Report

of the

Examination of

Lebanon-Clyman Mutual Insurance Company

Lebanon, Wisconsin

As of December 31, 2011

# TABLE OF CONTENTS

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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

***Wisconsin.gov***

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: ociinformation@wisconsin.gov
Web Address: oci.wi.gov

May 18, 2012

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

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2011, of the affairs and financial condition of:

LEBANON-CLYMAN MUTUAL INSURANCE COMPANY
Lebanon, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Lebanon-Clyman Mutual Insurance Company (the company) was made in 2007 as of December 31, 2006. The current examination covered the intervening time period ending December 31, 2011, and included a review of such subsequent transactions deemed essential to complete this examination.

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

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

The company was organized as a town mutual insurance company in 1887, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Lebanon Farmers Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation increasing the number of counties the company may write business from ten to eleven. There was one amendment to the bylaws. The amendment added Milwaukee County to their authorized territory.

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

| | |
|---|---|
| Columbia | Milwaukee |
| Dane | Ozaukee |
| Dodge | Walworth |
| Fond du Lac | Washington |
| Green Lake | Waukesha |
| Jefferson | |

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year, with the policy term matching the billing term, and premiums payable on the advance premium and assessment basis. The company does not charge any other fees to policyholders.

Business of the company is acquired through 31 agents, 1 of whom is the company manager. There are no directors who are agents for the company. Agents are presently compensated for their services as follows:

| Type of Policy | Compensation |
|---|---|
| All business, new and renewal | 12% |
| When agent’s annual net written is greater than $50,000, new and renewal | 14% |

In any year that the agent has a loss ratio of less than 50% and growth of premium in force or an increase in policy count from the previous year, agents will receive a bonus commission as follows:

**Performance Commission**

| Agent's Loss Ratio | Net Written Premium $20,000 to $50,000 | $50,000 and over |
|---|---|---|
| 0% to 20% | 3% | 4% |
| 21% to 35% | 2% | 3% |
| 36% to 50% | 1% | 2% |
| Greater than 50% | 0% | 0% |

Agents have no authority to adjust losses. Losses are adjusted by an independent adjusting company or by members of the adjusting committee, who are appointed by the board of directors. When adjusted by adjusting committee members, losses in excess of $5,000.00 are adjusted by two members. Adjusting committee members receive $50.00 for each loss adjusted.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

**Board of Directors**

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

| Name | Principal Occupation | Residence | Expiry |
|---|---|---|---|
| Sam Stangler | Farming | Watertown | 2012 |
| David Manning | Retired | Juneau | 2012 |
| Ellward Kuehl | Retired | Watertown | 2013 |
| Ruth Lehmann | Retired | Watertown | 2013 |
| Stan Grulke | Life Insurance Agent | Watertown | 2013 |
| Gene Gerth | Retired | Iron Ridge | 2014 |
| Daryl Pernat | Farming | Oconomowoc | 2014 |

Members of the board currently receive $65.00 for each meeting attended and $0.515 per mile for travel expenses. The mileage reimbursement is changed yearly to match the IRS allowable mileage reimbursement rate.

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

(1) If a town mutual has fewer than nine directors, no more than one director may be an employee or representative of the town mutual; and

(2) Employees and representatives of a town mutual may not constitute a majority of its board.

The company is in compliance with these requirements.

**Officers**

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

| Name | Office | 2011 Compensation* |
|---|---|---|
| Ellward Kuehl | President | $ 3,200 |
| David Manning | Vice President | 800 |
| Sam Stangler | Treasurer | 1,400 |
| Stan Grulke | Secretary | 1,400 |
| Judith Bickel | Manager | 42,868 |

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

**Committees of the Board**

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

| Adjusting Committee | Executive Committee |
|---|---|
| Ellward Kuehl, Chair | Ellward Kuehl, Chair |
| David Manning | David Manning |
| Sam Stangler | Sam Stangler |
| Stan Grulke | Stan Grulke |
| Judith Bickel | Judith Bickel |

