Report

of the

Examination of

Pella Mutual Insurance Company

Marion, Wisconsin

As of December 31, 2011

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Scott Walker, *Governor*
Theodore K. Nickel, *Commissioner*

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November 7, 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:

PELLA MUTUAL INSURANCE COMPANY
Marion, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Pella Mutual Insurance Company (Pella or 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 in 1876, under the provisions of the then existing Wisconsin Statutes. The original name of the company was Pella 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 were no amendments to the articles of incorporation and bylaws.

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 counties:

Brown	Lincoln	Oconto	Waupaca
Calumet	Manitowoc	Outagamie	Waushara
Kewaunee	Marathon	Portage	Winnebago
Langlade	Menominee	Shawano	Wood

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 and assessment basis. Pella also charges a $20 policy fee, which is retained by the company.

Agents are presently compensated for their services as follows:

	Commission Rates	
	New	**Renewal**
Homeowner's	20%	15%
Rentals and Tenants	20	15
Mobile Homeowner's	20	15
Farmowners	18	13
Commercial Fire and Extended Coverage	18	13

Agents have no authority to adjust losses. Losses are adjusted by a salaried in-office claims adjuster.

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
Patrick Laws	Pella Manager	Manitowoc	2013
Charles Bartz	Farmer	Shawano	2013
James Egen	Retired	Shawano	2013
Gary Dalke	Farmer	Gresham	2014
Bruce Buettner	Farmer	Shawano	2014
Al Beyer	Carpenter	Shawano	2014
Mike Bystol	Assessor	Bowler	2012
Charles Mehlhorn	Farmer	Shawano	2012
Dennis Zahn	Farmer	Clintonville	2012

Annual salaries for directors are $1,000.00 each. Members of the board currently receive $100.00 for each meeting attended and $.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	2011 Compensation
Mike Bystol	President	$ 3,000
Bruce Buettner	Vice President	1,500
Patrick Laws	Secretary, Treasurer, and Manager	25,208*

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

*Mr. Laws began employment in 2011 and the amount here represents his compensation for only a portion of that year.

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
Mike Bystol, Chair
Bruce Buettner
Patrick Laws

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	$1,920,077	5,418	$ 44,129	$3,880,710	$1,963,671
2010	1,927,561	5,424	(152,880)	4,058,239	1,927,346
2009	2,048,566	5,607	224,347	4,098,059	2,043,045
2008	1,944,358	5,526	(335,441)	3,823,129	1,788,791
2007	2,061,120	5,640	293,188	4,066,667	2,144,714
2006	1,976,927	5,657	125,325	3,855,379	1,857,677

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
2011	$3,096,288	$1,945,295	$1,963,671	99%	158%
2010	3,045,837	1,921,245	1,927,346	100	158
2009	3,050,984	2,035,519	2,043,045	100	149
2008	3,100,566	2,021,234	1,788,791	113	173
2007	3,112,843	1,989,170	2,144,714	93	145
2006	3,086,296	2,320,000	1,857,677	125	166

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	$1,280,008	$800,908	$1,920,077	67%	41%	108%
2010	1,684,063	766,987	1,927,561	87	40	127
2009	1,081,223	775,953	2,048,566	53	38	91
2008	1,710,430	740,032	1,944,358	88	37	125
2007	1,176,084	726,968	2,061,120	57	37	94
2006	1,225,070	785,437	1,976,927	62	34	96

During the period under examination the company has experienced stable retention of policyholders, given the widespread effects of job losses brought on by the ongoing financial crisis in recent years. Policies in force declined by 4.2% to 5,418 (2011), from 5,657 (2006). New business has been increasing annually while cancellations and nonrenewals have been trending downward over the examination period. In 2011, the company was writing as many new policies as were being canceled or nonrenewed. The company added policyholders in 2012 and the trends are expected to continue into the future.

Net income has fluctuated over the past five years. Policyholders’ surplus has been generally stable over the period under examination. Investment income is expected to be low in future years which will put more pressure on underwriting results.

