

**McGladrey & Pullen**

Certified Public Accountants

## **North Carolina Insurance Underwriting Association**

Financial Report

(Statutory Basis)

09.30.2009

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# McGladrey & Pullen

Certified Public Accountants

## 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 surplus of North Carolina Insurance Underwriting Association (the "Association") as of September 30, 2009 and 2008, and the related statutory statements of operations and changes in surplus, and cash flows for the years then ended. These financial statements are the responsibility of the Association'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 financial statements, the Association prepared these 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 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 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, 2009 and 2008, or the results of its operations or its cash flows for the years then ended.

The Association did not obtain an updated actuarial valuation as of and for the year ended September 30, 2008 for its postretirement health and life insurance benefits. Therefore, these financial statements do not include certain disclosures relating to the postretirement health and life insurance benefits that are derived from actuarial studies. In our opinion, disclosure of this information is required by statutory accounting practices.

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 two paragraphs, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of the Association as of September 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

As disclosed in Notes 2 and 3 to the financial statements, the North Carolina General Assembly made several changes to the method of operation of the Association during 2009. Also, 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*

Greensboro, North Carolina  
December 31, 2009

**North Carolina Insurance Underwriting Association**

**Statutory Statements of Admitted Assets, Liabilities, and Surplus**  
**September 30, 2009 and 2008**

	<b>2009</b>	<b>2008</b>
<b>Admitted Assets</b>		
Cash and short-term investments	\$ 255,123,124	\$ 254,401,039
Bonds and other debt instruments (Note 4)	560,081,231	444,019,350
<b>Cash and invested assets</b>	<b>815,204,355</b>	698,420,389
Interest income due and accrued	4,625,921	3,665,683
Other receivables, net	8,716,365	470,013
Data processing equipment, at cost less accumulated depreciation of \$573,824 in 2009 and \$515,150 in 2008	89,658	110,087
<b>Total admitted assets</b>	<b>\$ 828,636,299</b>	\$ 702,666,172
<b>Liabilities and Surplus</b>		
Liabilities:		
Unpaid losses (Notes 3 and 5)	\$ 4,156,128	\$ 7,602,893
Unpaid loss adjustment expenses (Notes 3 and 5)	370,440	515,638
Unearned premiums	161,757,555	149,304,076
Remittances and items not allocated	8,392,970	9,273,163
Net due to North Carolina Joint Underwriting Association (Note 6)	356,680	287,029
Accounts payable and accrued expenses (Note 10)	3,994,107	5,474,623
<b>Total liabilities</b>	<b>179,027,880</b>	172,457,422
Commitments and contingencies (Notes 2, 3, 7 and 8)		
Surplus	649,608,419	530,208,750
<b>Total liabilities and surplus</b>	<b>\$ 828,636,299</b>	\$ 702,666,172

See Notes to Statutory Financial Statements.

**North Carolina Insurance Underwriting Association**

**Statutory Statements of Operations and Changes in Surplus**  
**Years Ended September 30, 2009 and 2008**

	<b>2009</b>	<b>2008</b>
Direct premiums written	\$ 295,394,182	\$ 277,956,547
Change in unearned premiums	(12,453,479)	(22,661,808)
Ceded reinsurance premiums	(147,205,642)	(78,097,116)
	<b>135,735,061</b>	<b>177,197,623</b>
Underwriting expenses (Notes 5, 7 and 10):		
Losses incurred	6,312,706	11,154,608
Loss adjustment expenses incurred	937,551	1,037,632
Commissions	38,149,127	35,870,188
Salaries and benefits	2,553,284	2,071,095
Insurance taxes, licenses and fees	8,348,757	7,433,702
Occupancy	242,803	218,061
Postage	427,284	299,490
Credit card service fees	500,423	357,693
Information technology	208,714	109,232
Depreciation	187,317	132,656
Other	626,237	224,173
<b>Total underwriting deductions</b>	<b>58,494,203</b>	<b>58,908,530</b>
<b>Net underwriting gain</b>	<b>77,240,858</b>	<b>118,289,093</b>
Investment income:		
Interest income	25,898,769	26,828,634
<b>Net income</b>	<b>103,139,627</b>	<b>145,117,727</b>
Surplus:		
Beginning	530,208,750	385,001,757
Distributions to members (Note 9)	(23,673,376)	(14,968,232)
Assessments of members (Note 9)	40,133,461	14,968,232
Additional minimum pension liability (Note 10)	(468,675)	-
Change in nonadmitted assets	268,632	89,266
Ending	<b>\$ 649,608,419</b>	<b>\$ 530,208,750</b>