**Growth of Company**

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

| Year | Net Premiums Earned | Policies In Force | Net Income | Admitted Assets | Policyholders' Surplus |
|---|---|---|---|---|---|
| 2011 | $384,972 | 963 | $ 15,585 | $1,713,362 | $1,312,776 |
| 2010 | 332,259 | 890 | (95,801) | 1,652,881 | 1,296,708 |
| 2009 | 351,232 | 856 | 141,441 | 1,609,416 | 1,349,486 |
| 2008 | 408,879 | 937 | 19,879 | 1,516,796 | 1,229,503 |
| 2007 | 449,183 | 1,004 | 55,876 | 1,488,028 | 1,194,890 |
| 2006 | 459,393 | 1,091 | 30,227 | 1,445,373 | 1,108,467 |

The ratios of gross and net premiums written to surplus as regards policyholders and operating ratios since the previous examination were as follows:

| Year | Gross Premiums Written | Net Premiums Written | Policyholders' Surplus | Writings Ratios Net | Writings Ratios Gross |
|---|---|---|---|---|---|
| 2011 | $736,002 | $410,355 | $1,312,776 | 31% | 56% |
| 2010 | 643,010 | 353,588 | 1,296,708 | 27 | 50 |
| 2009 | 620,729 | 332,309 | 1,349,486 | 25 | 46 |
| 2008 | 687,366 | 393,238 | 1,229,503 | 32 | 56 |
| 2007 | 706,912 | 441,397 | 1,194,890 | 37 | 59 |
| 2006 | 717,490 | 462,100 | 1,108,467 | 42 | 65 |

| Year | Net Losses and LAE Incurred | Other Underwriting Expenses Incurred | Net Premiums Earned | Loss Ratio | Expense Ratio | Com-posite Ratio |
|---|---|---|---|---|---|---|
| 2011 | $ 99,124 | $271,416 | $384,972 | 26% | 66% | 92% |
| 2010 | 183,410 | 252,774 | 332,259 | 55 | 71 | 127 |
| 2009 | 9,323 | 225,992 | 351,232 | 3 | 68 | 71 |
| 2008 | 169,722 | 226,440 | 408,879 | 42 | 58 | 99 |
| 2007 | 203,184 | 214,078 | 449,183 | 45 | 49 | 94 |
| 2006 | 239,470 | 216,348 | 459,393 | 52 | 47 | 99 |

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there are currently two ceding treaties. All treaties reviewed contained proper insolvency clauses. All treaties complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

| | |
|---|---|
| Reinsurer: | Wisconsin Reinsurance Corporation |
| Effective date: | January 1, 2011 |
| Termination provisions: | Any January 1st, by either party with 60 days' advance written notice |

The coverages provided under this treaty are summarized as follows:

| | | |
|---|---|---|
| 1. | Type of contract: | Casualty Excess of Loss |
| | Lines reinsured: | Liability business |
| | Company's retention: | $1,000 per claim |
| | Coverage: | 75% of the net premium written |
| 2. | Type of contract: | Property First Surplus |
| | Lines reinsured: | All property business written by the company |
| | Company's retention: | The company may cede on a pro rata basis up to $800,000 on a risk when the company's net retention is $350,000 or more. When the company's net retention is $350,000 or less in respect to a risk, the company may cede, on a pro rata basis, and the reinsurer shall be obligated to accept up to 50% of such risk. |
| | Coverage: | Pro rata portion of each and every loss, including loss adjustment expenses, corresponding to the amount of the risk ceded |
| | Premium: | Pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of risk ceded hereunder |
| | Commission: | Ceding commission: 15%<br>Profit commission: 15% |

In 2011, the company earned a $2,808 profit commission under the above portion of the reinsurance treaty, due to favorable operating results.

