

**MICHIGAN TOWNSHIP  
PARTICIPATING PLAN**

AUDITED FINANCIAL STATEMENTS

Years ended June 30, 2011 and 2010

# MICHIGAN TOWNSHIP PARTICIPATING PLAN

## TABLE OF CONTENTS

	<b>Page</b>
<b>Independent Auditors' Report</b>	1
<b>Financial Statements</b>	
Statements of Financial Position	2
Statements of Revenues, Expenditures and Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Michigan Township Participating Plan

We have audited the accompanying statements of financial position of the Michigan Township Participating Plan, (a Michigan Public Act 138 entity), as of June 30, 2011 and 2010, and the related statements of revenues, expenditures and net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Plan'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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Michigan Township Participating Plan as of June 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*UHY* LLP

Farmington Hills, Michigan  
September 28, 2011

# MICHIGAN TOWNSHIP PARTICIPATING PLAN

(a Michigan Public Act 138 Entity)

## STATEMENTS OF FINANCIAL POSITION

	June 30,	
	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash in bank	\$ 590,334	\$ 1,156,554
Membership fees receivable	24,180	20,280
Deposits	<u>11,021</u>	<u>325</u>
	<u><u>\$ 625,535</u></u>	<u><u>\$ 1,177,159</u></u>
 <b>LIABILITY AND NET ASSETS</b>		
<b>CURRENT LIABILITY</b>		
Premiums and accounts payable	\$ 565,498	\$ 1,116,774
<b>NET ASSETS</b>	<u>60,037</u>	<u>60,385</u>
	<u><u>\$ 625,535</u></u>	<u><u>\$ 1,177,159</u></u>

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**STATEMENTS OF REVENUES, EXPENDITURES AND NET ASSETS**

	For the years ended June 30,			
	2011		2010	
	Amount	Percent of Net Contributions from Members	Amount	Percent of Net Contributions from Members
<b>Gross insurance premiums</b>	<b>\$ 20,723,310</b>		\$ 24,238,103	
Less agent commissions	<u>2,499,123</u>		<u>2,766,978</u>	
Gross contributions from members	<u>18,224,187</u>		<u>21,471,125</u>	
Less administrative fees to plan administrator, claims and risk control	3,239,410		3,949,401	
Expense for reinsurance	<u>14,724,257</u>		<u>17,246,969</u>	
	<u>17,963,667</u>		<u>21,196,370</u>	
Net contributions from members	<u>260,520</u>	<u>100.0 %</u>	<u>274,755</u>	<u>100.0 %</u>
Operating expenses:				
Advertising	80,830	31.0	84,847	30.9
Travel and meetings	92,852	35.6	91,966	33.5
Newsletter publishings	25,000	9.6	25,000	9.1
Professional fees	26,716	10.3	29,970	10.9
Actuarial costs	26,000	10.0	26,500	9.6
Risk control	1,900	.7	7,155	2.6
Insurance	1,909	.7	1,873	.7
Office supplies and expense	<u>5,661</u>	<u>2.2</u>	<u>3,405</u>	<u>1.2</u>
	<u>260,868</u>	<u>100.1</u>	<u>270,716</u>	<u>98.5</u>
Operating income (loss)	(348)	(.1 )	4,039	1.5
Other income - settlement	<u>-</u>	<u>-</u>	<u>7,715</u>	<u>2.8</u>
Excess of revenues (expenditures)	<u>(348)</u>	<u>(.1 ) %</u>	<u>11,754</u>	<u>4.3 %</u>
Net assets, beginning	<u>60,385</u>		<u>48,631</u>	
Net assets, ending	<u>\$ 60,037</u>		<u>\$ 60,385</u>	

**MICHIGAN TOWNSHIP PARTICIPATING PLAN  
STATEMENTS OF CASH FLOWS**

	<u>Years ended June 30,</u>	
	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from members	\$ 20,719,410	\$ 24,241,028
Expenditures to reinsurer, agents, administrator and other vendors	(21,285,630)	(23,738,200)
Cash received from settlement	-	7,715
	<u>                    </u>	<u>                    </u>
Net cash (used in) provided by operating activities	(566,220)	510,543
<b>CASH, beginning</b>	<u>1,156,554</u>	<u>646,011</u>
<b>CASH, ending</b>	<u><u>\$ 590,334</u></u>	<u><u>\$ 1,156,554</u></u>
 <b>RECONCILIATION OF THE EXCESS OF REVENUES (EXPENDITURES) TO NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Excess of revenues (expenditures)	\$ (348)	\$ 11,754
Adjustments to reconcile the excess of revenues to net cash flows from operating activities:		
Changes in:		
Membership fees receivable	(3,900)	2,925
Deposits	(10,696)	(325)
Premiums and accounts payable	(551,276)	496,189
	<u>                    </u>	<u>                    </u>
Net cash (used in) provided by operating activities	<u><u>\$ (566,220)</u></u>	<u><u>\$ 510,543</u></u>

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following is a summary of certain accounting policies followed in the preparation of these financial statements. The policies conform to accounting principles generally accepted in the United States of America and the procedures provided by the Michigan Department of Treasury as required under Section 124.8(2) of the Michigan Compiled Laws and have been consistently applied in the preparation of the financial statements.

