



**INTEGRITY INSURANCE COMPANY  
IN LIQUIDATION**

**FINANCIAL STATEMENTS  
(WITH SUPPLEMENTARY INFORMATION)**

**December 31, 2013**

INTEGRITY INSURANCE COMPANY  
IN LIQUIDATION  
  
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(WITH SUPPLEMENTARY INFORMATION)

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## INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Department of Banking and Insurance of the State of New Jersey  
and Integrity Insurance Company in Liquidation

We have reviewed the accompanying statement of net liabilities (liquidation basis) of Integrity Insurance Company in Liquidation (the "Estate") as of December 31, 2013, and the related statement of changes in net liabilities (liquidation basis) for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting policies described in Note 2 and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the accounting policies described in Note 2.

As described in Note 1, the liquidation of the Estate is governed primarily by the provisions of New Jersey law dealing with the liquidation of insolvent insurers and the accounting policies described in Note 2, used in the preparation of the accompanying statement of net liabilities (liquidation basis), differ in some respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present the financial position in conformity with generally accepted accounting principles.

Our review was made primarily for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with accounting policies described in Note 2. The supplementary information contained on pages 12 to 14 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplementary information has been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and we did not become aware of any material modifications that should be made to this information.

This report is intended solely for the information of the Department of Banking and Insurance of the State of New Jersey and Integrity Insurance Company in Liquidation and should not be used for any other purpose.



Iselin, New Jersey  
February 24, 2014

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Statement of Net Liabilities (Liquidation Basis)  
December 31, 2013  
(In Thousands)

Assets

Cash and investments	
Cash	\$ 1,496
Bonds at market value (amortized cost - \$189,447)	189,215
Short-term investments, at cost (approximates fair value)	5,179
	<u>195,890</u>
Reinsurance recoverable	
Receivable from solvent insurers	241
	<u>241</u>
Other assets	
Advances to guaranty/non-guaranty associations	701,170
Accrued investment income	2,354
Other assets	260
	<u>703,784</u>
Total assets	<u>\$ 899,915</u>

Liabilities

Priority 1 - expenses of administration	
Claim handling expenses reported by guaranty associations	\$ 21,309
Payable for securities purchased	3,079
Estate administration accrued expenses	134
	<u>24,522</u>
Priority 4 - claims by policyholders, beneficiaries and insureds	
Due to guaranty associations	357,687
Allowed to policyholders	596,907
	<u>954,594</u>
Total liabilities	<u>979,116</u>
Net liabilities in liquidation	<u>\$ 79,201</u>

See independent accountants' review report and  
accompanying notes to the financial statements.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Statement of Changes in Net Liabilities (Liquidation Basis)  
For the Year Ended December 31, 2013  
(In Thousands)

Net liabilities in liquidation, at beginning of year	<u>\$ 163,556</u>
Incurred losses net of reinsurance	(81,760)
Administrative and claims expenses	1,296
Federal income taxes	430
Investment income	(1,175)
Income from commutations and insolvent receivable sale	(3,443)
Decrease in unrealized gains, net	297
Decrease in net liabilities in liquidation	<u>(84,355)</u>
Net liabilities in liquidation, at end of year	<u>\$ 79,201</u>

See independent accountants' review report and  
accompanying notes to the financial statements.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 1 -

Organization

Prior to being placed in rehabilitation, Integrity Insurance Company (the "Company") was primarily engaged in multi-line property and casualty insurance coverages largely issued through general agents. Among the coverages with the large premium volumes and extended development patterns were excess and umbrella insurance for commercial operations and commercial multi-peril insurance. Many of the risks written by the Company were substantially reinsured by other insurance companies.

On December 30, 1986, the Company was found by the New Jersey Superior Court, Chancery Division - Bergen County (the "Court") to be insolvent on a statutory accounting basis and placed in rehabilitation under the control of the Commissioner of Banking and Insurance of New Jersey (the "Commissioner"). On March 24, 1987, the Court terminated the rehabilitation, placed the Company into liquidation, terminated all of the Company's policies, and appointed the Commissioner as Liquidator to marshal the assets and liquidate the Company's liabilities. The Company, in liquidation is referred to as the "Estate".

On June 20, 2008, the Estate received approval from the Court for an Amended Liquidation Closing Plan ("LCP") that established June 30, 2009 as a final bar date. All claims paid prior to this final bar date had to be filed and documented prior to September 30, 2009 in order to be eligible for allowance.

