Report

of the

Examination of

Ellington Mutual Insurance Company

Hortonville, Wisconsin

As of December 31, 2015

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, *Governor*
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August 26, 2016

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

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

ELLINGTON MUTUAL INSURANCE COMPANY
Hortonville, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Ellington Mutual Insurance Company (the company) was conducted in 2011 as of December 31, 2010. The current examination covered the intervening period ending December 31, 2015, and included a review of such 2016 transactions as deemed necessary to complete the examination.

The examination was conducted using a risk-focused approach in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. This approach sets forth guidance for planning and performing the examination of an insurance company to evaluate the financial condition, assess corporate governance, identify current and prospective risks (including those that might materially affect financial condition, either currently or prospectively), and evaluate system controls and procedures used to mitigate those risks.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management’s compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations. The examination does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately at the end of the “Financial Data” section in the area captioned "Reconciliation of Surplus per Examination."

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

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

In addition to auditing, the public accounting firm performs non-auditing services for the company including preparation of tax returns and annual statement and consulting related to regulatory law changes. On December 10, 2010, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

II. HISTORY AND PLAN OF OPERATION

The company was originally organized as a town mutual insurance company on July 16, 1878, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Farmers Home Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. On February 21, 1999, a stipulation and order allowed the company to convert from a town mutual insurer to a non-assessable mutual insurer authorized under ch. 611, Wis. Stat. This order was superseded by another dated November 17, 2007, which states, among other matters, that the company shall maintain a permanent surplus of $2,000,000 and the company must notify the Commissioner 30 days prior to a change in its reinsurance program and such changes are subject to disapproval by the Commissioner. On July 15, 1999, Waupaca Mutual Insurance Company merged into Ellington Mutual Insurance Company, with Ellington Mutual Insurance Company being the surviving company.

The company is licensed exclusively in the state of Wisconsin and all of its business is conducted in Wisconsin. The major products marketed by the company include homeowner's, farmowner's, inland marine, commercial multiple peril, allied lines, fire, liability and incidental medical expense coverage. In addition, the company is authorized to write automobile insurance only on an excess basis in conjunction with its umbrella excess liability program. The major products are marketed through 160 independent agents.

The following table is a summary of the net insurance premiums written by the company in 2015. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Ceded	Net Premium
Fire	$ 165,316	$ 69,016	$ 96,300
Allied lines	194,050	81,012	113,038
Farmowner's multiple peril	1,042,926	435,402	607,524
Homeowner's multiple peril	2,192,666	915,397	1,277,269
Commercial multiple peril	212,746	88,817	123,929
Other liability – occurrence	23,485	23,250	235
Total All Lines	$3,831,189	$1,612,894	$2,218,295

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. Three directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The board members currently receive $90.00 per meeting plus the IRS mileage rate for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Jennifer Bauer Ogdensburg, Wisconsin	Self-employed	2018
Judy Bauer Ogdensburg, Wisconsin	Retired	2017
Joseph Bricco New London, Wisconsin	Farmer	2019
Angela Hanson Manawa, Wisconsin	Mortgage Lender	2019
Mike Mehlberg Clintonville, Wisconsin	Bank Manager	2018
Terry Schley New London, Wisconsin	Retired	2018
Keith Suprise Shiocton, Wisconsin	Retired	2017
Ralph Thern New London, Wisconsin	Retired	2017
Lisa Visocky Hortonville, Wisconsin	Public Works Clerk	2019

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2015 Compensation
Michael Mehlberg*	Chairman of the Board	$ 1,440
Judy Bauer*	Vice Chairman of the Board	1,320
Howard J. Schwartz	President and Chief Executive Officer	97,759
Janice A. Henn	Operations Supervisor	63,930
Daniel Peeters	Field Services Supervisor	54,805

* For 2015, James Loughrin and LaWellyn Tesch served as Chairman and Vice Chairman, respectively, and received compensation during 2015 in the amounts of $3,280 and $1,440, respectively.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Scholarship Committee
Judy Bauer
Lisa Visocky
Mike Mehlberg

