Report

of the

Examination of

Flyway Mutual Insurance Company

Waupun, Wisconsin

As of December 31, 2012

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 17, 2013

Honorable Theodore K. Nickel
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2012, of the affairs and financial condition of:

FLYWAY MUTUAL INSURANCE COMPANY
Waupun, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Flyway Mutual Insurance Company (also company) was made in 2008 as of December 31, 2007. The current examination covered the intervening time period ending December 31, 2012, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

In addition to auditing, the public accounting firm provided non-auditing services for the company related to re-titling assets and other matters incidental to the merger of Rosendale Mutual Insurance Company (Rosendale Mutual) with and into the company in 2012.

The company was organized as a town mutual insurance company on March 13, 1874, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Waupun Farmers Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation and one amendment to the bylaws. Article II, Section 3, of the articles of incorporation was amended to add Adams and Marquette counties to the company’s authorized territory, and the bylaws were amended to add a new Sub-Section 2 to Section1 to document duties of the manager.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following 12 counties:

Adams	Marquette
Columbia	Sheboygan
Dodge	Washington
Fond du Lac	Waukesha
Green Lake	Waushara
Jefferson	Winnebago

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year with premiums payable on the advance premium basis. The company also charges a policy fee of $25, which is added to all policies other than certain types of homeowner’s policies. Flyway Mutual Insurance Company collects premiums on a direct bill basis only, and payments may be made annually, semiannually, or quarterly.

Business of the company is acquired through 42 agents, one of whom is the company's manager. Agents presently receive a 14% commission on all lines of business written.

Agents do not have authority to adjust losses. The company's office manager and its underwriter have authority to adjust losses below $5,000. Losses in excess of this amount are adjusted by the outside adjusters, Pilon Adjustment Service, Inc., and Crawford & Company. The fees and expenses of independent adjustment services are billed to the company on a claim-per-claim basis.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Wayne Albright	Farmer	Ripon, Wisconsin	2015
Kevin Beske	Farmer	Markesan, Wisconsin	2015
Donald Vande Zande	Retired Controller for Waupun Utilities	Waupun, Wisconsin	2015
Richard Bille	Farmer	Brandon, Wisconsin	2013
Todd Cotteril	Farmer	Markesan, Wisconsin	2013
Anthony Brossard	Farmer	Beaver Dam, Wisconsin	2014
Harris Cotter	Retired	Rosendale, Wisconsin	2013
Harold Birschbach	Retired	Rosendale, Wisconsin	2014
Gordon Pucker*	Retired	Rosendale, Wisconsin	2014

* George Pucker was elected to the board on June 18, 2013, to replace Dennis Grahn, who resigned effective March 1, 2013.

Members of the board currently receive $75 for each meeting attended and $0.555 per mile for travel expenses.

Section 612.13 (1m), Wis. Stat., requires:

(1) If a town mutual has fewer than nine directors, no more than one director may be an employee or representative of the town mutual; and

(2) Employees and representatives of a town mutual may not constitute a majority of its board.

The company is in compliance with these requirements.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2012 Compensation
Richard Bille	President	$ 5,528.39
Kevin Beske	Vice President	1,563.07
Ramona Monacelli	Secretary/Treasurer and Manager	54,395.06

Reported compensation is the total compensation paid by the insurer for the year and includes salary, commissions, director fees and rental income as applicable. The manager received commissions of $4,379.06 as an agent for the company during 2012.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
Richard Bille, Chair
Kevin Beske
Ramona Monacelli

Executive Committee
Richard Bille, Chair
Kevin Beske
Ramona Monacelli

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows. As previously noted, Rosendale Mutual Insurance Company merged with and into Flyway Mutual Insurance Company as of April 1, 2012. Flyway Mutual's financial statements and other key information are combined with Rosendale Mutual's for all years prior to the merger.

