associations"), has entered into joint property catastrophe excess of loss reinsurance agreements on a per risk basis covering risks located in North Carolina, as defined by the Association, in order to reduce its exposure to wind losses that may result from a catastrophic event. For 2010, in the event of a named storm, the Associations retain the first $1.4 billion of loss and cede approximately 69.1% of losses in 6 layers excess of $1.4 billion up through $4.0 billion of losses. Losses in a $300 million layer excess of $4.0 billion are 100% ceded through a catastrophe recovery charge. All losses above $4.3 billion are retained by the Associations. The Associations have also purchased reinstatement premium protection where the Associations cede approximately 88.4% in two $500 million layers excess of $1.6 billion up to $2.6 billion. The reinsurers' responsibility for losses from all loss occurrences during the term of the contract cannot exceed $4.8 billion. The 2010 reinsurance agreements cover the period from May 1, 2010 to May 1, 2011. The Associations also purchased similar agreements in recent years with lower coverage amounts.

During 2009, the Associations entered into agreements related to a principal at-risk variable rate note program under which a special purpose entity has issued $200 million of notes (commonly referred to as "catastrophe bonds"), which mature in May 2011 unless extended under the terms of the notes, to support the Associations' reinsurance program at levels in excess of the Associations' traditional reinsurance program. Because these agreements contain an indemnity trigger, the Associations have accounted for transactions related to this program as ceded reinsurance. The result of this program is that 27% of losses in the layer of $700 million in excess of $2.6 billion is reinsured leaving the Associations with 10.05% retention in this layer.

During 2010, the Associations entered into agreements related to another principal at-risk variable rate note program under which a special purpose entity has issued $305 million of notes (catastrophe bonds), which mature in May 2013 unless extended under the terms of the notes, to support the Associations' reinsurance program at levels in excess of the Associations' traditional reinsurance program. The notes were issued in traunches of $200 million and $105 million. In May 2011, the $200 million notes from 2011 will move down one layer to cover the May 2009 notes that will be expiring. Because these agreements contain an indemnity trigger, the Associations have accounted for transactions related to this program as ceded reinsurance. The result of this program is that 43.6% of the 49.7% of losses in the layer of $700 million in excess of $3.3 billion is reinsured leaving the Associations with 6.1% retention in this layer.

There were no reimbursed losses and loss adjustment expenses for the years ended September 30, 2010 and 2009.

For the excess of loss coverages described above, the Associations are charged a provisional premium, which may be adjusted in accordance with a formula included in the reinsurance agreement for each excess layer if the limits of insurance in force (total insured value) increases or decreases by an average of greater than 10%. The effect of reinsurance on premiums written and earned during the years ended September 30, 2010 and 2009 is as follows:

	2010		2009	
	Written	**Earned**	Written	Earned
Direct	**$ 303,258,229**	**$ 302,197,256**	$ 295,394,182	$ 282,940,703
Ceded	**(174,234,853)**	**(174,234,853)**	(147,205,642)	(147,205,642)
Net premiums	**$ 129,023,376**	**$ 127,962,403**	$ 148,188,540	$ 135,735,061

Note 12. Reinsurance Agreements (Continued)

Reinsurance contracts do not relieve the Associations of their primary obligation to policyholders and failure of the reinsurers to discharge their obligations could result in losses to the Associations. The Associations, with the assistance of their reinsurance intermediary, regularly evaluate the financial condition of their reinsurers and monitor concentrations of credit risk related to their reinsurance activities. No credit losses resulted from ceded reinsurance activities during the years ended September 30, 2010 or 2009.

There is no unsecured reinsurance recoverable on paid and unpaid losses and loss adjustment expenses for individual reinsurers whose balances exceeded 3% of the Association's surplus as of September 30, 2010 or 2009.

The maximum amount of return commission which would have been due reinsurers if either the reinsurers or the Association had canceled the Association's reinsurance as of the end of the years ended September 30, 2010 or 2009 is not material.

Note 13. Subsequent Events

Events or transactions that occur after the Statements of Admitted Assets, Liabilities, Capital and Surplus date, but before statutory financial statements are complete and available to be issued, are reviewed by the Association to determine if they are to be recognized.

All of the effects of subsequent events that provide additional evidence about conditions that existed at the Statements of Admitted Assets, Liabilities, Capital and Surplus date, including the estimates inherent in the process of preparing the statutory financial statements, are recognized in the statutory financial statements. The Association does not recognize subsequent events that provide evidence about conditions that did not exist at the Statements of Admitted Assets, Liabilities, Capital and Surplus date but arose after, but before the statutory financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the statutory financial statements from being misleading.

On January 13, 2011, the North Carolina Insurance Underwriting Association's Board of Directors voted to resolve administrative proceedings initiated against it by the N. C. Department of Insurance concerning a net distribution of $16,460,085 to member companies made in December, 2009 for the revised settlement of the 2003 policy fiscal year. The Department of Insurance contended that the Association should not have made the distribution, but the Association believed that it acted reasonably and permissibly in so doing. The Association and the Department of Insurance have agreed to execute a Consent Order pursuant to which the $16,460,085 net distribution will be reversed, and all further administrative proceedings will cease. In the Consent Order, as currently agreed to, the Department of Insurance acknowledges that the Association acted in good faith and did not violate either accounting practices or surplus retention requirements in making the net distribution, and the reversal of the net distribution will be accomplished by the end of the first quarter of calendar year 2011.

In early 2011, the Internal Revenue Service notified the Association that it intended to conduct an examination of the Association's 2008 exempt organization tax return. As of March 3, 2011, the IRS audit has begun and remains underway. Management is unable to express an opinion about the ultimate outcome of the examination.

The Company has evaluated subsequent events through March 3, 2011, which is the date the statutory financial statements were available to be issued.