See Notes to Statutory Financial Statements.

**North Carolina Insurance Underwriting Association**

**Statutory Statements of Cash Flows**  
**Years Ended September 30, 2009 and 2008**

	<b>2009</b>	<b>2008</b>
<b>Cash Flows From Operations</b>		
Premiums collected net of reinsurance	\$ 147,479,091	\$ 201,538,283
Losses and loss adjustment expenses paid	(10,842,220)	(10,535,494)
Net interest income	24,938,531	25,479,642
Underwriting expenses paid	(52,834,425)	(45,613,567)
<b>Net cash from operations</b>	<b>108,740,977</b>	<b>170,868,864</b>
<b>Cash Flows From Investments</b>		
Cost of long-term investments acquired:		
Bonds and other debt instruments	(213,191,879)	(364,198,519)
Proceeds from investments sold, matured or repaid:		
Bonds and other debt instruments	97,129,998	121,010,373
<b>Net cash from investments</b>	<b>(116,061,881)</b>	<b>(243,188,146)</b>
<b>Cash Flows From Financing and Miscellaneous Sources</b>		
Assessments	31,716,365	14,968,232
Distributions	(23,673,376)	(15,008,366)
<b>Net cash from financing and miscellaneous sources</b>	<b>8,042,989</b>	<b>(40,134)</b>
<b>Net increase (decrease) in cash and short-term investments</b>	<b>722,085</b>	<b>(72,359,416)</b>
<b>Cash and short-term investments:</b>		
Beginning	254,401,039	326,760,455
Ending	<b>\$ 255,123,124</b>	<b>\$ 254,401,039</b>
<b>Supplemental Disclosure of Noncash Investing and Financing Activities</b>		
Accounts receivable for assessments	\$ 8,417,096	\$ -

See Notes to Statutory Financial Statements.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 1. Nature of Organization and Significant Accounting Policies

North Carolina Insurance Underwriting Association (the "Association") was formed August 15, 1969 as a mandatory association of insurance companies ("Members") 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.

For the year ended September 30, 2009, the Association had surplus of \$649,608,419.

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

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.

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.

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.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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

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.

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 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.

Accrued investment income: The Association nonadmits investment income due and accrued if amounts are over 90 days past due. As of September 30, 2009 and 2008, the Association had no income due or accrued over 90 days past due.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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

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.

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 \$187,317 and \$132,656 for the years ended September 30, 2009 and 2008, 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:

	2009	2008
Furniture and equipment, less accumulated depreciation of \$566,008 in 2009 and \$443,716 in 2008	\$ 208,385	\$ 330,731
Prepaid expenses	111,760	90,752
Accounts receivable, assessments	721	168,015
	<b>\$ 320,866</b>	<b>\$ 589,498</b>

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.

Establishing liabilities for claims is subject to significant uncertainties that make reserve estimation difficult. Legal decisions have tended to expand insurance coverage beyond the 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.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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

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: The Association has received correspondence from the Internal Revenue Service indicating that it is tax-exempt under Section 501(c)(6) of the Internal Revenue Code.

Use of estimates: The preparation of financial statements in accordance with SAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates.

Subsequent events: The Association has evaluated its subsequent events (events occurring after September 30, 2009) through December 31, 2009, which represents the date the financial statements were available to be issued.