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2012	$572,361	1,430	$ (95,017)	$2,800,325	$1,985,725
2011	575,712	1,384	(150,189)	2,953,894	2,263,272
2010	606,913	1,381	(101,028)	3,065,322	2,442,767
2009	607,845	1,427	81,464	3,025,868	2,391,842
2008	600,852	1,458	(415,061)	3,010,025	2,205,420
2007	626,962	1,513	(153,080)	3,629,863	2,862,734

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Policyholders' Surplus	Writings Ratios	
				Net	Gross
2012	$1,381,724	$612,271	$1,985,725	31%	70%
2011	1,396,220	630,053	2,263,272	28	62
2010	1,301,256	582,544	2,442,767	24	53
2009	1,343,006	585,748	2,391,842	24	56
2008	1,396,116	575,643	2,205,420	26	63
2007	1,431,410	609,734	2,862,734	21	50

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Com-posite Ratio
2012	$414,865	$418,836	$572,361	72.5%	60.6%	133.1%
2011	355,899	452,927	575,712	61.8	71.9	133.7
2010	322,593	468,596	606,913	53.2	80.4	133.6
2009	162,454	437,728	607,845	26.7	74.7	101.4
2008	596,583	474,999	600,852	99.3	82.5	181.8
2007	426,825	478,155	626,962	68.1	78.4	146.5

Flyway Mutual Insurance Company has experienced underwriting losses in 19 of the past 20 years and net losses in 10 of the past 20 years. From 1992 to 2011, Rosendale Mutual Insurance Company experienced underwriting losses in 19 of the 20 years and net losses in 15 of the 20 years. The average expense ratio of the company over the last 5 years is 79.8% and the company has reported composite ratios of over 100% during the same period. The consistently poor underwriting results and limited premium growth have resulted in higher reinsurance costs. The company's new manager, who took over in the spring of 2012 following the recent merger, has indicated a commitment to attend carefully to underwriting, rating, insurance to value, and the use of reinsurance. The examination noted careful regard for inspection of risks and the implementation of rate surcharges based upon claims experience. Since the main driver of returns for a small property and casualty insurer are its underwriting results, it is vital for the company's survival to maintain these commitments and improve results.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2013
Termination provisions:	By either party, on any January 1st, with 90 days' advanced notice in writing

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Exhibit AX1 - Casualty Excess of Loss
	Lines reinsured:	Liability (nonproperty) business
	Company's retention:	$5,000 for each and every loss occurrence up to policy limits
	Coverage:	100% in excess of retention including loss adjustment expense, subject to policy limits of $1,000,000 for bodily injury and property damage and $25,000 per person and $25,000 per accident for medical payments
	Reinsurance premium:	60% of gross liability premiums charged for each policy issued
2.	Type of contract:	Exhibit B1 - First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	The company may cede to the reinsurer on a pro rata basis up to $800,000 of reinsurance of such risk when the company's net retention is $400,000 or more. When the company's first surplus liability in respect to a risk is less than $400,000, the company may cede, on a pro rata basis, and the reinsurer shall accept up to 50% of reinsurance of such risk.
	Coverage:	Pro rata portion of each and every loss, including loss adjustment expenses, corresponding to the amount of the risk ceded by the company as it bears to the gross liability on such risk
	Premium:	The company agrees to pay pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of risk ceded hereunder

	Ceding commission:	15% of the premiums paid to the reinsurer
	Profit commission:	15% of the net profit calculated as follows: a) Premiums earned for the period less b) Ceding commission allowed the company on premiums earned for the period less c) 10% of premiums earned for the period to cover incurred expenses less d) Losses and loss adjustment expenses incurred for the period less e) The reinsurer's net loss, if any, from the preceding period
3.	Type of contract:	Exhibit C1 - First Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$55,000 for each and every risk from one loss occurrence
	Coverage:	$95,000 each and every risk and loss occurrence, including loss adjustment expense, above the company's retention
	Reinsurance premium:	Rate based on net premium written and losses incurred for the immediately preceding four years, subject to a minimum rate of 8% and maximum rate of 15% of current net premium written. The 2013 annual rate is 14.71%.
4.	Type of contract:	Exhibit C2 - Second Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$150,000 each and every risk from one loss occurrence
	Coverage and limits:	$250,000 each and every risk and loss occurrence, including loss adjustment expenses, above the company's retention
	Reinsurance premium:	6% of subject net premiums written
5.	Type of contract:	Exhibit DE1 - First Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company's retention:	Losses in aggregate equal to 75% of net premiums written
	Coverage :	60% of the company's aggregate net losses in the annual period, including loss adjustment expenses, which exceed the company's retention
	Reinsurance premium:	Net premium written times [sum of the prior eight years' losses incurred by the reinsurer divided by the total net premiums written for the same period times 100/80ths], subject to a minimum rate of 8% and a maximum rate of 15%. The 2013 annual rate is 11.95%.