Nominating Committee
Joseph Bricco
Angela Hanson
Lisa Visocky

Adjusting Committee
Joseph Bricco
Ralph Thern
Keith Suprise

Auditing Committee
All Board Members

Strategic Committee
Mike Mehlberg
Terry Schley
Angela Hanson
Jennifer Bauer

IV. REINSURANCE

The company's reinsurance portfolio and strategy is described below. By Stipulation and Order dated February 21, 1999, the company's retention limits, stop-loss and catastrophic coverages under its reinsurance program must comply with the requirements applicable to a town mutual insurer operating under ch. 612, Wis. Stat. In addition, net losses resulting from the company's umbrella excess liability program may not exceed $50,000 per occurrence. Any changes to its reinsurance contracts must be submitted 30 days prior to the effective date and are subject to disapproval by the Commissioner. The contracts contained proper insolvency provisions.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2016
Termination provisions:	January 1, 2017, or any subsequent January 1st , by either party providing at least 90 days' advance notice in writing

Nonaffiliated Ceding Contracts

1.	Type:	Class A – Liability
	Scope:	All liability business written by the company
	Retention:	$10,000
	Coverage:	100% of loss in excess of retention $1,000,000 per occurrence single limit $1,000,000 split limits in any combination bodily injury and property damage liability $25,000 for medical payments per person, $25,000 per accident
	Premium:	50% of premium written Annual deposit premium $345,000
2.	Type:	Umbrella Quota Share and Excess of Loss
	Scope:	All business written classified as Umbrella Liability
	Retention:	1st Layer: $10,000
	Coverage:	1st Layer: 99% of $1,000,000 each occurrence 2nd Layer: 100% of $1,000,000 each occurrence
	Premium:	99% of premium written
	Commissions:	27.5% of premium written

3.	Type:	Class B – First Surplus
	Scope:	All property business
	Retention:	$600,000
	Coverage:	$800,000 excess of $600,000 retention Company may cede 50% of risks less than $600,000
	Premium:	The pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of each risk ceded
	Commissions:	15% premium commission; 15% profit commission of reinsurer's net profit accruing to the reinsurer under the contract
4.	Type:	Class C-1 – Excess of Loss
	Scope:	All property business
	Retention:	$125,000
	Coverage:	$125,000 excess of $125,000 retention
	Premium:	Current rate 11.60% of net premiums written Annual deposit premium $358,903 Minimum premium $269,177
5.	Type:	Class C-2 – Second Excess of Loss
	Scope:	All property business
	Retention:	$250,000
	Coverage:	$350,000 excess of $250,000 retention
	Premium:	4.00% of net premiums written Annual deposit premium $123,760 Minimum premium $92,820
6.	Type:	Class D/E1 – Stop Loss
	Scope:	All business written by the company
	Retention:	60% of net premiums written
	Coverage:	100% of losses in excess of a 60% loss ratio, up to a loss ratio of 110%
	Premium:	Current rate 12.27% of net premiums written Annual deposit premium $421,993 Minimum premium $316,495

7.	Type:	Class D/E2 – Stop Loss
	Scope:	All business written by the company
	Retention:	110% of net premiums written
	Coverage:	100% of all loss in excess of retention
	Premium:	4% of net premiums written Deposit premium $137,569 Minimum premium $103,177

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2015, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination." Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation.

Ellington Mutual Insurance Company
Assets
As of December 31, 2015

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$1,610,293	$	$1,610,293
Stocks:			
Preferred stocks	275,670		275,670
Common stocks	2,276,530		2,276,530
Real estate:			
Properties occupied by the company	147,857		147,857
Cash, cash equivalents, and short-term investments	757,267		757,267
Investment income due and accrued	19,650		19,650
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	30,699		30,699
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	331,567		331,567
Reinsurance:			
Amounts recoverable from reinsurers	1,405		1,405
Other amounts receivable under reinsurance contracts	8,766		8,766
Net deferred tax asset	205,950	171,950	34,000
Electronic data processing equipment and software	16,160	2,699	13,461
Furniture and equipment, including health care delivery assets	9,800	9,800	
Aggregate write-ins for other-than-invested assets			
Prepaid expenses	4,535	4,535	
Total Assets	$5,696,149	$188,984	$5,507,165

