VIRTUS® Excellence Builds Trust

National Catholic Report
Summer 2006 Newsletter

In This Issue

The National Catholic Risk Retention Group and the Claims Function

It is a widely accepted notion that quality commercial insurers should provide an array of services that go beyond mere provision of insurance coverage. These “ancillary” services usually include risk control (loss prevention and loss control) services/products, claims management assistance (as with litigation planning and management), and in the case of property insurers, appraisal services/products.

Nonetheless, for virtually all insureds, when they experience a loss, file a claim and need to be reimbursed for the related costs and expenses, is where “the rubber meets the road” in their experience with their insurance company.

In recognition of this reality, this article will explain how The National Catholic Risk Retention Group (TNCRRG) approaches claims handling matters—from both a philosophical and “mechanical” perspective; how and why disputes may arise; and finally, how disputes may be avoided.

Initially, we must briefly examine the fundamental element that substantively affects all aspects of coverage provision and claim payments. I am referring to the “insurance mechanism” itself.

While many people perceive their purchase of insurance to be a risk transfer undertaking, this is not entirely accurate. More specifically, the insurance mechanism involves risk transfer, but also, it significantly entails risk spreading (or risk distribution) *and* risk sharing. Consequently, to maintain long-range financial viability, every insurer “spreads” its risk assumption across all of its insureds, and each of its insureds share—to some extent—the fortunes of all the other insureds. This phenomenon is reflected in the fact that—dependent upon its loss experience—every insured is at any point in time either a subsidizer of (when its experience is excellent) or is being subsidized by (when its experience is poor) the other individuals/entities insured by the same company. This is how the insurance mechanism functions.

How does this relate to TNCRRG and how it handles claims?

TNCRRG’s claim philosophy can be summarized in the following fashion:

1. TNCRRG exists to protect and preserve the assets of the Church;

2. TNCRRG is concerned about—and vitally committed to—this mission, because TNCRRG *actually is* a part of the Church and as such wants Church resources to be utilized in ministry, rather than being paid to plaintiff attorneys or on preventable losses/claims;

3. TNCRRG recognizes that it has both a moral, and also, legal fiduciary duty on behalf of all its shareholders and the Church;

4. TNCRRG is dedicated to claim resolutions that are fair, just and reasonable from the perspective of both the shareholder, *and also*, the claimant/victim;

5. TNCRRG staff is committed and dedicated to claim handling interactions that always meet the highest moral, ethical and professional standards.

And yet, in spite of the foregoing, we have occasionally been confronted by shareholders threatening a “bad faith” action (in this case, a legal term of art and not a moral judgment), against TNCRRG. So, let’s examine that issue for a moment.

Generally speaking, in order for a bad faith action to be successfully asserted against an insurer, the insured must show that the insurer breached the duty that requires insurance companies to provide the same degree of attention and concern for the interests of the policyholder as it would for its own interests in a particular claim matter.

How might this situation arise in relation to TNCRRG? Consider that TNCRRG is 100 percent wholly-owned by the Church. No profit oriented individual or entity has a single penny’s equity in TNCRRG. No profit oriented individual or entity has ever at any time invested (by loan or otherwise) a single penny into TNCRRG. No profit oriented individual or entity has any governance participation in, or control of, TNCRRG. No profit oriented individual or entity has any voting rights in TNCRRG. TNCRRG is totally owned, governed and controlled by 67 dioceses and one Catholic risk pooling trust (which itself represents over 1300 religious order, institute and congregation locations spread over all 50 states). Finally, by operation of federal law (the Liability Risk Retention Act of 1986) it is a *federal requirement* that all of TNCRRG’s shareholder owners *also* be policyholders *and* vice versa. In other words, TNCRRG has *no interest* that is separate and distinct from that of the Church.

So why is it that claim disputes with shareholders occasionally occur (and they *do* occur, although infrequently)?