6.	Type of contract:	Exhibit DE2 - Second Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company’s retention:	Losses in aggregate equal to 135% of net premiums written
	Coverage:	100% of the company’s aggregate net losses in the annual period, including loss adjustment expenses, which exceed the company’s retention
	Reinsurance premium:	2.75% of net premiums written for business covered

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2012, annual statement. Adjustments and reclassifications made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Flyway Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2012

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 61	$	$	$ 61
Cash in checking	188,012			188,012
Cash deposited at interest	3,371			3,371
Bonds	642,552			642,552
Stocks and mutual fund investments	1,664,364			1,664,364
Real estate	105,164			105,164
Other invested assets	24,430			24,430
Premiums, agents' balances and installments:				
In course of collection	15,833		470	15,363
Deferred and not yet due	180,292			180,292
Investment income accrued		11,286		11,286
Assessments receivable				
Reinsurance recoverable on paid losses and LAE	(41,799)			(41,799)
Electronic data processing equipment	484			484
Other nonexpense-related assets:				
Federal income tax recoverable	6,745			6,745
Furniture and fixtures	2,976		2,976	
Totals	$2,792,485	$11,286	$3,446	$2,800,325

Liabilities and Surplus

Net unpaid losses	$ 115,562
Unpaid loss adjustment expenses	7,500
Commissions payable	40,803
Fire department dues payable	480
Unearned premiums	504,662
Reinsurance payable	104,597
Amounts withheld for the account of others	1,569
Payroll taxes payable (employer's portion)	4,470
Other liabilities:	
Expense-related:	
Accounts payable	14,290
Nonexpense-related:	
Premiums received in advance	20,667
Total liabilities	814,600
Policyholders' surplus	1,985,725
Total Liabilities and Surplus	$2,800,325

Flyway Mutual Insurance Company
Statement of Operations
For the Year 2012

Net premiums and assessments earned		$572,361
Deduct:		
Net losses incurred	$346,110	
Net loss adjustment expenses incurred	68,755	
Net other underwriting expenses incurred	418,836	
Total losses and expenses incurred		833,701
Net underwriting gain (loss)		(261,340)
Net investment income:		
Net investment income earned	22,812	
Net realized capital gains (losses)	91,985	
Total investment gain (loss)		114,797
Other income (expense):		
Miscellaneous	893	
Installment and policy fees	50,633	
Total other income		51,526
Net Income (Loss)		$(95,017)

Flyway Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2012

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2012	**2011***	**2010***	**2009***	**2008***
Surplus, beginning of year	$2,263,272	$2,442,767	$2,391,842	$2,205,420	$2,862,734
Net income	(95,017)	(150,189)	(101,028)	81,464	(415,061)
Net unrealized capital gain or (loss)	(183,159)	(26,676)	149,646	98,073	(242,791)
Change in nonadmitted assets	629	(2,630)	2,307	6,885	538
Surplus, End of Year	$1,985,725	$2,263,272	$2,442,767	$2,391,842	$2,205,420

* Note that the company merged with Rosendale Mutual Insurance Company effective April 1, 2012. Financial results from 2008 to 2011 include balances from both companies.

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2012, is accepted.

Examination Reclassifications	Debit	Credit
Reinsurance recoverable on paid losses and LAE	$41,799	$
Reinsurance payable		41,799
Total Reclassifications	$41,799	$41,799

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is again recommended that the company develop a comprehensive business plan on an annual basis. It is further recommended that the company's board approve the business plan annually and disclose this approval in the board meeting minutes.

