ProMutual Group

Comments and Recommendations and Management's Responses

2004

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Board of Directors and Audit Committee of
the ProMutual Group
101 Arch Street
Boston, Massachusetts 02205

Gentlemen:

In planning and performing our audit of the financial statements of Medical Professional Mutual Insurance Company, ProSelect Insurance Company and ProSelect National Insurance Company, Inc. (the "Company") for the year ended December 31, 2004, we made a study and evaluation of the Company's internal control to the extent we considered necessary for the expression of our opinion on the financial statements. Although our consideration of internal control was more limited than would be necessary to express an opinion on the internal control taken as a whole, and accordingly would not necessarily disclose all matters which might be material control weaknesses, we noted certain matters involving internal control and are submitting for your consideration the accompanying recommendations designed to help the Company improve internal accounting control and achieve operational efficiencies. Our comments reflect our desire to be of continuing assistance to management.

The accompanying comments and recommendations are intended solely for the information and use of the Audit Committee, Board of Directors, management and others within ProMutual Group and are not intended to be and should not be used by anyone other than those specified parties.

We appreciate the cooperation we have received from the Company in connection with developing these recommendations. Should you have any questions about our recommendations, this letter, or other matters, please contact us at your convenience.

Very truly yours,

PricewaterhouseCoopers LLP

ProMutual Group
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Section I: Comments and Recommendations with Management's Responses

1. Update Definition in Incentive Compensation Plan

The Company-Wide Incentive Compensation Plan Document Schedules for the President/Chief Executive Office, Senior Vice Presidents, Vice-Presidents, and Employees defines "adjusted net income" as "net income as published in the GAAP financial statements for the calendar year, adjusted to exclude realized and unrealized capital gains or losses, policy holder dividends, and expense items that could not be anticipated or are not under management control". PwC noted through discussions with management and procedures performed on the Plan that the intended definition of "adjusted net income" is actually "statutory net income, adjusted to exclude realized capital gains or losses, policy holder dividends, and expense items that could not be anticipated or are not under management control". This is also noted in our report dated March 23, 2005 for the 2004 Incentive Compensation agreed-upon procedures.

If "adjusted net income" is not accurately defined in the Plan Document Schedules, the financial performance factor may be interpreted as it is currently documented, rather than how it is truly intended. Although there was no impact in 2004, this could ultimately lead to a discrepancy in determining whether an individual met the conditions for an award payment.

PwC recommends the Company-Wide Incentive Compensation Plan Document Schedules be updated for President/Chief Executive Office, Senior Vice Presidents, Vice-Presidents, and Employees to accurately define "adjusted net income" as it is intended to be interpreted.

Management's Response:

Management agrees with this recommendation and will make the following change to the Company – Wide Incentive Compensation Plan Schedules for the 2005 performance year.

Substitute the existing definition of "adjusted net income" with the following language:

"Adjusted net income " means net income as published in the December 31 statutory financial statements for the calendar year, adjusted to exclude realized capital gains or losses, policyholder dividends, and expense items that could not be anticipated or are not under management control (for example, merger and acquisition expenses).

2. Implement Enhancements to Monitor Underwriters' Performance

As part of our audit procedures, PwC met with the Vice President of Underwriting to obtain and update our understanding of the Company's underwriting processes. During our discussions, it was brought to our attention that the Company does not have the ability to review losses by underwriter and territory as a means for assessing underwriting performance.

As the company continues to grow, the ability for management to adequately monitor the underwriting process on an individual level will become more difficult. The absence of a formal report to review losses by underwriter and territory, could allow issues with an individual underwriters' performance to go undetected for a significant period of time. This could ultimately lead to a negative impact on the Company's profitability.

We recommend management develop a formal report to identify losses by underwriter and territory to facilitate regular monitoring of underwriting performance at a more detailed level.

Management's Response:

Management does run reports periodically based upon the underwriter's territory, but do not have a formal program to do so. We question the credibility and value of the data when it is limited to this extent. Also, being a long tail line of business, it is quite likely that the losses that may drive a high loss ratio in a territory were the result of a previous underwriter for that territory and would have no reflection on the current underwriter. We feel that the quarterly self audits that are conducted, the bi-weekly training sessions, the individual letters of authority given to the underwriters along with the rather tight managerial span of control are sufficient to quickly detect any deficiencies in an underwriter's performance.

