Report

of the

Examination of

Little Black Mutual Insurance Company

Medford, Wisconsin

As of December 31, 2012

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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October 7, 2013

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:

LITTLE BLACK MUTUAL INSURANCE COMPANY
Medford, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Little Black Mutual Insurance Company (the company or LBMIC) was conducted in 2009 as of December 31, 2008. The current examination covered the intervening period ending December 31, 2012, and included a review of such 2013 transactions as deemed necessary to complete the examination.

The examination was conducted using a risk-focused approach in accordance with the NAIC Financial Condition Examiners Handbook, which sets forth guidance for planning and performing an examination to evaluate the financial condition and identify prospective risks of an insurer. This approach includes the obtaining of information about the company including corporate governance, the identification and assessment of inherent risks within the company, and the evaluation of system controls and procedures used by the company to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation and management's compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing
Underwriting

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, which includes bookkeeping assistance in connection with closing year-end financial records, assistance in preparing statement filings, tax return preparation, and the administration of the company's payroll function. On December 13, 2010, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

II. HISTORY AND PLAN OF OPERATION

The company was originally organized as a town mutual insurance company on June 4, 1889, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Little Black Farmers Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to Little Black Mutual Insurance Company. Effective January 1, 1998, the company converted from a town mutual insurance company to an assessable mutual insurance company under ch. 611, Wis. Stat. The Stipulation and Order approving the company's conversion to a limited assessable mutual insurer requires the company to agree to the following terms and conditions:

1) The company shall maintain a permanent surplus of $1,000,000.
2) The company's authorized territory shall be all counties within the state of Wisconsin.
3) After conversion, the company shall be required to continue to comply with the various statutes and rules regarding reinsurance retention limits, stop-loss and catastrophic coverages applicable to town mutual insurers operating under ch. 612, Wis. Stat.
4) The assessment liability of the company's policyholders shall be one times the annual premium in force at the date of the assessment. Assessments not exceeding the annual premium of the terminated policy may also be levied upon persons whose policies terminated within four months before the assessment.
5) The Commissioner may revoke the authority for limited assessability, by order, if the Commissioner finds that the methods, practices or financial condition of the company are such as to endanger the insurance protection of members if the limited assessability were not revoked.

The company underwent a self-imposed moratorium on the writing of new business effective June 1, 2002, following several years of deteriorating surplus. The company has since re-underwritten its entire book of business and has strengthened its underwriting standards to address the deficiencies underlying the poor underwriting results. The company gradually lifted its moratorium on writing new business on all classes of business prior to the commencement of the previous examination of the company.

In September 2007, the company purchased a new home office building and officially moved its operations to Medford, Wisconsin.

In 2012 the company sustained a significant decrease of approximately 31% in its surplus position after the completion of the first half year of operations, which was attributable to negative underwriting results and net unrealized capital losses from its holdings of its primary reinsurer's common stock issues of $428,138. The company experienced continued surplus deterioration in the third quarter due to underwriting losses. This resulted in the company implementing an action plan in November of 2012 to improve its surplus position, which included the following actions:

1) Raising rates on almost all coverage types and additional increases on certain specific risk coverages both in 2012 and 2013;
2) Raising policy fees;
3) Raising the surcharge for those risks with wood burning units;
4) Self-imposing a moratorium on writing new business, which became effective for homeowner risks on August 15, 2012, and for all other coverages on November 19, 2012;
5) Increased the minimum deductible on new policies to $1,000;
6) Began terminating agents that had poor loss history results;
7) Cancelling policies due to claims frequency and severity; and
8) Implementation of a claims frequency surcharge for policies that have a number of claims over a certain period of time that may not warrant cancellation.

The company has since lifted its moratorium on writing new business for all of its coverages in 2013, with the exception of those risks with wood burning appliances (excluding farm policies). It is the company's plan to reduce its policy count by approximately 6% to 5,000 policies by the end of 2013 as the company believes this is a more appropriate number of policies the company can manage due to its current surplus position. The company plans on reducing the policy count by continuing to terminate agents that have historically poor loss results or are not writing a certain minimum amount of premium, cancelling policies with poor loss history, and by having policyholders nonrenewing their policies at the anniversary dates due to the higher rates and surcharges.