Ellington Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2015

Losses		$ 335,171
Loss adjustment expenses		27,000
Commissions payable, contingent commissions, and other similar charges		47,860
Other expenses (excluding taxes, licenses, and fees)		103,916
Taxes, licenses, and fees (excluding federal and foreign income taxes)		4,377
Current federal and foreign income taxes		4,396
Unearned premiums		1,813,838
Advance premium		20,454
Ceded reinsurance premiums payable (net of ceding commissions)		10,622
Total liabilities		2,367,634
Unassigned funds (surplus)	$3,139,531	
Surplus as regards policyholders		3,139,531
Total Liabilities and Surplus		$5,507,165

Ellington Mutual Insurance Company
Statement of Income
For the Year 2015

Underwriting Income		
Premiums earned		$2,112,784
Deductions:		
Losses incurred	$ 996,294	
Loss adjustment expenses incurred	172,553	
Other underwriting expenses incurred	1,187,442	
Total underwriting deductions		2,356,289
Net underwriting gain (loss)		(243,505)
Investment Income		
Net investment income earned	77,098	
Net realized capital gains (losses)	7,907	
Net investment gain (loss)		85,005
Other Income		
Finance and service charges not included in premiums	164,455	
Aggregate write-ins for miscellaneous income	433	
Total other income		164,888
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		6,388
Federal and foreign income taxes incurred		(4,000)
Net Income		$ 10,388

Ellington Mutual Insurance Company
Cash Flow
For the Year 2015

Premiums collected net of reinsurance			$2,137,160
Net investment income			97,649
Miscellaneous income			164,888
Total			2,399,697
Benefit- and loss-related payments		$1,190,617	
Commissions, expenses paid, and aggregate write-ins for deductions		1,162,164	
Total deductions			2,352,781
Net cash from operations			46,916
Proceeds from investments sold, matured, or repaid:			
Bonds	$307,284		
Stocks	40,155		
Total investment proceeds		347,439	
Cost of investments acquired (long-term only):			
Bonds	200,737		
Stocks	49,649		
Total investments acquired		250,386	
Net cash from investments			97,053
Cash from financing and miscellaneous sources:			
Other cash provided (applied)		(20,883)	
Net cash from financing and miscellaneous sources			(20,883)
Reconciliation:			
Net change in cash, cash equivalents, and short-term investments			123,086
Cash, cash equivalents, and short-term investments:			
Beginning of year			634,181
End of Year			$ 757,267

Ellington Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2015

Assets		$5,507,165
Less liabilities		2,367,634
Adjusted surplus		3,139,531
Annual premium:		
Lines other than accident and health	$2,218,295	
Factor	20%	
	443,659	
Compulsory surplus (subject to a minimum of $2 million)		2,000,000
Compulsory Surplus Excess (or Deficit)		$1,139,531
Adjusted surplus (from above)		$3,139,531
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		2,800,000
Security Surplus Excess (or Deficit)		$ 339,531

Ellington Mutual Insurance Company
Analysis of Surplus
For the Five-Year Period Ending December 31, 2015

The following schedule details items affecting surplus during the period under examination as reported by the company in its filed annual statements:

	2015	2014	2013	2012	2011
Surplus, beginning of year	$3,045,704	$2,738,844	$3,377,084	$3,542,455	$3,860,050
Net income	10,388	(155,284)	(744,975)	(62,914)	(451,450)
Change in net unrealized capital gains/losses	74,310	305,820	83,082	(150,576)	(29,682)
Change in net deferred income tax	16,280	74,713	269,220	41,732	169,660
Change in non-admitted assets	(7,151)	81,611	(245,567)	6,387	(6,123)
Surplus, End of Year	$3,139,531	$3,045,704	$2,738,844	$3,377,084	$3,542,455

