Report

of the

Examination of

Liberty Mutual Fire Insurance Company

Stitzer, Wisconsin

As of December 31, 2011

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 22, 2012

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, 2011, of the affairs and financial condition of:

LIBERTY MUTUAL FIRE INSURANCE COMPANY
Stitzer, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Liberty Mutual Fire Insurance Company (the company) was made in 2007 as of December 31, 2006. The current examination covered the intervening time period ending December 31, 2011, 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.

The company was organized as a town mutual insurance company on January 6, 1872, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the German Mutual Fire Insurance Company of the Town of Liberty. 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 no amendments to the bylaws. The change to the articles of incorporation was a change in 2007 for the addition of Juneau County to the company’s territory.

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

Crawford	Grant
Iowa	Juneau
La Crosse	Lafayette
Monroe	Richland
Sauk	Vernon

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 equal to $30 on an annual basis.

Business of the company is acquired through 42 agents, none of whom are directors of the company. There are five main independent agencies responsible for writing 84% of the company’s business. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
Homeowner’s and farmowner’s	14%
Mobile homeowner’s	14
Commercial	14
Dwelling fire and farm fire	14
Mobile home fire	14
Preferred farmowner’s	12
New policy bonus	$5.00

Agents have no authority to adjust claims. Adjustments are completed by the company manager, who is reimbursed at $0.555 per mile for travel allowance.

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
James Reed	Farmer	Platteville, Wisconsin	2013
Maurice Grim	Carpenter	Richland Center, Wisconsin	2014
Gary Schneider	Farmer	Lancaster, Wisconsin	2012
Daniel Swenson	Farmer	Boscobel, Wisconsin	2014
André Keller	Accountant	Stitzer, Wisconsin	2012
Pat Schroeder	Farmer	Lancaster, Wisconsin	2012
Mark Nelson	Sales Manager	Stitzer, Wisconsin	2013
Terry Runde	Farmer	Platteville, Wisconsin	2013
Stan Nodolf	Farmer	Platteville, Wisconsin	2014

None of the directors work as insurance agents. Members of the board currently receive $80.00 for each half-day meeting and $100.00 for each full-day meeting attended and $0.555 per mile for travel expenses.

Section 612.13 (1m), Wis. Stat., requires after April 30, 2006:

(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 vote of the directors annually for a one-year term or until their successors are duly elected and qualified. The manager is not elected annually. Officers serving at the present time are as follows:

Name	Office	2011 Compensation
James Reed	President	$ 5,336
Maurice Grim	Vice President	1,040
Gary Schneider	Secretary/Treasurer	4,380
Steven Crist	Manager	72,999

Reported compensation is the total compensation paid by the insurer for the year and includes salary, commissions, director fees and rental income as applicable.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. All members of the board of directors serve on the Adjusting and the Investment Committees.

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2011	$604,902	1,284	$ 76,803	$2,977,983	$2,449,636
2010	719,797	1,272	156,182	2,985,463	2,411,682
2009	739,917	1,324	(168,143)	2,739,529	2,174,536
2008	730,511	1,358	148,194	3,012,653	2,322,420
2007	679,899	1,329	97,310	2,919,508	2,237,204
2006	682,467	1,348	290,261	2,710,056	2,095,504

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	Writings Ratios Gross
2011	$1,051,406	$599,298	$2,449,636	25%	43%
2010	1,059,525	689,597	2,411,682	29	44
2009	1,126,635	713,724	2,174,536	33	52
2008	1,215,975	759,800	2,322,420	33	52
2007	1,081,624	679,681	2,237,204	30	48
2006	1,073,730	685,540	2,095,504	33	51

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
2011	$215,013	$361,370	$604,902	36%	60%	96%
2010	226,054	349,851	719,797	31	51	82
2009	740,468	354,970	739,917	100	50	150
2008	256,950	370,638	730,511	35	49	84
2007	354,988	359,718	679,899	52	53	105
2006	159,807	351,212	682,467	23	51	75

The financial position of the company has improved since the prior examination as of December 31, 2006. The policyholder count has remained relatively stable at 1,284 policies as compared to 1,348 policies in force at the time of the prior examination. With the exception of 2009, the company has experienced favorable operating results since the last examination. The company has reported net income in four of the last five years. During this time period, policyholder surplus has increased 17% from $2,095,504 to $2,449,636.

