Report

of the

Examination of

Northern Finnish Mutual Insurance Company

Marengo, Wisconsin

As of December 31, 2013

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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July 22, 2014

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, 2013, of the affairs and financial condition of:

NORTHERN FINNISH MUTUAL INSURANCE COMPANY
Marengo, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Northern Finnish Mutual Insurance Company (the company) was made in 2009 as of December 31, 2008. The current examination covered the intervening time period ending December 31, 2013, 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 November 14, 1914, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Northern Wisconsin Finnish Farmers Mutual Town Fire 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, the company amended its Articles of Organization and Bylaws. An amendment made in 2010 changed Article IV and V of the Articles of Organization and Subsections 5, 6, and 7 of the Bylaws. The amendment was made in response to a prior examination recommendation to reflect the current practice of having a manager instead of a co-manager after the former co-manager resigned in 2006 and the co-manager position was eliminated. The amendment also changed the timing of the annual meeting of the policyholders.

The company is currently licensed to write property, including windstorm and hail, nonproperty, and commercial insurance. The company is currently licensed to write business in the following counties: Ashland, Bayfield, Douglas, and Iron.

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 or three years with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through five agents, one of whom is an officer and director of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
All new business	15%
All renewal and endorsements	11%

In addition to the above compensation the agents are awarded contingent commissions based on their individual loss ratios. For policies written or renewed on the company’s lines of business, a 2% contingent commission is awarded to agents obtaining loss ratios between zero and 45%. If the agent obtains a loss ratio between 45.1% and 50%, a 1% contingent commission is awarded.

Agents have no authority to adjust claims. Ninety-five percent or more of the claims are handled by independent adjusters. The company's manager adjusts a small volume of simple inexpensive claims.

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 seven 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
Janice M. Penn*	Nurse Practitioner/Insurance Agent	Highbridge, WI	2014
Thomas Riemer	Construction Worker	Ashland, WI	2014
Barbara Bell	Retired	Highbridge, WI	2015
John Swanson	Retired	Brule, WI	2016
Susan Sederholm	Social Worker	Highbridge, WI	2014
John Nedden-Durst	Pastor	Cornucopia, WI	2015
M. James Norturen	Retired	Marengo, WI	2016

Directors who are also agents are identified with an asterisk.

All board members receive a meeting per diem of $90.00 and are compensated for travel cost at the IRS guideline rate of $.56 per mile.

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

(1) If a town mutual has fewer than ninr 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	Compensation
Janice M. Penn	President	$1,650
Thomas Riemer	Vice President	700
Barbara Bell	Secretary/Treasurer	700

Company office management duties are performed by the manager of the company, Katherine Beach, who is currently employed pursuant to a written two-year management contract having an annual salary of $48,000.

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:

Executive Committee
Janice M. Penn, Chair
Thomas Riemer
Barbara Bell
M. James Norturen

Personnel Committee
M. James Norturen
Susan Sederholm
John Swanson

Claims Committee
Entire Board

The company has two advisory committees, marketing and underwriting. The underwriting committee discusses the company’s underwriting guidelines and gives the board advice should any changes be needed. The marketing committee discusses ways to market the company better to the public and potential new customers. The marketing committee consists of one director and two agents; the underwriting committee consists of one director and three agents. These committees meet at least once a year and do not make any formal decisions for the company but do provide guidance to the board.

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
2013	$493,590	1,244	$ 91,254	$1,426,266	$878,384
2012	511,734	1,331	65,132	1,305,273	776,534
2011	496,591	1,342	(95,773)	1,261,777	752,436
2010	494,971	1,358	(124,803)	1,365,113	837,177
2009	537,221	1,374	21,706	1,446,510	931,175
2008	505,597	1,419	(25,737)	1,507,071	927,012

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
2013	$904,674	$494,734	$878,384	56%	103%
2012	891,681	526,110	776,534	68	115
2011	850,480	502,788	752,436	67	113
2010	854,552	499,430	837,177	60	102
2009	813,576	523,221	931,175	56	87
2008	935,738	620,970	927,012	67	101

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
2013	$ 99,656	$344,086	$493,590	20%	70%	90%
2012	165,896	319,391	511,734	32	61	93
2011	309,411	336,639	496,591	62	67	129
2010	334,058	337,089	494,971	67	67	135
2009	198,905	366,741	537,221	37	70	107
2008	208,104	377,829	505,597	41	61	102

During the period under examination, surplus decreased by over $48,000 or 5%; gross premium written decreased by 3% to $904,674; and total admitted assets decreased by 5% to $1,426,266. The company had net income in three of the five intervening years.