**Plan Operations**

The Michigan Township Participating Plan was established April 1, 1985, pursuant to laws of the State of Michigan which authorize local units of Government to exercise jointly any power, privilege or authority which each might exercise separately. The purpose of the Plan is to jointly exercise powers common to each participating member to establish and administer a risk management program; to prevent or lessen the incidence and severity of casualty losses occurring in the operations of its members; and to defend and protect any member of the authority against liability or loss. The powers, duties and the described activities of the Plan are not intended to constitute the issuance of a policy of insurance. The members intend, in the creation of the Plan, to establish an organization for joint risk management and have not created as between member and member any relationship for the debts of or claims against any member.

**Use of Estimates**

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

**Revenue Recognition**

The Plan generally recognizes revenue when persuasive evidence of an arrangement exists, service occurred, the fee is fixed or determinable, and collectibility is probable.

**Concentration of Credit Risk**

The Plan may, from time to time during the years covered by these financial statements, have bank balances in excess of FDIC insured limits. Management has deemed this as a normal business risk.

**Income Taxes**

The Plan is a municipal self-insurance entity operating pursuant to the State of Michigan Public Act 138 of 1982. This law allows local governmental units to provide joint funding for risk management and self-insurance purposes.

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

**Income Taxes** (Continued)

A ruling has been received from the Internal Revenue Service stating that the Plan is a corporation in form but the activities are not subject to taxation, therefore no provision has been made for income taxes.

The Plan adopted Accounting Standards Codification (ASC) guidance regarding accounting for uncertainty in income taxes. This guidance clarifies the accounting for income taxes by prescribing the minimum recognition threshold an income tax position is required to meet before being recognized in the financial statements and applies to all income tax positions. There were no uncertain tax positions at June 30, 2011 and 2010.

**Advertising**

Advertising costs are expensed as incurred.

**Subsequent events**

Plan management has performed a review of events subsequent to the statement of financial position date through September 28, 2011, the date the financial statements were available to be issued.

**NOTE 2 – SELF-RETENTION AND REINSURANCE**

The Michigan Township Participating Plan, while it operates under the Michigan Legislation of Public Act 138, does not operate as a risk pool due to a total transfer of risk to reinsurance companies backing the Michigan Township Participating Plan. Due to this reinsurance purchase, there is no pooling of risk between members. The Plan has protected itself in the event reinsurance becomes uncollectible by purchasing a reinsurance treaty for uncollectible reinsurers.

During the years ended June 30, 2011 and 2010, gross member assessments written were \$20,723,310 and \$24,238,103, respectively. The amount of member assessments paid to reinsurers was \$14,724,257 and \$17,246,969, respectively. There were no member assessments assumed from other entities and the net amount of member assessments retained was \$260,520 and \$274,755, respectively.

The Michigan Township Participating Plan chose to adopt the forms and endorsements of conventional insurance protection and to reinsure these coverages 100%, rather than utilize a risk pool of member funds to pay individual and collective losses up to a given retention, and then have reinsurance above that retention amount.

The individual members are responsible for their self-retention amount, which vary from member to member.

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2011 and 2010**

**NOTE 2 – SELF-RETENTION AND REINSURANCE (Continued)**

The Plan had entered into a multi-line three year reinsurance contract with Montpelier Re Holdings Ltd. (Montpelier) on April 1, 2005. Under the provisions of the contract, Montpelier could elect to renew for an additional three years effective April 1, 2008.

During the year ended June 30, 2008, the above election was exercised. At this time the contract renewed and was extended through June 30, 2011. The contract contains a provision stating that Montpelier has the option to cancel the contract effective at the immediately succeeding March 31, by giving at least 90 days written notice, in the event that the Plan's annual actuarial report indicates that the ultimate loss and loss adjustment expense ratio for the accident year ending June 30, 2008, and each subsequent fiscal year ending June 30, is 75% or greater. In the event the Plan's loss ratio exceeds 75% and Montpelier elects not to renew the contract for the subsequent year, reinsurance coverage for all policies in force would not be affected as Montpelier is obligated to run off all in-force policies through their expiration. The actuarial report showed that the results for each of the accident years ended June 30, 2011 and 2010 were less than 75% and thus this election did not apply.