The company is authorized to write insurance throughout the state of Wisconsin but confines its writings largely to a 17-county area in northern Wisconsin. The company's major lines of business include homeowner's and farmowner's multiple peril coverages. The company began offering umbrella liability coverage and equipment breakdown coverage in 2009 and 2012, respectively, which are 99% and 100% ceded to third-party reinsurers, respectively, and will be discussed further in the "Reinsurance" section of this report. The company's products are marketed through over 200 independent agents who receive a flat 13% commission on all business and are eligible for a contingent bonus if the 3-year combined ratio is less than 90% and the agent writes $25,000 or more in direct premium.

The following table is a summary of the insurance premiums written by the company in 2012. 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	$ 201,562	$ 78,901	$ 122,661
Allied lines	470,313	184,102	286,211
Farmowner's multiple peril	1,133,736	435,979	697,757
Homeowner's multiple peril	1,665,557	651,977	1,013,580
Commercial multiple peril	208,051	81,441	126,610
Boiler and machinery	12,847	12,847	0
Total all lines	$3,692,066	$1,445,247	$2,246,819

III. MANAGEMENT AND CONTROL

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 three-year term. Officers are elected at the board's annual meeting. The board members currently receive a per diem of $100.00 for any evening meetings attended, a per diem of $125.00 for any meetings attended that take place during the day which may require a member to take time off of work, and $0.515 per mile for travel expenses.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Bryce A. Hinke Medford, Wisconsin	Retired Farmer	2016
Clarence E. Schreiner Athens, Wisconsin	Retired Farmer	2016
Donald C. Boss Abbotsford, Wisconsin	Farmer	2014
Donald O. Koerner Curtiss, Wisconsin	Retired Farmer	2015
Thomas B. Odeen Loyal, Wisconsin	Crop Insurance Agent with BMO Harris Bank	2014
Thomas P. Rasmussen Westboro, Wisconsin	Owner and Operator of TCR Solutions, LLC	2015
Peter F. Wanke* Medford, Wisconsin	Retired Building Contractor	2016

* Mr. Wanke retired from the company's board of directors in April of 2013. At the July 24, 2013, board meeting Mr. Michael E. Kassie was elected to serve as a board member until the 2014 annual policyholders' meeting. Mr. Kassie's principal occupation is a program technician for the USDA Farm Service Agency.

Officers of the Company

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

Name	Office	2012 Compensation
Thomas B. Odeen*	Chairman of the board	$ 1,225
Anthony P. Wilke	President	72,080
Donald C. Boss	Secretary	2,825
Clarence E. Schreiner	Treasurer	1,950
Donald O. Koerner	Vice-Chairman of the board	1,725

* As reported in the previous section of this report, Mr. Peter F. Wanke retired from the company's board of directors in April of 2013. Mr. Wanke served as the company's Chairman of the board in 2012 and received total compensation of $3,500 that year. Mr. Thomas B. Odeen was elected to as the Chairman of the board at the March 12, 2013, board organizational meeting.

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:

Audit Committee
Thomas B. Odeen, Chair
Comprised of the entire board

Claims Committee
Thomas B. Odeen, Chair
Comprised of the entire board

Wage and Benefits Committee
Clarence E. Schreiner, Chair
Bryce A. Hinke
Thomas B. Odeen