#### Note 2. Legislative Changes to the Plan

During the 2009 session of the North Carolina General Assembly, substantial changes were made to the insurance plan that constitutes all of 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 the nonrecoupable assessments levied by the Association upon the occurrence of a deficit event (an event in

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 2. Legislative Changes to the Plan (Continued)

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 shall 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 shall 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 members companies shall 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 shall 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 shall be 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 shall be 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.

3. The accumulated surplus of the Association shall 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.

## **North Carolina Insurance Underwriting Association**

### **Notes to Statutory Financial Statements**

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#### **Note 2. Legislative Changes to the Plan (Continued)**

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.

#### **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 \$74 billion of exposure along the North Carolina coast.

Management estimates indicate 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 depend upon receipts of those assessments from the member companies (see Note 2).

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 4. Bonds and Other Debt Instruments

Since most of the Association's investments consist of securities that are traded in the public securities markets, they are subject to risk related to fluctuations in overall market performance and are potentially subject to heightened levels of market risk attributable to issuer, industry, and geographic region concentrations. Investments in debt securities subject an investor to credit risk, and concentrations in debt securities of single issuers, issuers operating in similar industries, or securities backed by similar collateralizing assets subject an investor to heightened levels of credit risk. The Company's investment portfolio is regularly reviewed and the extent of its diversification is considered in the context of statutory requirements and other risk management and performance objectives.

Amortized cost (admitted amount), aggregate market value and gross unrealized gains and losses pertaining to the portfolio of bonds and other debt instruments as of September 30, 2009 and 2008 are as follows:

	September 30, 2009			
	Amortized Cost	Gross 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
	<b>\$ 560,081,231</b>	<b>\$ 20,689,530</b>	<b>\$ (156,678)</b>	<b>\$ 580,614,333</b>

	September 30, 2008			
	Amortized Cost	Gross Gains	Gross Unrealized (Losses)	Market Value
U. S. Treasury obligations	\$ 41,057,973	\$ -	\$ (368,773)	\$ 40,689,200
Federal agency obligations	255,494,278	1,369,717	(1,212,180)	255,651,815
Federal agency mortgage-backed securities	147,467,099	199,209	(1,894,058)	145,772,250
	<b>\$ 444,019,350</b>	<b>\$ 1,568,926</b>	<b>\$ (3,475,011)</b>	<b>\$ 442,113,265</b>

Debt securities, other than short-term investments of \$113 million, are all included in bonds and other debt instruments in the accompanying statutory statement of admitted assets, liabilities and surplus as of September 30, 2009. Debt securities, other than short-term investments of \$63 million, are all included in bonds and other debt instruments in the accompanying statutory statement of admitted assets, liabilities and surplus as of September 30, 2008. The estimated fair value of bonds and other debt instruments as of September 30, 2009 and 2008, excluding any short-term investments, approximated NAIC market values since substantially all issues owned by the Association are public issues for which quoted prices are available.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 4. Bonds and Other Debt Instruments (Continued)

Amortized cost and aggregate market value of bonds and other debt instruments held as of September 30, 2009, 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	\$ 53,177,628	\$ 54,333,820
Amounts due after one year through five years	149,663,716	155,490,784
Amounts due after five years through ten years	181,047,954	187,515,559
Amounts due after ten years through twenty years	176,191,933	183,274,170
	<b>\$ 560,081,231</b>	<b>\$ 580,614,333</b>

There were no significant sales of bonds and other debt instruments during the years ended September 30, 2009 or 2008.