   Action—Compliance

2. Underwriting—It is recommended that the company amend its inspection process to have all inspections be performed by the inspector and associated reports be reviewed by office personnel prior to renewal notices being sent to policyholders in order to utilize any finding from those inspections to alter the terms of the policies if found necessary. It is further recommended that the company formally track the inspection results, report the results to the board of directors and use the results to plan for future inspections.

   Action—Compliance

3. Underwriting—It is also recommended that the company consistently follow its inspection criteria when deciding which policies to inspect or amend the inspection criteria in order to better prioritize the risks to be inspected. Notification sent to policyholders of the renewal of policies with altered terms is governed under s. 631.36 (5), Wis. Stat.

   Action—Compliance

4. Underwriting—It is recommended that the company implement a formal written policy on agent performance that includes, but is not limited to, criteria that agents have to meet as well as consequences that are to be enforced by the company when agents continually write unprofitable business.

   Action—Compliance

5. Underwriting—It is suggested that the company consider a formal written policy to nonrenew policies that have had multiple claims within a reasonable period of time set by the company.

   Action—Compliance

6. Underwriting—It is recommended that the company develop an adequate business continuity plan, which should be filed with this office within 30 days after its approval by the board of directors.

   Action—Compliance

7. Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards to custody and control of its invested assets.

   Action—Compliance

8. Stocks and Mutual Fund Investments—It is recommended that the company report its invested assets, particularly preferred stock securities, in accordance with Town Mutual Annual Statement Instructions.

Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 175,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Bodily injury (each accident)	100,000
Bodily injury by disease (each employee)	100,000
Bodily injury by disease policy limit	500,000
Property coverage:	
Building	320,000
Business personal property	39,400
Liability coverage:	
Liability and medical (per occurrence)	2,000,000
Medical payments (per person)	5,000
Tenant's property damage legal liability	300,000
Personal and advertising injury (per person or organization)	2,000,000
Products–completed operations (annual aggregate)	4,000,000
General annual aggregate	4,000,000
Professional liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	10,000
Directors and officers liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	10,000

Underwriting

The company does have a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. The company utilizes outside inspectors to perform the inspection function on their behalf. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

Once an application is received, a quote is set up in the computer system, printed out, and an inspection sheet is created based on type of policy. The inspector sends out a notice advising the insured that he will be inspecting the property. The inspector completes the survey and takes photographs of the property, documenting any items needing attention. The company’s underwriter reviews the inspection and underwrites according to the company’s manual and Wisconsin Reinsurance Corporation specifications.

The board has adopted a policy to add surcharges of between 10% and 100% to all policies that have had multiple claims in a three-year period.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained.
2. A proper cash receipts journal is maintained.
3. A proper cash disbursements journal is maintained.
4. A proper general journal is maintained.
5. A proper general ledger is maintained.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2012.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company’s electronic data processing environment. Access to the computers is limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept off-site.

The company has manuals documenting the use of its software and outlining the steps to complete specific tasks. The manuals assist in the continuity of operations by providing instructions for seldom-used applications or when staff turnover occurs. The examination determined that the level of documentation contained in the manuals was reasonable.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The business continuity plan was filed with this office on June 25, 2013. The company's business continuity plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is not in compliance with these requirements. It was noted that the company has a custodial agreement with Waukesha State Bank; however, the bank uses a non-bank subcustodian, the brokerage firm of Cetera Advisor Networks, LLC, for nearly all of the company assets held by the bank. Since the custodial agreement, which dates from 2011, does not include provisions for a subcustodian, it is unclear what responsibility the bank has with respect to the non-bank subcustodian. Furthermore, the examination could only confirm specific assets held on behalf of the company through statements from the brokerage firm. It is recommended that the company obtain a custodial agreement with an authorized custodian under s. 610.23, Wis. Stat., and if a subcustodian is used, the custodian's indemnification for negligence or dishonesty under the custodial agreement should be extended to apply to any subcustodians. It is further recommended that the company obtain custodial statements from their custodian that include a detailed list of securities under custody at least quarterly and such statements should be reconciled to any applicable statements from the investment brokerage firm.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$1,114,600
2.	Liabilities plus 33% of gross premiums written	1,270,569
3.	Liabilities plus 50% of net premiums written	1,120,736
4.	Amount required (greater of 1, 2, or 3)	1,270,569
5.	Amount of Type 1 investments as of 12/31/2012	804,348
6.	Excess or (deficiency)	$ (466,221)

The company does not have sufficient Type 1 investments.