3. Review Internal Control Reports from Third Party Administrators

The Company uses various third party administrators (TPAs), such as Northern Trust and Sungard, for certain processing activities. A TPA will often engage its external auditors to provide an annual independent auditors' report on the effectiveness of controls it has placed in operation and, in some cases, results of testing of the operating effectiveness of those controls. The report also contains a list of user controls the TPA recommends its customers have in place to ensure an effective control environment surrounding data sent to and received from the TPA. During the audit, we noted that the Company does not Proactively obtain and review the results of internal control reports from its TPAs.

The internal control reports for TPAs may unveil internal control deficiencies that could negatively impact the operations of the Company. Additionally, user controls that are recommended by the TPA might not be in place at the Company or may be deemed ineffective to mitigate the risk of potential misstatement of the activity processed by the TPA.

On an annual basis, management should obtain the most recent internal control reports from its significant TPAs and read them to determine whether control weaknesses identified would have an impact on the Company's operations. Additionally, management should read the recommended user controls and evaluate whether existing controls at the Company sufficiently address the controls recommended by the TPA to mitigate the risk of potential misstatement.

Management's Response:

Management agrees with this recommendation. Although, Corporate Finance currently receives and reviews SAS 70 reports from its custodial bank (Northern Trust) and investment accounting software vendor (Sungard), we will request and review SAS 70 reports from other third party administrators such as Citizens Bank and the various investment fund managers.

Several of ProMutual Group's other business units have service level agreements (SLA) with application service providers (ASP). Management will implement procedures so that the respective business units responsible for engaging a vendor obtain their SAS 70 internal control reports annually. Each business unit will collaborate with IT management to review and evaluate the providers' internal control reports.

4. Establish Role-based Privileges for System User Access

To establish effective control over significant business processes, distinct roles are established. For example, one individual enters a claim while another individual approves the payment of the claim. No single individual can both initiate and pay a claim. These distinct roles require that individuals are limited to the system privileges associated with their role.

The definition of standard role-based privileges is important for two reasons:

- Individual employees can be consistently assigned the pre-determined privileges appropriate to their assigned role;
- Users' access privileges can be periodically validated by comparing their actual privileges to the role-based privileges.

At ProMutual Group, the business area assigns privileges to an individual by requesting that Information Technology ("IT") either copy the access profile of another user or uniquely specify privileges.

The practices of copying or creating unique access profiles may result in instances of excessive or inappropriate user access, including an inadequate segregation of duties, within an application or across multiple applications.

Although departments periodically review employee listings and confirm that all system users are employees, there is no periodic review of the access privileges of current employees.

We noted that IT is currently initiating an effort to enhance ProMutual Group's approach to user access assignment. This initiative should include IT partnering with the business areas to establish a role based approach to user access assignment, that may include:

- Creation of standard access profiles based on user roles and responsibilities for each financially significant application;
- Periodic review of the standard access profiles for appropriateness;
- Assignment of a standard access profile to a user and approval of that assignment by the business area manager;
- Periodic recertification by the business area of users and their application rights to identify instances of excessive or inappropriate user access.

Management's Response:

ProMutual Group agrees that assigning access rights by modeling a new employee's profile after an existing employee's profile can potentially lead to instances of inappropriate access rights being assigned. And, that the best way to assign access rights is to build role templates for each job duty.

As noted in PWC's findings, IT is currently revising ProMutual Group's approach to user access assignment. Getting to this new approach will require the combined efforts of IT and the business units. This process will include:

- Running reports of every employee's current access rights;
- Verification by all business unit VPs of their employee's access rights;
- Creation of templates, by job duty, with minimum necessary access rights as verified by the business unit VPs;
- Customization of the EARP system (Employee Access Requests) to include individual access rights;
- Training of business unit managers on what functions and privileges each access right allows (particularly for those outside of the templates to be requested on an individual basis).

Once this process is complete, the business unit managers and VPs will no longer be able to request access rights for an employee by requesting that they be modeled after another employee in the same position. All system privileges will be requested by the business unit manager and VP by choosing a job duty template (e.g. Claim Rep Assistant), and in rare instances any additional rights individually.

