Report on the Examination

As of December 31, 2011

of

VLCT Property and Casualty Intermunicipal Fund, Inc.

by the

Vermont Department of Financial Regulation

Division of Insurance

VERMONT

State of Vermont
assistance
Department of Financial Regulation
89 Main Street
Montpelier, VT 05620-3101
www.dfr.vermont.gov

For consumer

[All Insurance] 800-964-1784
[Securities] 877-550-3907
[Banking] 888-568-4547

September 24, 2012

Stephen Jeffrey
Executive Director
VLCT Property and Casualty Intermunicipal Fund, Inc.
89 Main Street
Montpelier, VT 05602

Dear Mr. Stephen Jeffrey:

ORDER OF ADOPTION

Pursuant to and in accordance with the provisions of Title 8, Chapter 101, Section 3563 and 3566 of the Vermont Statutes Annotated, and other applicable laws, I, do hereby adopt the Report on the Examination of VLCT Property and Casualty Intermunicipal Fund, Inc. for the year ending December 31, 2011.

S. W. Kimbell

Stephen Kimbell, Commissioner

10/24/12

Date

VLCT PROPERTY AND CASUALTY INTERMUNICIPAL FUND, INC.

EXAMINATION REPORT

AS OF DECEMBER 31, 2011

TABLE OF CONTENTS

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September 24, 2012

Stephen W. Kimbell, Commissioner

Department of Financial Regulation

89 Main Street

Montpelier, VT 05620-3101

Dear Commissioner Kimbell:

Pursuant to the April 17, 2012 examination order, the Insurance Division's financial examination team has conducted an examination of:

VLCT Property and Casualty Intermuncipal Fund, Inc.
with their offices located at
89 Main Street, Suite 4
Montpelier, Vermont 05602

The examination was performed pursuant to 8 V.S.A. §3563 and Regulation I-90-1, in order to ascertain the Company's financial condition, ability to fulfill its obligations and compliance with the provisions of Vermont law.

SCOPE OF EXAMINATION

The VLCT Property and Casualty Intermunicipal Fund, Inc.'s (PACIF) or the (Company) last financial condition examination was as of December 31, 2006 for the previous five year period. The financial condition examination was conducted by the Insurance Division of the Vermont Department of Financial Regulation (the Department).

The financial condition examination was conducted pursuant to 8 V.S.A. §3563 and Regulation I-90-1, and guidance provided by the National Association of Insurance Commissioners (NAIC). The examination covered the period from January 1, 2007 through December 31, 2011. The examiners conducted the examination in accordance with NAIC *Financial Condition Examiners Handbook* (Handbook). The Handbook requires that the examiners plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company, including corporate governance, identifying and assessing inherent risks within the company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with accounting principles and state regulations. The examination team also included a review of any material transactions and/or events occurring subsequent to the examination date that were noted during the course of this examination. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

As required by law and the NAIC standard examination procedures, the Company instructed their independent accounting firm, Johnson & Lambert LLP, to make available for the department's review all workpapers concerning procedures followed, tests performed, information obtained and conclusions reached pertinent to the audit of the Company's financial statements for the period covered by the examination. The examination team reviewed the workpapers of Johnson & Lambert LLP to identify additional solvency risk areas and to determine the extent of work performed on high-risk areas, which may have provided insight and efficiencies for the current examination. To the extent possible, the examination team utilized the workpapers and analyses to supplement the examination work.

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

SUMMARY OF SIGNIFICANT FINDINGS

There were no material adverse findings in the prior exam report or the current exam report. There were no material adjustments made to the financial statements in this report based on this examination.

SUBSEQUENT EVENTS

There are no reportable subsequent events.

HISTORY

The Vermont League of Cities and Towns (VLCT) is a nonprofit, nonpartisan organization that serves Vermont's municipal officials founded in 1967. VLCT is owned by its member municipal governments and provides educational workshops and consulting advice to municipal officials, information to the public regarding local government; support for legislation that strengthens local government; comprehensive insurance coverage for municipalities; and a Municipal Assistance Center for consultation on a wide range of municipal issues.