I believe the answer relates to one or more of the following issues:

1. Our insured shareholder, its TPA and/or its legal counsel do not understand that TNCRRG underwrites and issues indemnity policies, so that TNCRRG has *no duty to defend*;

2. Conversely, TNCRRG has significant contract rights within the policy (and the shareholder has related obligations) to be associated with claim matters in certain circumstances, and also, to receive the assistance and cooperation of its insureds (including their advisers) in these same circumstances (reference either the Assistance and Cooperation Condition within your policy, or alternatively, the Special Conditions for Self-Insured Retention, part A. within your policy);

3. Our insureds sometimes run afoul of the Notification of Claims Condition within their policy. Note that while this condition is occasionally viewed by some as overly stringent, the TNCRRG Board believes that it remains necessary to protect TNCRRG’s limited surplus from the extreme volatility of its claim results (as witnessed by last year’s $4.134M loss). Also, and critically, remember that notification to your TPA **does not** constitute notification to TNCRRG (unless the TPA immediately conveys the same information to us).

4. Finally, disputes may arise because of differences in our evaluation of the value of the claim(s) as compared to the evaluation of our shareholder’s local advisers. In this last instance, we are motivated **solely** by our fiduciary duty on behalf of **all** TNCRRG shareholders and our related stewardship concern that any claim resolution that pays out more than necessary to effect a just settlement, ultimately diminishes the ministry of all the other shareholders, because it requires TNCRRG to increase rates/premiums accordingly (recall the insurance mechanism discussion above).

The fact is, the TNCRRG staff is here to serve and we want to help you. We really do have claim resources and expertise that go *far beyond* our two person claim department. Meanwhile, our own internal claim team is very professional and eager to assist you. We are not your adversaries—we are on your team! So please avail yourselves of our services, advice and counsel. Finally, remember the “old saw” that states: “Liability claims are not like fine wine—they don’t age very well.” You have much to gain—and nothing to lose—to quickly report serious incidents to TNCRRG, even when you and your local advisers may feel that the incident is unlikely to penetrate to TNCRRG's coverage attachment point, or even when the incident has not yet produced a claim.

[N.B. The TNCRRG Claim Practices Philosophy and Pledge immediately follows for your review and consideration.]

By Michael Bemi, President & CEO

The National Catholic Risk Retention Group, Inc.

Claim Practices Philosophy and Pledge

Preamble:

The National Catholic Risk Retention Group, Inc. (National Catholic) is an insured, owned, not–for–profit insurance company. All of its owners are insured entities, and all of them are institutions of the Catholic Church. National Catholic exists to serve the Church in the performance and accomplishment of its temporal activities; most particularly, in the insurance and risk management realms. The employees of National Catholic are Church workers in the same sense as though they were employed by a diocese or religious order. National Catholic seeks to serve by providing knowledge, products, and services that help Church institutions to be more effective and efficient stewards in their insurance and risk management undertakings, so that the financial, physical, and human assets of the Church are best protected. In this fashion, National Catholic allows the Catholic Church to pursue its Gospel ministry unimpeded by insurance and risk management related concerns and responsibilities.

We are confident that we can assist you in such matters. We sincerely desire to do so. We would like you to consider us to be members of your team and invite you to use us in this manner not only at the point of loss/claim, but also even well before then.

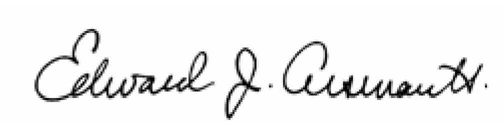
Remember, we are not "the insurer," but rather *your* (owned) insurer. We work for you! Consequently, we offer you the following pledge:

- We commit to the provision of claim service that is consistently prompt, courteous, friendly and respectful.
- We will strictly adhere, at all times, to the highest moral, ethical and professional standards and conduct in all of our claim-related activities.
- The standards of justice, equitable treatment, and integrity are of utmost importance to us, and we will employ these standards equally in all our dealings with both our insureds *and* claimants.
- We are committed to communication with both our insureds and claimants that is at all times open, honest, and respectful.
- Our orientation is always to effect claim settlements that are eminently fair and appropriate, as dictated by the circumstances of the loss/claim and professional standards.
- We are committed to the use of alternative dispute resolution and will only resort to litigation when absolutely necessary.
- We will never interact with our insureds in an adversarial manner, unless this is unavoidably necessary in order to defend the interests of the other owner-insureds of National Catholic.
- Whenever conflict or disagreement arises in the handling of a claim, we will consistently respond with professional and respectful behavior that clearly demonstrates and expresses our desire to achieve a fair and reasonable