3. Type of contract: First Per Risk Excess of Loss

   Lines reinsured: All property business written by the company

   Company's retention: $50,000

   Coverage: Up to $75,000 excess of $50,000

   Premium: 9.86% (Minimum = 6%, Maximum = 15%, modified by volume and profitability factors)

4. Type of contract: Second Per Risk Excess of Loss

   Lines reinsured: All property business written by the company

   Coverage and limits: $225,000 excess of $125,000

   Premium: 4.5% of subject net premiums written

5. Type of contract: First Aggregate Excess of Loss

   Lines reinsured: All business written by the company

   Coverage and limits: 100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 65% of the company's net premiums written

   Premium: 6.5% (Minimum = 6.5%, Maximum = 15%, modified by volume and profitability factors)

6. Type of contract: Second Aggregate Excess of Loss

   Lines reinsured: All business written by the company

   Coverage and limits: 100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 135% of the company's net premiums written

   Premium: 3%

Reinsurer: Factory Mutual Insurance Company

Effective date: January 1, 2011

Termination provisions: Effective until terminated as of January 1st any year by either party with 90 days' notice

The coverages provided under this treaty are summarized as follows:

1. Type of contract: 100 % Net retained liability

   Lines reinsured: Equipment breakdown on farmowner's and homeowner's

Limits: Farmowner's $10,000,000 and homeowner's $50,000 per equipment breakdown occurrence on each risk. One policy constitutes one risk.

Conditions: Reinsurer shall investigate all claims and recommend to the company any settlements subject to mutual agreement

Premium: Within 45 days of the end of each quarter the company will report the premium in force including unearned portion, premiums written within the quarter, and losses and LAE paid in excess of salvage and pay within 20 days of that 100% of written premium less commission

Commission: 35% on all premium ceded. Return premium commissions are at the same rate.

Reinsurance premium: Homeowner's policies, $25 per policy flat charge
Farmowner's policies, total insured value means the sum of the dwelling, farm personal property excluding inventory, grain, livestock and agri-mobile, and farm business income values if applicable

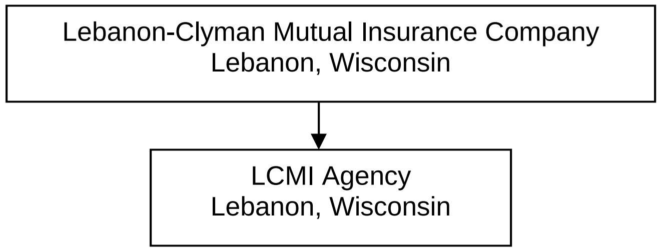
| **Total Insured Value** | **Country Estates & Small Farms** | **Industrial Agriculture** |
|---|---|---|
| | | |
| $1 - $200,000 | $ 25 | $ 35 |
| $201,000 - $500,000 | 44 | 96 |
| $501,000 - $1,000,000 | 95 | 210 |
| $1,000,001 - $2,000,000 | 183 | 408 |
| ➢ $2,000,000 | 380 | 823 |

Profit sharing: Year 1-3 if losses are < 30% of premium earned the reinsurer will pay to the company the following percentage of the difference between "Losses Incurred" and 30% of "Premium Earned" during the profit-sharing period. As of effective date the combined policy count is 606.

- 90% if policy penetration is > 80%
- 70% if policy penetration is > 50% and ≤ 80%
- 60% if policy penetration is > 30% and ≤ 50%
- 50% if policy penetration is ≤ 30%

## III. AFFILIATED COMPANY

The company is the parent in an insurance holding company system, as defined by s. Ins 40.01 (6), Wis. Adm. Code. The holding company organizational chart below depicts the relationship currently in place.




LCMI Agency, formed in 2006, is an insurance agency owned entirely by the company. LCMI Agency sells only company business. At December 31, 2011, LCMI Agency reported a market value of $120,978 and a 2011 net gain of $13,051.

# IV. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2011, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**Lebanon-Clyman Mutual Insurance Company**
**Statement of Assets and Liabilities**
**As of December 31, 2011**

| Assets | Ledger | Nonledger | Not Admitted | Net Admitted |
|---|---|---|---|---|
| Cash on hand | $ 50 | $ | $ | $ 50 |
| Cash in checking | 14,215 | | | 14,215 |
| Cash deposited at interest | 164,910 | | | 164,910 |
| Bonds | 688,668 | | | 688,668 |
| Stocks and mutual fund investments | 786,536 | | | 786,536 |
| Real estate | 35,447 | | | 35,447 |
| Premiums, agents' balances and installments: | | | | |
| In course of collection | 7,327 | | | 7,327 |
| Investment income accrued | | 7,287 | | 7,287 |
| Reinsurance recoverable on paid losses and LAE | 151 | | | 151 |
| Electronic data processing equipment | 9,290 | | 7,980 | 1,310 |
| Other expense-related assets: | | | | |
| Reinsurance commission receivable | 2,808 | | | 2,808 |
| Other nonexpense related assets: | | | | |
| Federal income tax recoverable | 2,028 | | | 2,028 |
| Receivable from Subsidiary | 2,625 | | | 2,625 |
| Totals | $1,714,055 | $7,287 | $7,980 | $1,713,362 |