The company has experienced relatively favorable loss ratios over the past five years with the average being 51%. The average of all town mutuals over the last five years was 58%. A review of the company’s expense ratio shows that it has averaged 53% over the past five years.

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, 2012
Termination provisions:	January 1, 2013, or any subsequent January 1, by either party providing at least 90 days' advance notice in writing

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Casualty Excess of Loss Reinsurance
	Lines reinsured:	Liability (nonproperty)
	Company's retention:	$5,000 for each and every loss occurrence
	Coverage:	100% in excess of the retention including loss adjustment expenses, subject to policy limits of $1,000,000 for bodily injury and property damage and $25,000 per accident for medical payments
	Reinsurance premium:	55% of gross liability premiums charged subject to a minimum premium of $75,875 and annual deposit premium of $88,000
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property business
	Company's retention:	Up to $500,000 of each risk ceded pro rata
	Coverage:	The pro rata portion of each and every loss, including loss adjustment expenses up to $800,000. If the net retention for a risk is $500,000 or less, the company may cede 50% pro rata.
	Reinsurance premium:	The pro rata portion of all premiums, fees and assessments charged by the company on each risk ceded
	Ceding commission:	Commission of 15% and a profit commission of up to 15% based on the reinsurer's net profit relating to business covered under this contract
3.	Type of contract:	Class C-1 First Per Risk Excess of Loss
	Lines reinsured:	All property business

	Company's retention:	$55,000 per each and every risk resulting from one loss occurrence
	Coverage:	100% of each loss occurrence, including loss adjustment expense, in excess of company's retention up to a maximum of $80,000
	Reinsurance premium:	Rate based on net premium written and losses incurred for the four immediately preceding years. Minimum rate of 7% and a maximum rate of 20%. The 2012 annual rate was 14.21%. Annual deposit premium of $121,638.
4.	Type of contract:	Class C-2 Second Per Risk Excess of Loss
	Lines reinsured:	All property business
	Company's retention:	$135,000 per each and every risk resulting from one loss occurrence
	Coverage:	100% of each loss occurrence, including loss adjustment expense, in excess of company's retention up to a maximum of $365,000
	Reinsurance premium:	5.00% of net premiums written for business covered subject to a deposit premium of $42,800
5.	Type of contract:	Class DE-1 First Aggregate Excess of Loss
	Lines reinsured:	All business written
	Company's retention:	75% of net premiums written
	Coverage:	100% of the amount by which the aggregate net losses, including loss adjustment expenses, exceed the retention up to 60% of net premium written
	Reinsurance premium:	10.04% of net premium written with a minimum rate of 6.45% and a maximum rate of 15%. The 2012 annual rate was 10.04%, subject to an annual deposit premium of $93,171.
6.	Type of contract:	Class D/E 2 Excess of Loss Second Aggregate
	Lines reinsured:	All business written
	Company's retention:	135% of net premium written
	Coverage:	100% of the amount, if any, by which the aggregate of the company's losses, including loss adjustment expenses, which occur during any annual period exceed an amount equal to 135% of the company's net premiums written
	Reinsurance premium:	3.5% of net premium written, subject to an annual deposit premium of $32,480

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, 2011, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Liberty Mutual Fire Insurance Company
Statement of Assets and Liabilities
As of December 31, 2011

Assets

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in company's office	$ 25	$	$	$ 25
Cash deposited in checking account	19,624			19,624
Cash deposited at interest	1,454,412			1,454,412
Bonds	238,827			238,827
Stocks and mutual fund investments	1,017,070			1,017,070
Real estate	36,323			36,323
Premiums, agents' balances and installments:				
In course of collection	24,468			24,468
Deferred and not yet due	115,327			115,327
Reinsurance recoverable on paid losses and LAE	2,796			2,796
Investment income accrued		11,865		11,865
Electronic data processing equipment	6,770			6,770
Fire dues recoverable	174			174
Reinsurance commission receivable	4,467			4,467
Furniture and fixtures	154		154	
Federal income tax recoverable	45,835			45,835
Totals	$2,966,272	$11,865	$154	$2,977,983