resolution.
- We recognize and accept our role as financial stewards with a fiduciary duty on behalf of all our insured shareholders and the Church, and we expect to be held fully accountable for the faithful performance of this role.
- Our focus and commitment is to interpret our coverage in the broadest, most expansive manner possible, so as to maximize protection for our insureds. Realistically, however, we cannot guarantee that every loss circumstance and related claim(s) will be covered.

This document has been subscribed and sworn to.

Michael J. Bemi
President & CEO



Reverend Edward J. Arsenault
Chairman of the Board

From the Office of the President

By Michael Bemi, President & CEO

Enclosed is our unaudited financial report reflecting TNCRRG results through July 31, 2006 and comparatively year-over-year. I am indeed grateful that I am able to immediately highlight for you the very significant improvement in TNCRRG results from 2005 to 2006. More specifically, you will note that we produced a $1,254,149 operating profit through seven months of our fiscal year, compared to a $682,665 operating *loss* for this same period last year. So what has changed? Let me analyze that for you now.

To begin, the most significant development benefiting our company has been a substantial reduction in losses and loss adjustment expenses year-over-year. This may be surprising in light of the persistent negative circumstances regarding sexual misconduct experience in the Church. However, the actual number of sexual misconduct incident and claim reports to TNCRRG has declined substantially in 2006 from its peak in 2002 (by 51 percent). Further, it is a fact that the vast majority of these reports will never generate a loss to TNCRRG. The primary reason is that they relate to activities/victimization that pre-dates the existence of TNCRRG, and therefore occurred prior to the applicable retroactive dates of our claims-made coverage for sexual misconduct. In any event, we experienced a $2,010,253 improvement in loss results for the period, year-over-year.

An additional factor in our improved results is the increase ($80,298) in our underwriting income. This increase was produced by several concurrent circumstances. These are:

1. Our 5 percent rate increase in 2006;

2. Our addition of a one new shareholder in the analysis period, the Diocese of San Jose, CA on July 1st;

3. Our success in writing new excess coverage layer placement business so far in 2006;

4. Premiums that TNCRRG earned in the first half of 2006, that were generated by the addition of one new shareholder—the Diocese of Raleigh—in the second half of 2005; and a sizeable increase in our ceding commission (the commission TNCRRG receives from its reinsurers). All these improvements were largely offset, however, by an increase in our reinsurance costs.

Another positively contributing factor to the improvement in our results was our ability to largely contain overall non-loss expenses. We accomplished this in spite of quite significant one-time outlays related to necessary systems repairs, upgrades and enhancements, plus the impact of operational cost increases that we have little or no control of (e.g., premium taxes and broker commissions), and finally, a nonrecurring professional fees increase associated with two Board authorized consulting engagements.

On a slightly negative note, our net investment income, when further adjusted by realized losses on the sale of investments, was essentially flat year-over-year. This was not the result of any alteration in our investment philosophy, our investment strategies, or our investment managers/adviser. The outcome was primarily the effect of an increase in losses on the sale of investments, comparatively year-over-year.

In closing, while I am very happy to report these results, I also need to remind you that the by far the single most important element “driving” TNCRRG results, is loss experience. Certainly we can significantly and positively influence that experience through our risk control efforts with our extremely successful VIRTUS® program, but much of these results simply remain random and beyond our control. That is why we are always thankful when we experience improvement in our loss results. Looking “down the road,” if we continue to have favorable loss results in 2006, TNCRRG should be able to generate a sizable operating profit. But I admonish you to recall the oft-repeated quote from Yogi Berra (of New York Yankee’s fame): “It ain’t over till it’s over!”

