

**CHURCH MUTUAL
INSURANCE COMPANY**

Statutory Financial Statements
and Supplemental Schedules
(With Independent Auditors' Report Thereon)
December 31, 2019 and 2018

CHURCH MUTUAL INSURANCE COMPANY

December 31, 2019 and 2018

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KPMG LLP
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Independent Auditors' Report

The Board of Directors
Church Mutual Insurance Company:

We have audited the accompanying financial statements of Church Mutual Insurance Company, which comprise the statutory statements of admitted assets, liabilities, and surplus of policyholders as of December 31, 2019 and 2018, and the related statutory statements of operations, surplus of policyholders, and cash flow for the years then ended, and the related notes to the statutory financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in note 1 to the financial statements, the financial statements are prepared by Church Mutual Insurance Company using statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin, which is a basis of accounting other than U.S. generally accepted accounting principles. Accordingly, the financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.

The effects on the financial statements of the variances between the statutory accounting practices described in note 1 and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.



Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the variances between statutory accounting practices and U.S. generally accepted accounting principles discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of Church Mutual Insurance Company as of December 31, 2019 and 2018, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of Church Mutual Insurance Company as of December 31, 2019 and 2018, and the results of its operations and its cash flow for the years then ended, in accordance with statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin described in note 1.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information included in the Supplemental Investment Risks Interrogatories, Summary Investment Schedule, and Supplemental Schedule of Reinsurance Risk Interrogatories is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information required by the Office of the Commissioner of Insurance of the State of Wisconsin. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

Milwaukee, Wisconsin
May 18, 2020

CHURCH MUTUAL INSURANCE COMPANY

Statutory Statements of Admitted Assets, Liabilities, and Surplus of Policyholders
December 31, 2019 and 2018
(Dollars in thousands)

Admitted Assets	<u>2019</u>	<u>2018</u>
Cash and invested assets:		
Bonds	\$ 1,094,485	\$ 1,014,489
Preferred stock	9,890	11,344
Common stock	369,200	359,075
Cash, cash equivalents, and short-term investments	69,925	18,361
Other invested assets	96,968	111,662
Receivable for securities	83	—
Cash surrender value of life insurance	20,977	20,458
Land and buildings – at cost, less accumulated depreciation of \$15,355 and \$14,713 in 2019 and 2018, respectively	12,248	12,672
Total cash and invested assets	<u>1,673,776</u>	<u>1,548,061</u>
Other assets:		
Premiums and other receivables	214,100	174,072
Contingent commissions receivable	275	919
Receivables from reinsurers	16,691	14,395
Receivables from subsidiaries	9,061	5,864
Federal income taxes receivable	7,121	42,850
Net deferred tax asset	37,453	31,877
Guaranty funds on deposit	197	227
Accrued interest and dividends	7,984	8,033
Electronic data processing equipment – at cost, less accumulated depreciation of \$11,741 and \$10,443 in 2019 and 2018, respectively	2,337	3,005
Other	12,281	2,323
Total other assets	<u>307,500</u>	<u>283,565</u>
Total admitted assets	<u>\$ 1,981,276</u>	<u>\$ 1,831,626</u>

See accompanying notes to statutory financial statements.

CHURCH MUTUAL INSURANCE COMPANY

Statutory Statements of Admitted Assets, Liabilities, and Surplus of Policyholders (continued)

December 31, 2019 and 2018

(Dollars in thousands)

Liabilities and Surplus of Policyholders	2019	2018
Liabilities:		
Reserve for losses and loss adjustment expenses	\$ 708,526	\$ 684,011
Reinsurance payable on paid losses and loss adjustment expenses	5,215	3,710
Unearned premiums	419,325	378,212
Dividends payable to policyholders	17,324	19,529
Ceded reinsurance premiums payable	10,996	6,886
Accrued expenses	38,295	29,899
Funds held under reinsurance treaties	5,855	10,763
Funds held for others	3,878	1,250
Premium deposits	8,033	8,100
Payable for securities	—	150
Other taxes	5,670	4,851
Liability for deferred compensation and pension	22,231	20,328
Liability for postretirement benefits other than pension	54,989	38,273
Other liabilities	1,509	5,806
Total liabilities	1,301,846	1,211,768
Surplus of policyholders:		
Guaranty fund	1,600	1,600
Unassigned surplus	677,830	618,258
Total surplus of policyholders	679,430	619,858
Total liabilities and surplus of policyholders	\$ 1,981,276	\$ 1,831,626

See accompanying notes to statutory financial statements.

CHURCH MUTUAL INSURANCE COMPANY

Statutory Statements of Operations
Years ended December 31, 2019 and 2018
(Dollars in thousands)

	<u>2019</u>	<u>2018</u>
Underwriting:		
Premiums earned	\$ 806,824	\$ 750,708
Losses and expenses incurred:		
Losses incurred	470,163	553,030
Loss adjustment expenses incurred	90,003	92,298
Other underwriting expenses	<u>279,039</u>	<u>246,947</u>
Total losses and expenses incurred	<u>839,205</u>	<u>892,275</u>
Net underwriting (loss) gain	<u>(32,381)</u>	<u>(141,567)</u>
Investment and other income:		
Interest	28,814	26,229
Dividends	6,299	7,099
Real estate income	4,000	4,000
Net realized gain on sales of investments, net of tax expense of \$6,089 and \$989 in 2019 and 2018, respectively	22,906	3,629
Investment expenses	(4,381)	(4,333)
Other	<u>(106)</u>	<u>391</u>
Net investment and other income	<u>57,532</u>	<u>37,015</u>
Income (loss) before dividends to policyholders and federal income tax expense	25,151	(104,552)
Dividends to policyholders	<u>9,470</u>	<u>12,736</u>
Income (loss) before federal income tax expense	15,681	(117,288)
Federal income tax (benefit) expense	<u>(1,823)</u>	<u>(32,077)</u>
Net income (loss)	<u>\$ 17,504</u>	<u>\$ (85,211)</u>

See accompanying notes to statutory financial statements.

CHURCH MUTUAL INSURANCE COMPANY
Statutory Statements of Surplus of Policyholders
Years ended December 31, 2019 and 2018
(Dollars in thousands)

	2019	2018
Balance – beginning of year	\$ 619,858	\$ 703,690
Net income (loss)	17,504	(85,211)
Other changes:		
Net unrealized gains (losses) on investments, net of capital gains tax expense of \$6,193 and \$(4,282) in 2019 and 2018, respectively	43,224	(7,259)
Net deferred income taxes	5,317	4,111
Provision for reinsurance	—	14
Nonadmitted assets	3,214	825
Post retirement and pensions	(9,687)	3,688
Balance – end of year	\$ 679,430	\$ 619,858

See accompanying notes to statutory financial statements.

CHURCH MUTUAL INSURANCE COMPANY

Statutory Statements of Cash Flow
Years ended December 31, 2019 and 2018
(Dollars in thousands)

	<u>2019</u>	<u>2018</u>
Cash flows from operations:		
Premiums collected – net of reinsurance	\$ 805,797	\$ 793,923
Loss and loss adjustment expenses paid – net of salvage and subrogation recoveries (including reinsurance)	(456,055)	(416,138)
Underwriting expenses paid	(344,422)	(308,903)
Net investment income	42,139	41,353
Other (loss) income	(105)	(9,609)
Dividends to policyholders	(11,675)	(15,397)
Federal income taxes received (paid)	31,463	(1,443)
Net cash provided by operations	<u>67,142</u>	<u>83,786</u>
Cash flows from investments:		
Proceeds from investments sold, matured, or repaid	685,967	525,393
Cost of investments acquired including purchases of real estate of \$238 and \$18 in 2019 and 2018, respectively, and purchases of other invested assets of \$7,564 and \$29,849 in 2019 and 2018, respectively	<u>(688,468)</u>	<u>(631,903)</u>
Net cash used in investments	<u>(2,501)</u>	<u>(106,510)</u>
Cash flows from financing and miscellaneous sources:		
Other	<u>(13,077)</u>	<u>(7,244)</u>
Net cash used in financing and miscellaneous sources	<u>(13,077)</u>	<u>(7,244)</u>
Net change in cash, cash equivalents, and short-term investments	51,564	(29,968)
Cash, cash equivalents, and short-term investments:		
Beginning of year	<u>18,361</u>	<u>48,329</u>
End of year	<u>\$ 69,925</u>	<u>\$ 18,361</u>

See accompanying notes to statutory financial statements.

CHURCH MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2019 and 2018

(Dollars in thousands)

(1) NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations

Church Mutual Insurance Company (the Company) is incorporated under the laws of the State of Wisconsin. The Company is engaged in the property-liability insurance business in the United States. The Company's primary business is the sale of property, liability, workers' compensation, and automobile insurance to religious and religious-affiliated organizations.

The Company has a 100% interest in six subsidiaries, CMIC Specialty Services Inc. (Specialty), CM Regent LLC, CM Regent Insurance Company (CM Regent), CM Vantage Specialty Insurance Company (CM Vantage), CM Select Insurance Company (CM Select), and CM Indemnity Insurance Company (CM Indemnity). Specialty and CM Regent LLC are non-insurance companies valued at U.S. generally accepted accounting principles (GAAP) equity. Specialty is treated as an investment in common stock. CM Regent LLC is treated as a limited liability company and shown as an other invested asset. CM Regent, CM Vantage, CM Select, and CM Indemnity are stock property and casualty insurance companies and their common stock is valued on the Company's balance sheet at its statutory equity basis.

The Company incorporated CM Vantage on November 12, 2015, under the laws of the State of Wisconsin, as a wholly owned stock insurance company; 5,000 common shares authorized at \$1 par value. The Company capitalized CM Vantage on December 4, 2015 through a \$52,000 stock sale of 2,600 shares, issued and outstanding. CM Vantage is a stock property and casualty insurance company which commenced operations in 2016.

The Company incorporated CM Select on May 4, 2017, under the laws of the State of Wisconsin, as a wholly owned stock insurance company; 5,000,000 common shares authorized at \$1 par value. The Company capitalized CM Select on April 14, 2017 through a \$20,000 stock sale of 4,000,000 shares, issued and outstanding. CM Select is a stock property and casualty insurance company which commenced operations in 2018.

The Company purchased 100% of School Boards Insurance Company of Pennsylvania, Inc. (SBIC) and School Claims Services, LLC (SCS) on June 1, 2016. The names of both organizations were subsequently changed in 2016. SBIC is now CM Regent Insurance Company, and SCS is now CM Regent LLC. CM Regent is a stock based insurance company domiciled in the State of Pennsylvania whose capitalization consists of 10,000 shares of common stock and offers a variety of commercial insurance products to Pennsylvania School Boards Association (PSBA) member school boards. CM Regent LLC is a limited liability company organized under the laws of Pennsylvania and performs insurance services for the affiliated group.

The purchases were accounted for as a statutory purchase with the combined cost of the entities recorded at \$37,452 and a resulting negative goodwill of \$34,303. The negative goodwill is being amortized over a ten year period. Goodwill amortization was \$2,830 and \$2,830 for the years ended December 31, 2019 and 2018, respectively.