The liquidation of the Estate is governed primarily by the provisions of New Jersey law dealing with the liquidation of insolvent insurers. The distribution priorities of the Estate's assets are prescribed by N.J.S.A. 17:30C (the "Statute"), as discussed in Note 3. Insurance guaranty associations (the "Associations") in all states are statutorily responsible to assume certain of the Estate's obligations to defend and pay claims that are within the statutory coverage of each Association. The Estate is generally bound by settlements entered into by the Associations, which are subrogated to the rights of the claimants against the Estate. In turn, reinsurers are contractually obligated to pay the Estate the amount of any claim ceded to the reinsurer, in the amount allowed by the Liquidator.

Note 2 -

Basis of Presentation

The following is a summary of the significant accounting policies used in preparing the statements of net liabilities.

(a) Liquidation Basis of Accounting

The Company adopted the liquidation basis of accounting on January 1, 2007. This basis of accounting is considered appropriate when, among other things, liquidation of a Company is probable and the net realizable values of assets are reasonably determinable. Under this basis of accounting, assets are valued at their net realizable values and liabilities are stated at their estimated settlement amounts.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 2 - Basis of Presentation (continued)

(b) Investments

Bonds are considered to be available for sale and carried at current market values. Unrealized gains and losses from investments in bonds are reflected as a separate caption in the statement of changes in net liabilities.

Short-term investments include money market funds. These investments are carried at cost, which approximates market value.

Investment income is accrued and includes revenue from the Estate's investment portfolio that is earned but not yet received.

(c) Asset Restrictions

Certain of the Estate's assets are limited in their use until specified events occur that remove the restriction. These events relate to the payment of Court-approved distributions.

(d) Income Taxes

The Estate was exempt from federal income tax under Section 501(c)(15) of the Internal Revenue Code for the tax years January 1, 1988 through December 31, 2007. Beginning January 1, 2008, the Estate is liable for federal income taxes as section 501(c)(15) was revised. Under the revised code section, an insurance company is only exempt from income taxes if its gross receipts for the taxable year do not exceed \$600,000 and more than 50% of those receipts consist of premiums.

(e) Use of Estimates

The preparation of the statement of net liabilities requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(f) Subsequent Events

The Estate evaluated subsequent events through February 24, 2014, which is the date the financial statements were available to be issued.

## INTEGRITY INSURANCE COMPANY IN LIQUIDATION

Notes to Financial Statements

December 31, 2013

- Note 3 - Priorities of Distribution of Estate Assets  
The asset distribution priorities of an insolvent insurer domiciled in New Jersey are, with certain exceptions, governed by the Statute, which establishes the following priorities:
- (a) Priority 1 - Expenses of administration, including certain claim handling expenses of Associations;
  - (b) Priority 2 - Compensation of employees (no claims of this type have been filed);
  - (c) Priority 3 - Tax claims by federal or state authorities, which are secured by liens perfected prior to the commencement of insurer delinquency proceedings (no claims of this type have been filed);
  - (d) Priority 4 - Claims by policyholders and beneficiaries arising from and within the coverage of insurance policies issued by the Company, including claims by state Guaranty Associations; and
  - (e) All other claims. It is not likely these claims will be eligible for a distribution as Priority 4 claims must be paid in full before all other claims are eligible.

In a prior year, the Estate eliminated the \$41 million liability for “all other claims” as it was considered likely that the higher priority claims would exhaust the assets available for distribution.

In addition to the above priorities, the holder of a secured claim is entitled to resort to its security to satisfy its claim, and to assert an unsecured claim in the amount of any deficiency. The Estate does not have any secured claims as of December 31, 2013.

- Note 4 - Advances/Distributions to Guaranty Associations and Non-Guaranty Association Claimants

Assets may only be distributed in accordance with the New Jersey laws regulating the liquidation of the Estate and upon approval by the Liquidation Court.

Guaranty associations must sign a refunding agreement providing for return of the advance in the event the funds are needed by the Liquidator to pay claims of an equal or greater priority.

Non-guaranty association claimants receiving a distribution in excess of \$25,000 must also sign a refunding agreement, providing for return of the distribution payment in the event the funds are needed by the Liquidator to pay claims of an equal or greater priority.