Additionally, IT will provide the business units with the job duty templates quarterly so that they can be reviewed to ensure that the access profiles assign appropriate rights for the designated position. The business units will also, on an annual basis, receive from IT reports of the access rights of all of their employees to recertify the appropriateness of those rights.

ProMutual Group
Comments and Recommendations issued in 2003
With Management's Updates

2004

Section II: Comments and Recommendations issued in 2003, with Management's Updates

1. Monitoring of Investment Activity

We noted in the prior year that the Company relies on its third party investment advisors to reconcile between their statements and the Northern Trust custodian statements, and that the Company does not perform a reconciliation to monitor differences between the advisors and Northern Trust. The result is a number of reconciling items between Northern Trust and the investment advisors, arising primarily from the difference in the manner in which sales are recorded. Our recommendation at the time was that management establish a more formal reconciliation process between the investment advisor statements and the Northern Trust statements to ensure that Schedule D transactions are properly recorded.

The reconciliation process we audited in 2003 remains virtually unchanged from 2002. We continue to note variances between the advisors and Northern Trust, which management attributes to differences in the recording of sales. We reiterate our recommendation that management institute a formal reconciliation process to support the variances noted between the Company's investment advisors and Schedule D.

Our comments in 2002 also included discussion of management's review for other than temporary impairments. Because the guidance relating to identification of other than temporary impairments had changed at year end, we recommended that management work with the Company's investment advisors to establish a process for identifying and evaluating securities for impairment under the new guidance. We also recommended that management also take an active role in reviewing the portfolio for impairments.

In 2003, we noted that the investment advisors appeared to be using the new guidance in providing management with quarterly reporting on securities with potential for impairment. We persist in our belief that additional involvement by management in this review would strengthen the control environment around investment reporting.

Management's Response:

The comprehensive reconciliations that were developed in 2002 allow management to closely monitor and analyze all investment activity between statutory reports and the individual investment manager accounts with the custodian. Differences in purchase lots arising from the manner in which sales were recorded in the past are evident and disclosed in the cost reconciliation of the portfolio. With cash being the primary focus of the reconciliations, these cost differences between the company and the custodian are fully offset in the realized and unrealized gains and losses, and the variances are reconciled.

In 2003, investment managers began submitting to management, monthly reconciliations with the custodial bank. Once we modify these reconciliations for uniformity with the Company's existing reconciliations we will be able to compare investment activity from the fund manager to the custodian to the Company.

Management has relied upon its investment managers to run the necessary objective tests to determine potential impairments within the portfolios. We believe this process has saved the Company valuable time and resources. However, our investment accounting software vendor (Sungard) has recently developed a module dedicated to the tracking and accounting of impaired securities. Management intends to research this application for feasibility as an additional objective evaluation of impairments and possible implementation in 2004.

PwC's 2004 Update:

We noted management has significantly improved the reconciliation process between the third party investment advisor statements and the Northern Trust custodian statements, and has performed a reconciliation to monitor differences between the advisors and Northern Trust. Additionally, management has implemented a new model this year to monitor investments for other than temporary impairments.

Consideration of Sarbanes Oxley Provisions by the NAIC

During its fall meeting, held in September of 2003, the NAIC/AICPA Working Group began discussing a report entitled "Comparison of the Sarbanes-Oxley Act of 2002 to the Current Provisions of the Model Rule Requiring Annual Audited Financial Reports." Some key differences between the Sarbanes-Oxley Act and the Model Audit Rule are:

- The Act requires the audit committee to pre-approve certain services provided by the company's external auditor, while the Model Audit Rule does not.
- The Act requires rotation of the audit engagement partner every five years. The Model Audit Rule requires rotation of the engagement partner every seven years, based on the former SEC requirements.
- The Act requires the CEO and CFO to make certain certifications, while the Model Audit Rule does not require these. (Note, however, that the Jurat Page of the Annual Statement does require the president, secretary, and treasurer to certify that the annual statement is a "full and true statement of all the assets and liabilities and of the condition and affairs of the reporting entity.")
- The Act requires a report from the auditor to the audit committee covering certain topics, while the Model Audit Rule does not require this.
- The Act contains extensive requirements for management's assessment of internal controls, and the Model Audit Rule does not contain these requirements. The Rule does require that "significant deficiencies" noted in an audit (by the external auditor) should be communicated to the domiciliary insurance department.