The investment rule prescribes that a town mutual shall divest of any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. It is recommended that the company submit a plan to realign its investment portfolio to rectify its deficiency in Type 1 investments.

Since the inception of the investment rule in 1996, the company has made additional Type 2 investments without having an adequate amount of Type 1 investments. It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$191,444**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 61
Cash deposited in banks—checking accounts	188,012
Cash deposited in banks at interest	3,371
Total	$191,444

Cash in company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of two deposits in two depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2012 totaled $5 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.1100% to 0.1600%. Accrued interest on cash deposits totaled $0 at year-end.

Book Value of Bonds **$642,552**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2012. Bonds owned by the company are held by a brokerage firm as subcustodian to Waukesha State Bank.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

As part of the examination, the examiners requested prospectuses for certain variable rate corporate debt securities in order to understand the characteristics of these bonds. The company did not have, and could not timely obtain, copies of the prospectuses. It is recommended that the company maintain copies of prospectuses for future bond investments.

Interest received during 2012 on bonds amounted to $51,569 and was traced to cash receipts records. Accrued interest of $10,785 at December 31, 2012, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments $1,664,364

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2012. Stocks owned by the company are located in either the company's locked fireproof filing cabinet or held by a brokerage firm as subcustodian to Waukesha State Bank.

Stock certificates located on the company premises were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2012 on stocks and mutual funds amounted to $29,901 and were traced to cash receipts records.

Book Value of Real Estate $105,164

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2012. The company's real estate holdings consisted of its home office building located at 918 West Main Street in Waupun, Wisconsin.

The required documents supporting the validity of this asset were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Other Invested Assets **$24,430**

The company's other invested assets consist of a corporate trust backed security issued by an affiliate of The Goldman Sachs Group, Inc., and a senior note issued by Viacom, Inc.

Interest income received in 2012 was $864 and the accrued interest was $501.

Premiums, Agents' Balances in Course of Collection **$15,363**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

Premiums Deferred and Not Yet Due **$180,292**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company's detailed list of deferred premiums verified the accuracy of this asset.

Investment Income Accrued **$11,286**

Interest due and accrued on the various assets of the company at December 31, 2012, consists of the following:

Bonds	$10,785
Other invested assets	501
Total	$11,286

Reinsurance Recoverable on Paid Losses and LAE **$(41,799)**

This asset is intended to represent recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2012. The company reported a balance for this line item of $(41,799) as of December 31, 2012, while the examination resulted in a balance of $0. This balance was reclassified to the liability line item "Reinsurance Payable" because the net balances to and from the company's reinsurer, Wisconsin Reinsurance Corporation, amounted to a liability to the company as of December 31, 2012.

Electronic Data Processing Equipment **$484**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2012. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Federal Income Tax Recoverable **$6,745**

This asset represents the balance recoverable at year-end for federal income taxes incurred prior to December 31, 2012. The examiners reviewed the company's 2012 tax return and verified amounts paid to cash receipt records to verify the accuracy of this asset.

Furniture and Fixtures **$0**

This asset consists of $2,976 of furniture and fixtures owned by the company at December 31, 2012. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$115,562**

This liability represents losses incurred on or prior to December 31, 2012, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2012, with incurred dates in 2012 and prior years. To the actual paid loss figure was added an estimated amount for 2012 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule:

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$648,110	$707,895	$ (59,785)
Less: Reinsurance recoverable on unpaid losses	532,548	654,426	121,878
Net Unpaid Losses	$115,562	$ 53,469	$ 62,093

Reserves appeared redundant at the examination date based on the examiners' development; no adjustment has been made for purposes of this examination report in fair consideration of the possibility of further loss development.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and claims that were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$7,500**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2012, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is to multiply the company's open claims as of year-end by its average per claim paid loss adjustment expense experience for the year.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$40,803**

This liability represents the commissions payable to agents as of December 31, 2012. The examiners reviewed the company's commission calculation and tested subsequent commission payments and found the liability to be reasonably stated.