The National Catholic Risk Retention Group, Inc. AND National Catholic Services, LLC
CONSOLIDATED BALANCE SHEETS

	Period Ended July 31, 2006 (unaudited)	Period Ended July 31, 2005 (audited)
ASSETS		
Cash and Investments	61,784,058	62,087,834
Accrued Interest / Investment Income	301,798	339,233
Premiums Receivable	2,966,475	2,605,160
Reinsurance Recoverable on Paid Losses	4,541,671	2,335,360
Reinsurance Recoverable on Unpaid Losses	14,355,805	16,821,479
Prepaid Reinsurance Premiums	4,292,473	4,036,378
Other Assets	407,627	394,029
TOTAL ASSETS	**88,649,907**	**88,619,473**
LIABILITIES & SHAREHOLDERS' EQUITY		
LIABILITIES		
Loss and Loss Adjustment Reserves	40,394,690	39,372,649
Unearned Premiums	9,314,202	8,726,325
Reinsurance Balances Payable	2,715,958	2,600,327
Premium Taxes Payable	124,655	136,236
Unearned Ceding Commissions	405,883	378,422
Other Liabilities	351,812	341,834
TOTAL LIABILITIES	53,307,200	51,555,793
SHAREHOLDERS' EQUITY		
Capital Stock:		
Class A	1,320	1,300
Class B	298,872	298,804
Additional Paid-In-Capital - Cash	482,292	474,735
Additional Paid-In-Capital - Policyholder Dividend	8,862,639	8,862,639
Unrealized Gain (Loss) on Investment	5,587,984	5,119,722
Retained Earnings	18,855,448	22,989,146
Net Operating Income / (Loss)	1,254,152	(682,666)
TOTAL SHAREHOLDERS' EQUITY	35,342,707	37,063,680
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	**88,649,907**	**88,619,473**
REVENUES		
Underwriting Income	5,271,787	5,191,489
Net Investment Income	958,552	872,592
Net Realized Gains (Losses) on Sales of Investments	(143,839)	(58,207)
Ceding Commission Income	541,765	471,652
TOTAL REVENUES	6,628,265	6,477,526
EXPENSES		
Losses and Loss Adjustment Expenses	3,405,340	5,415,593
Premium Taxes	317,155	276,975
Commission Expenses	312,709	301,234
VIRTUS Expenses	(40,656)	(67,841)
Management & Regulatory Fees	65,020	67,530
Professional Fees	317,220	228,115
Salary & Fringe Benefits Expense	541,050	538,948
Travel Expenses	151,392	154,282
Other Expenses	304,886	245,355
TOTAL EXPENSES	5,374,116	7,160,191
NET INCOME	**1,254,149**	**(682,665)**

THE NATIONAL CATHOLIC RISK RETENTION GROUP, INC.

16th Annual National Catholic Winter Meeting

MARK YOUR CALENDARS TODAY!

January 28 - 30, 2007

The Hyatt Regency Islandia on San Diego's Mission Bay

1441 Quivira Road San Diego, California

Workshops to include:

* Rate Making & Reserve Development

* Background Screening—Perils & Pitfalls

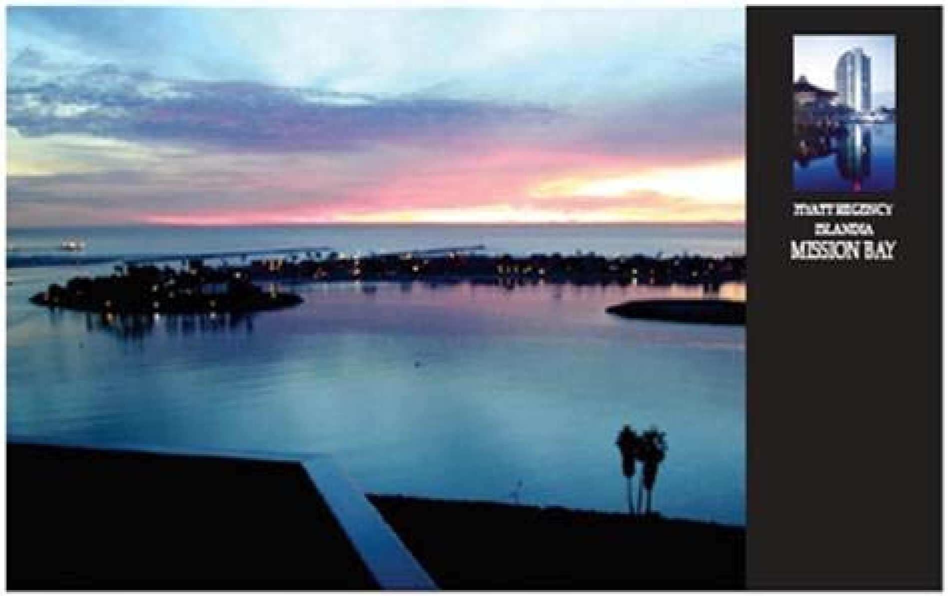
* 15 Passenger Vans—Problems, Options, Solutions