Liabilities and Surplus

Net unpaid losses	$ 22,000
Unpaid loss adjustment expenses	500
Commissions payable	31,152
Unearned premiums	453,852
Reinsurance payable	10,295
Amounts withheld for account of others	1,965
Other liabilities:	
Premiums received in advance	8,583
Total liabilities	528,347
Policyholders' surplus	2,449,636
Total Liabilities and Surplus	$2,977,983

Liberty Mutual Fire Insurance Company
Statement of Operations
For the Year 2011

Net premiums and assessments earned		$604,902
Deduct:		
Net losses incurred	$181,367	
Net loss adjustment expenses incurred	33,646	
Net other underwriting expenses incurred	361,370	
Total losses and expenses incurred		576,383
Net underwriting gain (loss)		28,519
Net investment income:		
Net investment income earned	21,474	
Net realized capital gains (losses)	355	
Total investment gain (loss)		21,829
Other income (expense):		
Policy/installment fees	45,454	
Other income	3	
Total other income		45,457
Net income (loss) before federal income taxes		95,805
Federal income taxes incurred		19,000
Net Income (Loss)		$ 76,805

Liberty Mutual Fire Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2011

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:

	2011	2010	2009	2008	2007
Surplus, beginning of year	$2,411,682	$2,174,536	$2,322,420	$2,237,204	$2,095,504
Net income	76,805	156,182	(163,143)	148,194	97,310
Net unrealized capital gains or (losses)	(39,005)	80,811	5,617	(80,514)	25,790
Change in nonadmitted assets	154	153	14,642	17,535	18,600
Surplus, End of Year	$2,449,636	$2,411,682	$2,174,536	$2,322,420	$2,237,204

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2011, is accepted.

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. EDP Environment—It is recommended that the company develop and/or obtain manuals documenting the use of its software.

   Action—Compliance.

2. Cash and Invested Cash—It is recommended that the company report in a timely manner escheatable checks in accordance with ss. 177.17 and 177.19, Wis. Stat.

   Action—Compliance.

3. Premium Deferred and Not Yet Due—It is suggested that adjustments made for premium billed in advance should be credited to the current premium receivable for billed premium for policies becoming effective after year-end and to deferred premium for billed installments becoming effective after year-end.

   Action—Compliance.

4. Electronic Data Processing Equipment—It is recommended that the company properly depreciate EDP equipment and operating system software over a time period that does not exceed three years in compliance with the Town Mutual Annual Statement Instructions.

   Action—Compliance.

5. Net Unpaid Losses—It is suggested that the company report its reserve for liability losses as nonproperty claims on Schedule J-1 of the annual statement, in accordance with the 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	$ 140,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Commercial property	
Structure	140,000
Personal	50,000
Deductible	500
Commercial liability	
General and aggregate	500,000
Each occurrence	500,000
Medical expense	5,000
Professional liability	
General and aggregate	1,000,000
Each occurrence	1,000,000

Underwriting

The company has 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. Each new policy application and every third year renewal policy is inspected and updated by the company manager who is independent of the risk under consideration and review.

Formal inspection reports are not essential for mid-term policy cancellations under s. 631.36 (2) (a), Wis. Stat. However, in the event of a disputed mid-term cancellation under this section, formal inspection reports could be helpful to the company in resolving disputes.

An underwriting checklist could be helpful to the company when new business is acquired to ensure that underwriting decisions for risks written by the company are justified. It is the stated policy of management that inspections are performed in writing new business and that inspections are performed at a minimum of three years. Sampling of the policy files has shown that there is evidence that the management is performing both underwriting and inspection functions in an effective and routine manner. It is suggested that the management consider keeping formal underwriting checklists for new policies and formal inspection reports for new and existing policies.