These advances are reported as assets under the caption advances to guaranty/non-guaranty associations. As of December 31, 2013, the Estate had distributed approximately \$701 million, subject to these refunding agreements, to guaranty and non-guaranty association claimants and there was \$2.2 million in unpaid distributions outstanding.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 4 - Advances/Distributions to Guaranty Associations and Non-Guaranty Association Claimants (continued)

<u>Type of Distribution</u>	Estate Distributions (In Millions)		<u>Paid/Offset as of 12/31/13</u>	<u>Remainder To be Paid</u>
	<u>Date Approved By the Court</u>	<u>Percent of Approved Claims Distributed</u>		
<b><u>1. First Priority Guaranty Associations</u></b>				
Initial through Second Extension Of the Seventh Interim	1/21/92-3/26/09	100%	\$ 19.6	\$ .03
<b><u>2. Fourth Priority Guaranty Associations</u></b>				
First through Fifteenth Early Access	1/31/92-4/25/07	70%	\$ 247.0	\$ -
Sixteenth Early Access	5/26/08	75%	18.3	.06
Seventeenth Early Access	4/07/09	75%	2.4	-
Eighteenth Early Access	9/24/09	75%	.8	-
Nineteenth Early Access	2/23/12	75%	.1	-
			<u>\$ 268.6</u>	<u>\$ .06</u>
<b><u>Non-Guaranty Associations</u></b>				
Initial Interim through Seventh Interim	12/21/94-5/06/08	70%	\$ 253.6	\$ .30
Extension of the Seventh Interim	11/01/08	70%	3.6	-
Second Extension of the Seventh Interim	3/26/09	70%	18.2	-
Third Extension of the Seventh Interim	9/10/09	70%	5.5	-
Fourth Extension of the Seventh Interim	2/23/12	70%	138.6	1.79
			<u>\$ 419.5</u>	<u>\$ 2.09</u>
All distributions			<u>\$ 707.7</u>	<u>\$ 2.18</u>

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 4 - Advances/Distributions to Guaranty Associations and Non-Guaranty Association Claimants (continued)

Differences between amounts approved by the Court and paid by the Estate were caused by revisions to claim allowances, releases of statutory deposits and a negotiated reduction of Guaranty Association First Priority claims. The Priority 4 Liability "Allowed to policyholders" is reduced for distribution payments that are not subject to refunding agreements.

At December 31, 2013, the \$21.3 million of Priority 1 liability for claims handling expenses reported by guaranty associations included \$5.6 million that will be paid at the same distribution rate as payable to all Priority 4 creditors.

Note 5 - Reinsurance Recoverable

Prior to its liquidation, the Company wrote insurance coverage on a direct basis through general agents and assumed and ceded reinsurance with other insurance companies in the ordinary course of business. Reinsurance arrangements include a wide variety of treaty and facultative contracts providing pro-rata and excess of loss coverage. The reinsurance recoverable represents amounts due from solvent reinsurers for paid or allowed claims and loss adjustment expenses.

At December 31, 2007, the Estate changed to an accrual from a cash basis of accounting for recording reinsurance recoverable amounts estimated to be received from insolvent insurers. The Company sold insolvent reinsurer receivables of \$11.1 million for \$13.1 million during 2013. There was no remaining insolvent reinsurer receivable at December 31, 2013.

Note 6 - Asset Restrictions

The provision for federal government restricted funds was established pursuant to the Early Access and Initial Interim Distribution Plans, which were approved by the Liquidation Court. In 2013, the federal government lifted the restriction on \$11.4 million of restricted funds. There was no remaining provision for federal government claims at December 31, 2013.

There was \$2.2 million of unpaid Interim and Early Access Distributions at December 31, 2013 (see Note 4 for additional information).

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 7 - Direct Liability for Estimated Loss and Loss Adjustment Expenses

On June 20, 2008 the Court approved a LCP that established June 30, 2009 as a final bar date. All claims that are paid prior to this final bar date must be filed and documented prior to September 30, 2009 in order to be eligible for allowance pursuant to N.J.S.A. 17:30C-28.

The Estate reviewed the Proofs of Claim (“POC”) submitted by individual claimants and issued a NOD that either disallowed, allowed or partially allowed the submitted claim. Claimants had sixty (60) days from their NOD date of issuance to submit an objection with the Court. If no objection is filed the NOD will become a final order of the Court.

The Estate reviewed the claimant objection filed and determined if the objection could be resolved by further negotiations with the claimant. If the issues raised could not be resolved a notice is sent to the claimant advising of the Estate’s intent to request a hearing before the Court appointed Special Master within fifteen (15) days of the date of issuance.

The SM is Court appointed with the responsibility to hear and adjudicate any objections which claimants may assert to NOD’s issued by the Estate pursuant to the LCP. The decision rendered by the SM must be affirmed by the Court.

The estimated liability for loss and loss adjustment expenses is for those policyholders that objected to the NOD issued by the Estate and the SM issued a determination that was subsequently approved by the Liquidation Court.