PACIF was established in June 1986 by VLCT. Its purpose is to provide its members of the VLCT with various forms of property, workers' compensation, casualty and fidelity insurance, reinsurance, and excess insurance through admitted and surplus lines carriers; to develop selfinsurance and risk retention pools for the benefit of members; to act as an advocate before governmental regulatory agencies with respect to municipal property and casualty insurance coverage and availability; and to develop, promote and implement risk management, risk containment and loss control programs for the benefit of Vermont municipalities and their employees.

Political subdivisions joining the Company must remain for a minimum of one year but may withdraw after that time by giving notice sixty (60) days prior to the end of the fund year. The Company underwriting and rate setting policies are established after consultation with an actuary. If the assets of the Company were to be exhausted, members would be responsible for the Company's liabilities. At December 31, 2011, the Company provided property and casualty and workers' compensation coverage to 321 political subdivisions including, cities, towns, villages and special purpose districts providing water, solid waste management and fire protection.

The Company receives its contributions from municipalities based upon the loss experience of the Company, operating expenses, excess insurance and reinsurance costs and exposures for each member. Such contributions are used to pay all administrative expenses, reinsurance costs, claims and claim-related costs. The Company maintains separate funds for each plan year to reserve monies for claims related to those years.

The Company's members may be subject to an assessment for an amount determined by the Company's Board of Directors (Board) to cover a loss fund deficiency. In the event that an assessment is required, such assessment shall be made against individual members in the proportionate share of each member's contribution in the total contribution for that fund year. No assessment has been determined since the Company's inception in 1986.

<u>Lines of Business/Operations</u>

The Company offers the following coverage's:

- Workers' Compensation

- Auto Liability
- General Liability
- Law Enforcement Liability
- Public Officials Liability
- Auto Physical Damage
- Property

Each year, the Company analyzes whether premium credits are appropriate. As of December 31, 2011, $1,250,000 of premium credits will be applied to 2012 and $250,000 will be allocated to fund the member safety grant program. The Board also designated $1,045,499 for the safety margin recommended by the Company's actuary in order to maintain a 90% confidence level in the adequacy of the non-case reserves. As of December 31, 2010, $800,000 of premium credits were applied to 2011 and $200,000 was allocated to fund the member safety grant program.

As of December 31, 2011, the change in net ultimate incurred losses (not including safety margin) for prior years (2003 – 2010) is an increase of $46,112. This reflects less than 1% of the total ultimate incurred ($78,971,071 as estimated by the actuary).

The change in net position from 2011 to 2010 was significantly less than it was between 2009 and 2010 ($2,707,990 compared with $4,615,587) due to lower investment earnings, a workers compensation rate decrease and higher reinsurance premiums for added exposures. However, the fund contributions were more than sufficient to cover the change in losses and loss-related expenses resulting in an operating surplus of $1,138,270, despite an additional $14 million in incurred losses due to damage from Tropical Storm Irene. Reinsurance covered all but the $500,000 retention, offsetting most of those claims.

Net case and non case (IBNR) reserves as of December 31, 2011 decreased by 1.8% or $282,837 from December 31, 2010, from $15,383,674 to $15,100,837. By comparison, net case and non case (IBNR) reserves increased by 3.2% over the prior year at the end of 2009, from $14,911,010 to $15,383,674. The claims expense reserve and the worker's compensation state assessment reserve increased 25% over last year, from $937,030 in 2010 to $1,172,315 in 2011.

Actual losses compared to expected loss development has remained stable and generally favorable in the aggregate allowing the Company to strengthen its net position. This solid net position and reinsurance coverage that eliminated most of the risk for such a catastrophic even as Tropical Storm Irene, protected the Company and in fact allowed it to continue to grow in surplus in 2011. The safety margin has been discounted for future investment earnings at a rate of 3.5% for 2008 – 2011.

