Report

of the

Examination of

South Central Mutual Insurance Company

Friesland, Wisconsin

As of December 31, 2012

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 3, 2013

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

Commissioner:

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

SOUTH CENTRAL MUTUAL INSURANCE COMPANY
Friesland, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of South Central Mutual Insurance Company (hereinafter also the company or SCMIC) was made in 2009 as of December 31, 2008. The current examination covered the intervening time period ending December 31, 2012, and included a review of such subsequent transactions deemed essential to complete this examination.

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

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

In addition to auditing, the public accounting firm performs non-auditing services for the company, including providing assistance with complex transactions such as accounting for income taxes and compilation of the company's annual statement. On December 13, 2010, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

The company was organized as a town mutual insurance company on September 5, 1874, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Randolph & Scott Mutual Fire Insurance Company. On December 31, 1977, Westford Mutual Fire Insurance Company (hereinafter also Westford) was merged into Randolph & Scott Mutual Fire Insurance Company. Subsequent to the Westford merger, the name of the surviving company was changed to Randolph-Scott-Westford Mutual Insurance Company (hereinafter also RSWMIC). On January 1, 1995, RSWMIC then merged with Manchester, Kingston & Marquette 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 company's articles of incorporation or to its 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:

Adams	Columbia
Dane	Dodge
Fond du Lac	Green Lake
Jefferson	Marquette
Sauk	Waushara
Winnebago	

A review was performed of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for a term of one year for all policy types, with premiums payable on the advance premium basis. The company also charges a policy fee of $30 for homeowner's policies, $55 for commercial policies and from $30 to $80 for farmowners policies based on the policy premium. An installment fee is also charged policyholders of $5 for each semiannual installment and $7.50 for each quarterly installment. The company offers a discount for policyholders who have not had a claim in three or more years, which ranges from 3% to 10% based on the number of years without a claim.

Business of the company is acquired through 28 agents, none of whom are directors of the company. Agents presently receive a 15% commission on all lines of business written. Agents can also receive a bonus commission ranging from 0.5% to 2.5%, contingent on attainment of certain premium volume and loss ratio requirements. If an agent meets all the requirements for a contingent commission, the rate he/she receives directly relates to his/her pure loss ratio at year-end. A lower pure loss ratio results in a higher contingent commission rate and vice versa. Also, the company has an additional policy incentive program whereby an agent can receive $25 for each net addition in policy count growth.

Agents do not have authority to adjust losses. The company uses independent outside adjusting firms to adjust the majority of its claims. The outside adjusting firm bills the company based on time and expenses. The manager of the company can adjust minor claims which can be handled without the need of a professional adjusting service. The manager doesn't receive additional compensation for adjusting but does receive reimbursement of $0.44 per mile for travel expenses.

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
Tom Alsum	Farmer	Randolph, WI	2013
Lee Barden	Farmer	Cambria, WI	2015
Verlyn Jahnke	Farmer	Markesan, WI	2015
Judy Stiemsma	SCMIC Secretary & Treasurer	Cambria, WI	2014
Heather Tessmann	Farmer	Cambria, WI	2014
Jerry Westra	Retired Dairy Farmer	Randolph, WI	2013
Wallace Williams*	Farmer	Randolph, WI	2013

* Note that Mr. Wallace Williams declined the nomination for election to the 2013 board. At the March 5, 2013, Annual Meeting Mr. Brian Floeter was elected to a three-year term. Mr. Floeter's principal occupation is a financial analyst.

The company does not have any directors who are also agents.

Members of the board currently receive $85 for each director meeting attended, $85 for each educational meeting, $50 for each committee meeting and mileage reimbursement of $0.44 per mile for meetings away from the home office.

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 and Key Personnel

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

Name	Office	2012 Compensation
Lee Barden	President	$ 2,150
Tom Alsum*	Vice-President	560
Judy Stiemsma	Secretary & Treasurer	3,829
Denis Furstenberg	Manager	53,900

* As reported in the previous section of this report, Mr. Wallace Williams declined nomination to the 2013 board of directors. Mr. Williams served as the company's Vice-President in 2012 and received total compensation of $575 that year.

Reported compensation is the total compensation paid by the insurer for the year and includes salary and director fees. The manager is not an officer of the company but included as a key personnel. The manager does not have any voting rights.