The company’s financial results were negatively affected in 2010 and 2011 by inclement weather and a high number of claims. As a result, the company reported two consecutive years of significant net losses. Its surplus declined by 19% between 2009 and 2011. The company implemented higher rates in 2012 and, as the weather stabilized in the past two years, the company reported a net income of just over $65,000 and $91,000 in 2012 and 2013, respectively. Surplus increased by 17% in the last two years and in 2013 it was the second highest in the last five-year period. However, the policy count has been in decline the past five years, decreasing 12% from 1,419 in 2008 to 1,244 in 2013. The company's underwriting expense ratio ranged between 61% and 70% in the last five-year period, with the five-year average of 67%. The high expense ratio is largely due to a small volume of premium relative to expenses associated with the company's operations. In an attempt to reduce its underwriting expenses, the company reduced the number of employees from four to three in 2007. However, the expense ratio remained high due to the recent update in computer and operating systems and the costs associated with inspection and loss prevention programs. Although the high expense ratio allows little room for underwriting losses before breaking even, the company's composite ratio in each of the last two years was below 100%. The relatively calm weather and absence of large fires in the last two years contributed to the company reporting net underwriting gains in 2012 and 2013.

II. REINSURANCE

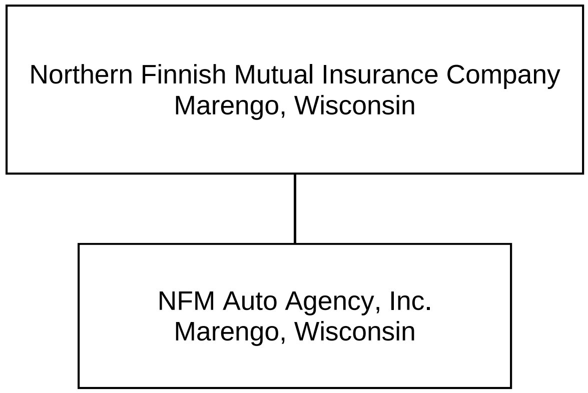
The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty with five coverage sections. All treaties reviewed contained proper insolvency clauses. All treaties complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Contracts assuming business from another town mutual insurer complied with s. 612.31 (6), Wis. Stat. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

	Reinsurer:	Wisconsin Reinsurance Corporation (WRC)
	Effective date:	January 1, 2014
	Termination provisions:	Either party may terminate on any January 1st by giving at least 90 days' written notice to the other party
1.	Type of contract:	Class A Casualty Excess of Loss
	Lines reinsured:	Casualty business
	Company's retention:	$8,000 in respect to each and every loss occurrence
	Coverage:	100% of each and every loss occurrence, including loss adjustment expense, in excess of the company's retention subject to the maximum policy limits of: a. $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability b. $1,000,000 split limits, in any combination of bodily injury and property damage liability c. $25,000 for medical payments, per person; $25,000 per accident
	Reinsurance premium:	50% of the net premium written
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property business
	Company's retention:	$250,000 per ceded risk Per loss retention is 10%
	Coverage:	Pro rata share of each and every loss, including loss adjustment expense, corresponding to the amount of the risk ceded, up to $2,000,000
	Reinsurance premium:	The pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of each risk ceded

	Ceding commission:	Commission allowance: 15% of the premium paid Profit commission: 15% of the net profit
3.	Type of contract:	Class C-1 Excess of Loss First Layer
	Lines reinsured:	All property business
	Company’s retention:	$35,000 per loss per occurrence $35,000 aggregate deductible
	Coverage:	$90,000 excess of retention including loss adjusting expenses
	Reinsurance premium:	12.40% of net premium written Annual deposit premium: $86,996
4.	Type of contract:	Class C-2 Excess of Loss Second Layer
	Lines reinsured:	All property business
	Company’s retention:	$125,000 per loss per occurrence
	Coverage:	$125,000 excess of retention including loss adjustment expenses for each and every loss occurrence
	Reinsurance premium:	7.5% of net premiums written Annual deposit premium: $52,618
5.	Type of contract:	Class D/E-1 First Aggregate Excess of Loss Reinsurance
	Lines reinsured:	All business including nonproperty
	Company's retention:	57.5% of net premium written
	Coverage:	67.5% of the amount by which the aggregate of the company’s losses, including loss adjustment expenses, exceed the retention with a limit of 57.5% of NWP (losses from 57.5% to 67.5% of net written premium). Estimated attachment point is $434,169.
	Reinsurance premium:	6.45% of net premium written
6.	Type of contract:	Class D/E-2 Second Aggregate Excess of Loss Reinsurance
	Lines reinsured:	All business including nonproperty
	Company's retention:	125% of net premium written
	Coverage:	100% of the amount by which the aggregate of the company’s losses, including loss adjustment expenses, exceed 125% of NWP
	Reinsurance premium:	2.50% of net premium written