During 2013, four of the five remaining NOD’s were resolved. At December 31, 2013, there was one unresolved NOD. The NJAD had ruled for the Estate and this decision was appealed by the claimant to the NJSC. On January 30, 2014, the NJSC denied the claimant’s petition for certification. There were no remaining estimated loss and loss adjustment expenses at December 31, 2013.

Note 8 - Operating Leases

The Estate leased office space under a five-year lease that commenced October 1, 2007 and ended November 30, 2012. The Estate is now maintaining the lease on a month to month renewal basis.

The Estate is required to pay a monthly rental payment of \$4,944 and an annual electric charge monthly, which is subject to escalation. Operating expenses and real estate taxes escalate based on any increase in excess of the base amount.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 9 - Legal Matters

On March 14, 2008, the Estate filed with the Court a Liquidation Closing Plan that establishes June 30, 2009 as a final bar date. All claims that are paid prior to this final bar date must be filed and documented prior to September 30, 2009 in order to be eligible for allowance pursuant to N.J.S.A. 17:30C-28.

A court hearing was held May 28, 2008 to review comments received from interested parties. On June 5, 2008, an Amended Liquidation Closing Plan (“LCP”) was filed with the changes agreed to by the Estate at the May 28<sup>th</sup> hearing. This LCP was approved by the Court on June 20, 2008.

On July 21, 2008, a Notice of Motion for Leave to File was filed with the Appellate Division by parties objecting to the extension of the final bar date to September 30, 2009 from the September 30, 2004 bar date established in the FDP.

On October 3, 2008, the Appellate Division advised the appellant that they may seek reconsideration of the order denying leave to appeal provided they sought reconsideration of the Order. The appellant resubmitted the original motion for Leave to Appeal on October 21, 2008. On November 21, 2008, the Appellate Division ordered that the appellant’s October 21st motion was denied although they would be allowed to resubmit their motion before the Estate closed.

Note 10 - Federal Income Taxes

The Estate was exempt from federal income tax for the tax years January 1, 1988 through December 31, 2007. Beginning January 1, 2008, the Estate became liable for federal income taxes as the Internal Revenue Code was revised.

On January 6, 2010, the Estate made a request to the Department of Treasury for a ruling that the Estate qualified as an insurance company and was eligible to make the election to be taxed on its investment income. In April 2010, the ruling was granted. The Estate will be taxed on its investment income for all years beginning in 2009.

The Estate has filed requests for “Prompt Assessment” for the tax years 2008-2012. Once the Internal Revenue Service acknowledges this request they specify when the 18 month period begins and ends. The 2008, 2009 and 2010 tax years are now considered closed as the 18 month waiting period ended in 2012. The closing date for the 2011 tax year was February 17, 2014. The closing date for the 2012 tax year is January 16, 2015.

In 2013 the Estate had \$1.2 million in taxable investment income and paid \$430,000 in taxes.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Notes to Financial Statements  
December 31, 2013

Note 11 - Employee Retention Program

The Estate has a retention program that enables it to recruit qualified applicants and retain employees necessary to facilitate an orderly and effective liquidation of the Estate.

Effective August 1, 1998, the existing retention program was revised. Funds, which the Estate previously allocated towards separation benefits, were now allocated to a 401(k) Plan at a specified percentage of each employee's base salary. In the event an employee elected not to enroll and participate in the 401(k) Plan or withdrew from the 401(k) Plan subsequent to enrollment, separation benefits for such employee continued to accrue after July 31, 1998 up through July 6, 2007, based on the previous separation formula.

Effective July 6, 2007, the retention plan was revised and employees who elected not to participate in the 401(k) Plan will no longer receive any separation benefits.

The Estate contributed \$49,000 to the employees' 401(k) Plan in 2013.

INTEGRITY INSURANCE COMPANY  
IN LIQUIDATION

SUPPLEMENTARY INFORMATION

December 31, 2013

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Schedule of Cash Receipts  
For the Periods January 1, 2013 through December 31, 2013 and  
March 24, 1987 (Date of Inception) through December 31, 2013  
(In Thousands)

	<u>2013</u>	<u>Inception to Date</u>
Marshaling of estate assets		
Proceeds of reinsurance settlements and commutations	\$ 1,450	\$ 335,910
Reinsurance collections	317	272,386
Distributions from insurance companies	13,048	68,662
Salvage and subrogation recoveries	-	22,333
Director and officer settlement proceeds (including interest)	-	19,894
Transfers from Integrity Credit Corporation (“ICC”)	-	8,428
Agents balances	-	2,963
Statutory deposit refunds	-	2,799
Market Insurance Corp. settlement	-	2,200
Service fee income - other estates	-	1,748
SBA reimbursements	-	1,280
Miscellaneous	-	4,625
	14,815	743,228
 Investment income	 9,126	 357,426
Sales, maturities and early calls of bonds	321,138	4,993,521
Sales and maturities of short-term investments	310,673	4,077,400
Maturities of investments held on behalf of ICC	-	3,404
	-	3,404
 Total cash receipts	 <u>\$ 655,752</u>	 <u>\$ 10,174,979</u>

See accompanying notes to supplementary information.