CORPORATE RECORDS

The Company's articles of incorporation, by-laws and minutes of the Board meetings held during the period under examination were reviewed. Based upon our review, the Company is conducting its affairs in accordance with its own charter and by-laws. The recorded minutes of these meetings adequately documented approval of the Company's investment transactions, other material transactions, events and changes in directors.

MANAGEMENT AND CONTROL

Board of Directors

In accordance with Article IV of the Company's by-laws, the Board will be composed of eleven (11) individuals and no more than four (4) directors shall serve on the Board of the VLCT, or any of its other affiliated insurance trusts. Each director shall at the time of appointment be an appointed or elected official of a member. If during a director's term the member of which the director is an appointed or elected official is terminated or withdraws from membership in the Company, the director's appointment shall cease effective upon withdrawal or termination.

The following were elected to the Board of the Company in accordance with the by-laws and serving as of December 31, 2011:

Name	Principal Business Affiliation
Pat Scheidel, President	Manager, Essex Town, Vt.
Hunter Rieseberg, Vice President	Town Manager, Hartford, Vt.
Joshua Powers, Jr., Secretary/Treasurer	Trustee of Public Funds, Royalton, Vt.

Name	**Principal Business Affiliation**
Neal Fox	Selectboard Chair, Bethel, Vt.
Valdine Hall	Assistant Town Clerk/Treasurer, Greensboro, Vt.
Dan Hill	Municipal Administrator, Lyndon, Vt.
Stuart Hurd	Town Manager, Bennington, Vt.
Walker James	Selectperson, Orwell, Vt.
John Lawe	Town Health Officer, Norwich, Vt.
Carl Rogers	Town Manager, Barre Town, Vt.
Brendan Whittaker	Selectperson, Brunswick, Vt.
Keith Arlund	Town Manager, Brandon, Vt.

Management Team

The Management Team as of December 31, 2011 are as follows:

Name	**Title**
Steven Jeffrey	Executive Director
Ken Canning	Director, Risk Management Services
Mike Gilbar	Chief Financial Officer
Jim Burke	Director, Information and Technology and Communications

Conflict of Interest Policy

The Company has developed policies for standards of professional conduct including Fraud and Conflict of Interest Policies. The purpose of these policies is to set forth basic principles and guidelines to direct employees in the proper conduct of the business and personal affairs as representatives of the Company. The standards are expected to be followed by all board members and employees. The Board and employees of the Company sign an annual Conflict of Interest Disclosure Statement. The examination team reviewed the Conflict of Interest Disclosure Statements and no conflicts of interest were reported.

Affiliated Companies

- The Company has an Administrative Support Service Agreement with the VLCT. The agreement provides certain administrative, financial, investment, and management services to the Company. The amount payable under the agreement is based on the total direct expenses actually paid by the VLCT during the fiscal year and the appropriate percentage of expenses actually paid for services provided through the administrative agreement. The VLCT provides staff, office space and equipment usage to the Company. For the year ended December 31, 2011, total VLCT budgeted expenses allocated to the Company were $2,361,961 which amounted to 58.7% of total allocable VLCT expenses. The expense attributable to the Company includes allocations of the following:

- Salary and benefits for administrative staff including finance, human resource, production and general administrative support
- Office costs including all building-related expenses and insurances
- Equipment and communications costs
- Printing and supplies
- Travel and training for administrative functions
- VLCT Officers costs
- Contracted services
- Dues and subscriptions for administrative staff
- Services provided for administrative activities
- Miscellaneous costs related to administrative activities

For 2011, 21% of the expenses paid were for administration and marketing, 20% for underwriting, 37% for claims handling and 22% for loss prevention.