III. AFFILIATED COMPANIES

The company is a member of a holding company system. It is the ultimate parent. The organizational chart below depicts the company's relationship with the affiliate in the group. A brief description of the affiliate follows the organizational chart.



The company formed the NFM Auto Agency, Inc., (the agency) through a Subscription Agreement dated November 11, 2002, for the total consideration of $5,000. An additional investment of $27,500 was made on December 21, 2006, to purchase a block of auto insurance policies. On February 25, 2011, the agency bought another block of auto policies for $13,000. The company owns all of the agency's 100 issued and outstanding shares of common stock at $300 par value per share. The purpose of NFM Auto Agency, Inc., is for offering insurance products that the company does not write such as auto, worker's compensation, off-road vehicles, and placing risks that the company chooses not to insure such as vacant properties and high-value dwellings. Using the agency, agents could write nearly all P&C policies their clients needed which improves their ability to retain business and qualify for multi-policy discounts that could not be obtained through the company alone. The agency currently has a service agreement with the company. According to the terms of the agreement the company provides administrative services, postage, office supplies, copier charges, and telephone services for certain percentage fees. The agreement was entered into on November 22, 2002, for an initial one-year term and automatically renews for successive one-year terms unless terminated by either party by giving a 30-day written notice to the other party. In 2013, the agency paid

$10,000 to the company under the administrative services agreement. As of December 31, 2013, the agency reported total assets of $84,352 and shareholder's equity of $80,836.

IV. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2013, 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."

Northern Finnish Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2013

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 150	$	$	$ 150
Cash in checking	119,542			119,542
Cash deposited at interest	70,241			70,241
Bonds	517,680			517,680
Stocks and mutual fund investments	487,094			487,094
Real estate	60,886			60,886
Premiums, agents' balances and installments:				
In course of collection	10,906		15	10,891
Deferred and not yet due	117,168			117,168
Investment income accrued		2,694		2,694
Reinsurance recoverable on paid losses and LAE	1,927			1,927
Electronic data processing equipment	8,511			8,511
Reinsurance premium recoverable	22,506			22,506
Other expense-related assets:				
Reinsurance commission receivable	2,569			2,569
Due from agency	2,500			2,500
Building insurance refund receivable	539			539
Other nonexpense-related assets:				
Federal income tax recoverable	1,368			1,368
Furniture and fixtures	8,430		8,430	
Totals	$1,432,017	$2,694	$8,445	$1,426,266

Northern Finnish Mutual Insurance Company
Statement of Assets and Liabilities (cont.)
As of December 31, 2013

Liabilities and Surplus

Net unpaid losses	$ 39,935
Unpaid loss adjustment expenses	700
Commissions payable	27,144
Fire department dues payable	97
Unearned premiums	432,575
Reinsurance payable	17,129
Amounts withheld for the account of others	2,180
Payroll taxes payable (employer’s portion)	930
Other liabilities:	
Expense-related:	
Accounts payable	611
Accrued wages	13,436
Nonexpense-related:	
Premiums received in advance	13,145
Total liabilities	547,882
Policyholders' surplus	878,384
Total Liabilities and Surplus	$1,426,266

Northern Finnish Mutual Insurance Company
Statement of Operations
For the Year 2013

Net premiums and assessments earned		$493,590
Deduct:		
Net losses incurred	$ 62,576	
Net loss adjustment expenses incurred	37,080	
Net other underwriting expenses incurred	344,086	
Total losses and expenses incurred		443,742
Net underwriting gain (loss)		49,848
Net investment income:		
Net investment income earned	(8,441)	
Net realized capital gains (losses)	4,367	
Total investment gain (loss)		(4,074)
Other income (expense):		
Miscellaneous income	47,914	
Total other income		47,914
Net income (loss) before policyholder dividends and before federal income taxes		93,688
Net income (loss) before federal income taxes		93,688
Federal income taxes incurred		2,434
Net Income (Loss)		$ 91,254