The Company purchased 100% of American Sterling Insurance Company (ASIC) on September 14, 2018. The name of the organization was subsequently changed in 2019. ASIC is now CM Indemnity Insurance Company. CM Indemnity had gone through bankruptcy proceedings in the state of California and had no assets or liabilities prior to the acquisition by the Company. CM Indemnity is a stock-based property and casualty insurance company domiciled in

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the state of Wisconsin whose capitalization consists of 13,000 shares of common stock. CM Indemnity has not commenced operations as of December 31, 2019.

The purchase was accounted for as a statutory purchase with the cost of the entity recorded at \$459 and a resulting goodwill of \$459. The goodwill is being amortized over a ten year period. Goodwill amortization was \$46 and \$15 for the years ended December 31, 2019 and 2018, respectively.

The Company is authorized to sell property-liability insurance in all 50 states and the District of Columbia. The top geographic jurisdictions for statutory premiums earned were Texas (10.8%), California (10.8%), and New York (8.6%) for the year ended December 31, 2019. No other jurisdiction accounted for more than 5.0% of statutory premiums earned for the years ended December 31, 2019 or 2018.

The Company distributes the majority of its property-liability products through employees of the Company.

The Company has exposure to catastrophes that are an inherent risk of the property-liability insurance business, that have contributed, and will continue to contribute, to material year-to-year fluctuations in the Company's results of operations and financial position.

Based on the Company's capital levels at December 31, 2019, management is confident in the Company's ability to continue as a going concern.

(b) Summary of Significant Accounting Policies

The Office of the Commissioner of Insurance of the State of Wisconsin (the Commissioner of Insurance), requires insurance carriers domiciled in Wisconsin to prepare their statutory financial statements in accordance with the National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual*, subject to certain deviations prescribed or permitted by the state of Wisconsin. The Company does not have any prescribed or permitted statutory accounting practices from Wisconsin for 2019 or 2018 that deviate from the NAIC Statutory Accounting Principles (SAP).

The accounting treatment prescribed by SAP varies in some respects from GAAP. The most significant differences between SAP and GAAP accounting are as follows:

- Investments in bonds are generally carried at amortized cost (except bonds with NAIC 3-6 ratings, which are carried at the lower of fair value or amortized cost), while under GAAP, such bonds are designated at purchase as held-to-maturity, available-for-sale, or trading. Held-to-maturity investments are reported at amortized cost. Available-for-sale investments are reported at fair value with unrealized gains and losses reported as a separate component of stockholder's equity, net of applicable deferred income taxes. Trading investments are reported at fair value with unrealized gains and losses reported in operations.
- For loan-backed and structured securities only, the determination of other-than-temporary impairment includes a review of the recovery of the carrying value of the security based on the estimated present value of the security's projected future cash flows, exclusive of the Company's intent to retain the security. If the security is considered to be other-than-temporarily impaired, a realized loss is recognized for the noninterest-related decline. For bonds, the Company considers the size and duration of the excess of carrying value over fair value and the likelihood and expected timing of a recovery in value along with the credit quality of the bond issuer. If the bond is determined

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to be other-than-temporarily impaired, the Company writes the carrying value down to the fair value and recognizes a realized loss. Under GAAP, other-than-temporary impairments for all debt securities where the Company does not have intent to sell, or it is more likely than not that the Company will be required to sell prior to recovery, a realized loss is recognized for the noninterest related decline while an unrealized loss is recognized for the interest related decline.

- Common stocks are stated at fair value as required by SAP and GAAP. Unrealized common stock investment gains and losses, net of deferred taxes, are credited or charged directly to unassigned policyholders' surplus. Under GAAP, unrealized common stock gains and losses are reported in net income.
- Acquisition costs, such as commissions and other costs related to successfully acquiring new business are expensed as incurred, while under GAAP, they are deferred and amortized to income as premiums are earned.
- SAP requires an amount to be recorded for deferred taxes; however, there are limitations as to the amount of deferred tax assets that may be reported as "admitted assets" and the change in deferred taxes is recorded directly to surplus for SAP. Under GAAP, the provision for deferred taxes is made within the income statement.
- Assets in the accompanying statutory financial statements are stated at "admitted asset values" in accordance with the rules and regulations of the Commissioner of Insurance. The Company had "nonadmitted assets" of \$33,561 and \$36,775 at December 31, 2019 and 2018, respectively. Under GAAP, such assets would be recognized at the lower of cost or net realizable value.
- The change in provision for reinsurance is charged or credited directly through surplus under SAP, while this provision is not prescribed for GAAP purposes, rather an allowance for amounts deemed uncollectible is established as a charge to the statement of operations.
- The statutory statements of admitted assets, liabilities, and surplus of policyholders under SAP are reported net of reinsurance, while under GAAP, the balance sheets report reinsurance recoverables, including amounts related to losses incurred but not reported, and prepaid reinsurance premiums as assets.
- Comprehensive income and its components are not presented for statutory financial statements and there is no statement of comprehensive income under SAP.
- Subsidiaries are included as common stock carried under the equity method, with the equity in net income of subsidiaries credited directly to the Company's surplus for SAP, while GAAP requires either consolidation or the equity in earnings of subsidiaries or net income of subsidiaries to be credited to operations.
- Policyholder dividends are recognized and accrued for when declared. For GAAP, they are recognized over the term of the related policies, and are accrued based on estimates of ultimate payments on current policies.
- The estimated rental cost (imputed rent) of home office facilities owned is presented in the statutory statements of operations as investment income and underwriting expense, whereas in GAAP imputed rent is not recorded.
- Cash, cash equivalents, and short-term investments in the statutory statements of cash flow represent cash, cash equivalents, and short-term investment balances with initial maturities of one year or less and are prepared

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(Dollars in thousands)

according to a prescribed format for statutory accounting. Under GAAP, the corresponding caption of cash and cash equivalents would include cash balances and investments with initial maturities of three months or less.

- Negative cash balances are reported as a contra-asset under SAP. Under GAAP, the negative cash balance would be reclassified as a liability.
- Realized investment gains or losses are reported net of related income taxes while under GAAP such gains or losses are reported gross of tax.
- Business purchases are recorded at cost, including direct costs of acquisition, with goodwill (including negative goodwill) recorded and amortized over no more than ten years. Under GAAP, acquired assets and liabilities are recorded at fair value, costs of acquisition are expensed as incurred, positive goodwill is not amortized but annually tested for impairment, and negative goodwill is recognized as a bargain purchase gain.

The aggregate effect of the foregoing differences has not been determined, although such effects are presumed to be material, as would be expected when comparing SAP to GAAP.

(c) Use of Estimates

The preparation of statutory financial statements in accordance with SAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Similar to most companies with property and casualty operations the Company uses estimates and assumptions for some assets and liabilities including loss and loss adjustment expenses (LAE), pension liabilities, other-than-temporarily impaired investments and income tax balances.

The reserves for losses and LAE, although supported by actuarial science and other supportive data, are ultimately based on management's reasoned expectations of future development.

Management utilizes external pension actuaries to assist them in developing pension liability estimates. As of December 31, 2019 and 2018, the Company has recorded balances in accordance with these actuarially determined amounts.

The Company's other-than-temporarily impaired evaluation of a particular investment includes management making assumptions and estimates about future earnings potential and operations of the issuer. Management considers such factors when evaluating whether a decline in fair value is other-than-temporary (1) the Company's ability and intent to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; (2) the recoverability of principal and interest; (3) the duration and extent to which the fair value has been less than the statement value; (4) the financial condition of the issuer along with future prospects, including relevant industry conditions and trends and rating agency implications; and (5) the specific reasons that a security is in a significant unrealized loss position, including market conditions, which could affect access to liquidity.

For income tax balances, management utilizes external tax accounting experts and management's reasoned expectations of future events.

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It is reasonably possible that expectations associated with the above assumptions and estimates can change. Such changes are generally recorded in the statutory statements of operations in the period of the change.

(d) Investments

Bonds, preferred stock, common stock, short-term investments, and other investments are stated at values as prescribed by the NAIC, as follows:

Bonds, excluding loan-backed and structured securities, are generally stated at amortized cost using the scientific interest method. Loan-backed and structured securities are generally stated at either amortized cost, including anticipated prepayments, or the lower of amortized cost or the present value of estimated future cash flows. Prepayment assumptions are obtained from external sources based on historical trends. The retrospective adjustment method is used to value all securities except for interest only securities or securities where the yield has become negative; those securities are valued using the prospective method. The fair value of bonds is determined based on values determined by an independent pricing service, which management reviews for reasonableness.

Common stocks, other than the investments in the stock of a subsidiaries, and preferred stocks are carried at fair value from an independent pricing service, which management reviews for reasonableness. The change in the stated value is recorded as a change in net unrealized gains (losses), a component of unassigned surplus. Highest-quality or high-quality preferred stocks (NAIC designations 1 and 2), which have characteristics of equity securities, are valued at fair value. All other preferred stocks (NAIC designations 3 to 6) are reported at the lower of cost or fair value. There are no restrictions on preferred stock.

Common stock of the Company's investments in CM Vantage, CM Regent, CM Select, and CM Indemnity are carried at their underlying statutory capital stock and surplus. The change in the subsidiaries' underlying equity between years is reflected as a change in unrealized gains (losses). The Company's investment in CMIC Specialty was nonadmitted at December 31, 2019 and 2018 as the financial statements are not audited. The Company's investment in CM Regent LLC is treated as a limited liability company, shown as an other invested asset, and carried at underlying GAAP equity.

The Company's other invested assets are comprised of ownership interests in joint ventures, partnerships, and limited liability companies. If the Company does not have the power to control the direction of these interests, the Company will carry these investments based on the underlying audited GAAP equity of the investee. If the underlying GAAP equity value is unknown, these interests are nonadmitted with a book/adjusted carrying value of zero. If the Company's ownership interest is in excess of 10% (considered minority interest) it will then determine if it has the power to control the joint ventures, partnerships, and limited liability companies. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of management and policies of the investee. It is the intention of the Company's management to not invest in or contract with joint ventures, partnerships or limited liability companies in such a manner that causes the Company to have control over the direction of these investees.

Short-term investments include all investments whose maturities, at the time of acquisition, are one year or less and are stated at amortized cost, which approximates fair value.

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Fair value adjustments for securities carried at fair value are charged to unassigned surplus as unrealized gains (losses) on investments net of any related deferred tax. Realized gains and losses are determined on the specific identification method on the trade date and are presented in the statutory statements of operations net of federal income tax. Realized investment gains and losses also include valuation adjustments for impairment of bonds, stocks, and other invested assets with a decline in value that management considers to be other-than-temporary. In determining whether impairments are other-than-temporary, the Company considers the size and duration of the excess of carrying value over fair value for preferred and common stocks and the likelihood and expected timing of a recovery in value. For bonds, the credit quality of the issuer is also considered. When it is determined that an investment is other-than-temporarily impaired, the Company writes the carrying value down to the fair value and recognizes a realized loss. For loan-backed and structured securities, the determination of other-than-temporary impairment is measured based on an estimate of the noninterest loss, which is recognized in operations. Such impairments result in the establishment of a new cost basis for these assets for book purposes.