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 Gains
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
	<b>\$ 29,050,605</b>	<b>\$ 156,678</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 29,050,605</b>	<b>\$ 156,678</b>

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, 2008:

	12 Months or Less		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U. S. Treasury obligations	\$ 40,689,200	\$ 368,773	\$ -	\$ -	\$ 40,689,200	\$ 368,773
Federal agency obligations	224,631,187	2,473,983	48,910,042	632,255	273,541,229	3,106,238
	<b>\$ 265,320,387</b>	<b>\$ 2,842,756</b>	<b>\$ 48,910,042</b>	<b>\$ 632,255</b>	<b>\$ 314,230,429</b>	<b>\$ 3,475,011</b>

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 4. Bonds and Other Debt Instruments (Continued)

The temporary impairments in the tables above were caused by market conditions. The Association relies on its investment manager's guidance to address such factors as industry analyst reports, sector credit ratings, volatility of a particular security's market price, and/or any other information that the Association may need to take into consideration in determining if other than temporary impairments exist. Based on past experience and current knowledge, the Association believes that investment managers typically do not hold investments for which there is little chance of appreciation during the short term, and therefore none of the above investments constitutes a situation which would require an adjustment of cost basis of the investment for an impairment.

Investment income, net of investment expenses, which are not material, for the years ended September 30, 2009 and 2008 is comprised of primarily interest on bonds and other debt instruments 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:

	<b>2009</b>	<b>2008</b>
Balance at October 1	<b>\$ 8,118,531</b>	<b>\$ 6,461,785</b>
Incurred related to:		
Current year	10,434,136	12,207,821
Prior years	(3,183,879)	(15,581)
<b>Total incurred</b>	<b>7,250,257</b>	<b>12,192,240</b>
Paid related to:		
Current year	(6,900,821)	(5,689,494)
Prior years	(3,941,399)	(4,846,000)
<b>Total paid</b>	<b>(10,842,220)</b>	<b>(10,535,494)</b>
Balance at September 30	<b>\$ 4,526,568</b>	<b>\$ 8,118,531</b>

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 2009 and 2008 resulted from favorable development of claims on an overall basis. No individual events were responsible for a large change in prior year incurred claims.

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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

The components of unpaid losses and loss adjustment expenses as of September 30, 2009 and 2008 are as follows:

	<b>2009</b>	<b>2008</b>
Unpaid losses:		
Case basis	\$ 1,522,063	\$ 2,917,957
Incurred but not reported	2,634,065	4,684,936
	<b>\$ 4,156,128</b>	<b>\$ 7,602,893</b>
Unpaid loss adjustment expenses:		
Case basis	\$ 175,836	\$ 225,515
Incurred but not reported	194,604	290,123
	<b>\$ 370,440</b>	<b>\$ 515,638</b>
	<b>\$ 4,526,568</b>	<b>\$ 8,118,531</b>

#### 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. At September 30, 2009, the Association had a net payable to NCJUA of \$356,680. At September 30, 2008, the Association had a net payable to NCJUA of \$287,029.

#### Note 7. Lease Commitments

The Association and NCJUA jointly rent home office facilities under an operating lease agreement, which expires in 2015. The Association was allocated 71% and 62% of the costs under this lease agreement in 2009 and 2008, respectively. The Association's allocated share of rent expense was \$242,803 in 2009 and \$218,061 in 2008.

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, 2009 is as follows:

Year Ending	Amount
September 30,	
2010	\$ 384,345
2011	354,243
2012	340,324
2013	340,539
2014	349,540
Thereafter	58,507
	<b>\$ 1,827,498</b>

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

## **North Carolina Insurance Underwriting Association**

### **Notes to Statutory Financial Statements**

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#### **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. In the opinion of management, 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 \$40,133,461 and a distribution totaling \$23,673,376 were made in 2009. An assessment and an offsetting distribution totaling \$14,968,232 were made in 2008.

#### **Note 10. Employee Benefit Plans**

The Association and NCJUA are members of a multiple-employer pension trust. 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. The Association is currently allocated 71% of the costs and obligations associated with their participation in the plan under the current cost-sharing arrangement with NCJUA. The Association was allocated 62% of the costs and obligations associated with their participation in the plan during 2008.

In addition to pension benefits, the Association and 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.