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, 2011.

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 computer is limited to people authorized to use the computers. Company personnel back up the computers on Tuesday and Thursday of each week 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.

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 in compliance with these requirements.

The company has not established formal procedures for the approval of electronic disbursements. There are also no formal policies regarding approval of electronic disbursements over $5,000 that are similar to the company's check approval procedures. It is recommended that the company establish formal procedures for the approval of electronic disbursements.

The examination noted that the existing agreement between the company and the custodian is not in compliance with the NAIC Financial Condition Examiners Handbook and s. 610.23, Wis. Stat. It is recommended that the company obtain a custodial agreement for the custody of its investments in accordance with the NAIC Financial Condition Examiners Handbook, and this agreement should be between the company and a bank or banking and trust company in accordance with s. 610.23 (1), Wis. Stat.

The terms of the agreement with the investment broker appear to give the broker significant authorization to make trades in the name of the company. However, there is no investment policy that is authorized by the board to ensure that investments are executed in compliance with investment standards applicable to town mutual insurers. The examiners have determined that a formal board-authorized investment policy in accordance with the limitations described in s. 612.36, Wis. Stat., and ch. 620, Wis. Stat., is advisable. It is recommended that the company develop a formal investment policy that is authorized by the board of directors to direct the investment broker which is in accordance with s. 612.36, Wis. Stat., and ch. 620, Wis. Stat.

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	$ 828,347
2.	Liabilities plus 33% of gross premiums written	875,311
3.	Liabilities plus 50% of net premiums written	827,996
4.	Amount required (greater of 1, 2, or 3)	875,311
5.	Amount of Type 1 investments as of 12/31/2011	1,712,131
6.	Excess or (deficiency)	$ 836,135

The company does have sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$1,474,061**

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

Cash in company's office	$ 25
Cash deposited in banks-checking accounts	19,624
Cash deposited in banks at interest	1,454,412
Total	$1,474,061

Cash in the 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 one checking account maintained in one bank. Verification of the checking account balance was made by obtaining a confirmation directly from the depository and reconciling the amount shown thereon to company records.

Cash deposited in banks at interest represents the aggregate of 16 deposits in 9 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 totaled $26,574 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.75% to 4.90%. Accrued interest on cash deposits totaled $9,685 at year-end.

Bond Investments **$238,827**

The above asset consists of the aggregate book value of bonds held by the company at December 31, 2011. The account consists of seven bond instruments from seven issuers. The issuers were all governmental units: municipal, county, or states. The bonds were directed at various public projects, such as utilities, school districts, environmental protection, and general use promissory notes. All bonds owned by the company at year-end were rated between AA3 and A+ and had maturities that ranged from December 1, 2015, through September 1, 2018.

Bond investments are held by a custodian on behalf of the company. The statement value of the bond portfolio was $246,439 as of December 31, 2011. Bond holdings were confirmed with the custodian by the independent auditors. The bond portfolio produced $8,813 of annual investment income in 2011. Bond interest due and accrued was $1,180 at December 31, 2011. Bond values were traced between the custodial statements to the supporting schedule in the company’s financial statement using the par value method. Bond ratings and market values at year-end were also verified.

Stocks and Mutual Fund Investments **$1,017,070**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2011. Stocks owned by the company are kept in the company safe.

Stock certificates 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 2011 on stocks and mutual funds amounted to $17,361 and were traced to cash receipts records. The company had no accrued dividends at December 31, 2011.

Book Value of Real Estate **$36,323**

The above amount represents the company's investment in real estate as of December 31, 2011. The company's real estate holdings consisted of its office building.

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 section of this report captioned, "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.

Premiums, Agents' Balances in Course of Collection **$24,468**

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 reasonableness of this asset.

Premiums Deferred and Not Yet Due **$115,327**

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 reasonableness of this asset.