The Company analyzes its investment portfolio holdings for other-than-temporary impairments. For loan-backed and structured securities where the Company has not recorded other-than-temporary impairments as a realized loss, the Company has the ability and intent to hold the securities to maturity or recovery. Additionally, for loan-backed and structured securities, the Company expects to recover the carrying value of the security from the estimated present value of the security's projected future cash flows. For stocks and bonds that are not loan-backed or structured securities, management looks at a number of factors to determine if the investment is other-than-temporarily-impaired including the Company's ability and intent to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; the recoverability of principal and interest; the duration and extent to which the fair value has been less than the statement value; the financial condition of the issuer along with future prospects, including relevant industry conditions and trends and rating agency implications; the specific reasons that a security is in a significant unrealized loss position, including market conditions, which could affect access to liquidity; and objective evidence that it will recover in a reasonable period of time.

Land is stated at cost, and buildings are stated at cost, less accumulated depreciation.

Life insurance contracts are policies in which the Company is both the owner and beneficiary. The contracts are carried at the cash surrender value, meaning the amount that is realizable on demand, as of December 31, 2019 and 2018. There are no contractual restrictions on the ability to surrender the policies.

Investment income consists primarily of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned at the ex-dividend date. Interest income on mortgage- and asset-backed securities is determined using the effective-yield method based on estimated principal repayments.

(e) Premiums and Related Commissions

Premiums are earned on a pro rata basis over the terms of the related insurance policies and reinsurance contracts. Unearned premium reserves are established to cover the unexpired portion of premiums written.

Premiums receivable that are over 90 days past due are nonadmitted with a corresponding decrease in surplus.

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Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions, are charged to operations as incurred. Expenses incurred are reduced for ceding allowances received or receivable. Earned but unbilled premiums are reported as a component of earned premiums.

(f) Reserve for Losses and LAE

The reserve for unpaid losses and LAE includes an amount for reported losses, which includes an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and while management believes the amount is reasonable, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed and any adjustments are reflected in the period a change is determined to be necessary. The Company does not discount the liability for unpaid losses and LAE.

(g) Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. The Company provides for depreciation of property and equipment using straight-line and accelerated methods over the estimated useful lives of the assets. Buildings are generally depreciated over 40 years. Furniture and fixtures are generally depreciated over 5 to 10 years. The Company provides for amortization of leasehold improvements using the straight-line method over the lesser of the useful life of the asset or the remaining original lease term, excluding options or renewal periods. Leasehold improvements are generally depreciated over 3 to 20 years. Depreciation and amortization expense was approximately \$6,051 and \$5,174 for the years ended December 31, 2019 and 2018, respectively.

Maintenance and repairs are charged to expense as incurred.

(h) Reinsurance

Under state regulations, insurance companies are permitted to treat risks that have been reinsured with other approved insurance companies, to the extent of the reinsurance and within the limits specified, as though they were not risks for which the Company is liable. However, in the event of nonperformance by reinsurers, the Company remains primarily liable to policyholders.

The Company records a provision for reinsurance liability for non-collateralized unauthorized reinsurance recoveries and overdue reinsurance recoveries on paid losses. This is recorded as a liability and the change between years is recorded as a gain or loss directly to unassigned funds (surplus). An authorized reinsurer is licensed, accredited, or approved by the State of Wisconsin; an unauthorized reinsurer is not licensed, accredited, or approved by the State of Wisconsin.

In addition to the provision for reinsurance liability, the Company evaluates its reinsurance recoveries for evidence of any settlements in dispute or reinsurance that is deemed uncollectible based on the underlying circumstances of the reinsurance transaction or the financial capacity of the reinsurer. As of December 31, 2019 and 2018, the Company did not have any reinsurance settlements that were in dispute or reinsurance recoveries that were deemed uncollectible.

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(i) **Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the statutory financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The admissibility of the net deferred tax assets recorded is subject to the limitation. Changes in deferred tax assets and liabilities are recognized as a separate component of the change in policyholders' surplus. Tax planning strategies designed to recognize the benefits afforded under the tax law that (a) are prudent and feasible, (b) are taken to prevent an operating loss or tax credit carryforward from expiring unused, or (c) would result in realization of deferred tax assets, are considered in determining the statutory valuation allowance adjustment of the adjusted gross admitted deferred tax assets and the realization of deferred tax assets. The Company has determined that there is no impact from tax planning strategies on the adjusted gross and net admitted deferred tax assets as of December 31, 2019.

Management uses best estimates to establish reserves based on current facts and circumstances regarding tax exposure items where the ultimate deductibility is open to interpretation.

(j) **Postretirement Benefits and Pensions**

Pension and other postretirement benefit liabilities are recognized at the full unfunded amount determined by comparing the projected benefit obligation for pension plans and the accumulated benefit obligation for other postretirement plans to the fair value of plan assets.

(2) INVESTMENTS

The Company monitors its investment exposure by investing its funds in accordance with guidelines set by the Company's Risk Management Committee. The carrying value, gross unrealized gains, gross unrealized losses, and fair value of bonds at December 31, 2019 and 2018 were as follows:

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		2019			
		<u>Carrying</u> <u>value</u>	<u>Gross</u> <u>unrealized</u> <u>gains</u>	<u>Gross</u> <u>unrealized</u> <u>losses</u>	<u>Fair value</u>
Bonds:					
U.S. government					
and government agencies	\$	226,828	\$ 1,081	\$ (2,287)	\$ 225,622
States and political subdivisions		64,399	2,729	(27)	67,101
Special revenue and special					
assessment obligations		397,848	12,432	(350)	409,930
Corporate		405,410	7,734	(334)	412,810
		<u>1,094,485</u>	<u>23,976</u>	<u>(2,998)</u>	<u>1,115,463</u>
Total bonds	\$	<u>1,094,485</u>	\$ <u>23,976</u>	\$ <u>(2,998)</u>	\$ <u>1,115,463</u>
		2018			
		<u>Carrying</u> <u>value</u>	<u>Gross</u> <u>unrealized</u> <u>gains</u>	<u>Gross</u> <u>unrealized</u> <u>losses</u>	<u>Fair value</u>
Bonds:					
U.S. government					
and government agencies	\$	236,714	\$ 1,169	\$ (3,767)	\$ 234,116
States and political subdivisions		82,372	726	(477)	82,621
Special revenue and special					
assessment obligations		365,042	3,694	(2,712)	366,024
Corporate		330,361	632	(4,658)	326,335
		<u>1,014,489</u>	<u>6,221</u>	<u>(11,614)</u>	<u>1,009,096</u>
Total bonds	\$	<u>1,014,489</u>	\$ <u>6,221</u>	\$ <u>(11,614)</u>	\$ <u>1,009,096</u>

Preferred stock was carried at \$9,890, with a fair value of \$9,904 at December 31, 2019, an actual cost of \$10,222 and unrealized loss of \$318. Preferred stock was carried at \$11,344, with a fair value of \$11,344 at December 31, 2018 with an actual cost of \$12,884 and unrealized loss of \$1,540.

Common stocks, excluding investments in subsidiaries, were carried at fair value of \$193,867 at December 31, 2019 with an actual cost of \$152,795, unrealized gains of \$42,107 and unrealized losses of \$1,035. Common stocks were carried at fair value of \$201,471 at December 31, 2018 with an actual cost of \$192,519, unrealized gains of \$18,673 and unrealized loss of \$9,721.

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Other invested assets are comprised of ownership interests in joint ventures, partnerships, and limited liability companies. Other invested assets, excluding investments in subsidiaries, were carried at fair value of \$80,846 at December 31, 2019 with an actual cost of \$60,292 unrealized gains of \$3,312 and unrealized losses of \$377. Other invested assets were carried at fair value of \$97,721 at December 31, 2018 with an actual cost of \$73,345, unrealized gains of \$6,808 and unrealized losses of \$212. The Company has \$11,412 and \$16,859 in unfunded commitments to joint ventures, partnerships, and limited liability companies at December 31, 2019 and 2018, respectively. These commitments represent agreements to provide additional capital contributions.

Included within the above tables are mortgage- and asset-backed securities with carrying values of approximately \$229,773 and \$162,092 as of December 31, 2019 and 2018, respectively, with approximately 58% and 57% classified as government agency securities for the years ended December 31, 2019 and 2018, respectively, and the remainder classified as nongovernment agency securities.

Securities with government guarantees are reflected within the U.S. government and government agencies and the special revenue and special assessment obligations above. Securities with government guarantees that are in an unrealized loss position have fair values of approximately \$168,280 and \$352,708 at December 31, 2019 and 2018, respectively. The remaining securities that are in an unrealized loss position are reflected in corporate bonds.

Fair values for bonds and stocks are determined using market quotations from independent pricing services. The Company's investments in Specialty and CM Regent LLC are carried at their underlying GAAP equity, while the investments in CM Vantage, CM Select, CM Regent, and CM Indemnity are carried at their underlying statutory equity. Unrealized gains and losses on investments in preferred and common stock are reported directly in unassigned surplus. Specialty was nonadmitted at December 31, 2019 and 2018.

The risks inherent in reviewing the impairment of any investment include the risk that market results may differ from expectations; facts and circumstances may change in the future and differ from estimates and assumptions; or the Company may later decide to sell the security as a result of changes in circumstances.

The Company's bonds and stocks are subject to normal market fluctuations. The Company intends to hold them until they mature or recover in value. However, if the specific facts and circumstances surrounding a bond or stock or the outlook for its industry sector change, the Company may sell the bond or stock and realize a loss.

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The following tables summarize, for all bonds and stocks in an unrealized loss position and deemed to be temporarily impaired at December 31, 2019 and 2018, the aggregate fair value and the gross unrealized loss by length of time such securities have been in an unrealized loss position:

	2019					
	Less than 12 months		12 months or longer		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
At December 31, 2019:						
Bonds:						
U.S. government and government agencies	\$ (385)	\$ 59,895	\$ (1,902)	\$ 54,085	\$ (2,287)	\$ 113,980
States and political subdivisions	(27)	1,285	—	—	(27)	1,285
Special revenue and special assessment obligations	(246)	44,086	(104)	8,929	(350)	53,015
Corporate	(225)	47,450	(109)	17,321	(334)	64,771
Preferred stock	—	—	(318)	9,904	(318)	9,904
Common stock - unaffiliated	(144)	2,267	(891)	7,786	(1,035)	10,053
Total temporarily impaired bonds and preferred and common stock	\$ (1,027)	\$ 154,983	\$ (3,324)	\$ 98,025	\$ (4,351)	\$ 253,008

	2018					
	Less than 12 months		12 months or longer		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
At December 31, 2018:						
Bonds:						
U.S. government and government agencies	\$ (4)	\$ 2,051	\$ (3,763)	\$ 134,726	\$ (3,767)	\$ 136,777
States and political subdivisions	(50)	18,136	(427)	23,060	(477)	41,196
Special revenue and special assessment obligations	(894)	94,344	(1,818)	80,391	(2,712)	174,735
Corporate	(1,628)	128,671	(3,030)	114,335	(4,658)	243,006
Preferred stock	(1,540)	11,344	—	—	(1,540)	11,344
Common stock - unaffiliated	(9,546)	46,854	(175)	1,443	(9,721)	48,297
Total temporarily impaired bonds and preferred and common stock	\$ (13,662)	\$ 301,400	\$ (9,213)	\$ 353,955	\$ (22,875)	\$ 655,355

There were no bonds with a NAIC rating of 3 or lower at December 31, 2019 or 2018.