**Liabilities and Surplus**

| | |
|---|---|
| Net unpaid losses | $ 18,938 |
| Unpaid loss adjustment expenses | 708 |
| Commissions payable | 18,927 |
| Fire department dues payable | 713 |
| Unearned premiums | 247,465 |
| Reinsurance payable | 29,015 |
| Other liabilities: | |
| Expense-related: | |
| Accounts payable | 5,715 |
| Accrued sick leave | 14,594 |
| Nonexpense-related: | |
| Premiums received in advance | 17,102 |
| Securities payable | 47,409 |
| Total liabilities | 400,586 |
| Policyholders' surplus | 1,312,776 |
| Total Liabilities and Surplus | $1,713,362 |

**Lebanon-Clyman Mutual Insurance Company**
**Statement of Operations**
**For the Year 2011**

| | | |
|---|---|---|
| Net premiums and assessments earned | | $384,972 |
| Deduct: | | |
| Net losses incurred | $ 69,888 | |
| Net loss adjustment expenses incurred | 29,236 | |
| Net other underwriting expenses incurred | 271,416 | |
| Total losses and expenses incurred | | 370,540 |
| Net underwriting gain (loss) | | 14,432 |
| Net investment income: | | |
| Net investment income earned | (7,057) | |
| Net realized capital gains (losses) | 2,088 | |
| Total investment gain (loss) | | (4,969) |
| Other income (expense): | | |
| Miscellaneous income | | 9,017 |
| Net income (loss) before federal income taxes | | 18,480 |
| Federal income taxes incurred | | 2,895 |
| Net Income (Loss) | | $ 15,585 |

**Lebanon-Clyman Mutual Insurance Company**
**Reconciliation and Analysis of Surplus as Regards Policyholders**
**For the Five-Year Period Ending December 31, 2011**

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

| | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Surplus, beginning of year | $1,296,708 | $1,349,486 | $1,229,503 | $1,194,890 | $1,108,467 |
| Net income | 15,585 | (95,801) | 141,441 | 19,879 | 55,876 |
| Net unrealized capital gain or (loss) | 8,463 | 39,747 | (18,563) | 14,472 | 30,223 |
| Change in nonadmitted assets | (7,980) | 3,276 | (2,895) | 262 | 324 |
| Surplus, End of Year | $1,312,776 | $1,296,708 | $1,349,486 | $1,229,503 | $1,194,890 |

**Reconciliation of Policyholders' Surplus**

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2011, is accepted.

# V. SUMMARY OF EXAMINATION RESULTS

## Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that biographical data relating to the company's manager be reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action—The company complied with this recommendation.

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

   Action—The company complied with this recommendation.

3. Service Area—It is recommended that, except for the "recreational" properties of the insureds with the main residences insured by the company, the company not write or renew any policies with property risks located outside of the company's approved service area in order to comply with s. 612.32 (1), Wis. Stat.

   Action—The company complied with this recommendation.

4. Holding Company Annual Filings—It is recommended that the company annually file Forms B and C, "Insurance Holding Company System Annual Registration Statement" and "Summary of Registration Statement." It is further recommended that the company file a Form D, "Prior Notice of a Transaction," when the nature of LCMI transactions warrant.

   Action—The company complied with this recommendation.