The Chair of the AICPA/NAIC Task Force stated that the AICPA supports the requirements of the Sarbanes-Oxley Act, and that the task force believes that some of the requirements of the Act are appropriate for inclusion in the Model Audit Rule.

During the NAIC's subsequent winter meeting, the NAIC/AICPA Working Group reached a consensus that the Model Audit Rule should be revised to incorporate ten specific sections of Sarbanes-Oxley. These include:

- Section 201 – Services Outside the Scope of the Practice of Auditors
- Section 202 – Pre-approval Requirements
- Section 203 – Audit Partner Rotation
- Section 204 – Auditor Reports to Audit Committees
- Section 206 – Conflicts of Interest and Cooling Off Period
- Section 303 – Improper Influence on Conduct of Audits
- Section 304 – Forfeiture of Certain Bonuses and Profits
- Section 402 – Enhance Conflict of Interest Provisions
- Section 404 – Managements' Assessment of Internal Controls
- Section 409 – Real Time Issuer Disclosures

Three additional sections of Sarbanes-Oxley are under consideration, while the remainder have been rejected as irrelevant.

Of all the sections to be incorporated into the Model Audit Rule, Sarbanes-Oxley Section 404 will likely have the greatest impact to the Company. Section 404 will require management to document and report on the Company's internal controls each year, and to assess the effectiveness of these controls and procedures. This report will require attestation from an external auditor. The Public Company Accounting Oversight Board has created guidelines regarding management's responsibilities, as well as defining how the external auditors should evaluate the design and operating effectiveness of controls.

Prior to the NAIC's winter meeting, the Sarbanes-Oxley Act had been of interest primarily to public companies, although there were some sections that applied to non-SEC registrants as well. In light of the impending revisions to the Model Audit Rule, however, this legislation takes on significance for all insurers. We recommend that the Company's management, both operational as well as financial, focus on gaining an understanding of the impact on the Company's operations related to adoption of Sarbanes-Oxley provisions, and remain cognizant of NAIC activity with respect to the Act's adoption.

Management's response:

Management agrees and is closely monitoring the activities of the NAIC/AICPA Working Group through its trade association, the Property Casualty Insurers Association of America (PCI) and various industry periodicals.

PwC's 2004 Update:

In its NAIC Summer meeting in 2004, the NAIC Working Group had further discussed a number of issues which includes the following:

a) The earliest effect of any final model regulation would be for the year ended December 31, 2006.
b) The requirements would apply to all insurers subject to the Model Audit Rule. However there is a small company exemption for the Section 404 reports for insurers with less than $25M in direct and assumed premiums.
c) The Section 404 reports would be required at the enterprise level, not legal entity level, when the insurer is a member of an insurance holding company.
d) The members of the Audit Committee must be members of the Board of Directors and be independent with respect to the insurer. In order to be considered to be independent for purposes of this requiremnet, a member of an audit committee of an insurer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee accept any consulting, advisory or other compensatory fee from the insurer or any of its subsidiaries, or be an affiliated person of the insurer.

The Working Group met again in September 2004 to discuss the potential adoption of certain provisions of the Sarbanes-Oxley Act of 2002 and had consequently presented tentative conclusions on the following:

a) Services prohibited to be performed by the company's auditor will be the same as those under Sarbanes-Oxley, except that companies with less than

$100M in premium may apply for an exemption. The exemption is not automatic.

b) Required rotation for the audit partner will be the same as Sarbanes-Oxley (5 years on and 5 years off) with the same exemption as discussed above.
c) The "cooling off" period for employment of independent CPAs by their clients applies only to the "partner involved in the audit and anyone who helps set the scope or reviews others work on the audit".

More recently, the NAIC subgroup agreed to require insurance entities with more than $250 million in direct and assumed premiums to have a supermajority (75%) of its audit committee members be independent. Additionally, the audit committee would be required to have a financial expert.

We have discussed the above developments with management and have continued to encourage management to gain an understanding of the Sarbanes-Oxley provisions and remain cognizant of NAIC activity with respect to the Act's adoption.