An additional provision of the multi-year reinsurance treaty stated that Montpelier could cancel if there was a material change in ownership or management of the Plan, including a change in the underwriting manager (Kenrick Corporation) without prior consent of Montpelier. This provision was required to assure consistency in management and in the processes and procedures that have historically been used to generate the Plan's loss results. In the event that a material change did occur, the Plan would need to obtain the consent of Montpelier prior to the change, or negotiate alternate reinsurance contracts.

See Note 8 for subsequent events relating to the above.

**NOTE 3 – UNRECOVERABLE REINSURANCE**

The Plan entered into a reinsurance agreement on June 30, 2003 with Motors Insurance Corporation, a subsidiary of General Motors, to provide protection to the Plan members in the event that the Plan had difficulties in the collection of claim recoverables from one or more of the reinsurers. At June 30, 2011 and 2010, this unrecoverable agreement had a limit of \$3,065,063 and \$3,028,133, respectively. This agreement allows the Plan the option to increase the limit of protection through additional premium payments.

Motors Insurance Corporation was acquired by Maiden Holdings North America, Ltd. ("Maiden NA") on October 31, 2008. The agreement referred to above remains in place as of June 30, 2011.

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2011 and 2010**

**NOTE 4 – INCOME AND EXPENSE RECOGNITION**

As discussed in Note 2, the Plan does not operate a risk pool, but provides conventional insurance protection and reinsures these coverages one hundred percent. As such, when contributions are received from members, they are immediately turned over to the Plan administrator for remittance to reinsurers, less administrative fees, on a timely basis. During the years ended June 30, 2011 and 2010, the costs for risk control and claims administration were included in the rate paid to the administrator.

**NOTE 5 – PLAN TERMINATION**

While the board is not presently considering Plan termination, the Plan may cease its activities upon a three-fourths vote of the members to such effect. The Plan shall be administered by the Board of Directors holding office on the effective date of the termination until all of the Plan's affairs are completed.

**NOTE 6 – LOSS RESERVES**

The Plan has reinsured one hundred percent of its loss reserves and consequently has not reflected a liability for loss reserves on its statements of financial position.

**NOTE 7 – CLASS ACTION LAWSUIT SETTLEMENT**

During the year ended June 30, 2010, the Plan received a \$7,715 class action lawsuit settlement from an insurance company. The settlement called for the repayment of certain commissions charged by the insurance company which were questionable. These commissions had not been charged directly to the Plan by any of their reinsurers. Rather, they were indirectly charged by a reinsurance intermediary. The policies held by the Plan with this insurance company were in-force several years ago.

**NOTE 8 – SUBSEQUENT EVENTS**

On July 1, 2011 the Plan did not renew the re-insurance agreement with Montpelier Re Holdings Ltd. discussed in Note 2. The Plan will no longer issue coverage documents under the name of the Michigan Township Participating Plan. Instead, a traditional insurance program is being offered to the Plan members on a U.S. Specialty Insurance Company (USSIC) master insurance policy issued to the Plan who will then issue individual certificates of insurance to each member. USSIC is a subsidiary of HCC Insurance Holdings, Inc. (HCC) and is an admitted carrier in the State of Michigan.

The Plan will no longer receive its funding as it had prior to July 1, 2011. Rather, USSIC will pay 2.6% of net annual written premium, subject to a maximum of \$650,000 for each underwriting year, to the Plan to fund operations as well as the new MTPP Risk Reduction Grant Program.

**MICHIGAN TOWNSHIP PARTICIPATING PLAN**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2011 and 2010**

**NOTE 8 – SUBSEQUENT EVENTS** (Continued)

USSIC is also providing a dividend plan to the program going forward. It will be funded by USSIC to the Plan, which in turn, will disburse funds it receives, if any, to its members.

As stated in Note 3, in the past the Plan had purchased reinsurance to cover its default credit risk should a reinsurer become unable to fulfill its assumed financial obligation. Starting with the July 1, 2011 fiscal year, this policy will be commuted back to the Plan. The Plan has entered into an agreement with HCC to cover up to \$20 million in losses to the Plan resulting if a prior reinsurer, including Montpelier Re, is unable or unwilling to make some or all payments under its reinsurance agreements. Proceeds from the commutation of the unrecoverable reinsurance agreement back to the Plan will be used to fund the agreement with HCC.

As a result of this agreement the Plan will no longer need to purchase reinsurance. USSIC will provide coverage and purchases its own reinsurance. Reinsurance placed prior to July 1, 2011 will remain in effect as stated in the prior agreements.