Both the frequency and severity of claims are under review by the management. The frequency of claims appears to be on a longer trend downward, with an uptick in 2010, due to storms in July, an unusual wind storm in October, and two large fires in November. Claims severity was higher than normal during 2008 and 2010, and swings in claims severity have been a longer term trend. To address the severity of claims a full-time inspector has been hired in 2012 and record keeping is being standardized. Management is also reviewing rates, which may be substantially below market for some classes of business, in anticipation of possible rate increases in 2013.

The expenses of the company are also under the review of management. Other underwriting expenses increased over the period both in total dollars and as a percentage of net premiums written. Other underwriting expenses incurred increased from $785,437 reported in 2006 to $800,908 reported in 2011, and the expense ratio increased from 34% to 41% during the same period. Both the underwriting expenses incurred and the expense ratio reached their highest amounts in 2011. The management is currently responding with a variety of expense reduction strategies.

II. REINSURANCE

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

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2012
Termination provisions:	Any January 1st, by either party, with 60 days' advance written notice

The coverage provided under this treaty is summarized as follows:

1.	Type of contract:	Casualty Excess of Loss
	Lines reinsured:	Liability business
	Company's retention:	$5,000 per claim
	Coverage:	100% excess of $5,000
	Premium:	60% of the net premium written
	Annual deposit premium:	$309,000
2.	Type of contract:	Property First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	The company may cede on a pro rata basis up to $800,000 on a risk when the company's net retention is $500,000 or more. When the company's net retention is $500,000 or less in respect to a risk, the company may cede, on a pro rata basis, and the reinsurer shall be obligated to accept up to 50% of such risk.
	Coverage:	Pro rata portion of each and every loss, including loss adjustment expenses, corresponding to the amount of the risk ceded.
	Premium:	Pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of risk ceded hereunder.
	Commission:	Ceding commission: 15% Profit commission: 15%

In 2011, Pella earned a $30,693.49 profit commission under the above portion of the reinsurance treaty due to favorable operating results.

3.	Type of contract:	First Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$60,000
	Coverage:	Up to $100,000
	Premium:	13.00% (Minimum = 6%, Maximum = 15%, modified by volume and profitability factors)
	Annual deposit premium:	$316,397
4.	Type of contract:	Second Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Coverage and limits:	$340,000 excess of $160,000
	Premium:	5.0% of subject net premiums written
	Annual deposit premium:	$121,684
5.	Type of contract:	First Aggregate Excess
	Lines reinsured:	All business written by the company
	Coverage and limits:	60% of the company's aggregate net losses, including loss adjustment expenses, which exceed 55% of the company's net premiums written
	Estimated attachment point:	$1,583,809
	Premium:	7.60% (Minimum = 7.6%, Maximum = 12.5%, modified by volume and profitability factors)
	Annual deposit premium:	$200,616
6.	Type of contract:	Second Aggregate Excess
	Lines reinsured:	All business written by the company
	Coverage and limits:	100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 115% of the company's net premiums written
	Premium:	2.5% of net premium written
	Annual deposit premium:	$65,992

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. No adjustments were made to the financial data as a result of this examination.

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

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 200	$	$	$ 200
Cash in checking	84,635			84,635
Cash deposited at interest	668,542			668,542
Bonds	1,900,307			1,900,307
Stocks and mutual fund investments	601,830			601,830
Real estate	109,660			109,660
Premiums, agents' balances and installments:				
In course of collection	49,610		242	49,368
Deferred and not yet due	375,486			375,486
Investment income accrued		24,337		24,337
Reinsurance recoverable on paid losses and LAE	47,485			47,485
Electronic data processing equipment	462			462
Other assets:				
Reinsurance commission receivable	10,025			10,025
Federal income tax recoverable	5,000			5,000
Software	3,373			3,373
Furniture and fixtures	24,538		24,538	
Software	165		165	
Totals	$3,881,318	$24,337	$24,945	$3,880,710

Liabilities and Surplus

Net unpaid losses	$ 150,181
Unpaid loss adjustment expenses	5,000
Commissions payable	94,044
Unearned premiums	1,458,273
Reinsurance payable	147,541
Amounts withheld for the account of others	3,377
Payroll taxes payable (employer's portion)	2,316
Other liabilities:	
Expense-related:	
Accrued expenses	20,644
Nonexpense-related:	
Premiums received in advance	35,663
Total liabilities	1,917,039
Policyholders' surplus	1,963,671
Total Liabilities and Surplus	$3,880,710