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
All board members are also members of the Adjusting Committee

Executive Committee
Lee Barden, Chair
Tom Alsum
Judy Stiemsma

Investment Committee
Lee Barden, Chair
Tom Alsum
Judy Stiemsma

Nominating Committee
Tom Alsum, Chair
Jerry Westra
Brian Floeter

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
2012	$579,359	1,541	$ 77,556	$2,311,755	$1,653,633
2011	568,217	1,475	(112,424)	2,422,940	1,712,178
2010	529,230	1,408	32,757	2,497,812	1,867,904
2009	503,830	1,334	91,301	2,388,142	1,775,586
2008	454,712	1,302	(109,899)	2,335,445	1,738,524

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
2012	$1,197,352	$612,677	$1,653,633	37%	72%
2011	1,088,553	577,332	1,712,178	34	64
2010	1,013,980	556,825	1,867,904	30	54
2009	936,196	507,407	1,775,586	29	53
2008	870,373	466,059	1,738,524	27	50

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

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Com-posite Ratio
2012	$225,286	$353,082	$579,359	39%	58%	97%
2011	464,817	306,616	568,217	82	53	135
2010	286,179	282,455	529,230	54	51	105
2009	197,049	264,613	503,830	39	52	91
2008	409,136	234,526	454,712	90	50	140

As part of the company's business plan it has been trying to grow its block of business in a profitable manner which supports the reason why gross and net premiums written have steadily increased over this period by 37.6% and 31.5%, respectively. Part of the increase in writings is due to rate changes and surcharges implemented by the company over the last four years; however, policy growth is the primary component of the increases. Policy in-force count has increased on average of about 60 policies each year, with the largest increase occurring in 2010 of 74 policies. Despite the company's efforts to grow its business profitably through sound underwriting practices, the company has recorded negative underwriting results in two of the last four years. Surplus has decreased by 4.9% overall during that period. Even with the decrease in surplus the company is considered fairly well leveraged with gross and net writings ratios of 72% and 37%, respectively, in 2012. The large underwriting loss of $112,424 that incurred in 2011 was primarily a result of two large fire claims and two major hail events that hit the company's territory that year. The reported decrease in the company's surplus in 2012 was primarily attributable to a $166,465 unrealized capital loss relating to its holdings of its primary reinsurer's common stock.

The expense ratio has not fluctuated significantly and has ranged from 51% in 2010 to 58% in 2012 over the four-year period under examination. The increase in 2012 was primarily driven by the purchase of new office equipment as the increase in costs related to agents' commissions and inspections was fairly consistent with the increase in gross writings that year. Overall the company's expense ratio appears quite high at above 50% but is not unusual for a small mutual insurer. The controlled underwriting expenses along with investment income earned helped the company record net income in three of the last four years.

The net investment income earned by the company has steadily decreased over the last four years from $45,755 in 2008 to $11,914 in 2012, which is primarily attributable to the company's stock holdings paying very little in dividends, the low bond and certificate of deposit interest rate environment, market conditions, and to a lesser extent reduced cash and investment holdings. However, in 2012 net investment income earned decreased by 45.1% to $11,915, while the company's cash and investment holdings (excluding non-interest bearing cash and real estate holdings) only decreased by 5.1% to $1,944,274. The decrease appears to be due to timing of interest payments between cash deposited at interest of $445,074 that were disposed of in 2012 and the bonds acquired in 2012 whose balance increased by $444,474.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there are currently two ceding treaties. Both treaties reviewed contained proper insolvency clauses. The primary treaty with Wisconsin Reinsurance Corporation complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss, and s. Ins 13.06, Wis. Adm. Code, concerning company retentions of risk. It was noted that the company knowingly retains losses on all property risks exceeding its first surplus reinsurance coverage with its primary reinsurer.

<u>Primary Ceding Contract</u>

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2013, and is continuous
Termination provisions:	By either party, on any January 1, with 90 days' advanced written notice

The following is a summary of the company's 2013 reinsurance program:

The coverage provided under this treaty for the 2013 contract year is summarized as follows:

1.	Type of contract:	Casualty Excess of Loss
	Lines reinsured:	All casualty or liability business written by the company
	Company's retention:	$10,000 in respect to each and every loss occurrence up to policy limits
	Coverage:	100% in excess of retention including loss adjusting expense, subject to policy limits of $1,000,000 for bodily injury and property damage, and $25,000 per person and $25,000 per accident for medical payments
	Reinsurance premium:	45% of gross liability premiums charged for each policy issued, subject to a minimum annual premium equal to 75% of the annual deposit premium of $101,250
2.	Type of contract:	First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	$350,000 of each risk ceded pro rata. If net retention for a risk is $350,000 or less, the company may cede 50% pro rata.
	Coverage:	Pro rata portion of each loss and LAE up to $800,000 above retention
	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:	The current commission rate of 15% of the premiums ceded. Return commission shall be allowed at the same rate on all return premiums paid to the company. The reinsurer also pays a profit commission rate of 15% of the net profit it incurs in an annual period.
3.	Type of contract:	First Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$50,000 for each and every risk from one loss occurrence
	Coverage:	100% of each and every loss, including loss adjustment expense in excess of the company's net retention, $50,000, subject to a limit of $100,000
	Reinsurance premium:	Rate based on net premium written and losses incurred for immediate preceding four years. There is a minimum rate of 6.5% and maximum rate of 17.5% of current net premium written charged. The 2013 annual rate is 16.19%, subject to a minimum annual premium equal to 75% of the annual deposit premium of $125,267.
4.	Type of contract:	Second Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$150,000 for each and every risk from one loss occurrence
	Coverage:	100% of each and every loss, including loss adjustment expense, in excess of the company's net retention, $150,000, subject to a limit of $200,000
	Reinsurance premium:	4.5% of net premiums written for business covered, subject to minimum annual premium equal to 75% of the annual deposit premium of $34,818
5.	Type of contract:	First Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company's retention:	Losses in aggregate equal to 75% of the net premiums written for the annual period
	Coverage:	100% of the amount by which the aggregate of the company's losses, including loss adjustment expenses, exceeds the company's retention with a limit of 50% of net premium written
	Reinsurance premium:	Rate of losses incurred divided by net premiums written for last eight years losses incurred times 125%, applied to net premiums written with a minimum rate of 6.45% and maximum of 12.00%. The 2013 annual rate is 6.45%, subject to minimum annual premium equal to 75% of the annual deposit premium of $57,888.

6.	Type of contract:	Second Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company's retention:	Losses in aggregate equal to 125% of the net premiums written for the annual period
	Coverage:	100% of aggregate net losses, including loss adjustment expenses, in the annual period that exceed the retention
	Reinsurance premium:	3.0% of net premiums written for business covered, subject to minimum annual premium equal to 75% of the annual deposit premium of $26,924

<u>Equipment Breakdown Quota Share Coverage</u>

Reinsurer:	Factory Mutual Insurance Company
Effective date:	January 1, 2011, and is continuous
Lines reinsured:	All equipment breakdown liability Farmowners and Homeowners business, with stated exclusions
Company's retention:	None
Coverage:	100% of losses ceded under this treaty
Reinsurance premium:	100% of the subject gross written premium relating to risks covered under this agreement
Ceding commission:	The current commission rate of 35% of the premiums ceded. Return commission shall be allowed at the same rate on all return premiums paid to the company.
Termination provisions:	By either party, on any January 1, with 90 days' advanced written notice by certified mail
Additional comments:	The treaty has a clause where the reinsurer will share in its profits over a three-year period beginning January 1, 2011, through December 31, 2013. The company is to receive a profit sharing bonus if the net loss ratio for the business reinsured is below 30%. The profit sharing amount is calculated as a percentage of the difference between 30% of earned premium and losses incurred over the three-year period ranging from 50% to 90%. The profit sharing percentage is dependent on the number of SCMIC policyholders that had a policy in force as of January 1, 2011, eligible for equipment breakdown coverage who adds this coverage as a rider to their policy. The amount of eligible policies as of January 1, 2011, agreed upon for the penetration calculation was 1,044, with a penetration percentage equal to or below 30% being eligible for the lowest profit sharing rate of 50%.