* Complex Injury Claims Analysis & Evaluation

* AND MORE…

Registration information will be available on our website at:

www.NATIONALCATHOLIC.ORG



TNCRRG WELCOMES TWO NEW SHAREHOLDERS!

The National Catholic Risk Retention Group is extremely pleased to announce the addition of its two newest shareholders: the Diocese of San Jose, CA, which joined July 1st, and the Diocese of Jefferson City, MO, which joined August 1st. We extend an enthusiastic welcome to these new shareholders and we thank them for strengthening TNCRRG through their participation!

National Catholic Shareholders

Archdiocese of Boston, Massachusetts
Archdiocese of Cincinnati, Ohio
Archdiocese of Denver, Colorado
Archdiocese of Indianapolis, Indiana
Archdiocese of Miami, Florida
Archdiocese of the Military Services, USA
Archdiocese of Newark, New Jersey
Archdiocese of Oklahoma City, Oklahoma
Archdiocese of Philadelphia, Pennsylvania
Archdiocese of Portland, Oregon
Diocese of Albany, New York
Diocese of Allentown, Pennsylvania
Diocese of Altoona-Johnstown, Pennsylvania
Diocese of Austin, Texas
Diocese of Beaumont, Texas
Diocese of Birmingham, Alabama
Diocese of Brooklyn, New York
Diocese of Brownsville, Texas
Diocese of Buffalo, New York
Diocese of Burlington, Vermont
Diocese of Camden, New Jersey
Diocese of Charlotte, North Carolina
Diocese of Columbus, Ohio
Diocese of Dallas, Texas
Diocese of El Paso, Texas
Diocese of Erie, Pennsylvania
Diocese of Evansville, Indiana
Diocese of Gary, Indiana
Diocese of Greensburg, Pennsylvania
Diocese of Harrisburg, Pennsylvania
Diocese of Jefferson City, Missouri
Diocese of Kansas City-St. Joseph, Missouri
Diocese of Lafayette, Louisiana
Diocese of Las Cruces, New Mexico
Diocese of Little Rock, Arkansas
Diocese of Madison, Wisconsin
Diocese of Manchester, New Hampshire
Diocese of Metuchen, New Jersey
Diocese of Ogdensburg, New York
Diocese of Orlando, Florida
Diocese of Palm Beach, Florida
Diocese of Paterson, New Jersey
Diocese of Pensacola-Tallahassee, Florida
Diocese of Peoria, Illinois
Diocese of Pittsburgh, Pennsylvania
Diocese of Portland, Maine
Diocese of Raleigh, North Carolina
Diocese of Richmond, Virginia
Diocese of Rochester, New York
Diocese of Rockford, Illinois
Diocese of Saint Augustine, Florida
Diocese of San Jose, California
Diocese of Scranton, Pennsylvania
Diocese of Shreveport, Louisiana
Diocese of Sioux City, Iowa
Diocese of Springfield, Illinois
Diocese of Springfield, Massachusetts
Diocese of Syracuse, New York
Diocese of Trenton, New Jersey
Diocese of Tulsa, Oklahoma
Diocese of Venice, Florida
Diocese of Victoria, Texas
Diocese of Winona, Minnesota
Diocese of Youngstown, Ohio
Ukrainian Catholic Metropolitan Archdiocese of Philadelphia
Christian Brothers Risk Pooling Trust