The majority of the unrealized losses in the Company's bond investments were caused by interest rate increases.

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The Company's evaluation of a particular security for other than temporary impairment includes management making assumptions and estimates about future earnings potential and operations of the issuer. Management considers several factors when evaluating whether a decline in fair value is other-than-temporary such as (1) the Company's ability and intent to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; (2) the recoverability of principal and interest; (3) the duration and extent to which the fair value has been less than amortized cost for bonds; (4) the financial condition of the issuer along with future prospects, including relevant industry conditions and trends and rating agency implications; (5) the specific reasons that a security is in a significant unrealized loss position, including market conditions, which could affect access to liquidity. Based on the evaluation of the fundamentals of the issuers' financial condition and other objective evidence, the issuer's continued satisfaction of the securities' obligations in accordance with their contractual terms and the expectation that they will continue to do so, and the Company's ability to hold these investments until a recovery of fair value, which may be maturity, the Company recorded other-than-temporary impairments in its stock portfolio, resulting in a total realized loss of \$1,570 and \$970 for the years ended December 31, 2019 and 2018, respectively.

For mortgage- and asset-backed securities, management considers such factors as the Company's intent and ability to retain the security until its amortized cost is recovered and its ability to recover the entire amortized cost based on the present value of the security's cash flows, regardless of the intent and ability to retain. For specific holdings where the Company does not expect to recover the entire amortized cost, management performs cash flow analysis to determine whether other-than-temporary impairment has occurred. If the results of this cash flow modeling result in a negative yield (i.e., present value of expected future cash flows are less than amortized cost), an other-than-temporary impairment is recorded for the noninterest-related decline, which is the difference between the security's amortized cost and the present value of cash flows expected to be collected. The Company continues to receive contractual principal and interest payments on all of its mortgage- and asset-backed securities. The Company does not hold any mortgage- or asset-backed securities in its December 31, 2019 portfolio that were other-than-temporarily impaired in prior years.

The Company has reviewed all loan-backed and structured securities held as of December 31, 2019 and 2018 and believes that there are no noninterest related declines in which other-than-temporary impairment should have been recorded for the years ended December 31, 2019 or 2018.

The table below sets forth the maturity aging schedule of bonds at December 31, 2019. The actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Statement value</u>	<u>Fair value</u>
Due in 1 year or less	\$ 83,643	\$ 83,799
Due after 1 year through 5 years	436,999	446,455
Due after 5 years through 10 years	250,177	258,098
Due after 10 years	93,893	96,629
Mortgage- and asset-backed securities	<u>229,773</u>	<u>230,482</u>
Total	<u>\$ 1,094,485</u>	<u>\$ 1,115,463</u>

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Proceeds from sales of bonds during 2019 and 2018 were \$586,476 and \$463,609, respectively. Gross gains of \$9,445 and \$828 were realized in 2019 and 2018, respectively, relating to those sales. Gross losses of \$804 and \$5,714 were realized in 2019 and 2018, respectively, relating to those sales.

Proceeds from the sale of investments in common stocks during 2019 and 2018 totaled \$67,548 and \$60,899, respectively. Gross gains of \$14,340 and \$11,568 were realized in 2019 and 2018, respectively, relating to those sales. Gross losses of \$903 and \$90 were realized in 2019 and 2018, respectively, relating to those sales. Proceeds for the sale of investments in preferred stocks during 2019 and 2018 were \$2,728 and \$605, respectively. Gross gains of \$0 and \$0 were realized in 2019 and 2018, relating to those sales. Gross losses of \$163 and \$30 were realized in 2019 and 2018, respectively, relating to those sales.

U.S. government securities with a carrying value of approximately \$85,578 and \$85,072 at December 31, 2019 and 2018, respectively, were on deposit with government agencies, as prescribed by law in the applicable state. Statement of Statutory Accounting Principles (SSAP) No. 1, *Accounting Policies, Risks & Uncertainties, and Other Disclosures*, was revised to require these securities on deposit be classified as restricted use assets.

The Company does not invest directly in mortgages. Any mortgage exposure in the portfolio is through mortgage-related securities. The Company has no direct investments in subprime mortgages as of December 31, 2019 and 2018. The Company defines subprime mortgage securities as residential mortgage securities that are not guaranteed by a government agency or government-sponsored entity and which include meaningful exposure to residential mortgages with special risk factors such as lower rated borrowers, high loan-to-value ratios, or second liens. The only exposure the Company has through other mortgage-backed investments is through commercial mortgage-backed securities.

During 2012, the Company obtained a line of credit for the amount of \$20,000. As of December 31, 2019 and 2018, there were no balances outstanding on this line of credit.

(3) FAIR VALUE MEASUREMENTS

Statutory accounting principles define the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Certain financial instruments and all nonfinancial instruments are excluded from statutory disclosure requirements.

The following methods and assumptions were used to estimate the fair value of each class of significant financial instrument for which it is practicable to estimate that value:

- Due to the relatively short-term nature of cash, cash equivalents, and short-term investments, accrued interest and dividends, premiums and all other receivables, accrued expenses and all other payables, the carrying value is a reasonable estimate of fair value.

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- Bonds and stocks are valued primarily by using quoted prices.

	2019		2018	
	Statement value	Estimated fair value	Statement value	Estimated fair value
Financial instruments recorded as assets:				
Bonds	\$ 1,094,485	\$ 1,115,463	\$ 1,014,489	\$ 1,009,096
Preferred stock	9,890	9,904	11,334	11,344
Common stock - unaffiliated	193,867	193,867	201,470	201,470
Cash, cash equivalents, and short-term investments	69,925	69,925	18,361	18,361

Included in various investment related line items in the statutory financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as when impaired or, for certain bonds and preferred stock, when carried at the lower of cost or fair value, based on the associated NAIC designation.

The fair value of an asset is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses a market approach and maximizes the use of observable inputs and minimizes the use of unobservable inputs.

For disclosure purposes, based on a hierarchy defined by SSAP No. 100R, *Fair Value*, the Company categorizes its financial instruments into a hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives highest priority to quotes in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument in its entirety.

The Company categorizes financial assets and liabilities as follows:

Level 1 – Management’s valuations are based on unadjusted quoted prices in active markets for identical, unrestricted assets. Since valuations are based on quoted prices that are readily available in an active market, valuation of these assets does not involve any meaningful degree of judgment. An active market is defined as a market where transactions for the financial instrument occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 inputs generally include common stocks and U.S. government debt securities, where management’s valuations are based on quoted market prices.

Level 2 – Management’s valuations are based on quoted market prices where such markets are not deemed to be sufficiently “active.” In such circumstances, additional valuation metrics will be used, which involve direct or indirect observable market inputs. Level 2 inputs generally include debt securities other than debt issued by the U.S. government. Third-party dealer quotes typically constitute a significant input in management’s determination of the fair value of these types of bonds. In developing such quotes, dealers will use the terms of the security and market-based inputs. Terms of the security include coupon, maturity date, and any special provision that may enable the investor to redeem the security prior to its maturity

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date. Market-based inputs include the level of interest rates applicable to comparable securities in the market and current credit ratings of the security.

Level 3 – Management’s valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Valuations under Level 3 generally involve a significant degree of judgment on the part of management. The Company does not hold Level 3 assets as of December 31, 2019 and 2018.

Assets and liabilities measured or disclosed at fair value as of December 31, 2019 and 2018 are as follows:

	December 31, 2019			Total
	Level 1	Level 2	Level 3	
Assets:				
Bonds:				
U.S. government and government agencies	\$ 179,928	\$ 45,694	\$ —	\$ 225,622
States and political subdivisions	—	67,101	—	67,101
Special revenue and special assessment obligations	—	409,931	—	409,931
Corporate	—	412,809	—	412,809
Total bonds	179,928	935,535	—	1,115,463
Preferred stock	9,904	—	—	9,904
Common stock, unaffiliated	193,867	—	—	193,867
Total bonds and stock	\$ <u>383,699</u>	\$ <u>935,535</u>	\$ <u>—</u>	\$ <u>1,319,234</u>

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(Dollars in thousands)

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Bonds:				
U.S. government and government agencies	\$ 207,313	\$ 26,803	\$ —	\$ 234,116
States and political subdivisions	—	82,622	—	82,622
Special revenue and special assessment obligations	—	366,024	—	366,024
Corporate	—	326,334	—	326,334
Total bonds	207,313	801,783	—	1,009,096
Preferred stock	11,344	—	—	11,344
Common stock, unaffiliated	201,470	—	—	201,470
Total bonds and stock	\$ 420,127	\$ 801,783	\$ —	\$ 1,221,910

There were no transfers into or out of Level 3 for the years ended December 31, 2019 and 2018.

(4) RESERVE FOR LOSSES AND LAE

The Company establishes a liability for losses and LAE to cover its estimated ultimate liability for property and casualty losses and LAE with respect to reported claims and claims incurred but not yet reported as of the end of each accounting period. As required by applicable accounting rules, no liabilities are established until a loss occurs, including a loss from a catastrophe. Loss and LAE liabilities are estimates of what the Company expects the ultimate settlement and administration of claims will cost based on facts and circumstances then known, predictions of future events, and estimates of future trends in claims severity and frequency, judicial theories of liability, and other factors.

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Activity in the liability for unpaid losses and LAE is summarized as follows:

	2019	2018
Balance at January 1	\$ 792,174	\$ 564,213
Less reinsurance recoverables	108,163	51,386
Net balance at January 1	\$ 684,011	\$ 512,827
Incurred related to:		
Current year	\$ 542,488	\$ 590,153
Prior years	17,678	55,175
Total incurred	\$ 560,166	\$ 645,328
Paid related to:		
Current year	\$ 234,841	\$ 245,287
Prior years	300,810	228,857
Total Paid	\$ 535,651	\$ 474,144
Net balance at December 31	\$ 708,526	\$ 684,011
Plus reinsurance recoverables	109,069	108,163
Balance at December 31	\$ 817,595	\$ 792,174

Current year incurred losses show a large improvement over 2018 in both current and prior accident years. Hurricanes, wildfires, large fire losses, and an increase in prior year development impacted 2018. These trends did not repeat in 2019 in part due to favorable weather patterns but also due to the Company's loss mitigation and underwriting strategies. As a result of changes in estimates of insured events in prior years, the provision for losses and LAE (net of the change in estimated reinsurance recoveries of \$19,507 and \$28,285 in 2019 and 2018, respectively) increased \$17,678 and \$55,175 in 2019 and 2018, respectively. Prior year development was slightly unfavorable in 2019 but to a much lower degree than 2018. In 2019 the prior year development was from small increases for commercial multi-peril plus additional catastrophe development from 2018. The 2018 prior year development was driven by the commercial-multi peril and workers' compensation lines of business.