Northern Finnish Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2013

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:

	2013	**2012**	**2011**	**2010**	**2009**
Surplus, beginning of year	$776,534	$752,436	$837,177	$ 931,175	$927,012
Net income	91,254	65,132	(95,773)	(124,803)	21,706
Net unrealized capital gain or (loss)	16,542	(42,375)	7,690	26,458	(22,634)
Change in nonadmitted assets	(5,946)	1,341	3,342	4,347	5,091
Surplus, End of Year	$878,384	$776,534	$752,436	$ 837,177	$931,175

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2013, is accepted.

V. 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 recommended that biographical data relating to the company's manager be reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action—Compliance

2. Articles of Organization and Bylaws—It is recommended that the company amend its Articles of Organization and Bylaws to reflect current business practices.

   Action—Compliance

3. Conflict of Interest—It is recommended that the company require the annual completion of the conflict of interest questionnaire by the company manager in accordance with the directive of the Commissioner of Insurance.

   Action—Compliance

4. Holding Company—It is recommended that the company annually file Form B "Insurance Holding Company System Annual Registration Statement" and Form C "Summary of Registration Statement," as required by ch. Ins 40, Wis. Adm. Code.

   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	$100,000 Single Loss Limit
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,00
Liability property	
Liability and medical (each occurrence)	1,000,000
General aggregate limit	2,000,000
Business owners:	
Building	225,542
Business personal property	40,000

Underwriting

The company has a written underwriting guide with the latest updates being in 2011. 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. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

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. The committee meets bi-monthly in conjunction with the bi-monthly board meetings.

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, 2013.

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 daily and the backed-up data is kept off-site. The company was able to produce a hard or electronic copy of the policy register record as required by s. Ins 6.80, Wis. Adm. Code, which requires the company to retain records of its operations and other financial records reasonably related to insurance operations since the last examination by this office.

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 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 in compliance with these requirements.

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	$847,882
2.	Liabilities plus 33% of gross premiums written	846,424
3.	Liabilities plus 50% of net premiums written	795,249
4.	Amount required (greater of 1, 2, or 3)	847,882
5.	Amount of Type 1 investments as of December 31, 2013	785,860
6.	Excess or (deficiency)	$(62,022)

The company does not have sufficient Type 1 investments.

ASSETS

Cash and Invested Cash $189,933

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

Cash in company's office	$ 150
Cash deposited in banks—checking accounts	119,542
Cash deposited in banks at interest	70,241
Total	$189,933

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 one account 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 at interest represents the aggregate of three deposits in three 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 2013 totaled $124 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.07% to 0.25%. Accrued interest on cash deposits totaled $0 at year-end.

Book Value of Bonds $517,680

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2013. Bonds owned by the company are located in the custody of a 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 examination noted that the company had two securities issued by financial corporations with floating rates that were dependent on year-over-year changes in the U.S. Consumer Price Index and one security with floating rates that was dependent on the ten-year

Constant Maturity Treasury rate. The floating rates can be subject to wide fluctuation based on changing economic conditions or other circumstances.

Town mutual insurers are considered restricted insurers under s. 620.03 (1), Wis. Stat., and s. Ins 6.20 (6) (a), Wis. Adm. Code. This office has imposed and may impose additional special investment restrictions for town mutual insurers that are subject to additional risk which may compromise their financial position and ability to provide uninterrupted service to their policyholders. Furthermore, pursuant to s. 620.04 (1), Wis. Stat., this office may impose reasonable and temporary restrictions upon the investments of an individual insurer, including prohibition or divestment of a particular asset. This office concludes that the company's investment in variable rate corporate debt securities presents an unreasonable amount of risk to the company and is not appropriate for a town mutual insurance company. The basis for this conclusion and the company's action required by this office is described below.