Investment Income Accrued **11,865**

Interest due and accrued on the various assets of the company at December 31, 2011, consists of the following:

Cash at interest	$ 9,685
Bonds	2,180
Total	$11,865

Reinsurance Recoverable on Paid Losses and LAE **$2,796**

The above balance consists of amounts due to the company as of December 31, 2011, under its contract with Wisconsin Reinsurance Corporation. The reinsurer is obligated to reimburse the company for all covered losses and loss adjustment expenses paid by the company. The examiners reviewed the amounts recoverable during the course of the examination.

Electronic Data Processing Equipment **$6,770**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2011. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Fire Dues Recoverable **$174**

This asset represents the amount overpaid to the state of Wisconsin for 2011 fire dues. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Reinsurance Commission Receivable **$4,467**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2011, under its contract with Wisconsin Reinsurance Corporation. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

Federal Income Tax Recoverable **$45,835**

This asset consists of amounts due the company from the Internal Revenue Service as of December 31, 2011. This asset resulted from an overpayment made by the company on its 2011 U.S. Property and Casualty Insurance Company Income Tax Return. The company's tax records were reviewed as a part of the examination.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$22,000**

This liability represents losses incurred on or prior to December 31, 2011, 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, 2011, with incurred dates in 2011 and prior years. To the actual paid loss figure was added an estimated amount for 2011 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	$30,499	$ 20,859	$ 6,555
Less: Reinsurance recoverable on unpaid losses	8,500	(3,085)	8,500
Net Unpaid Losses	$21,999	$ 23,944	$(1,945)

The difference resulted from an unpaid loss estimation and did not include a liability claim for a policyholder which should have been included. The deficiency of $(1,945) was not considered material for purposes of this examination.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which 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 **$500**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2011, but which remained unpaid as of year-end.

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 **$31,152**

This liability represents the commissions payable to agents as of December 31, 2011. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

Unearned Premiums **$453,852**

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. The examiner's tested this balance, on a sample basis, to verify that the liability is properly stated at year-end.

Reinsurance Payable **$10,295**

This liability consists of amounts due to the company's reinsurer at December 31, 2011, relating to transactions which occurred on or prior to that date. The examiners' review of this balance has determined that the balance is properly stated.

Amounts Withheld for Account of Others **$1,965**

This liability represents employee payroll deductions in the possession of the company at December 31, 2011. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$8,583**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2011. The examiners reviewed 2011 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

Liberty Mutual Fire Insurance Company is a town mutual insurer operating in a ten-county area of southwestern Wisconsin. The company has been in business for 140 years, providing property and liability insurance to its policyholders.

Overall, the financial position of the company has improved since the prior examination as of December 31, 2006. The policyholder count has remained relatively stable at 1,284 policies as compared to 1,348 policies in force at the time of the prior examination. With the exception of 2009, the company has experienced favorable operating results since the last examination. The company has reported net income in four of the last five years. During this time period, policyholder surplus has increased 17% from $2,095,504 to $2,449,636.

The company has experienced relatively favorable loss ratios over the past five years with the average being 51%. The average of all town mutuals over the last five years was 58%. A review of the company’s expense ratio shows that it has averaged 53% over the past five years.

The current examination resulted in three recommendations and one suggestion. The suggestion and recommendations relate to the underwriting procedures, the investment policy, and the investment custodial agreement. The examination resulted in no adjustment to surplus.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Underwriting—It is suggested that the management consider keeping formal underwriting checklists for new policies and formal inspection reports for new and existing policies.

2. Page 16 - Invested Assets—It is recommended that the company establish formal procedures for the approval of electronic disbursements.

3. Page 16 - Invested Assets—It is recommended that the company obtain a custodial agreement for the custody of its investments in accordance with the NAIC Financial Condition Examiners Handbook, and this agreement should be between the company and a bank or banking and trust company in accordance with s. 610.23 (1), Wis. Stat.

4. Page 17 - Invested Assets—It is recommended that the company develop a formal investment policy that is authorized by the board of directors to direct the investment broker which is in accordance with s. 612.36, Wis. Stat., and ch. 620, Wis. Stat.

VII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Gene M. Renard, CFE
Examiner-in-Charge