## Current Examination Results

### Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

### Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

### Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

| Type of Coverage | Coverage Limits |
|---|---|
| Fidelity bond | $ 250,000 |
| Worker's compensation: | |
| Employee injury | Statutory |
| Employee liability: | |
| Each accident | 100,000 |
| Each employee | 100,000 |
| Insurance company professional liability | |
| Each claim | 1,000,000 |
| Aggregate all claims in policy period | 1,000,000 |
| Directors and officers liability | |
| Each claim | 1,000,000 |
| Aggregate all claims in policy period | 1,000,000 |
| Building | 78,200 |
| Computers | 10,500 |

**Underwriting**

The company has a written underwriting guide. The guide covers the lines of business that the company is presently writing. Because of the underwriting difficulties discussed in the prior examination report, the examination focused strongly on current underwriting procedures. During the period under examination, the company has made improvements to its underwriting program. Steps taken to improve underwriting procedures include the following:

- Contracting with an independent inspector
- Rating and policy fee modifications
- Increasing policy deductibles
- Strengthening the underwriting manual
- Meeting agents to communicate underwriting needs

With an independent inspector, the company is better able to more objectively evaluate risks. The examiners noted instances where these inspections led to risk classification and rating improvements, “safety letters” to policyholders recommending improvements to insured premises, and sometimes notations signifying steps leading towards the nonrenewal of policies in question.

The independent inspector performs inspections on a contract basis. Inspections are completed on an as needed basis. Generally, the goal is to complete all inspections, as needed, within a three-year timeframe. The examiners’ review of policy files indicated the presence of inspections for the larger policies and the farmowner type policies. The examiners reviewed inspection reports and other documentation for a sampling of insurance policies and determined that these steps are being followed appropriately.

When reviewing board meeting minutes, the examiners noted that the company reviews loss experience, by agency. The company, when needed, meets with agents to communicate this experience. This communication stresses the company's underwriting guidelines.

**Claims Adjusting**

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. In practice, small claims are handled in the office or by one of the adjusting committee directors. Large claims or claims involving a director are handled by an outside adjusting firm. Currently, the company manager oversees the independent adjusters and consults with the adjustment committee as needed.

**Accounts and Records**

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

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

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2011.

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

**EDP Environment**

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

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

**Business Continuity Plan**

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The company's business continuity plan appears to be adequate.

**Invested Assets**

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

**Investment Rule Compliance**

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

| | | |
|---|---|---|
| 1. | Liabilities plus $300,000 | $ 700,586 |
| 2. | Liabilities plus 33% of gross premiums written | 643,467 |
| 3. | Liabilities plus 50% of net premiums written | 605,764 |
| 4. | Amount required (greater of 1, 2, or 3) | 700,586 |
| 5. | Amount of Type 1 investments as of 12/31/2011 | 1,001,582 |
| 6. | Excess or (deficiency) | $ 300,996 |

The company has sufficient Type 1 investments.

The company's investment plan states certain percentage limits for fixed income investments and investments in common stock or other equity. The current plan states not less than 80% of invested assets will be held in fixed income investments and not greater 25% of invested assets will be held in common stock or other equity. Currently, the company holds 61% of invested assets in fixed income investments and the remainder in common stock or other equity investments. The primary reason for the common stock and other equity investment exceeding the 25% limit is investments in Wisconsin Reinsurance Corporation stock, which was approved by our office. It is recommended the company update their investment policy to reflect their current distribution of invested assets between fixed income and common stock or other equity investments.

**Holding Company Annual Filings**

Holding company regulation, ch. Ins 40, Wis. Adm. Code, requires a series of holding company filings. These include the following:

Form A: Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer
Form B: Insurance Holding Company System Annual Registration Statement
Form C: Summary of Registration Statement
Form D: Prior Notice of a Transaction
Form E: Consent to Jurisdiction Statement

During the period under examination the company has made the annually required holding company filings.

## ASSETS

**Cash and Invested Cash** **$179,175**

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

| | |
|---|---|
| Cash in company's office | $ 50 |
| Cash deposited in banks—checking accounts | 14,215 |
| Cash deposited in banks at interest | 164,910 |
| Total | $179,175 |

Cash in company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of seven deposits in three depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2011 totaled $2,696 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1% to 2%. Accrued interest on cash deposits totaled $246 at year-end.

**Book Value of Bonds** **$688,668**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2011. Bonds owned by the company are held in book-entry form with a security depository.