The objectives of investment regulations as defined in s. 620.01, Wis. Stat., include, in part, to provide for the safety of principal and, to the extent consistent therewith, maximum yield and growth, and to provide sufficient liquidity to avoid the necessity in reasonably expected circumstances for selling assets at undue sacrifice. The interest rate on some of these bonds could drop to 0% for a prolonged period of time, which could significantly impair the value of the bond and prevent the company from earning a reasonable return on their investment. There also may not be a trading market for the security rendering the investment illiquid. There also may not be a trading market for the security in the event that the company may need to dispose of the bond in order to pay claims, rendering the investment illiquid. The risk that the market for trading these securities may not necessarily exist or be maintained in the future is substantially exacerbated by the very small size of the variable rate corporate debt issues that the company has purchased. Large issues tend to trade more frequently than small issues and investors may have greater awareness about a larger issue because it is widely held and analyzed. An issue size of $250 million represents an approximate lower boundary for a bond issue to attract significant institutional interest when liquidity is a concern. For example, the minimum par amount outstanding for a bond issue's inclusion in the Barclays U.S. Corporate Index is

$250 million. The minimum par amount outstanding for a bond issue's inclusion in the Barclays U.S. Floating Rate Note Index is $300 million. The par amounts outstanding for the variable rate corporate debt securities owned by the company ranged from $7.3 million to $200 million. It is recommended that, if the company invests in any variable rate corporate debt security, such security must have the following characteristics:

a. the reference for setting the interest rate must be a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
b. the interest rate must have a floor in excess of zero percent; and
c. the total outstanding principal amount of the security at the time of issuance must equal or exceed $250 million.

For the avoidance of any doubt, in investing in any variable rate corporate debt security, the company:

a. may assume that any U.S. Dollar London Interbank Offered Rate will exceed zero percent; and
b. may invest in a security that specifies some increment of interest in excess of a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
c. may invest in a security that is leveraged relative to a U.S. Dollar London Interbank Offered Rate of a single specified duration, provided that there is no basis point reduction in the index provided by the interest rate formula (for example, 125% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while 125% of the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable); and
d. may not invest in a security that specifies some increment of interest less than a U.S. Dollar London Interbank Offered Rate of a single specified duration, unless such increment is expressed as a percentage of the index (for example, 80% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable).

Interest received during 2013 on bonds amounted to $17,969 and was traced to cash receipts records. Accrued interest of $2,056 at December 31, 2013, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments $487,094

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2013. Stocks owned by the company are located in the company's safety deposit box.

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 unaffiliated 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.

During review of the financial statements the examiners noticed that the agency reported admitted assets of $25,060 which represented the purchase price of $40,500 of two blocks of auto insurance business reduced by accumulated depreciation of $15,440. The company has been amortizing the purchase price of each block of business over a period of 15 years. As discussed earlier in the report, the agency purchased the two blocks of auto insurance policies from retired agents in 2006 and 2011. In 2006 the company was granted permission by OCI to make an investment in the agency of $27,500. The permission stipulated that the agency amortize the purchase price over a period of no longer than five years. This period expired in 2011, and no assets should have been reported by the agency as of December 31, 2013. The second block of $13,000 purchased by the agency in February of 2011 is subject to the same accounting treatment and should have been amortized over a five-year period. Had the company used the five-year amortization schedule, the value of the assets would have been approximately $7,800. Therefore, the company’s investment in the agency was overstated by approximately $17,260. No adjustment to the company’s surplus was made because the amount of overstatement was not material for the purpose of this examination. It is recommended that going forward the value of blocks of business purchased by the company’s wholly owned subsidiary is amortized using a straight-line amortization method over a period of no longer than five years. The company should adjust the value of the remaining assets as of year-end 2014 to conform with the rules.

Dividends received during 2013 on stocks and mutual funds amounted to $6,890 and were traced to cash receipts records. Accrued dividends of $638 at December 31, 2013, were checked and allowed as a nonledger asset.

Book Value of Real Estate $60,886

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2013. The company's real estate holdings consist solely of its home office building purchased in 1991.

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 depreciation method.

Premiums, Agents' Balances in Course of Collection $10,891

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 individual agent's accounts verified the accuracy of this asset.

Premiums Deferred and Not Yet Due $117,168

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 $2,694

Interest due and accrued on the various assets of the company at December 31, 2013, consists of the following:

Bond income	$2,056
Stock and mutual fund income	638
Total	$2,694

Reinsurance Recoverable on Paid Losses and LAE $1,927

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2013. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment $8,511

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2013. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted. An adjustment was not deemed necessary for purposes of this examination due to a lack of materiality.