Nominating Committee
Clarence E. Schreiner, Chair
Bryce A. Hinke
Thomas B. Odeen

Property Committee
Donald O. Koerner, Chair
Thomas P. Rasmussen
Anthony P. Wilke

IV. REINSURANCE

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

Primary Ceding Contract

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

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

1.	Type of contract:	Casualty Excess of Loss
	Lines reinsured:	All casualty or liability business written by the company
	Company's retention:	$10,000 in respect to each and every loss occurrence up to policy limits
	Coverage:	100% in excess of retention including loss adjusting expense, subject to policy limits of $1,000,000 for bodily injury and property damage, and $25,000 per person and $25,000 per accident for medical payments
	Reinsurance premium:	40% of gross liability premiums charged for each policy issued, subject to a minimum annual premium equal to 75% of the annual deposit premium of $230,000
2.	Type of contract:	Combination Umbrella Quota Share and Excess of Loss
	Lines reinsured:	All umbrella liability business written by the company
	Coverage:	Part A – 99% Quota Share of the first $1,000,000 Limit of Liability The company shall cede on a pro rata basis and the reinsurer shall assume a 99% quota share of the business covered, subject to the limits of liability set forth in the following paragraph The reinsurer shall be liable for 99% of each loss occurrence, including loss adjustment expense, on the business covered,

		subject to a maximum limit of liability of $990,000 (99% of $1,000,000) on each loss occurrence <u>Part B – 100% of $1,000,000 in excess of $1,000,000 excess loss occurrence</u> The reinsurer shall be liable for 100% of each loss occurrence, on the business covered, in excess of the company's retention of $1,000,000, subject to the reinsurer's limit of liability of $1,000,000 each loss occurrence Loss adjustment expense is included in addition to losses covered hereunder and in addition to the reinsurer's limit of liability for Part A and Part B
	Reinsurance premium:	99% of net umbrella liability premium written
	Commission:	27.5% of the premium paid to the reinsurer
3.	Type of contract:	First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	$400,000 of each risk ceded pro rata. If net retention for a risk is $400,000 or less, the company may cede 50% pro rata.
	Coverage:	Pro rata portion of each loss and LAE up to $800,000 above retention
	Reinsurance premium:	The pro rata portion of all premiums, fees, and assessments charged by the company corresponding to the amount of each risk ceded
	Ceding commission:	The current commission rate of 15% of the premiums ceded. Return commission shall be allowed at the same rate on all return premiums paid to the company. The reinsurer also pays a profit commission rate of 15% of the net profit it incurs in an annual period.
4.	Type of contract:	First Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$100,000 for each and every risk from one loss occurrence
	Coverage:	100% of each and every loss, including loss adjustment expense in excess of the company's net retention, $100,000, subject to a limit of $125,000
	Reinsurance premium:	Rate based on net premium written and losses incurred for immediate preceding four years. There is a minimum rate of 6.0% and maximum rate of 15.0% of current net premium written charged. The 2013 annual rate is 15.0%, subject to a minimum annual premium equal to 75% of the annual deposit premium of $446,250.

5.	Type of contract:	Second Per Risk Excess of Loss
	Lines reinsured:	All property business written by the company
	Company’s retention:	$225,000 for each and every risk from one loss occurrence
	Coverage:	100% of each and every loss, including loss adjustment expense, in excess of the company’s net retention, $225,000, subject to a limit of $175,000
	Reinsurance premium:	6.0% of net premiums written for business covered, subject to minimum annual premium equal to 75% of the annual deposit premium of $178,500
6.	Type of contract:	First Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company’s retention:	Losses in aggregate equal to 55% of the net premiums written for the annual period
	Coverage:	100% of the amount by which the aggregate of the company’s losses, including loss adjustment expenses, exceeds the company’s retention with a limit of 70% of net premium written
	Reinsurance premium:	Rate of losses incurred divided by net premiums written for last eight years’ losses incurred times 125%, applied to net premiums written with a minimum rate of 9.1% and maximum of 15.0%. The 2013 annual rate is 9.1%, subject to minimum annual premium equal to 75% of the annual deposit premium of $302,122.
7.	Type of contract:	Second Aggregate Excess of Loss
	Lines reinsured:	All business written by the company
	Company’s retention:	Losses in aggregate equal to 125% of the net premiums written for the annual period
	Coverage:	100% of aggregate net losses, including loss adjustment expenses, in the annual period that exceed the retention
	Reinsurance premium:	3.0% of net premiums written for business covered, subject to minimum annual premium equal to 75% of the annual deposit premium of $99,601

Equipment Breakdown Quota Share Coverage

Reinsurer:	Factory Mutual Insurance Company
Effective date:	January 1, 2012, and is continuous
Lines reinsured:	All equipment breakdown liability farmowner’s and homeowner’s business, with stated exclusions
Company's retention:	None