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

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 10. Employee Benefit Plans (Continued)

##### Obligations and Funded Status

	Pension Benefits	
	2009	2008
<b>Changes in benefit obligations:</b>		
Obligations at beginning of year	\$ 1,842,097	\$ 1,954,717
Service cost	131,247	135,440
Interest cost	158,765	122,732
Plan amendments	(523)	-
Participant contributions	-	-
Actuarial (gains) losses	630,564	(304,073)
Benefits paid	(79,068)	(66,719)
Change in cost sharing with NCJUA	267,400	-
<b>Obligations at end of year</b>	<b>2,950,482</b>	<b>1,842,097</b>
<b>Changes in plan assets:</b>		
Fair value of assets at beginning of year, primarily pooled separate accounts with insurance companies and mutual funds	1,356,275	1,544,679
Actual return on assets	221,073	(246,213)
Association contributions	172,220	124,528
Participant contributions	-	-
Benefits paid	(79,068)	(66,719)
Change in cost sharing with NCJUA	196,878	-
<b>Fair value of assets at end of year, primarily pooled separate accounts with insurance companies and mutual funds</b>	<b>1,867,378</b>	<b>1,356,275</b>
<b>Funded status (plan assets less than benefit obligations) at end of years</b>	<b>(1,083,104)</b>	<b>(485,822)</b>
Amounts not recognized on statutory statements of admitted assets, liabilities, and surplus before additional minimum pension liability:		
Unrecognized net loss	933,303	354,552
Prior service cost	(523)	-
<b>Net amount recognized on statutory statements of admitted assets, liabilities, and surplus before additional minimum pension liability</b>	<b>(150,324)</b>	<b>(131,270)</b>

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 10. Employee Benefit Plans (Continued)

	Pension Benefits	
	2009	2008
Amounts recognized on statutory statements of admitted assets, liabilities, and surplus as:		
Accrued benefit cost	\$ (150,324)	\$ (131,270)
Additional minimum liability	(468,675)	-
<b>Net amount recognized on statutory statements of admitted assets, liabilities, and surplus</b>	<b>(618,999)</b>	<b>(131,270)</b>
Aggregate accumulated benefit obligation for defined benefit pension plan	2,486,377	1,604,364
For pension plan with accumulated benefit obligation in excess of assets at September 30 of the respective years:		
Projected benefit obligation	2,950,482	1,842,097
Accumulated benefit obligation	2,486,377	1,604,364
Fair value of plan assets	1,867,378	1,356,275

#### Components of Net Periodic Benefit Cost and Additional Information

	Pension Benefits	
	2009	2008
Components of net periodic benefit cost:		
Service cost	\$ 131,247	\$ 135,440
Interest cost	158,765	122,732
Recognized actuarial loss	18,192	8,940
Expected return on plan assets	(121,872)	(124,906)
<b>Net periodic benefit cost</b>	<b>186,332</b>	<b>142,206</b>

#### Additional information:

Increase in minimum liability	468,675	-
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#### Assumptions

	Pension Benefits	
	2009	2008
Weighted-average assumptions used in computing ending obligations:		
Discount rate	5.50%	7.25%
Rate of compensation increase	4.00	4.00
Weighted-average assumptions used in computing net cost:		
Discount rate	7.25	6.00
Rate of compensation increase	4.00	4.00
Expected return on plan assets	7.75	8.00

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### 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.

For measurement purposes, the discount rate used in 2009, when the Association last obtained an actuarial valuation of its postretirement health and life insurance benefits, in determining the accumulated postretirement benefit obligation was 5.5%, and the health care cost-trend rate was 8.0% decreasing 0.5% per year to an ultimate rate of 5.0% in 2016. A nonvested accumulated postretirement benefit obligation of \$998,704 existed at September 30, 2009.

A nonvested pension projected benefit obligation and accumulated benefit obligation of \$154,521 and \$160,864, respectively, existed at September 30, 2009. A nonvested pension projected benefit obligation and accumulated benefit obligation of \$99,378 and \$89,684, respectively, existed at September 30, 2008.