Anticipated salvage and subrogation of approximately \$18,106 and \$15,512 are included as a reduction in loss reserves at December 31, 2019 and 2018, respectively.

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(5) INCOME TAXES

The Company files a consolidated federal income tax return including the results of operations of the Company, Specialty, CM Vantage, CM Select, CM Regent, CM Regent LLC, and CM Indemnity. At December 31, 2019 and 2018, the Company had no net operating loss or tax credit carryforwards.

The following are income taxes incurred in the current and prior years for federal tax reporting purposes that will be available for recoupment in the event of future losses:

2019	\$	6,087
2018		—
2017		—

The Company's total current federal income tax and change in net deferred income taxes without unrealized gains for the years ended December 31, 2019 and 2018 differ from the amount obtained by applying the federal statutory income tax rate of 21% in 2019 and 2018 to income before income taxes from the statutory statements of operations for the following reasons:

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	2019	2018
(Loss) income before taxes (excluding capital gains)	\$ (7,225)	\$ (120,917)
Capital gains	28,995	4,618
Income (loss) before taxes	\$ 21,770	\$ (116,299)
Income tax expense (benefit) at statutory rate	\$ 4,572	\$ (24,414)
Increase (decrease) in tax resulting from:		
Tax-exempt interest	(308)	(1,315)
Dividends received deduction	(1,326)	(328)
Nondeductible expenses	213	208
Other permanent items	134	(179)
Tax rate impact due to tax act enactment	—	(3,318)
Uncertain tax provisions	(3,437)	3,437
Rate differential on net operating loss carryback	602	(9,248)
Cash surrender value of life insurance increase	(109)	(153)
Total income tax expense (benefit) expected	\$ 341	\$ (35,310)
Current income taxes incurred	\$ 5,990	\$ (26,271)
Prior year overaccrual (underaccrual)	1,642	(8,327)
Uncertain tax provisions	(3,437)	3,437
Other items	71	73
Change in deferred income tax (without tax on unrealized gains and losses and nonadmitted assets)	(3,925)	(4,222)
Total statutory income tax (benefit) expense	\$ 341	\$ (35,310)

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The components of the net deferred tax asset at December 31, 2019 and 2018 are as follows:

	December 31, 2019			December 31, 2018			Change
	Ordinary	Capital	Total	Ordinary	Capital	Total	
Total gross deferred tax assets	\$ 53,928	\$ 467	\$ 54,395	\$ 47,134	\$ 2,639	\$ 49,773	\$ 4,622
Statutory valuation allowance	—	—	—	—	—	—	—
Adjusted gross deferred tax assets	53,928	467	54,395	47,134	2,639	49,773	4,622
Total gross deferred tax liabilities	(3,966)	(12,976)	(16,942)	(4,765)	(6,679)	(11,444)	(5,498)
Net deferred tax assets (liabilities)	49,962	(12,509)	37,453	42,369	(4,040)	38,329	(876)
Total deferred tax assets nonadmitted	—	—	—	(6,452)	—	(6,452)	6,452
Net admitted deferred tax assets (liabilities)	<u>\$ 49,962</u>	<u>\$ (12,509)</u>	<u>\$ 37,453</u>	<u>\$ 35,917</u>	<u>\$ (4,040)</u>	<u>\$ 31,877</u>	<u>\$ 5,576</u>
						Change in net admitted deferred tax assets	\$ 5,576
						Plus: tax effect of unrealized gains (losses)	<u>6,193</u>
						Equals change in net admitted deferred tax assets	\$ 11,769
						Less: Change in deferred tax assets nonadmitted	<u>6,452</u>
						Change in net deferred income taxes	<u>\$ 5,317</u>

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The amount of admitted adjusted gross deferred tax assets allowed under each component of SSAP No. 101, *Income Taxes*, as of December 31, 2019 and 2018 is as follows:

<u>Admission calculation</u>	December 31, 2019			December 31, 2018			<u>Change</u>
	Ordinary	Capital	Total	Ordinary	Capital	Total	
Admitted carrybacks for taxes paid in prior periods	\$ 5,620	\$ 467	\$ 6,087	\$ —	\$ 73	\$ 73	\$ 6,014
Admitted Gross DTAs:							
Admitted adjusted DTA expected to be realized within applicable period	32,688	—	32,688	31,658	146	31,804	884
Admitted per applicable percentage of surplus and capital excluding DTAs, EDP, operating software, and positive goodwill	—	—	95,946	—	—	87,746	8,200
Admitted Gross DTAs (equal to the lesser of adjusted DTA expected in applicable period and applicable percentage of surplus and capital adjusted for DTAs, EDP, operating software, and positive goodwill)	32,688	—	32,688	31,658	146	31,804	884
Admitted adjusted DTAs that can be offset against gross DTLs considering character of DTAs and DTLs such that offsetting would be allowed under federal income tax laws	15,620	—	15,620	9,024	2,420	11,444	4,176
Total admitted deferred tax assets	<u>53,928</u>	<u>467</u>	<u>54,395</u>	<u>40,682</u>	<u>2,639</u>	<u>43,321</u>	<u>11,074</u>
Total deferred tax liabilities	<u>(3,966)</u>	<u>(12,976)</u>	<u>(16,942)</u>	<u>(4,765)</u>	<u>(6,679)</u>	<u>(11,444)</u>	<u>(5,498)</u>
Net admitted deferred tax assets (liabilities)	<u>\$ 49,962</u>	<u>\$ (12,509)</u>	<u>\$ 37,453</u>	<u>\$ 35,917</u>	<u>\$ (4,040)</u>	<u>\$ 31,877</u>	<u>\$ 5,576</u>
Authorized control level ratio excluding DTAs			618%			542%	

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are as follows:

	2019		
	Ordinary	Capital	Total
Deferred tax assets:			
Tax basis discount on unpaid losses	\$ 13,801	\$ —	\$ 13,801
Adjustment for unearned premiums	17,612	—	17,612
Accrued deferred compensation	4,910	—	4,910
Accrued postretirement and pension benefits	8,750	—	8,750
Nonadmitted intangibles	59	—	59
Nonadmitted common stock/prepays	3,216	—	3,216
Acquired intangibles	1,166	—	1,166
Fixed assets	742	—	742
Other	3,672	467	4,139
Total deferred tax assets	53,928	467	54,395
Total deferred tax assets nonadmitted	—	—	—
Total admitted deferred tax assets	53,928	467	54,395
Deferred tax liabilities:			
Unrealized gains on stocks	—	12,872	12,872
Unpaid losses liability	3,286	—	3,286
Other	680	104	784
Total deferred tax liabilities	3,966	12,976	16,942
Net deferred tax asset admitted	\$ 49,962	\$ (12,509)	\$ 37,453

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	<u>Ordinary</u>	<u>2018 Capital</u>	<u>Total</u>
Deferred tax assets:			
Tax basis discount on unpaid losses	\$ 12,988	\$ —	\$ 12,988
Adjustment for unearned premiums	15,885	—	15,885
Accrued deferred compensation	4,269	—	4,269
Accrued postretirement and pension benefits	5,826	—	5,826
Nonadmitted intangibles	101	—	101
Nonadmitted common stock/prepays	2,926	—	2,926
Acquired intangibles	1,407	—	1,407
Fixed assets	1,215	—	1,215
Other	2,517	2,639	5,156
	<u>47,134</u>	<u>2,639</u>	<u>49,773</u>
Total deferred tax assets	47,134	2,639	49,773
Total deferred tax assets nonadmitted	<u>(6,452)</u>	<u>—</u>	<u>(6,452)</u>
	<u>40,682</u>	<u>2,639</u>	<u>43,321</u>
Total admitted deferred tax assets	40,682	2,639	43,321
Deferred tax liabilities:			
Unrealized gains on stocks	—	6,679	6,679
Unpaid losses liability	4,143	—	4,143
Other	622	—	622
	<u>4,765</u>	<u>6,679</u>	<u>11,444</u>
Total deferred tax liabilities	4,765	6,679	11,444
Net deferred tax asset admitted	<u>\$ 35,917</u>	<u>\$ (4,040)</u>	<u>\$ 31,877</u>

There are no deferred tax liabilities that are not recognized as of December 31, 2019 or 2018.

As of December 31, 2019, no statutory valuation allowance has been reported against the Company's deferred tax assets.

The Company's beginning balances for income tax contingencies were \$3,437 and \$0 for years ending December 31, 2019 and 2018. In 2019 the Company released a liability that had been recorded in 2018, in accordance with SSAP No. 5R *Liabilities, Contingencies and Impairments of Assets Revised*, for the net benefit of the filing position taken on its 2017 Federal Tax Return. The liability was released in 2019 based on facts and circumstances that became available in 2019. The Company has recorded a liability for the net benefit of \$0 and \$3,437, in 2019 and 2018, respectively; the 2018 liability was fully reversed in 2019.

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The changes in the main components of deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are as follows:

	2019	2018
Changes in deferred tax assets from book/tax differences in:		
Tax basis discount on unpaid losses	\$ 813	\$ 7,833
Adjustment for unearned premiums	1,727	881
Accrued deferred compensation	641	(252)
Accrued postretirement benefits and pension benefits	2,924	(558)
Nonadmitted intangibles	(42)	(42)
Nonadmitted common stock/prepays	290	(646)
Acquired intangibles	(241)	(254)
Fixed assets	(473)	(101)
Other	(1,017)	1,838
Total change in gross deferred tax assets	4,622	8,699
Total change in nonadmitted deferred tax assets	6,452	(1,065)
Total change in net admitted deferred tax assets	\$ 11,074	\$ 7,634
Deferred tax liabilities resulting from book/tax differences in:		
Unrealized gains on stocks	\$ (6,193)	\$ 4,282
Unpaid losses liability	857	(4,143)
Other	(162)	(445)
Total change in deferred tax liabilities	(5,498)	(306)
Total change in net deferred tax assets	\$ 5,576	\$ 7,328

The change in net deferred income taxes comprises the following at December 31, 2019:

	2019	2018	Change
Total deferred tax assets	\$ 54,395	\$ 49,773	\$ 4,622
Total deferred tax liabilities	16,942	11,444	5,498
Net deferred tax asset	\$ 37,453	\$ 38,329	(876)
Tax effect of unrealized gains			6,193
Change in net deferred income taxes			\$ 5,317

The Internal Revenue Services ("IRS") requires insurance companies to discount loss reserves using either company-specific payment patterns, or industry average tables published by the IRS, for tax years beginning before December 31, 2017. The Company has previously elected to follow its company-specific payment pattern. The Tax Cuts and Jobs Act ("TCJA") changed the discount rate and payment patterns utilized to discount certain lines of business when computing the allowable tax reserve deduction. The IRS issued Revenue Procedure 2019-31, which provided taxpayers with the updated discount factors

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for use in these computations. The Company utilized these discount factors in preparing its 2018 tax return. As a result of this additional guidance, the Company recorded an increase to its gross deferred tax assets for loss reserve discounting of \$4,736 and an increase to its gross deferred tax liability for salvage and subrogation and reserve transition liability of \$4,736 during 2018. The recorded adjustment had no impact on the Company's effective tax rate. As of December 31, 2018, accounting for the TCJA requirement was complete and remains complete at December 31, 2019.