III. FINANCIAL DATA

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

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

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 100	$ 0	$0	$ 100
Cash in checking	68,859	0	0	68,859
Cash deposited at interest	315,565	0	0	315,565
Bonds	683,400	0	0	683,400
Stocks and mutual fund investments	945,309	0	0	945,309
Real estate	98,883	0	0	93,883
Premiums, agents' balances and installments:				
In course of collection	13,245	0	0	13,245
Deferred and not yet due	165,978	0	0	165,978
Investment income accrued		6,873	0	6,873
Reinsurance recoverable on paid losses and LAE	18,362	0	0	18,362
Other nonexpense-related assets:				
Federal income tax recoverable	181	0	0	181
Totals	$2,304,882	$6,873	$0	$2,311,755

Liabilities and Surplus

Net unpaid losses	$ 100,000
Unpaid loss adjustment expenses	2,800
Commissions payable	39,971
Fire department dues payable	763
Unearned premiums	454,028
Reinsurance payable	43,776
Other liabilities:	
Expense-related:	
Accounts payable	5,100
Nonexpense-related:	
Premiums received in advance	11,684
Total liabilities	658,122
Policyholders' surplus	1,653,633
Total Liabilities and Surplus	$2,311,755

South Central Mutual Insurance Company
Statement of Operations
For the Year 2012

Net premiums and assessments earned		$579,359
Deduct:		
Net losses incurred	$191,412	
Net loss adjustment expenses incurred	33,874	
Net other underwriting expenses incurred	353,082	
Total losses and expenses incurred		578,368
Net underwriting gain (loss)		991
Net investment income:		
Net investment income earned	11,915	
Net realized capital gains (losses)	10,078	
Total investment gain (loss)		21,993
Other income (expense):		
Fees	57,872	
Total other income		57,872
Net income (loss) before federal income taxes		80,856
Federal income taxes incurred		3,300
Net Income (Loss)		$ 77,556

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

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

	2012	**2011**	**2010**	**2009**
Surplus, beginning of year	$1,712,178	$1,867,904	$1,775,586	$1,738,524
Net income	77,556	(112,424)	32,757	91,301
Net unrealized capital gain or (loss)	(136,101)	(43,302)	59,371	(54,890)
Change in nonadmitted assets	0	0	190	651
Surplus, End of Year	$1,653,633	$1,712,178	$1,867,904	$1,775,586

Reconciliation of Policyholders' Surplus

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

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. Claims-Free Discount—It is recommended that the company properly deduct the claims-free discount from the unearned premium, deferred premium and premiums in force for the policyholders that qualify for the discount.

   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:	
Manager and office employees	$ 250,000
Deductible	1,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Bodily injury (per accident)	100,000
Bodily injury (per employee for disease)	100,000
Policy limit	500,000

Type of Coverage	Coverage Limits
Property coverage:	
Building	$ 224,000
Personal property	50,000
Money and securities:	
On premises	5,000
Off premises	2,500
Accounts receivable	25,000
Valuable papers	25,000
Deductible	500
Liability coverage:	
Liability and medical expenses (per occurrence)	1,000,000
Medical expenses (per person)	5,000
Products-completed operations limit	2,000,000
General aggregate policy limit	2,000,000
Tenants liability (per occurrence)	100,000
Professional liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	10,000
Directors and officers liability:	
Per claim limit	2,000,000
Aggregate limit	2,000,000
Deductible	10,000

Underwriting

The company 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. All new applications and a sampling of renewal business are 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.

Accounts and Records

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

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

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

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

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computers is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept off-site.

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

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The 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	$ 958,122
2.	Liabilities plus 33% of gross premiums written	1,053,248
3.	Liabilities plus 50% of net premiums written	964,461
4.	Amount required (greater of 1, 2, or 3)	1,053,248
5.	Amount of Type 1 investments as of 12/31/2012	1,164,961
6.	Excess or (deficiency)	$ 111,713

The company has sufficient Type 1 investments.

The company was granted an exception on March 25, 2005, by this office to hold up to 45% of admitted assets in common stocks, preferred stocks and convertible securities. There were no other investment exceptions granted.

ASSETS

Cash and Invested Cash **$384,524**

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

Cash in company's office	$ 100
Cash deposited in banks—checking accounts	68,859
Cash deposited in banks at interest	315,565
Total	$384,524

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 a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 14 deposits in 12 depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2012 totaled $16,487 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.25% to 4.43%. Accrued interest on cash deposits totaled $1,519 at year-end.

Book Value of Bonds **$683,400**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2012. Bonds owned by the company are held under a safekeeping agreement with a bank custodian.

Bonds were verified to applicable company investment custodial statement records, as documented in the independent CPA's work papers. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2012 on bonds amounted to $16,161 and was traced to cash receipts records. Accrued interest of $5,354 at December 31, 2012, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$945,309**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2012. Stocks owned by the company are located in the company safe or held by a bank under a safekeeping agreement.