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.

#### Plan Assets

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

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, 2009	September 30, 2008
Equity securities	60	67 %	70 %
Debt securities	40	27	26
Cash	-	6	4
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>

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.

## North Carolina Insurance Underwriting Association

### **Notes to Statutory Financial Statements**

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#### **Note 10. Employee Benefit Plans (Continued)**

##### **Cash Flows**

The Association expects to contribute approximately \$237,000 to its pension plan and approximately \$26,000 to its other postretirement benefit plan in fiscal year 2010.

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

Year	Pension Plan
2010	\$ 111,346
2011	121,174
2012	128,101
2013	133,963
2014	140,008
2015 - 2019	900,100

##### **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 75% of employee contributions up to 6% of the employee's earnings. The Association's expense for the years ended September 30, 2009 and 2008 was \$84,298 and \$70,349, respectively.

#### **Note 11. Estimated 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 and other debt instruments are estimated based on quoted market prices and approximated \$580,614,000 and \$560,081,000, respectively, at September 30, 2009. The fair value and amortized cost of bonds and other debt instruments approximated \$442,113,000 and \$444,019,000, respectively, at September 30, 2008.

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

## North Carolina Insurance Underwriting Association

### Notes to Statutory Financial Statements

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#### Note 12. Reinsurance Agreement

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 2009, in the event of a named storm, the Associations retain the first \$1.2 billion of loss, 34.867% of loss in the layer \$0.6 billion excess of \$1.2 billion (and first \$55 million of the Associations' share in this layer is 100% reinsured through December 15, 2009), 45.605% of loss in the layer \$0.75 billion excess of \$1.8 billion, 43.211% of loss in the layer \$0.75 billion excess of \$2.55 billion, and all loss above \$3.3 billion. The Associations have also purchased reinstatement premium protection where the Associations retain 28.817% in the layer \$0.6 billion excess of \$1.2 billion, 65.70% of the layer \$0.75 billion excess of \$1.8 billion and 58.168% in the layer \$0.75 billion excess of \$2.55 billion. The reinsurers' responsibility for losses from all loss occurrences during the term of the contract cannot exceed \$4.2 billion. The 2009 reinsurance agreement covers the period from May 1, 2009 to May 1, 2010. The Associations also purchased similar agreements in recent years with lower coverage amounts.

During 2009, the Associations also 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, 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 26.67% of the 43.211% of loss in the layer \$0.75 billion in excess of \$2.55 billion is reinsured leaving the Associations with 16.541% retention in this layer.

Information about reimbursed losses and loss adjustment expenses for the years ended September 30, 2009 and 2008 follows:

	2009	2008
Reinsurance recoverable on losses and loss adjustment expense as of September 30	\$ -	\$ -
Reinsurance recoverable on unpaid losses and loss adjustment expenses as of September 30	- -	- -
Reinsurance recoveries on incurred claims during the year	- -	- -

For this catastrophe coverage 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 increase or decrease by an average of greater than 10%. The effect of reinsurance on premiums written and earned during the years ended September 30, 2009 and 2008 is as follows:

	2009		2008	
	Written	Earned	Written	Earned
Direct	<b>\$ 295,394,182</b>	<b>\$ 282,940,703</b>	<b>\$ 277,956,547</b>	<b>\$ 255,294,739</b>
Ceded	<b>(147,205,642)</b>	<b>(147,205,642)</b>	<b>(78,097,116)</b>	<b>(78,097,116)</b>
<b>Net premiums</b>	<b>\$ 148,188,540</b>	<b>\$ 135,735,061</b>	<b>\$ 199,859,431</b>	<b>\$ 177,197,623</b>

## **North Carolina Insurance Underwriting Association**

### **Notes to Statutory Financial Statements**

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#### **Note 12. Reinsurance Agreement**

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, 2009 or 2008.

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, 2009 or 2008.

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, 2009 or 2008 is not material.