Coverage:	100% of losses ceded under this treaty
Reinsurance premium:	100% of the subject gross written premium relating to risks covered under this agreement
Ceding commission:	The current commission rate of 35% of the premiums ceded. Return commission shall be allowed at the same rate on all return premiums paid to the company.
Termination provisions:	By either party, on any January 1, with 90 days' advance written notice by certified mail
Additional comments:	The treaty has a clause where the reinsurer will share in its profits over a three-year period beginning January 1, 2012, through December 31, 2014. The company is to receive a profit-sharing bonus if the net loss ratio for the business reinsured is below 30%. The profit-sharing amount is calculated as a percentage of the difference between 30% of earned premium and losses incurred over the three-year period ranging from 50% to 90%. The profit-sharing percentage is dependent on the number of LBMIC policyholders that had a policy in force as of January 1, 2012, eligible for equipment breakdown coverage who adds this coverage as a rider to their policy. The amount of eligible policies as of January 1, 2012, agreed upon for the penetration calculation was 3,151, with a penetration percentage equal to or below 30% being eligible for the lowest profit-sharing rate of 50%.

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, 2012, annual statement. 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. 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."

Little Black Mutual Insurance Company
Assets
As of December 31, 2012

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$1,399,600	$ 0	$1,399,600
Common stocks	1,455,634	0	1,455,634
Real estate:			
Occupied by the company	220,179	0	220,179
Cash, cash equivalents, and short-term investments	133,494	0	133,494
Investment income due and accrued	11,626	0	11,626
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	16,027	2,313	13,714
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	518,654	0	518,654
Reinsurance:			
Amounts recoverable from reinsurers	4,625	0	4,625
Net deferred tax asset	107,000	107,000	0
Electronic data processing equipment and software	4,042	1,556	2,486
Furniture and equipment, including health care delivery assets	4,730	4,730	0
Write-ins for other than invested assets:			
Vehicles	36,667	36,667	0
Total Assets	$3,912,278	$152,266	$3,760,012

Little Black Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2012

Losses		$ 271,875
Loss adjustment expenses		16,000
Commissions payable, contingent commissions, and other similar charges		87,242
Other expenses (excluding taxes, licenses, and fees)		49,660
Taxes, licenses, and fees (excluding federal and foreign income taxes)		2,710
Borrowed money and interest thereon		36,667
Unearned premiums		1,758,789
Advance premium		77,107
Ceded reinsurance premiums payable (net of ceding commissions)		146,299
Amounts withheld or retained by company for account of others		2,093
Total liabilities		2,448,442
Unassigned funds (surplus)	$1,311,570	
Surplus as regards policyholders		1,311,570
Total Liabilities and Surplus		$3,760,012

Little Black Mutual Insurance Company
Summary of Operations
For the Year 2012

Underwriting Income		
Premiums earned		$2,192,577
Deductions:		
Losses incurred	$1,392,206	
Loss adjustment expenses incurred	242,925	
Other underwriting expenses incurred	1,021,348	
Total underwriting deductions		2,656,479
Net underwriting gain (loss)		(463,902)
Investment Income		
Net investment income earned	15,113	
Net realized capital gains (losses)	150	
Net investment gain (loss)		15,263
Other Income		
Write-ins for miscellaneous income:		
Policy, installment and other fees	176,534	
Total other income		176,534
Net Loss		$ (272,105)

Little Black Mutual Insurance Company
Cash Flow
For the Year 2012

Premiums collected net of reinsurance			$2,244,685
Net investment income			24,075
Miscellaneous income			176,534
Total			2,445,294
Benefit- and loss-related payments		$1,312,441	
Commissions, expenses paid, and aggregate write-ins for deductions		1,248,604	
Total deductions			2,561,045
Net cash from operations			(115,715)
Proceeds from investments sold, matured, or repaid:			
Bonds	$722,222		
Total investment proceeds		722,222	
Cost of investments acquired (long-term only):			
Bonds	599,600		
Real estate	14,875		
Total investments acquired		614,475	
Net cash from investments			107,747
Cash from financing and miscellaneous sources:			
Borrowed funds		(14,667)	
Other cash provided (applied)		26,659	
Net cash from financing and miscellaneous sources			11,992
Reconciliation:			
Net change in cash, cash equivalents, and short-term investments			3,988
Cash, cash equivalents, and short-term investments:			
Beginning of year			129,506
End of Year			$ 133,494