Stock certificates were physically examined and the December 31, 2012, custodial statement was reviewed by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2012 on stocks and mutual funds amounted to $17,487 and were traced to cash receipts records. There were no accrued dividends at December 31, 2012.

Book Value of Real Estate **$93,883**

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2012. The company's real estate holdings consisted of its home office building.

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 **$13,245**

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 **$165,978**

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 **$6,873**

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

Cash deposited at interest	$1,519
Bonds	5,354
Total	$6,873

Reinsurance Recoverable on Paid Losses and LAE **$18,362**

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, 2012. A review of year-end accountings with the reinsurer verified the above asset.

Federal Income Tax Recoverable **$181**

This asset represents the amount overpaid to the federal government for 2012 corporate income taxes, which is based solely on investment income. The examiners reviewed the company's tax calculation and found this asset to be correctly calculated.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$100,000**

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

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$247,889	$157,802	$90,087
Less: Reinsurance recoverable on unpaid losses	147,889	122,705	25,184
Net Unpaid Losses	$100,000	$ 35,097	$64,903

Net unpaid losses as noted above were found to be adequate. The examiners determined the company estimate to be based on sound reserving methodology and to be within a reasonable range. The large redundancy in the reserve development was primarily attributable to the company's conservative approach regarding the establishment of its incurred but not reported (IBNR) reserve, which was estimated at $60,995 as of December 31, 2012. The company had only two small losses against its IBNR, thus resulting in a large redundancy.

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 when applicable.

Unpaid Loss Adjustment Expenses **$2,800**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2012, but which remained unpaid as of year-end. The company sets loss adjustment expense reserves at the time individual claims are being set up. The company establishes the liability at year-end by totaling all loss adjustment expense reserves associated with open claims and adding an estimated IBNR reserve of $1,000.

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 **$39,971**

This liability represents the commissions on deferred premiums due to the company's agents as well as bonus commissions due to the company's agents as of December 31, 2012. Bonus commissions are contingent upon individual agent's year-end results in meeting criteria described under the company's contingent commission program. The contingent commission portion of the above liability totaled $14,280 at year-end. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

Fire Department Dues Payable **$763**

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

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

Unearned Premiums **$454,028**

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 and was determined to be materially correct.

Reinsurance Payable **$43,776**

This liability consists of amounts due to the company's reinsurers at December 31, 2012, relating to transactions which occurred on or prior to that date. Amounts listed below are the reinsurers' portion of premiums collected in the fourth quarter of 2012 by contract type, the year-end adjustment for the company's written premium results, and the reinsurer's portion of deferred premiums at year-end.

Contract Description	Amount
Class A, Liability	$ 1,076
Class B, First Surplus	0
Class C-1, Excess of Loss	(4,281)
Class C-2, Excess of Loss	(2,796)
Class D/E-1, Stop Loss	(3,965)
Class D/E-2, Stop Loss	(1,841)
Deferred First Surplus Reinsurance Premium Payable	52,757
Equipment Breakdown	2,826
Total	$43,776

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Accounts Payable **$5,100**

This liability represents amounts for expenses incurred in 2012 but not paid as of year-end. A search for unrecorded liabilities as well as review of subsequent cash disbursements verified this balance.

Premiums Received in Advance **$11,684**

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

V. CONCLUSION

Policyholders' surplus has decreased from $1,738,524 per the examination report as of year-end 2008 to $1,653,633 as of year-end 2012. This represents a decrease of 4.9% during the period under examination. In 2012 the company's surplus was negatively affected by a $166,465 unrealized capital loss relating to its holdings of its primary reinsurer's common stock. The company experienced underwriting losses in two of the last four years with the largest loss occurring in 2011 of $112,424, which was primarily a result of two large fire claims and two hail events that hit the company's territory that year. The company's average expense ratio over the last four years is 53.5% and it has reported composite ratios of over 100% in two of those years. On a gross basis, premium writings since 2008 have increased by 37.6% partially due to rate increases and surcharges but primarily due to its business plan to profitably grow its business as supported by the fact that its in-force policy count increased by 207 policies since 2008. Net writings during this period have increased reasonably proportionally to the company's gross writings.

The examination verified the financial condition of the company as reported in its annual statement as of December 31, 2012. The examination of SCMIC did not result in any recommendations, adjustments to surplus or reclassifications. It was determined that the company complied with its sole prior examination recommendation.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

There were no recommendations made as a result of this examination.

VII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

John Litweiler
Examiner-in-Charge