The Company has determined that there is no impact from tax-planning strategy on the adjusted gross and net admitted deferred tax assets as of December 31, 2019. The Company's tax-planning strategy does not include the use of reinsurance related tax-planning strategies.

The examinations of the Company's consolidated federal income tax returns for the years 2015 and prior are closed, and the years 2016 through 2019 remain open under the IRS statute of limitations.

(6) EMPLOYEE BENEFIT PLANS

(a) Pension Plan

The Company sponsors a noncontributory defined benefit pension plan (Pension Plan), which covers substantially all employees.

The Company's plan was amended and restated effective November 1, 2012 converting to a cash balance plan. Prior to this amendment, benefits were based on a defined percentage of average annual compensation for the highest five consecutive years during which the employee was an active participant. Under the amended plan, the cash balance account at the end of any plan year is equal to the beginning cash balance account plus any interest credit, contribution credit, and transition credit for the plan year. For participants as of October 31, 2012, the initial cash balance account at November 1, 2012 was equal to a conversion factor multiplied by the October 31, 2012 accrued retirement account. Contribution credit was available to each participant using a defined percentage based on years of service applied to their compensation. Transition credits were available for employees over age 45 with 15 or more years of service as of October 31, 2012. Interest credit was equal to the participant's beginning cash account balance multiplied by the greater of an IRC Section 417(e) (3) (D) calculated interest factor or 4%.

The normal cost for the years ended December 31, 2019 and 2018 and applicable amortization of prior service costs have been funded in accordance with the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). As of December 31, 2019 and 2018, the Company has reported pension balances in accordance with actuarially determined amounts.

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Summarized information on the Pension Plan for the years ended December 31, 2019 and 2018 is as follows:

	Measurement date	
	December 31, 2019	December 31, 2018
Change in benefit obligation:		
Projected benefit obligation at beginning of year	\$ 100,840	\$ 107,810
Service cost	3,048	3,141
Interest cost	4,540	4,201
Actuarial loss (gain)	5,728	(1,846)
Settlements	(8,726)	(11,283)
Other benefits paid	(1,308)	(1,183)
Projected benefit obligation at end of year	\$ 104,122	\$ 100,840
	Measurement date	
	December 31, 2019	December 31, 2018
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 111,368	\$ 124,047
Actual return on plan assets	14,551	(2,153)
Employer contribution	935	1,878
Settlements	(8,103)	(11,221)
Other benefits paid	(1,308)	(1,183)
Fair value of plan assets at end of year	117,443	111,368
Funded (unfunded) status	\$ 13,321	\$ 10,528
Items not yet recognized as a component of net periodic pension costs:		
Unrecognized prior service cost (vested)	\$ (8,759)	\$ (9,750)
Unrecognized actuarial loss	14,409	18,069
Components of net periodic benefit cost:		
Service cost	\$ 3,048	\$ 3,141
Interest cost	4,540	4,201
Expected return on plan assets	(6,811)	(7,624)
Amortization of net loss (gain) from earlier periods	443	—
Amortization of unrecognized prior service (credit) cost	(991)	(991)
Total net period benefit cost (income)	\$ 229	\$ (1,273)

The accumulated benefit obligations as of December 31, 2019 and 2018 are \$102,789 and \$100,113, respectively. A measurement date of December 31, 2019 and 2018 was used to determine the benefit obligation and net benefit cost.

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The Company had a nonadmitted prepaid pension asset of \$13,321 at December 31, 2019 and a nonadmitted prepaid pension asset of \$10,528 at December 31, 2018.

The following table summarizes benefits expected to be paid in each of the next five years and, in the aggregate, for the five fiscal years thereafter:

2020	\$	5,869
2021		6,614
2022		7,078
2023		7,074
2024		7,879
2025 – 2029		<u>43,125</u>
Total	\$	<u>77,639</u>

The Company does not expect to make contributions to the 2020 Pension Plan year.

The following weighted average assumptions were used in determining the costs and liabilities associated with the Pension Plan:

	<u>2019</u>	<u>2018</u>
Used to determine benefit cost:		
Measurement date	12/31/2019	12/31/2018
Discount rate	4.63%	3.98%
Rate of compensation increase	3.75	3.75
Expected long-term rate of return on plan assets	6.25	6.25
Interest crediting rates	4.90	4.25
Used to determine benefit obligation:		
Measurement date	12/31/2019	12/31/2018
Discount rate	3.64%	4.63%
Rate of compensation increase	3.75	3.75
Interest crediting rates	4.00	4.90

The Company's investment objectives are designed to (1) provide a long-term investment return greater than the actuarial assumption; (2) maximize investment returns commensurate with appropriate levels of risk; and (3) invest funds in a manner consistent with ERISA's fiduciary standards. Assets are allocated to provide adequate liquidity for plan disbursements and managed such that all retirement benefits payments are met as they become due. The Company's guidance to its manager permits equity exposure up to 40.0% of the portfolio depending on market conditions.

The tables below present the fair value hierarchy for the balances of the assets of the Pension Plan measured at fair value on a recurring basis and other balances as of December 31, 2019 and December 31, 2018. Fair value of Level 1 assets is based on unadjusted quoted prices for identical assets in active markets that are accessible to the Company. Fair value of Level 2 assets is based on quoted prices other than those included within Level 1 that are observable for

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the asset, either directly or indirectly. Fair value of Level 3 assets is estimated by the Company using one or more significant unobservable inputs.

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ 4,013	\$ —	\$ —	\$ 4,013
U.S. government securities	11,510	—	—	11,510
Corporate bonds and debentures	—	60,572	—	60,572
Foreign issued bonds and debentures	—	1,057	—	1,057
Common stock	39,029	—	—	39,029
Mutual funds	667	—	—	667
Accrued income	595	—	—	595
Total	\$ 55,814	\$ 61,629	\$ —	\$ 117,443

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ 5,158	\$ —	\$ —	\$ 5,158
U.S. government securities	9,581	—	—	9,581
Corporate bonds and debentures	—	59,253	—	59,253
Foreign issued bonds and debentures	—	984	—	984
Common stock	35,293	—	—	35,293
Mutual funds	496	—	—	496
Accrued income	603	—	—	603
Total	\$ 51,131	\$ 60,237	\$ —	\$ 111,368

The expected long-term rate of return on the Pension Plan's assets is reviewed at least annually, taking into account the asset allocation, historical and future returns on the types of assets in the plan, and the current economic environment. The Company strives to keep asset allocation consistent over time and within a relatively narrow band of asset class ranges regardless of short-term market moves. Based on these factors, the Company expects the plan assets will earn an average 6.00% per year in the future. This return assumption is based on its expectations for expected returns in the equity and bond markets over a longer-term expectation horizon.

In 2019 and 2018, the cost of all settlements in the defined benefit plan exceeded the sum of the service cost and interest cost of the plan. As a result of these settlements, the Projected Benefit Obligation was reduced by \$8,726 in 2019 and \$11,283 in 2018, with a corresponding reduction in the Fair Value of Plan Assets of \$8,103 in 2019 and \$11,221 in 2018, for an increase to the Funded Status of the Plan of \$623 in 2019 and \$62 in 2018. Following settlement accounting treatment, the Company also recognized a net loss of \$1,208 in 2019 and \$2,023 in 2018 from previously

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unrecognized net loss. The net result was an additional pension expense of \$585 and \$1,961 in the Statutory Statement of Operations for the years ended December 31, 2019 and 2018, respectively.

(b) Postretirement Benefits Other than Pensions

The Company sponsors a defined benefit plan that provides certain postretirement healthcare and life insurance benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach age 60 and have 20 years of service with the Company. New employees hired after January 1, 2010 remain eligible for the plan; however, they are required to pay 100% of the premium. The plan is contributory, with retiree contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance.

The postretirement benefit plan is unfunded and as such, there are no assets associated with the plan.

In 2018, the Company offered current retirees covered by the post-retirement health plan the option to take a buyout from the plan and obtain future health care coverage outside of the Company's insurance plan. In 2018, 104 retirees and spouses elected to take this buyout which was a settlement of their interest in the plan. The accumulated post-retirement benefit obligation was reduced by \$3,531 due to these settlements. Since the plan has no assets, the funded status of the plan was increased by \$3,531. The buyout payments were treated as additional benefit payments in 2018. The net result was a reduction in post-retirement health expense of \$3,011 in 2018 income.

The following tables present the Plan's funded status reconciled with amounts recognized in the Company's surplus of policyholders at December 31:

	2019	2018
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 38,273	\$ 48,640
Service cost	2,270	2,216
Interest cost	1,901	1,649
Actuarial loss (gain)	11,815	(9,726)
Other events: Settlement	—	(3,531)
Amendment: Voluntary retirement incentive	1,484	195
Benefits paid	(754)	(1,170)
Accrued postretirement cost	\$ 54,989	\$ 38,273

	2019	2018
Fair value of plan assets	\$ —	\$ —
Benefit obligation at end of year	54,989	38,273
Unfunded status	\$ (54,989)	\$ (38,273)

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	<u>2019</u>		<u>2018</u>
Items not yet recognized as a component of net periodic postretirement costs:			
Unrecognized prior service (credit) (vested)	\$ (2,210)	\$	(4,014)
Unrecognized prior service cost (nonvested)	11,304		12,567
Unrecognized actuarial loss (gain)	10,818		(996)
	<u>2019</u>		<u>2018</u>
Components of net periodic benefit cost:			
Service cost	\$ 2,270	\$	2,216
Interest cost	1,901		1,649
Amount of recognized prior service credit (vested)	(320)		(403)
Amount of recognized prior service cost (nonvested)	1,263		1,263
Amount of recognized losses	—		1
Total net periodic benefit cost	\$ <u>5,114</u>	\$	<u>4,726</u>

The following assumptions were used in determining the costs and liabilities associated with the postretirement benefit plan:

	<u>2019</u>		<u>2018</u>
Used to determine benefit obligation and benefit cost:			
Measurement date	12/31/2019		12/31/2018
Discount rate benefit cost	4.40%		3.77%
Discount rate benefit obligation	3.35		4.40

The Company has accrued a liability of \$54,989 and \$38,273 as of December 31, 2019 and 2018, respectively.