Ellington Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2015

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	2015	2014	2013	2012	2011
#1	Gross Premium to Surplus	122%	120%	122%	82%	66%
#2	Net Premium to Surplus	71	71	74	53	44
#3	Change in Net Premiums Written	3	5	15	14	3
#4	Surplus Aid to Surplus	0	0	0	0	0
#5	Two-Year Overall Operating Ratio	101*	120*	120*	113*	131*
#6	Investment Yield	1.5*	2.1*	1.6*	2.6*	2.1*
#7	Gross Change in Surplus	3	11	-19*	-5	-8
#8	Change in Adjusted Surplus	3	11	-19*	-5	-8
#9	Liabilities to Liquid Assets	41	42	44	34	25
#10	Agents' Balances to Surplus	1	2	2	1	1
#11	One-Year Reserve Development to Surplus	-1	-12	-5	2	-1
#12	Two-Year Reserve Development to Surplus	-12	-6	2	0	-1
#13	Estimated Current Reserve Deficiency to Surplus	-5	-7	-4	-8	2

Ratio No. 5, “Two-Year Overall Operating Ratio,” measures the company’s profitability over the previous two-year period. The exceptional results during the period were attributable to the company’s high expense ratio and a number of unusually severe weather events.

Ratio No. 6, “Investment Yield,” measures the average return on the company’s investments. The exceptional results for this ratio during the period under examination are attributable to the very low level of interest rates generally and the level of investment in the common stock of Wisconsin Reinsurance Corporation, which does not pay dividends.

Ratio No. 7 measures the Gross Change in Policyholders’ Surplus. Ratio No. 8 measures the Change in Adjusted Policyholders’ Surplus. Exceptional negative results for these ratios occurred in 2013. These results were driven by severe storms, which resulted in a net loss of $744,975.

Growth of Ellington Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2015	$5,507,165	$2,367,634	$3,139,531	$ 10,388
2014	5,418,242	2,372,538	3,045,704	(155,284)
2013	4,896,640	2,157,796	2,738,844	(744,975)
2012	5,240,174	1,863,090	3,377,084	(62,914)
2011	4,907,402	1,364,947	3,542,455	(451,450)
2010	5,337,382	1,477,332	3,860,050	(356,320)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2015	$3,831,189	$2,218,295	$2,112,784	55.3%	46.1%	101.4%
2014	3,668,241	2,147,821	2,003,141	63.3	46.3	109.6
2013	3,336,710	2,036,277	1,751,852	97.5	46.0	143.5
2012	2,771,583	1,774,570	1,579,687	61.2	45.0	106.2
2011	2,332,484	1,563,469	1,493,600	93.2	41.7	134.9
2010	2,206,994	1,518,701	1,457,390	103.1	40.4	143.5

During the period under examination, Ellington Mutual Insurance Company‘s assets increased 3.2%, liabilities increased 60.3%, and surplus decreased 18.7%. The company has experienced an operating loss during each year of the period under examination, mainly due to its high expense ratio and the inability of investment income to provide any significant contribution due to an extended period of exceptionally low interest rates. In 2013 and 2015, the company's unfavorable results were exacerbated by significant losses due to severe weather events. The company reported a net loss every year under examination except 2015, when it had a small net income in the amount of $10,388.

The loss ratio of 97.5% in 2013 was the highest in the past five years and contributed to a combined ratio of 143.5% in that year. The expense ratio over the last five years averaged 45% compared to an average of 28% for the property and casualty industry. Between 2010 and 2015, the company's gross and net premiums written increased by 73.6% and 46.1%, respectively. The company is engaged in a geographic expansion of the area over which it writes within Wisconsin, which could increase premium volume. The company plans to eliminate its net underwriting losses through a combination of lower reinsurance premiums, as high claim years run off, and a premium rate increase on property business effective January 1, 2017.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December, 31, 2015, is accepted.

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Net Unpaid Losses—It is recommended that the company establish an IBNR reserve for liability claims based on its retention of risk under applicable reinsurance contracts.

   Action—Compliance.

2. Valuation of Wisconsin Reinsurance Corporation Series B Preferred Stock—It is recommended that the company report preferred stock designations in accordance with the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

   Action—Compliance.