Little Black Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2012

Assets		$3,760,012
Less liabilities		2,448,442
Adjusted surplus		1,311,570
Annual premium:		
Lines other than accident and health	$2,246,819	
Factor	20%	
	449,364	
Compulsory surplus (subject to a minimum of $1 million per order for limited assessability)		1,000,000
Compulsory Surplus Excess (or Deficit)		$ 311,570
Adjusted surplus (from above)		$1,311,570
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%)		1,400,000
Security Surplus Excess (or Deficit)		$ (88,430)

Little Black Mutual Insurance Company
Analysis of Surplus
For the Four-Year Period Ending December 31, 2012

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

	2012	**2011**	**2010**	**2009**
Surplus, beginning of year	$2,060,185	$2,292,961	$2,630,367	$2,820,941
Net income	(272,105)	(267,821)	(497,070)	137,071
Change in net unrealized capital gains/losses	(428,138)	(42,331)	105,459	(262,153)
Change in net deferred income tax	34,000	24,000	82,000	(12,000)
Change in non-admitted assets	(82,372)	53,376	(27,795)	(53,492)
Surplus, End of Year	$1,311,570	$2,060,185	$2,292,961	$2,630,367

Little Black Mutual Insurance Company
Insurance Regulatory Information System
For the Four-Year Period Ending December 31, 2012

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	**2012**	**2011**	**2010**	**2009**
#1	Gross Premium to Surplus	281%	166%	140%	116%
#2	Net Premium to Surplus	171	100	88	76
#3	Change in Net Premiums Written	10	1	1	(12)
#4	Surplus Aid to Surplus	0	0	0	0
#5	Two-Year Overall Operating Ratio	111*	118*	108*	92
#6	Investment Yield	0.4*	0.8*	1.1*	1.3*
#7	Gross Change in Surplus	(36)*	(10)*	(13)*	(7)
#8	Change in Adjusted Surplus	(36)*	(10)*	(13)*	(7)
#9	Liabilities to Liquid Assets	64	49	45	43
#10	Agents' Balances to Surplus	1	0	0	0
#11	One-Year Reserve Development to Surplus	(1)	(1)	(3)	(4)
#12	Two-Year Reserve Development to Surplus	(2)	(3)	(5)	0
#13	Estimated Current Reserve Deficiency to Surplus	(12)	(1)	7	(6)

The Two-Year Overall Operating Ratio (IRIS ratio No. 5) measures the company's profitability over the previous two-year period and was exceptional in 2010, 2011, and 2012. The exceptional result in 2010 was primarily due to several large losses and a few large catastrophic storm loss events that were incurred by the company, which caused it to reach its aggregate excess of loss reinsurance coverage that year. In 2011 the company's underwriting results improved, but the company continued to incur significant losses primarily due to four large fires and four storm events that year. Also impacting 2011 operational results was the fact that the company changed its reinsurance retention (from $60,000 to $75,000 per loss) under its first excess of loss reinsurance layer in order to reduce the cost of reinsurance, which would have increased more due to the company's 2010 loss experience. The large underwriting loss in 2012 was primarily as a result of a few large fires, destruction of two pieces of expensive farm equipment and claims from two major windstorms that hit the company's territory on June 15, 2012, and October 25, 2012. The company also increased its first excess of loss retention in 2012 to $100,000 for the same reason as the 2011 increase. Also impacting the exceptional two-year operating ratio results in each of the three years was the fact that the company's general expenses as a percentage of net premiums written were quite high which is not unusual for small property and casualty insurers as premium volume for those insurers have trouble supporting their expense structure.