FIDELITY BOND AND OTHER INSURANCE

The Company is covered under the terms of a fidelity bond that is part of their Trustees Errors and Omissions and Directors and Officers Liability insurance policy. The amount of coverage in force at December 31, 2011 exceeds the minimum amount of coverage recommended by the NAIC. All other insurance coverages, such as commercial property, general liability, crime coverage, auto coverage, workers' compensation, etc., appear to be maintained at sufficient levels.

PENSIONS AND INSURANCE PLANS

The Company does not have any employees. The employees are all employed by the VLCT under the agreement mentioned above.

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed only in the state of Vermont and is the leading provider of property/casualty and workers' compensation coverage to Vermont municipalities. The Company started with 27 founding members and has grown to 321 current members. The Company provides coverage for losses to member municipalities for general liability, law enforcement, crime and fidelity, property damage, auto accidents, injured employees, public official liability, and employment practices liability. The Company serves a range of Vermont political subdivisions that include cities, towns, villages and special purpose districts providing water, solid waste management and fire protection.

GROWTH OF COMPANY

The growth of the Company over the five most recent years is shown in the following table:

Revenue, Expenses and Investment Income

(amounts in 000's)	2011	2010	2009	2008	2007
Fund Contributions	$17,551	$18,078	$17,320	$16,335	$14,553
Fund Contributions net of Reinsurance	14,486	15,241	14,751	13,599	12,017
Operating Income/(Loss)	1,138	2,542	1,987	3,165	(712)
Net Non-Operating Revenue/(Loss)	2,362	2,824	3,857	(1,425)	1,559
Member Distributions – contribution credit	792	750	500	723	791
Change in Net Position	2,708	4,616	5,344	1,017	56

Operating Ratios

	2011	2010	2009	2008	2007
Net Position (Surplus) to Total Asset Ratio	.56	.55	.51	.43	.41
Loss Reserves to Net Position(Surplus)	.56	.68	.81	1.08	1.27
Net Contributions to Net Position (Surplus)	.54	.63	.75	.95	.92
Combined Ratio	.94	.87	.89	.81	1.06

Assets, Liabilities and Net Position

	2011	2010	2009	2008	2007
Assets	$48,012	$43,900	$38,443	$32,541	$31,640
Liabilities	21,240	19,836	18,995	18,438	18,553
Net Position	26,772	24,064	19,448	14,104	13,087

REINSURANCE

Affiliated Reinsurer

The Company is a member of the NLC Mutual Insurance Company, which is a Vermont licensed association captive insurance company that provides reinsurance to various state league sponsored risk sharing pools. Members make capital contributions and pay premiums in exchange for reinsurance. The total investment by the Company in NLC at December 31, 2011 is $2,026,321.

Reinsurance

The Company has various occurrence basis quota-share and excess-of-loss reinsurance agreements to limit its exposure to large claims. Such reinsurance reduces the magnitude of sudden and unpredictable changes in net position; however the Company remains contingently liable should the reinsurer fail for any reason to perform their obligations under the agreements. The reinsurance in place is as follows:

Line of Coverage	Reinsurance Term	Company Retention	Policy Limit
Property	1/1/2009-1/1/2012	$500,000	$500,000,000

	1/1/2005-1/1/2009	$150,000	$500,000,000
	1/1/1996-1/1/2005	$150,000	$500,000,000
Casualty	1/1/2011-1/1/2012	$500,000	$10,000,000
	1/1/2010-1/1/2011	$500,000	$5,000,000
	1/1/2005-1/1/2010	$500,000	$2,000,000
	1/1/1996-1/1/2005	$250,000	$2,000,000
Workers' Compensation	1/1/2006-1/1/2012	$500,000	Statutory/$5,000,000
	1/1/2005-1/1/2006	$350,000	Statutory/$5,000,000
	1/1/1996-1/1/2005	$250,000	Statutory/$5,000,000
Boiler & Machinery	1/1/1996-1/1/2012	$100,000	$50,000,000

ACCOUNTS AND RECORDS

The Company prepares financial statements in accordance with accounting principles generally accepted in the United States (GAAP). The operations of the Company are recorded utilizing a general ledger system and claims system, however the two systems are not automated. Entries for investment activity, claims, etc. are recorded in the general ledger by journal entry. The Company's information technology environment is not complex and a review by a specialist was not considered necessary.