Pella Mutual Insurance Company
Statement of Operations
For the Year 2011

Net premiums and assessments earned		$1,920,077
Deduct:		
Net losses incurred	$1,066,503	
Net loss adjustment expenses incurred	213,505	
Net other underwriting expenses incurred	800,908	
Total losses and expenses incurred		2,080,916
Net underwriting gain (loss)		(160,839)
Net investment income:		
Net investment income earned	62,696	
Net realized capital gains (losses)	6,233	
Total investment gain (loss)		68,929
Other income (expense):		
Miscellaneous	13,395	
Policy fees	114,801	
Late payment and re-write fees	7,844	
Total other income		136,040
Net income (loss) before federal income taxes		44,130
Federal income taxes incurred		1
Net Income (Loss)		$ 44,129

Pella Mutual 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	$1,927,346	$2,043,045	$1,788,791	$2,144,714	$1,857,677
Net income	44,129	(152,880)	224,347	(335,441)	293,188
Net unrealized capital gain or (loss)	(13,231)	35,667	17,846	(35,940)	22,514
Change in nonadmitted assets	5,427	1,514	12,061	15,458	(28,665)
Surplus, End of Year	$1,963,671	$1,927,346	$2,043,045	$1,788,791	$2,144,714

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. Conflict of Interest—It is recommended that the company ensure that respondents designate either “yes” or “no” to each question, as needed, in the conflict of interest questionnaire.

   Action—Compliance

2. Conflict of Interest—It is recommended that the company manager disclose his membership to the Wisconsin Reinsurance Corporation board of directors as a potential conflict on his conflict of interest questionnaire.

   Action—Compliance

3. Signed Undertakings—It is recommended that the company begin a procedure to obtain a signed undertaking from all insureds at renewal when one does not exist in its files.

   Action—Compliance

4. Unclaimed Property—It is recommended that the company remit unclaimed property to the State of Wisconsin Treasurer pursuant to ch. 177, Wis. Stat.

   Action—Compliance

5. Book Value Bonds—It is recommended that the company not invest in any additional Type II investments until the company has sufficient Type I investments.

   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."

During the review of the investment agreements there were indications that the company has an investment management agreement with Rochdale Investment Management. However, the management did not provide the examiners with a fully executed agreement for Rochdale Investment Management for the review. The document provided contained only the Schedule A, Schedule B, Information Section, and Consent to Electronic Delivery of Documents (unsigned). The examiners were unable to determine the nature of the business relationship and the related compensation between the company and Rochdale Investment Management. Section Ins 6.80 (4) (b), Wis. Adm. Code, requires that insurers keep records "reasonably related to insurance operations." It is recommended that the company maintain completed copies of all corporate agreements in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code.

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	$ 250,000
Worker's compensation:	Statutory
Employee injury	
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
D&O and commercial liability:	
Limit each claim	3,000,000
Aggregate limit	3,000,000
Business owners:	
Building, replacement cost	378,000
Liability and medical	1,000,000
Fire legal liability	50,000

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. A sampling of new applications and renewal business is inspected by board members who are independent of the risk under consideration and review. The board currently has no inspections committee.

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 computers is limited to people authorized to use the computers.

Company personnel back up the computers daily and the daily back up is stored in the company safe. Every Thursday the backed-up data is stored 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.

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 two officers, directors or employees of the company.

The company has a custodial agreement with Waukesha State Bank (WSB or the bank); however, all assets are held with a sub-custodian, a subdivision of the brokerage firm of Charles Schwab Corporation. According to the guidelines for custodial agreements contained in the NAIC Financial Condition Examiners Handbook, the terms of the custodial agreement must define, among other things, the custodian's responsibilities for the securities that were lost due to the custodian's negligence or dishonesty. The custodial agreement between the company and WSB, which is dated September 2, 2010, does not contain provisions for a sub-custodian. Moreover, the custodian agreement states that the custodian is responsible only for securities actually deposited with and receipted by WSB. It is unclear what responsibility the bank has with respect to the non-bank sub-custodian. Furthermore, provided that the bank does not have the physical custody of the company's assets, it is also unclear what services are covered by the compensation paid by the company to the bank. During the examination, it was also noted that the company does not receive custodial statements from WSB on a regular basis and relies instead on the investment statements received from the brokerage firms. Reconciling investments from custodian statements to brokerage statements and company's records is an important step designed to insure the safety and the accuracy of reporting of the company's assets. It is recommended that the company obtain a custodial agreement with an authorized custodian under s. 610.23, Wis. Stat., and, if a sub-custodian is used, the custodian's indemnification for negligence or dishonesty under the custodial agreement should be extended to apply to any sub-custodians. 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 the applicable statements from the investment brokerage firms.