For measurement of the benefit obligation, the following medical trend rates were assumed for the annual increase in the per capita cost of covered healthcare benefits:

	<u>Medical Pre-65</u>		<u>Medical Post-65</u>
2019 first year medical trend rate	5.60%		5.10%
2020 first year medical trend rate	5.30		5.00
Ultimate medical trend rate	3.80		3.80

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The Company has a profit-sharing plan covering substantially all full-time employees. Accrued profit sharing expense was \$1,832 as of December 31, 2019 and \$410 as of December 31, 2018. Profit-sharing contribution payments based on prior year accrued amounts were \$0 and \$3,150 in 2019 and 2018, respectively.

The Company sponsors a defined contribution plan. The plan includes an IRS qualified 401(k) plan, which provides for a Company matching contribution of 100% of the first 3% and 50% of the next 2% contributed or deferred annually by each eligible participant, to a maximum matched contribution of 4% of the participant's earnings. In addition, the Company will contribute 2% to each eligible participant regardless of their participation. The Company's matching contribution for the plan was \$4,284 and \$3,686 in 2019 and 2018, respectively.

(c) Deferred Compensation

The Company has granted various deferred compensation and supplemental retirement benefits to certain senior officers and sales representatives. The liability at December 31, 2019 and 2018 was approximately \$22,231 and \$20,328, respectively. The Company's expense for these plans was \$3,293 and \$1,390 for the years ended December 31, 2019 and 2018, respectively.

(7) REINSURANCE ACTIVITY

The Company limits the maximum net loss, which can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risks with other insurers or reinsurers, either on an automatic basis or under general reinsurance contracts known as "treaties" or by negotiation on substantial facultative risks. Ceded reinsurance is treated as the risk and liability of the assuming companies.

Effective January 1, 2013, the Company became an assuming member of the Mutual Reinsurance Bureau (MRB), an unincorporated joint reinsurance association made up of five member companies. Excluding any business ceded by the Company to MRB, all member companies participate equally (at 20%) in the association's underwriting results. Any business ceded by the Company to MRB is assumed equally (at 25%) by the other four member companies.

Effective January 1, 2016, October 1, 2016, and September 1, 2017, the Company entered into 100% assumptive quota-share reinsurance agreements with its wholly owned subsidiaries, CM Vantage, CM Regent, and CM Select, respectively. The agreements cover all written premiums after the effective date of the contracts.

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The following tables summarize amounts related to reinsurance assumed and ceded as of December 31, 2019 and 2018 and for the years then ended, respectively:

Premium activity:

	2019		
	<u>Written</u>	<u>Earned</u>	<u>Unearned</u>
Direct	\$ 815,636	\$ 778,160	\$ 375,474
Assumed - affiliated	94,626	92,579	49,490
Assumed - unaffiliated	20,872	19,456	5,636
Ceded	<u>(85,393)</u>	<u>(83,371)</u>	<u>(11,275)</u>
Net	<u>\$ 845,741</u>	<u>\$ 806,824</u>	<u>\$ 419,325</u>

	2018		
	<u>Written</u>	<u>Earned</u>	<u>Unearned</u>
Direct	\$ 733,672	\$ 722,243	\$ 335,801
Assumed - affiliated	92,682	80,892	47,443
Assumed - unaffiliated	14,072	14,506	4,221
Ceded	<u>(68,235)</u>	<u>(66,933)</u>	<u>(9,253)</u>
Net	<u>\$ 772,191</u>	<u>\$ 750,708</u>	<u>\$ 378,212</u>

Loss and LAE activity:

	2019		2018	
	<u>Incurred loss and LAE</u>	<u>Liability for loss and LAE</u>	<u>Incurred loss and LAE</u>	<u>Liability for loss and LAE</u>
Direct	\$ 563,822	\$ 700,740	\$ 656,262	\$ 705,689
Assumed - affiliated	27,622	86,893	35,653	59,653
Assumed - unaffiliated	56,787	29,962	39,417	26,832
Ceded	<u>(88,065)</u>	<u>(109,069)</u>	<u>(86,004)</u>	<u>(108,163)</u>
Net	<u>\$ 560,166</u>	<u>\$ 708,526</u>	<u>\$ 645,328</u>	<u>\$ 684,011</u>

Estimated amounts recoverable from reinsurers are deducted from the liability for losses and LAE.

The Company receives contingent commissions from reinsurance contracts. Contingent commissions of approximately \$2,491 and \$893 were recognized for the years ended December 31, 2019 and 2018, respectively.

On October 22, 2018, the Risk Management Agency (RMA), an agency within the United States Department of Agriculture (USDA), announced that the Company was approved to be a Standard Reinsurance Agreement holder through the Federal Crop Insurance Corporation. All of the multiple peril crop business will be 100% ceded to a group of four highly rated reinsurers. The reinsurers are Validus Reinsurance LTD (50%), Allied World Insurance Company (20%), Axis Specialty LTD

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(20%), and Toa Reinsurance Company of America (10%). The Company also entered into an agreement with Precision Risk Management, who will serve as the Managing General Agent (MGA), for the multiple peril crop insurance for the Company effective with the 2019 crop season.

The Company elected to compute unearned premium reserve associated with the Multiple Peril Crop Insurance Program on a daily pro rata method using a calendar period approach, as the Company did not believe it could demonstrate that the period of risk differs significantly from the contract period.

The Company reduced its loss expenses for expense payments associated with catastrophe coverage by \$0 and \$0 in 2019 and 2018 respectively. The Company reduced its other underwriting expenses for expense payments associated with buy-up coverage by \$0 and \$0 in 2019 and 2018, respectively.

Direct unearned premium reserves as of December 31, 2019 were \$375,474. The maximum amount of unearned premiums and returned commissions that would have been due reinsurers if they or the Company or a receiver canceled all insurance assumed as of the end of 2019 is as follows:

	Assumed reinsurance		Ceded reinsurance		Net	
	Unearned premiums	Commission equity	Unearned premiums	Commission equity	Unearned premiums	Commission equity
Affiliates	\$ 49,490	\$ 14,847	\$ —	\$ —	\$ 49,490	\$ 14,847
Nonaffiliates	5,636	1,069	11,275	2,608	(5,639)	(1,539)
Total	<u>\$ 55,126</u>	<u>\$ 15,916</u>	<u>\$ 11,275</u>	<u>\$ 2,608</u>	<u>\$ 43,851</u>	<u>\$ 13,308</u>

Unsecured aggregate recoverables from reinsurers for losses and LAE paid, losses and LAE unpaid, and unearned premium in excess of 3.0% of the Company's total surplus were \$26 and \$0 for the years ended December 31, 2019 and 2018, respectively.

(8) LEASES

The Company leases certain facilities and equipment under operating leases having terms of more than one year.

Total rent expense under the operating leases was approximately \$936 and \$532 for the years ended December 31, 2019 and 2018, respectively.

The following is a schedule of future minimum lease payments required under terms of the aforementioned leases as of December 31, 2019:

Fiscal year ending:	
2020	\$ 917
2021	942
2022	953
2023	964
Thereafter	<u>1,841</u>
Total minimum lease payments	<u>\$ 5,617</u>

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(9) CONTINGENCIES

In the ordinary course of business, the Company is involved in certain claim and nonclaim-related litigation, some of which involves or may involve substantial amounts. In the opinion of management, the ultimate liability, if any, will not have a material effect on the statutory financial condition of the Company.

In conjunction with structured claims settlements, the Company has purchased various annuities for which claimants are payees but for which the Company is contingently liable. The aggregate present value of such annuities was \$973 and \$1,009 as of December 31, 2019 and 2018, respectively.

As a condition of doing business, all states and jurisdictions have adopted laws requiring membership in the insurance guaranty funds. Member companies are subject to assessments each year based on premiums written in the state. The Company has estimated its costs related to past insolvencies and has recorded a charge to operations of \$4 and \$196 for the years ended December 31, 2019 and 2018, respectively. The Company has accrued a liability for future guaranty fund assessments of \$1,696 and \$1,719 as of December 31, 2019 and 2018, respectively.

The June 1, 2016, purchase agreement for CM Regent contains a contingent earn-out provision providing for up to \$15,000 payment over a five-year period to the Pennsylvania School Boards Administration. The contingent earn-out amounts shall be evaluated for each earn-out period (12-month period) separately for each contingent factor (retention, loss reserve development, and combined ratio). These contingent payments are not automatic, and certain financial outcomes in retention, reserve development, and combined ratio must be achieved before the payment is due. At the time the earn-out amounts become probable and reasonably estimable, the earn-out amount will be recorded as an additional cost of the acquired company, and goodwill will be adjusted accordingly. At December 31, 2019 and December 31, 2018, the Company determined that the earn-out provision of \$3.0 million had not been achieved and no payable for this amount was established with no corresponding increase in the cost of the acquired company.

(10) RELATED PARTIES

Included in the 2019 and 2018 operating expenses are the Company's \$0 and \$25, respectively, donations to the Church Mutual Insurance Company Foundation.

The Company provides labor and some administrative services to all of its subsidiaries under an expense sharing agreement. During the years ended December 31, 2019 and 2018, the total of all of these services were \$9,056 and \$15,271, respectively.

(11) RISK-BASED CAPITAL

The Company is regulated by the state in which it is domiciled, as well as by states in which it does business. Such regulations, among other things, limit the amount of dividends, impose restrictions on the amount and types of investments the Company may hold, and regulate rates insurers may charge for various products.

The NAIC has developed Property-Casualty Risk-Based Capital (RBC) standards that relate an insurer's reported statutory capital and surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated capital level to support asset risk (investment and credit) and underwriting risk (loss reserves, premiums written, and unearned premium). The NAIC model law calls for various levels of regulatory action based

CHURCH MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2019 and 2018

(Dollars in thousands)

on the magnitude of an indicated RBC deficiency, if any. The Company has determined that its capital levels are in excess of the minimum capital requirements for all RBC action levels.

Dividends paid to the Company from its insurance subsidiaries, may be limited by regulatory requirements.

(12) SUBSEQUENT EVENTS

The Company evaluated subsequent events through May 18, 2020, the date the accompanying statutory financial statements were available to be issued.

Effective January 1, 2020, the Company restructured into a mutual holding company structure pursuant to Chapter 644 of the Wisconsin Insurance Code. The Company will become a Wisconsin stock insurance company. All membership interests and rights in the surplus of the Company will be extinguished and the members of the Company will become members of Church Mutual Holding Company, Inc., with membership interests and rights in surplus of Church Mutual Holding Company, Inc. as provided pursuant to the Wisconsin Insurance Code and the articles of incorporation and bylaws of Church Mutual Holding Company, Inc.

As part of the restructuring the Company will transfer 100% of its shares in CM Vantage, CM Regent, CM Select, and CM Indemnity to Church Mutual Holding Company, Inc. The Company will transfer 100% of its shares in Specialty and 100% of its membership interests in CM Regent, LLC to CM Companies, Inc. and CM Companies, Inc. shall assume all of the Company's rights and obligations under the operating agreement of CM Regent, LLC and any related agreements and undertakings. These transactions will result in a decrease of the Company's assets as reported on the Statutory Statements of Admitted Assets, Liabilities, and Surplus of Policyholders of \$191,455.