The Company is not subject to requirements of either Sarbanes-Oxley Section 404, or the internal control attestation requirements expressed in Regulation 1-2009-06, section 16 because the Company is a non-profit corporation under the Vermont Nonprofit Corporation Act. The Company's income is tax-exempt under the Internal Revenue Code Section 115, which pertains to political subdivisions.

FINANCIAL STATEMENTS

The following statements show the financial position of the Company as of December 31, 2011 in accordance with generally accepted accounting principles (GAAP).

Statements of Net Position
As of December 31, 2011

Assets		
Investments		
Fixed-maturity securities, at fair value	$	31,464,715
Mutual funds, at fair value		5,011,256
Investment in NLC Mutual Insurance Company		2,026,321
Total Investments		38,502,292
Cash and cash equivalents		6,877,406
Accrued investment income		330,167
Contribution receivable		423,785
Accounts receivable – deductibles and subrogation		167,735
Prepaid expenses		785,229
Reinsurance recoverable – paid losses		303,394
Other assets		621,935
Total Assets	$	48,011,943
Liabilities and Net Position		
Liabilities		
Losses and loss adjustment expenses, net of reinsurance	$	15,100,837
Accounts payable		365,904
Contributions collected in advance		4,154,599
Reinsurance collected in advance		446,410
Claims expense and workers' compensation state assessment reserve		1,172,315
Total Liabilities		21,240,065
Net Position		
Restricted		
Contribution credits	$	1,250,000
Safety grant program		250,000
Unrestricted		25,271,878
Total Net Position		26,771,878
Total Liabilities and Net Position	$	48,011,943

Statement of Contributions, Expenses and Changes in Net Position
Year ended December 31, 2011

Operating Revenue:		
Fund contributions	$	17,550,963
Other income		46,163
Total operating revenues		17,597,126
Operating Expenses:		
Losses and loss adjustment expenses, net of reinsurance		9,669,523
General and administrative expenses		3,577,819
Reinsurance expenses		3,065,166
Broker fees for reinsurance		146,348
Total Operating Expenses		16,458,856
Operating income		1,138,270
Non-Operating Revenue (Expenses):		
Investment income – interest and dividends		1,409,700
Investment income – net change in fair value		982,949
Investment income – NLC Mutual Insurance Company		87,258
Investment management fees		(118,187)
Total non-operating revenue		2,361,720
Member distributions – contribution credit		792,000
Non-operating income, net		1,569,720
Change in Net Position		2,707,990
Net Position, Beginning of Year		24,063,888
Net Position, End of Year	$	26,771,878

COMMENTS AND RECOMMENDATIONS

There are no significant findings or financial adjustments as a result of this examination. A comment letter was issued to the Board of Directors as a result of this exam addressing opportunities for improvement and other items that did not reach a level of significance to warrant inclusion in this report.

CONCLUSION

As a result of this examination, the financial condition of the Company, as of December 31, 2011 was determined to be as follows:

Assets	$48,011,943
Liabilities	21,240,065
Net Position	$26,771,878
Total Liabilities and Net Position	$48,011,943

In addition to the undersigned, Karen Murphy, Administrative Insurance Examiner, and Jesse Lussier, Examiner-In-Charge, participated in this examination.

Respectfully submitted,

Kaj Samsom, CFE
Chief Examiner, Division of Insurance
Vermont Department of Financial Regulation

STATE OF VERMONT
COUNTY OF WASHINGTON

Kaj Samsom, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Subscribed and sworn to before me

This 25th day of Sept, 2012

Notary Public
my commission Expires: 2-10-15