Summary of Current Examination Results

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

Testing of Disaster Recovery and Business Continuity Plans

The examination noted that the company's disaster recovery and business continuity plans appear to be reasonable and complete. However, it was noted that the company had not tested its disaster recovery and business continuity plans during the period under examination. Testing of the plans helps ensure that the plans can be effectively executed in the event of a disaster. Due to the limited size of the company's operations, a walk-through, tabletop exercise to simulate a disaster would appear to be a reasonable testing method, as a real-time, live test may not be cost effective. It is recommended that, at a minimum, the company annually conduct a "tabletop" exercise to simulate a disaster to ensure that the disaster recovery and business continuity plans can be effectively executed.

Report on Executive Compensation

During this review, it was noted the Report on Executive Compensation did not include the company's contribution towards health insurance. The instructions on the Report on Executive Compensation require that compensation reported shall consist of any and all gross direct and indirect remuneration paid and accrued during the report year for the benefit of an individual director, officer, or manager, and shall include wages, salaries, bonuses, retirement benefits, deferred compensation, commissions, directors fees, retainers, stock grants, gains from the exercise of stock options, and all other forms of personal compensation (including employer-paid health, life and any other premiums). It is recommended that the company report all gross direct and indirect compensation paid or accrued during the year on its Report on Executive Compensation.

VII. CONCLUSION

Ellington Mutual Insurance Company reported assets of $5,507,165, liabilities of $2,367,634 and policyholders’ surplus of $3,139,531 as of December 31, 2015.

The following schedule summarizes the cumulative increases and decreases to surplus from December 31, 2010, when policyholders’ surplus was last verified by examination, to December 31, 2015:

Policyholders’ surplus, December 31, 2010	$ 3,860,050
Net income/(loss)	(1,404,235)
Change in net deferred income tax	571,605
Net unrealized capital gains and (losses)	282,954
Change in nonadmitted assets	(170,843)
Policyholders’ Surplus, December 31, 2015	$3,139,531

During the period under examination, Ellington Mutual Insurance Company‘s assets increased 3.2%, liabilities increased 60.3%, and surplus decreased 18.7%. The company has experienced an operating loss during each year of the period under examination, mainly due to its high expense ratio and the inability of investment income to provide any significant contribution due to an extended period of exceptionally low interest rates. In 2013 and 2015, the company’s unfavorable results were exacerbated by significant losses due to severe weather events. The company reported a net loss every year under examination except 2015, when it had a small net income in the amount of $10,388.

The loss ratio of 97.5% in 2013 was the highest in the past five years and contributed to a combined ratio of 143.5% in that year. The expense ratio over the last five years averaged 45% compared to an average of 28% for the property and casualty industry. Gross and net premiums written increased during the five-year period by 73.6% and 46.1%, respectively. The company is engaged in a geographic expansion of the area over which it writes within Wisconsin, which could increase premium volume. The company plans to eliminate its net underwriting losses through a combination of lower reinsurance premiums, as high claim years run off, and a premium rate increase on property business effective January 1, 2017.

The examination resulted in two recommendations. No adjustments to surplus or reclassifications of account balances were made. The company was in compliance with all of the recommendations made on the previous examination.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 19 - Testing of Disaster Recovery and Business Continuity Plans—It is recommended that, at a minimum, the company annually conduct a "tabletop" exercise to simulate a disaster to ensure that the disaster recovery and business continuity plans can be effectively executed.

2. Page 19 - Report on Executive Compensation—It is recommended that the company report all gross direct and indirect compensation paid or accrued during the year on its Report on Executive Compensation.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Xiaozhou Ye	Insurance Financial Examiner
Thomas R. Houston, CFE	Insurance Financial Examiner – Advanced, Information Systems Audit Specialist
Jerry C. DeArmond, CFE	Insurance Financial Examiner – Advanced, Policy and Claim Reserve Specialist
Karl K. Albert, CFE	Insurance Financial Examiner – Advanced, Exam Planning & Quality Control Specialist

Respectfully submitted,

Thomas C. Hilger
Examiner-in-Charge