The Investment Yield ratio (IRIS ratio No. 6) measures the amount of the company's net investment income earned as a percentage of the two-year average amount of cash and invested assets and was considered exceptional in each of the four years under examination. The exceptional ratios are primarily a result of low returns on its common stock portfolio which on average was 48.2% of the company's invested assets. The company's investment in common stock of its primary reinsurer on average comprised 99.4% of its stock portfolio for the four-year period under examination, but it only paid dividends totaling $13,020 in those years; therefore, it was not a large contributor towards LBMIC's net investment income. Net investment income from bond holdings, long-term certificate of deposits and money market fund was limited in the four-year period under examination and was affected by the low interest rate market during those years.

The Gross Change in Surplus ratio (IRIS ratio No. 7) was considered exceptional in 2010, 2011, and 2012 primarily due to the poor operational results discussed for ratio No. 5 which caused surplus to decrease those years. Also affecting the exceptional ratio results in 2011 and 2012 were unrealized capital losses of $51,299 and $504,395, respectively, from its holding of common stock issued by its primary reinsurer.

The Change in Adjusted Policyholders' Surplus ratio (IRIS ratio No. 8) measures the improvement or deterioration in the insurer's financial condition based on operational results by factoring out changes in surplus notes, paid-in or transferred capital and surplus. This ratio was also exceptional in 2010, 2011, and 2012 for the same reasons as ratio No. 7.

Growth of Little Black Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2012	$3,760,012	$2,448,442	$1,311,570	$(272,105)
2011	4,367,024	2,306,839	2,060,185	(267,821)
2010	4,400,283	2,107,322	2,292,961	(497,821)
2009	4,866,119	2,235,752	2,630,367	137,071
2008	5,039,019	2,218,078	2,820,941	81,271

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2012	$3,692,066	$2,246,819	$2,192,577	74.6%	37.6%	112.2%
2011	3,427,306	2,050,175	1,925,182	71.8	41.0	112.8
2010	3,198,747	2,026,493	1,977,330	87.3	39.2	126.5
2009	3,061,584	1,996,861	1,924,840	53.6	40.9	94.5
2008	2,905,049	2,275,723	2,016,316	59.9	35.2	95.1

The company has experienced a decline in surplus of 53.5% over the four-year period under examination which was primarily attributable to the company incurring large underwriting losses in 2010 (considered the worst underwriting results in the company's history), 2011, and 2012 as well as unrealized capital losses recorded in 2009, 2011, and 2012 from its holding of common stock issued by its primary reinsurer.

The company’s gross premium written ratio has increased from 1 to 1 in 2008 to 2.8 to 1 in 2012, and the net premium written to surplus ratio has increased from 0.8 to 1 in 2008 to 1.7 to 1 in 2012. Although gross premiums written increased each year under examination and by 27.1% over that four-year period, the increase in gross and net writing ratios were caused largely by the significant decrease in surplus, which was explained earlier. The increase in gross writings since year-end 2008 was mainly attributable to several rate increases implemented by the company, adding agencies to produce business for the company, and an increase in policy count each year. The same explanations also apply to the changes in net premiums written during those years except for 2009 as net premiums decreased that year because of changes made to its reinsurance program that year.

The company’s average combined ratio, net of reinsurance, during the period under examination has been above 100% primarily due to its high net expense ratio and the net losses incurred by the company during this period as described earlier in this report. The net expense ratio stayed fairly steady since 2009 but was considered fairly high. However, as discussed earlier in this report it is not unusual for a company of LBMIC’s size. The increase in the company's expense ratio in 2009 was primarily due to the decrease in net premiums written that year, which was described in the previous paragraph.

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, 2012, of $1,311,570 is accepted.

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were nine 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. Management and Control – Conflict of Interest Policy/Statements—It is recommended that the board of directors develop and approve a formal written conflict of interest policy which discusses the types of conflicts/potential conflicts requiring disclosure and which requires that conflict of interest statements be completed annually by all officers and directors. This policy should be shared with all officers and directors prior to their annual completion of the conflict of interest statements.

   Action—Compliance.