Subsequent to December 31, 2019, equity and financial markets have experienced significant volatility and interest rates have continued to decline due to the COVID-19 pandemic. The Company has adjusted certain aspects of its operations to protect its employees and customers while still meeting customers' needs for services. The Company will continue to monitor the situation closely and will implement further measures if necessary. In light of the uncertainty as to the length or severity of this pandemic, the Company cannot reasonably estimate the full impact of the pandemic on its operations and financial statements at this time. On April 30, 2020, the Company's Board of Directors authorized a COVID-19 dividend program for auto policyholders, the Company believes this payment may be material, but the exact amount is not known at this time. On March 27, 2020, H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act, "the CARES ACT", was signed into legislation which includes tax provisions relevant to businesses that during 2020 could impact taxes related to 2018 and 2019. The Company is required to recognize the effect on the financial statements in the period the law was enacted, which is 2020. At this time, for 2018 and 2019, the Company does not expect the impact of the CARES ACT on the Company's financial position or results of operations to be material.

No other subsequent events were identified.

CHURCH MUTUAL INSURANCE COMPANY
Supplemental Investment Risks Interrogatories
December 31, 2019
(Dollars in thousands)

1. The Company's total admitted assets as reported on page two of the Company's Annual Statement for the year ended December 31, 2019 was \$ 1,981,276

2. Ten largest exposures to a single issuer/borrower/investment (excluding U.S. government securities):

	Issuer	Amount	Percentage of total admitted assets
2.01	CM Regent Insurance Company	\$ 78,862	4.0
2.02	CM Vantage Specialty Insurance Company	54,967	2.8
2.03	Blackrock US Core Property Fund	38,773	2.0
2.04	CM Indemnity Insurance Company	20,824	1.1
2.05	CM Select Insurance Company	20,776	1.0
2.06	Vesey Street Fund V LP	19,038	1.0
2.07	Tiberius Acq Corp	17,423	0.9
2.08	CM Regent LLC	16,122	0.8
2.09	Valor Equity Partners IV LP	10,495	0.5
2.10	New Jersey State Higher Ed Assist	10,370	0.5

3. The Company's total admitted assets held in bonds and preferred stocks by NAIC rating at December 31, 2019 are:

	Bond and Preferred Stock NAIC rating	Amount	Percentage of total admitted assets
3.01	NAIC-1	\$ 1,066,698	53.8
3.02	NAIC-2	55,001	2.8
3.03	NAIC-3	—	—
3.04	NAIC-4	—	—
3.05	NAIC-5	—	—
3.06	NAIC-6	—	—
3.07	P/RP-1	—	—
3.08	P/RP-2	—	—
3.09	P/RP-3	—	—
3.10	P/RP-4	9,890	0.5
3.11	P/RP-5	—	—
3.12	P/RP-6	—	—

4. The Company's total admitted assets in foreign investments are more than 2.5% of total admitted assets.

Total admitted assets held in foreign investments	\$ 86,418	4.4
Foreign-currency-denominated investments	—	—
Insurance liabilities denominated in that same foreign currency	—	—

5. The Company's total admitted assets in foreign investment exposure by NAIC sovereign designation are:

	Foreign Investments by NAIC Sovereign Designation	Amount	Percentage of total admitted assets
Countries designated NAIC-1	\$ 86,418	4.4	
Countries designated NAIC-2	—	—	
Countries designated NAIC-3 or below	—	—	

6. The Company's total admitted assets in the largest foreign investment exposures by country, categorized by country's NAIC sovereign designation are:

	Foreign Investments in Countries Designated NAIC-1	Amount	Percentage of total admitted assets
Country 1: United Kingdom	\$ 26,432	1.3	
Country 2: France	12,174	0.6	

7. The Company does not have an aggregate unhedged foreign currency exposure.

8. The Company does not have an aggregate unhedged foreign currency exposure.

9. The Company does not have an aggregate unhedged foreign currency exposure.

10. Ten largest nonsovereign (i.e., nongovernmental) foreign issues:

	Issuer	Amount	Percentage of total admitted assets
10.01	HSBC Hldgs PLC	\$ 7,095	0.4
10.02	Santander UK PLC	4,559	0.2
10.03	BNP Paribas	3,374	0.2
10.04	Capital Gbl NT	3,364	0.2
10.05	DNB Bank	2,679	0.1
10.06	Swedbank AB	2,574	0.1
10.07	HSBC BK PLC	2,438	0.1
10.08	Mizuho Finl Group Inc	2,385	0.1
10.09	Macquarie BK LTD	2,334	0.1
10.10	National Australia BK	2,286	0.1

11. The Company's assets in Canadian investments are less than 2.5% of total admitted assets.

12. The Company's assets held in investments with contractual sales restrictions are less than 2.5% of total admitted assets.

CHURCH MUTUAL INSURANCE COMPANY
 Supplemental Investment Risks Interrogatories
 December 31, 2019
 (Dollars in thousands)

- 13 The Company's assets held in equity investments are more than 2.5% of total admitted assets.
 Amounts and percentages of admitted assets held in the ten largest equity interests:

	<u>Issuer</u>	<u>Amount</u>	<u>Percentage of total admitted assets</u>
13.02	CM Regent Insurance Company	\$ 78,862	4.0
13.03	CM Vantage Specialty Insurance Company	54,967	2.8
13.04	Blackrock US Core Property Fund	38,773	2.0
13.05	Ishares Core S&P 500 ETF	36,707	1.9
13.06	Ishares Edge MSCI USA Quality	27,383	1.4
13.07	Ishares Core High Dividend ETF	21,487	1.1
13.08	CM Indemnity Insurance Company	20,824	1.1
13.09	CM Select Insurance Company	20,776	1.0
13.10	Vesey Street Fund V LP	19,038	1.0
13.11	Ishared Edge MSCI Min Vol USA ETF	18,994	1.0

14. The Company's assets held in nonaffiliated, privately placed equities are less than 2.5% of total admitted assets.
15. The Company's assets held in general partnership interests are less than 2.5% of total admitted assets.
16. Mortgage loans reported in Schedule B are less than 2.5% of total admitted assets.
17. Due to the percentage of assets being less than 2.5% of total admitted assets, Question 17 is omitted.
18. The Company's assets held in real estate reported are less than 2.5% of total admitted assets.
19. The Company does not have any investments in mezzanine real estate loans
20. The Company does not have any securities agreements or repurchase agreements.
21. The Company does not have any warrants attached to financial instruments, options, caps, or floors.
22. The Company does not have potential exposure for collars, swaps, or forwards.
23. The Company does not have any potential exposure for futures contracts.

See accompanying independent auditors' report.

CHURCH MUTUAL INSURANCE COMPANY
Summary Investment Schedule
December 31, 2019
(Dollars in thousands)

Schedule 2

Investment categories	Gross investment holdings		Admitted assets as reported in the annual statement	
	1	2	3	4
	Amount	Percentage	Amount	Percentage
Long-Term Bonds				
U.S. governments	\$ 226,828	13.724	\$ 226,828	13.724
All other governments	374	0.023	374	0.023
U.S. states, territories and possessions, etc. guaranteed	17,970	1.087	17,970	1.087
U.S. political subdivisions of states, territories, and possessions, guaranteed	46,055	2.786	46,055	2.786
U.S. special revenue and special assessment obligations, etc. non-guaranteed	397,848	24.071	397,848	24.071
Industrial and miscellaneous	405,410	24.529	405,410	24.529
Hybrid securities	—	—	—	—
Parent, subsidiaries and affiliates	—	—	—	—
SVO identified funds	—	—	—	—
Unaffiliated bank loans	—	—	—	—
Total long-term bonds	1,094,485	66.220	1,094,485	66.220
Preferred stocks:				
Industrial and miscellaneous (Unaffiliated)	9,890	0.598	9,890	0.598
Parent, subsidiaries and affiliates	—	—	—	—
Total preferred stocks	9,890	0.598	9,890	0.598
Common stocks:				
Industrial and miscellaneous Publicly traded (Unaffiliated)	71,008	4.296	71,008	4.296
Industrial and miscellaneous Other (Unaffiliated)	—	—	—	—
Parent, subsidiaries and affiliates Publicly traded	—	—	—	—
Parent, subsidiaries and affiliates Other	175,333	10.608	175,333	10.608
Mutual funds	122,859	7.433	122,859	7.433
Unit investment trusts	—	—	—	—
Closed-end funds	—	—	—	—
Total common stocks	369,200	22.338	369,200	22.338
Mortgage loans:				
Farm mortgages	—	—	—	—
Residential mortgages	—	—	—	—
Commercial mortgages	—	—	—	—
Mezzanine real estate loans	—	—	—	—
Total mortgage loans	—	—	—	—
Real estate:				
Properties occupied by company	12,248	0.741	12,248	0.741
Properties held for production of income	—	—	—	—
Properties held for sale	—	—	—	—
Total real estate	12,248	0.741	12,248	0.741
Cash, cash equivalents and short-term investments:				
Cash	29,254	1.770	29,254	1.770
Cash equivalents	14,986	0.907	14,986	0.907
Short-term investments	25,685	1.554	25,685	1.554
Total cash, cash equivalents and short-term investments	69,925	4.231	69,925	4.231
Contract loans	—	—	—	—
Other invested assets	96,968	5.867	96,968	5.867
Receivables for securities	83	0.005	83	0.005
The Company does not have a securities lending program	—	—	—	—
Total invested assets	\$ 1,652,799	100	\$ 1,652,799	100

See accompanying independent auditors' report.

CHURCH MUTUAL INSURANCE COMPANY
 Supplemental Schedule of Reinsurance Risk Interrogatories
 December 31, 2019
 (Dollars in thousands)

(1) REINSURANCE INTERROGATORIES

- | | |
|--|------------------|
| <p>1. Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)?</p> | Yes [] No [X] |
| <p>2. If yes, indicate the number of reinsurance contracts containing such provisions.</p> | 0 |
| <p>3. If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)?</p> | Yes [] No [] |
| <p>4. Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:</p> <p style="margin-left: 20px;">a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;</p> <p style="margin-left: 20px;">b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;</p> <p style="margin-left: 20px;">c) Aggregate stop loss reinsurance coverage;</p> <p style="margin-left: 20px;">d) An unconditional or unilateral right by either party to commute the reinsurance contract except for such provisions which are only triggered by a decline in the credit status of the other party;</p> <p style="margin-left: 20px;">e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or</p> <p style="margin-left: 20px;">f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.</p> | Yes [] No [X] |

CHURCH MUTUAL INSURANCE COMPANY
 Supplemental Schedule of Reinsurance Risk Interrogatories
 December 31, 2019
 (Dollars in thousands)

5. Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:
- a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
 - b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.
- Yes [] No [X]
6. If yes to 4 or 5, please provide the following information:
- a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;
 - b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 4 or 5; and
 - c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.
7. Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62R, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:
- a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
 - b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP?
- Yes [] No [X]
8. If yes to 7, explain why the contract(s) is treated differently for GAAP and SAP. N/A

See accompanying independent auditors' report.