INTEGRITY INSURANCE COMPANY IN LIQUIDATION  
Schedule of Cash Disbursements  
For the Periods January 1, 2013 through December 31, 2013 and  
March 24, 1987 (Date of Inception) through December 31, 2013  
(In Thousands)

	<u>2013</u>	<u>Inception to Date</u>
Estate administration		
Salaries	\$ 684	\$ 69,560
Consultants	5	25,348
Legal and accounting services	225	221,441
Payroll taxes and employee benefits	225	16,101
Rent and other facilities cost	79	12,328
Other	95	9,214
Expenses related to salvage, subrogation and exoneration	-	3,890
Outside services	6	3,487
Computer and other equipment expense	30	3,433
Federal income taxes	430	3,935
Temporary help	-	1,539
Miscellaneous	1	1,343
Expense reimbursements from ICC	<u>-</u>	<u>(862)</u>
Total estate administration costs	1,780	370,757
Loss adjustment expenses associated with rehabilitation	-	2,517
Distributions to guaranty/non-guaranty associations	8,105	707,626
Director and officer personal claimants	-	564
Payment to secured creditor	<u>-</u>	<u>455</u>
Cash disbursements before investment activities	9,885	1,081,919
Purchases of bonds	334,867	5,207,378
Purchases of short-term investments	309,522	4,063,956
Funds invested/payments on behalf of ICC	<u>-</u>	<u>4,046</u>
Total cash disbursements	<u>\$ 654,274</u>	<u>\$ 10,357,299</u>

See accompanying notes to supplementary information.

# INTEGRITY INSURANCE COMPANY IN LIQUIDATION

## Notes to Supplementary Information

December 31, 2013

### Schedule of Cash Receipts

1. Proceeds of Reinsurance Settlements and Commutations  
The Estate enters into commutation and settlement agreements with various reinsurers. The amounts reflected as proceeds of reinsurance settlements and commutations represent actual cash received thereon, in accordance with the underlying agreements.
2. Distributions from Insurance Companies  
The Estate receives distributions from other impaired insurers on the amount of its allowed claim. In 2013 the Estate sold the unpaid portion of an allowed claim that was due from an insolvent insurance company.
3. Salvage and Subrogation Recoveries  
Salvage and subrogation recoveries are presented in the Schedule of Cash Receipts net of any expense deducted in the remittance.
4. Transfers from Investments in Former Subsidiaries  
Integrity Credit Corporation ("ICC"):  
As of April 1, 1992, the Estate assumed the future liabilities of ICC, a wholly owned subsidiary, with the intention of completing ICC's remaining affairs, which were not significant to the Estate. Dissolution of ICC commenced in December 1992 and, to the best of the Estate's knowledge, there are no significant remaining unsatisfied liabilities of ICC that have not been recorded on the books of the Estate.  
  
Prime Life Insurance Company ("Prime"):  
During 1987, the Estate liquidated its investment in Prime. In connection with this action, the Estate collected \$591,000, net. This consisted of \$741,000 of cash and securities (at market), offset by a disbursement of \$150,000 to commute a reinsurance contract on behalf of Prime. These transactions are included in marshaled assets on the Schedule of Cash Receipts.  
  
Integrity Realty Company ("IRC"):  
During 1987, the Estate realized \$8,000 from its investment in IRC.
5. Director and Officer Settlement Proceeds  
On July 20, 1998, \$19.9 million relating to the director and officer settlement and accumulated interest thereon were released from escrow according to the terms of the settlement agreement. On August 5, 1998, \$564,000 was paid to the attorney acting on behalf of the personal claimants in accordance with the terms of the settlement agreement.
6. Service Fee Income  
Commencing April 1, 2011, the Estate utilizes the services of another insolvent company for human resource and certain administrative functions. Prior to March 31, 2011, the Estate performed primarily human resource and administrative functions for other New Jersey insurance companies that are in liquidation. The operating expenses incurred such as salaries, rent and utilities were allocated based on a service fee agreement between the Estate and the other New Jersey insurance companies that are in liquidation.