Fire Department Dues Payable **$480**

This liability represents the fire department dues payable to the state of Wisconsin as of December 31, 2012.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$504,662**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$146,396**

This liability consists of the net amount due to the company's reinsurer at December 31, 2012, relating to transactions which occurred on or prior to that date. The company reported a balance for this line item of $104,597 as of December 31, 2012, while the examination resulted in a balance of $146,396. The $41,799 difference is due to this examination's reclassification of the negative net balance reported by the company in the asset line item "Reinsurance Recoverable on Paid Losses and LAE," because the net balances to and from the company's reinsurer, Wisconsin Reinsurance Corporation, amounted to a liability to the company as of December 31, 2012.

Amounts Withheld for the Account of Others **$1,569**

This liability represents employee payroll deductions in the possession of the company at December 31, 2012. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$4,470**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2012, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$14,290**

This liability represents amounts for expenses incurred in 2012 but not paid as of year-end. The balance includes accrued payroll amount, accrued expenses, and premium refunds.

Premiums Received in Advance **$20,667**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2012. The examiners reviewed 2012 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

Policyholders' surplus has decreased from $2,211,693 per the examination report as of year-end 2007, to $1,985,725 as of year-end 2012. This represents a decrease of 10.2% during the period under examination. Surplus for year-end 2012 includes the effect of the merger of Rosendale Mutual Insurance Company with and into Flyway Mutual Insurance Company as of April 1, 2012. If the combined surplus of the two companies were considered over the same period, the combined surplus of $2,862,734 as of year-end 2007 decreased by 30.6%, to $1,985,725.

The following schedule summarizes the cumulative increases and decreases to the combined surplus of Flyway Mutual Insurance Company and Rosendale Mutual Insurance Company from December 31, 2007, when policyholders' surplus was last verified by examination, to December 31, 2012:

Policyholders' surplus, December 31, 2007	$2,862,734
Net income	(679,831)
Unrealized capital gains or (losses)	(204,907)
Change in nonadmitted assets	7,729
Policyholders' Surplus, December 31, 2012	$1,985,725

Flyway Mutual Insurance Company has experienced underwriting losses in 19 of the past 20 years and net losses in 10 of the past 20 years. From 1992 to 2011, Rosendale Mutual Insurance Company experienced underwriting losses in 19 of the 20 years and net losses in 15 of the 20 years. The average expense ratio of the company over the last five years is 79.8% and the company has reported composite ratios of over 100% during the same period. The consistently poor underwriting results and limited premium growth have resulted in higher reinsurance costs. The company's new manager, who took over in the spring of 2012 following the recent merger, has indicated a commitment to attend carefully to underwriting, rating, insurance to value, and the use of reinsurance. The examination noted careful regard for inspection of risks and the implementation of rate surcharges based upon claims experience. Since the main driver of returns for a small property and casualty insurer are its underwriting results, it is vital for the company's survival to maintain these commitments and improve results.

Areas of improvement recommended by this examination were related to custody and investment matters, resulting in four recommendations. The company complied with the seven prior examination recommendations. There were no adjustments to surplus and one reclassification to the balance sheet.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Invested Assets—It is recommended that the company obtain a custodial agreement with an authorized custodian under s. 610.23, Wis. Stat., and if a subcustodian is used, the custodian's indemnification for negligence or dishonesty under the custodial agreement should be extended to apply to any subcustodians. It is further recommended that the company obtain custodial statements from their custodian that include a detailed list of securities under custody at least quarterly and such statements should be reconciled to any applicable statements from the investment brokerage firm.

2. Page.21 - Investment Rule Compliance—It is recommended that the company submit a plan to realign its investment portfolio to rectify its deficiency in Type 1 investments.

3. Page 22 - Investment Rule Compliance—It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

4. Page 24 - Book Value of Bonds—It is recommended that the company maintain copies of prospectuses for future bond investments.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Ana Careaga of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Vickie Ostien
Examiner-in-Charge