Reinsurance Premium Recoverable $22,506

The asset represents the amount of reinsurance premium that the company had overpaid as of December 31, 2013. The examiners verified the balance directly with the reinsurers.

Reinsurance Commission Receivable $2,569

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2013, under its contract with the reinsurer. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

Due from Agency $2,500

The above asset represents amounts due from the subsidiary at December 31, 2013. This amount was verified for subsequent collection.

Building Insurance Refund Receivable $539

The above asset represents the amount of refund that the company expected to receive as of December 31, 2013.

Federal Income Tax Recoverable $1,368

The above asset represents the amount of federal taxes which are expected to be recoverable in the next 12 months as of December 31, 2013.

Furniture and Fixtures $0

This asset consists of $8,430 of office equipment owned by the company at December 31, 2013. In accordance with annual statement requirements, this amount has been reported as nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses $39,935

This liability represents losses incurred on or prior to December 31, 2013, 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, 2013, with incurred dates in 2013 and prior years. 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	$44,021	$26,555	$17,466
Less: Reinsurance recoverable on unpaid losses	4,086	1,238	2,848
Net Unpaid Losses	$39,935	$25,317	$14,618

The above difference of $14,618 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 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 $700

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2013, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is an estimate.

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 $27,144

This liability represents the commissions payable to agents as of December 31, 2013. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

Fire Department Dues Payable $97

This liability represents the fire department dues payable to the state of Wisconsin as of December 31, 2013.

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 $432,575

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 $17,129

This liability consists of amounts due to the company's reinsurer at December 31, 2013, relating to transactions which occurred on or prior to that date. Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Amounts Withheld for the Account of Others $2,180

This liability represents employee payroll deductions in the possession of the company at December 31, 2013. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable $930

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2013, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable $611

This liability represents an accrual for the miscellaneous unpaid office bills as of December 31, 2008. The examiners’ subsequent search for unrecorded liabilities revealed no additional liability.

Accrued Wages $13,436

This liability represents an accrual for the wages of the employees as of December 31, 2013. The examiners’ subsequent search for unrecorded liabilities revealed no additional liability.

Premiums Received in Advance $13,145

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2013. The examiners reviewed 2013 premium and cash receipt records to verify the accuracy of this liability.

VI. CONCLUSION

The current examination resulted in no adjustments to surplus or reclassification; surplus as regards policyholders, per annual statement and examination, is $878,384. The surplus decreased by over $48,000, or 5%, in five years. This decline to surplus is attributable to large losses that occurred in 2010 and 2011.

The company's underwriting expense ratio ranged between 61% and 70% in the last five-year period. The high expense ratio is largely due to a small volume of premium relative to expenses associated with the company's operations. In the last two years, the company's net loss ratio was 32% in 2012 and 20% in 2013, reflecting the company's continual efforts to improve its underwriting standards and practices. During the period under examination the company established underwriting and marketing committees which contributed to the overall improvement of underwriting standards and marketing outreach.

The examination resulted in two recommendations, one dealing with variable rate bonds that have an issuance of less than $250 million and the proper amortization for intangible assets. All four recommendations from the prior examination were found to be in compliance.

VII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Book Value of Bonds—It is recommended that, if the company invests in any variable rate corporate debt security, such security must have the following characteristics:

   a. the reference for setting the interest rate must be a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
   b. the interest rate must have a floor in excess of zero percent; and
   c. the total outstanding principal amount of the security at the time of issuance must equal or exceed $250 million.

   For the avoidance of any doubt, in investing in any variable rate corporate debt security, the company:

   a. may assume that any U.S. Dollar London Interbank Offered Rate will exceed zero percent; and
   b. may invest in a security that specifies some increment of interest in excess of a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
   c. may invest in a security that is leveraged relative to a U.S. Dollar London Interbank Offered Rate of a single specified duration, provided that there is no basis point reduction in the index provided by the interest rate formula (for example, 125% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while 125% of the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable); and
   d. may not invest in a security that specifies some increment of interest less than a U.S. Dollar London Interbank Offered Rate of a single specified duration, unless such increment is expressed as a percentage of the index (for example, 80% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable).

2. Page 24 - Stocks and Mutual Fund Investments—It is recommended that going forward the value of blocks of business purchased by the company's wholly owned subsidiary is amortized using a straight-line amortization method over a period of no longer than five years.

VIII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Scott T. Bleifuss
Examiner-in-Charge