2. Management and Control – Conflict of Interest Policy/Statements—It is further recommended that the company ensure that conflict of interest statements be completed every year by all directors and officers.

   Action—Compliance.

3. Management and Control – Biographical Sketches—It is recommended that the company file biographical sketches with the department within 15 days of the date of election of new officers/directors in accordance with s. Ins 6.52 (5), Wis. Adm. Code.

   Action—Compliance.

4. Invested Assets – Repurchase Agreement—It is again recommended that the company disclose its repurchase agreements in the general interrogatories section and make other relevant disclosures in the notes to financial statements section of the annual statement in accordance with SSAP No. 45, par. 18, of the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions – Property and Casualty.

   Action—Compliance.

5. Undertaking Retention—It is recommended that the company take action to ensure that it has a signed undertaking for all policyholders in-house; an electronically stored image of the original signed undertaking is acceptable as long as it is readily available to the Commissioner and can be reproduced in hard copy in accordance with s. Ins 6.80, Wis. Adm. Code.

   Action—Partial compliance; see comments in the Summary of Current Examination Results.

6. Annual Statement Reporting – Bonus Accruals—It is recommended that any bonuses declared by the board be accrued in the company's financial statements in the fiscal year incurred in accordance with SSAP No. 5 of the NAIC Accounting Practices and Procedures Manual.

   Action—Compliance.

7. Annual Statement Reporting – Fire Dues Payable—It is again recommended that the company include Fire Dues Payable on the “Taxes, Licenses and Fees” line of the Liabilities, Surplus and Other Funds page of the annual statement in accordance with the NAIC Annual Statement Instructions – Property and Casualty.

   Action—Compliance.

8. Annual Statement Reporting – State Income Taxes Payable—It is recommended that the company report state income taxes payable on the “Taxes, Licenses and Fees” line of the Liabilities, Surplus and Other Funds page in future annual statements in accordance with SSAP, No. 10, par. 4, of the NAIC Accounting Practices and Procedures Manual.

   Action—Compliance.

9. Annual Statement Reporting – Unpaid Loss Adjustment Expenses—It is recommended that the company develop a methodology for reasonably estimating and reporting the true value of this liability, based on a study of past trends for this expense category and taking into consideration the payment patterns for LAE expenses over the life of the claim.

   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.

Agents

The company is required to file with this office all agents that write business for the company pursuant to s. 628.11, Wis. Stat. The examination found that seven agents on the company's list of active agents were not on the company's Registered Agent List maintained by this office, and five agents reported on the Registered Agent List provided by this office were not included on the company's list of active agents. It is recommended that the company submit an application to the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with s. 628.11, Wis. Stat., and that the company notify the Office of the Commissioner of Insurance of all agents that are terminated or are no longer writing business.

Undertaking Retention

During the previous examination it was discovered that the company no longer maintained signed applications, which includes signed undertakings to pay assessments, for new policies beginning in March of 2009 when the company began using an electronic quoting and application system. The system allowed agents to complete and submit applications to the company electronically but retention of the original applications and signed undertakings were maintained by the producing agents. The Stipulation and Order approving the company's conversion to a mutual insurer under ch. 611, Wis. Stat., included a condition that the company's policies shall continue to be subject to limited assessability.

The company's inability to produce all of the signed undertakings generated a concern that, in the event that an assessment is made, there could be a significant number of policyholders who demand to see their signed undertaking before they agree to pay. This could be exacerbated if: (1) the agent retires, dies or sells their book of business, and the new agent never takes custody of the old records, (2) the agent fails to maintain proper physical controls over the records, and the records are lost or destroyed, and/or (3) the agent's E&O policy does not cover this liability and/or the liability exceeds the agent's E&O policy limits. Therefore, a recommendation was made to have the company take action to ensure that it has a signed undertaking for all policyholders in-house; an electronically stored image of the original signed undertaking is acceptable as long as it is readily available to the Commissioner and can be reproduced in hard copy in accordance with s. Ins 6.80, Wis. Adm. Code.