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	$2,217,039
2.	Liabilities plus 33% of gross premiums written	2,938,814
3.	Liabilities plus 50% of net premiums written	2,889,723
4.	Amount required (greater of 1, 2, or 3)	2,938,814
5.	Amount of Type 1 investments as of 12/31/2011	2,638,145
6.	Excess or (deficiency)	$ (300,669)

The company does not have sufficient Type 1 investments in order to begin investing in Type 2 stock and stock mutual fund investments. However, the examiners noted that the company's current investment in Type 2 investments consists of $6,611 of NAMIC Class B, $442,336 of Wisconsin Reinsurance Corporation common stocks, and $168,222 of Type 2 bonds which have fallen below the BBB- rating. Total Type 2 investments reported as of December 31, 2011, are $617,169 for this company. The company has been given permission by this office to hold the securities in NAMIC and Wisconsin Reinsurance Corporation. The company has complied with a prior examination recommendation to refrain from purchasing Type 2 investments until it is Type 1 sufficient.

Investment Policy

The examination discovered that the company has not developed a written investment policy. According to s. Ins 6.20 (6) (h), Wis. Adm. Code, the company should prepare an investment policy with specific guidelines as to the quality, maturity, diversification of investments and other specifications. The investment policy should be approved and authorized by the board of directors and used as guidelines for investment decisions and transactions. It is recommended that the company adopt a written investment plan to comply with the requirements of s. Ins 6.20 (6) (h), Wis. Adm. Code.

Investment Limitations

There were two corporate bonds noted (Bear Stearns totaling $148,217) that exceeded the 3% of the total assets, or $116,421. Section Ins 6.20 (6) (f) 1., Wis. Adm. Code, limits insurers in holding securities from a single issuer in excess of 3% of assets unless the insurer obtains the prior written permission of the commissioner or unless the investment is in securities of the government of the United States or its instrumentalities or in securities guaranteed by the full faith and credit of the United States. The management has subsequently disposed of one of the bonds bringing the company into compliance with this provision. It is recommended that the company not exceed the 3% of admitted assets limit on its corporate investments by any one issuer in accordance with s. Ins 6.20 (6) (f) 1., Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$753,377**

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

Cash in company's office	$ 200
Cash deposited in banks—checking accounts	84,635
Cash deposited in banks at interest	668,542
Total	$753,377

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 two accounts maintained in two depositories. Verification of checking account balances was made by obtaining confirmations directly from the depositories and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of eight deposits in five 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 2011 totaled $6,491 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.75% to 3.4%. Accrued interest on cash deposits totaled $1,342 at year-end.

Book Value of Bonds **$1,900,307**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2011. As previously noted the bonds are held by the investment broker and not by the company.

Bonds maintained by the investment broker were reviewed by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The broker’s statements as of December 31, 2011, were agreed to the reported amounts both by our examination and the external auditor. Direct confirmations were also obtained for all investments. Except for the issues noted regarding custody and investment limitations discussed above, the company's investment in bonds was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2011 on bonds amounted to $114,843 and was traced to cash receipts records. Accrued interest on bonds of $23,011 at December 31, 2011, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$601,830**

The above asset consists of the aggregate market value of common stocks and money market mutual funds held by the company as of December 31, 2011. Of the total, $448,947 of stocks owned by the company includes NAMICO and Wisconsin Reinsurance Corporation common stock only and the stock certificates are located in the in-office fire-proof vault. There has been no stock acquisition since 1999. No stock acquisitions are anticipated. The residual amount of $152,883 is invested in a money market mutual fund and was checked to brokers' invoices and advices.