Bonds were confirmed by the company’s independent public accounting firm in their annual audit. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2011 on bonds amounted to $35,695 and was traced to cash receipts records. Accrued interest of $7,041 at December 31, 2011, was checked and allowed as a nonledger asset.

**Stocks and Mutual Fund Investments** **$786,536**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2011.

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

Dividends received during 2011 on stocks and mutual funds amounted to $1,388 and were traced to cash receipts records. The company reported no accrued dividends December 31, 2011.

**Book Value of Real Estate** **$35,447**

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

The required documents supporting the validity of this asset were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

**Premiums, Agents' Balances in Course of Collection** **$7,327**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

**Investment Income Accrued** **$7,287**

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

| | |
|---|---|
| Cash deposited at interest | $ 246 |
| Bond investment income | 7,041 |
| Total | $7,287 |

**Reinsurance Recoverable on Paid Losses and LAE** **$151**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2011. A review of year-end accountings with the reinsurer verified the above asset.

**Electronic Data Processing Equipment** **$1,310**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2011. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

**Reinsurance Commission Receivable** **$2,808**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2011, based on the profitability of the business ceded under its property first surplus contract with Wisconsin Reinsurance Corporation. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

**Federal Income Tax Recoverable** **$2,028**

This asset represents an intercompany federal income tax allocation coming from LCMI Agency.

**Receivable from Subsidiary** **$2,625**

This asset represents administrative services and rents coming from LCMI Agency.

## LIABILITIES AND SURPLUS

**Net Unpaid Losses** **$18,938**

This liability represents losses incurred on or prior to December 31, 2011, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2011, with incurred dates in 2011 and prior years. To the actual paid loss figure was added an estimated amount for 2011 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

| | Company Estimate | Examiners' Development | Difference |
|---|---|---|---|
| Incurred but unpaid losses | $ 26,154 | $20,549 | $5,605 |
| Less: Reinsurance recoverable on unpaid losses | 7,216 | 6,786 | 430 |
| Net Unpaid Losses | $ 18,938 | $13,763 | $5,175 |

The examiners concluded that the company estimate was reasonable and no surplus adjustment was made for this report.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and claims that were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

**Unpaid Loss Adjustment Expenses** **$708**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2011, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is a combination of actual accrued expense plus a percentage of unpaid claims.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

**Commissions Payable** **$18,927**

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

**Fire Department Dues Payable** **$713**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2011.

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

**Unearned Premiums** **$247,465**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

**Reinsurance Payable** **$29,015**

This liability consists of amounts due to the company's reinsurers at December 31, 2011, relating to transactions which occurred on or prior to that date. December invoices for Wisconsin Reinsurance Corporation and Factory Mutual Insurance Company were verified by the examiners in support of this account balance.

**Accounts Payable** **$5,715**

This liability represents general business expenses incurred prior to December 31, 2011, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

**Premiums Received in Advance** **$17,102**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2011. The examiners reviewed 2011 premium and cash receipt records to verify the accuracy of this liability.

**Accrued Sick Leave** **$14,954**

This liability represents the sick leave for the two company employees. The company manager accrues 15 days of sick leave per year, while the other employee accrues 9 days of sick leave per year. The examiners verified the balance through review of supporting payroll records.

**Securities Payable** **$47,409**

This liability represents a bond purchase made prior to year-end 2011, but not paid for until 2012. The examiners verified the balance by reviewing the document supporting the purchase of the bond and the applicable subsequent payment made in 2012.

## VI. CONCLUSION

During the period under examination, the company has undertaken a process of strengthening its underwriting program. Steps taken to improve underwriting procedures include an inspection program, rating modifications, and communications with agents. Good weather has also played a factor in improved underwriting results.

When reviewing the investment policy, the examiners noted current investment holdings of the company did not agree with the stated percentages of fixed income and common stock or other equity in their investment policy. A recommendation was made to update the investment policy.

The examination made no adjustments to company assets, liabilities or policyholders' surplus.

## VII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 19 - Investment Rule Compliance—It is recommended the company update their investment policy to reflect their current distribution of invested assets between fixed income and common stock or other equity investments.

## VIII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Derek Sliter
Examiner-in-Charge