The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and approvals given by the Commissioner of Insurance as regards the NAMICO and Wisconsin Reinsurance Corporation stocks.

Dividends received during 2011 on stocks and mutual funds amounted to $12 and were traced to cash receipts records. Accrued dividends of $449 at December 31, 2006, were checked and allowed as a nonledger asset.

Book Value of Real Estate **$109,660**

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2011. The company's real estate holdings consisted of the company’s home office located in Pella, 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.

Premiums, Agents' Balances in Course of Collection **$49,368**

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 **$375,486**

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 **$24,337**

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

Interest on deposits matured or disposed of	$ 1,326
Bond interest	23,011
Total	$24,337

Reinsurance Recoverable on Paid Losses and LAE **$47,485**

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, 2011. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$462**

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.

Reinsurance Commission Receivable **$10,025**

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 **$5,000**

The above asset represents overpayments due to the company from federal income tax which was paid prior to December 31, 2011. A review of subsequent tax reporting verified the above asset.

Software **$3,373**

The above account represents the adjusted book value of computer software admitted as of December 31, 2011. Since it is operating software it is an admitted asset.

Furniture and Fixtures **$0**

This asset is the book value of $24,538 of office furniture owned by the company at December 31, 2011. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

Software **$0**

The above account balance of $165 represents the adjusted book value of computer software nonadmitted as of December 31, 2011. Since it is nonoperating software it is a nonadmitted asset, thus the balance is zero.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$150,181**

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. 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	$706,266	$719,728	$(13,462)
Less: Reinsurance recoverable on unpaid losses	556,086	555,579	507
Net Unpaid Losses	$150,181	$164,149	$(13,968)

The above difference of $(13,963) 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 for new business were properly signed.

Unpaid Loss Adjustment Expenses **$5,000**

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 methodology used by the company in establishing this liability is an amount based upon an estimate of the time needed by an in-office claims person to handle both open and unreported 2011 and earlier years’ incurred claims.

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 **$94,044**

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

Unearned Premiums **$1,458,273**

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 examiners verified Pella's computation of unearned premium using the daily pro rata method on a sample of policies without exception.

Reinsurance Payable **$147,541**

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. Supporting records and subsequent cash disbursements verified this item.

Amounts Withheld for the Account of Others **$3,377**

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.

Payroll Taxes Payable **$2,316**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2011, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accrued Expenses **$20,644**

This balance represents the expenses of the company which were not paid as of December 301, 2011. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$35,663**

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

During the period under examination, the company has experienced adequate retention of policyholders, given the effects of the financial crisis, with policies in force declining by 4.2% from 2006. New writings have been trending upward annually while cancellations and nonrenewals have been trending downward over the examination period. The company added policyholders in 2012. The company had favorable net income over the past five years. Policyholders' surplus has been generally stable over the period. Investment income will be low in future periods putting pressure on underwriting.

Both the frequency and severity of claims are under review by the management. The frequency of claims appears to be on a longer trend downward. Claims severity was higher than normal during 2008 and 2010 and swings in claims severity have been a longer term trend.

Underwriting expenses were at a five-year high. The management is currently responding with a variety of expense reduction strategies. The hiring of the full-time inspector, for example, is expected to result in a net underwriting expense reduction to the company compared to using contractors.

The company complied with each of the prior examination recommendations. The current examination made five recommendations. All of the current recommendations pertain to the invested assets.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Corporate Records—It is recommended that the company maintain completed copies of all corporate agreements in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code.

2. Page 18 - 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 sub-custodian is used, the custodian's indemnification for negligence or dishonesty under the custodial agreement should be extended to apply to any sub-custodians.

3. Page 18 - Invested Assets—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 the applicable statements from the investment brokerage firms.

4. Page 19 - Investment Policy—It is recommended that the company adopt a written investment plan to comply with the requirements of s. Ins 6.20 (6) (h), Wis. Adm. Code.

5. Page 19 - Investment Limitations—It is recommended that the company not exceed the 3% of admitted assets limit on its corporate investments by any one issuer in accordance with s. Ins 6.20 (6) (f) 1., Wis. Adm. Code.

VII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Gene M. Renard, CFE
Examiner-in-Charge