The current examination reviewed 50 policies to verify if the company has retained in-house undertakings signed by policyholders. For one of the policies reviewed the company did not have a signed undertaking and it had to contact the producing agent to obtain a copy of the signed undertaking. The issue was discussed further with the company's management and it was disclosed to the examination team that the company implemented procedures to collect all missing signed undertakings for the period beginning February 1, 2009, through March 1, 2010, and began retaining signed undertakings for all new applications beginning March 1, 2010. The company's management also mentioned that it experienced some difficulty obtaining all signed undertakings for policies written from February 1, 2009, to March 1, 2010, from the producing independent agents; therefore, it was likely that some were never provided. Additionally the company informed this office that after further research there were approximately 50 signed undertakings that were obtained by the company from agents but mistakenly were not imaged into the company's policy system and approximately 100 policies whose signed undertakings were not received. Even though the company failed to obtain all missing signed undertakings to comply with the prior examination recommendation the company was able to demonstrate that it took reasonable measures to do so. Therefore, it was determined that LBMIC partially complied with the prior examination recommendation. However, it is again recommended that the company take action to ensure that it has a signed undertaking for all policyholders in-house; an electronically stored image of the original signed undertaking is acceptable as long as it is readily available to the Commissioner and can be reproduced in hard copy in accordance with s. Ins 6.80, Wis. Adm. Code.

The company advised examiners that it has since collected all missing signed undertakings for policies from its agents as of the end of September of 2013. However, this office has not confirmed this through on-site testing as the action took place subsequent to examination fieldwork.

VII. CONCLUSION

The company was originally organized as a town mutual insurance company on June 4, 1889, under the provisions of the then existing Wisconsin Statutes. Effective January 1, 1998, the company converted from a town mutual insurance company under ch. 611, Wis. Stat. The conversion expanded the company's authorized territory to all counties within the state of Wisconsin; however, the company continues to write primarily in 17 contiguous counties in northern Wisconsin.

Policyholders' surplus has decreased from $2,820,941 per the examination report as of year-end 2008 to $1,311,570 as of year-end 2012. This represents a decrease of 53.5% during the period under examination. In 2011 and 2012 the company's surplus was negatively affected by gross unrealized capital losses of $51,299 and $504,138, respectively, relating to its holdings of its primary reinsurer's common stock. The company experienced underwriting losses in each of the four years under examination, which also contributed to the decline in the company's surplus. Underwriting losses over that period have averaged $419,908 each year with the largest loss occurring in 2010 of $693,070. The company's average net expense ratio over the last four years is 39.7% and it has reported composite ratios of over 100% in each of those years. On a gross basis, premium writings since 2008 have increased by 27.1% and were due to a number of actions taken by the company to try and grow its business profitably, which includes, but is not limited to, rate increases and adding agencies. Net writings during this period have increased reasonably proportionally to the company's gross writings, except in 2009 due to higher costs for reinsurance ceded. The company's gross premiums written to surplus and net premiums written to surplus ratios have steadily increased each year over the period under examination and in aggregate, from 2008 to 2012, increased by 179% to 282% and by 90% to 171%, respectively. The higher leverage of risk in 2012 along with negative underwriting results has given rise to concerns about the company being able to handle the level of policies written in 2012.

The company had implemented an action plan to improve its surplus position in the third quarter of 2012 in response to a significant loss of surplus in the first half of that year.

Hopefully these efforts, along with consistently following its established underwriting practices and procedures which were strengthened since 2002, will result in the company becoming profitable and growing its policyholders' surplus.

The examination verified the financial condition of the company as reported in its annual statement as of December 31, 2012. The examination of LBMIC resulted in two recommendations, one of which was repeated from the previous examination, no adjustments to surplus and no reclassifications. The repeat recommendation relates to the company taking action to retain all policyholder signed undertakings. The other recommendation is in regards to the submission of an application with this office for all agents appointed by the company and providing notification to this office for those agents that were terminated or no longer actively writing business.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 24 - Agents—It is recommended that the company submit an application to the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with s. 628.11, Wis. Stat., and that the company notify the Office of the Commissioner of Insurance of all agents that are terminated or are no longer writing business.

2. Page 25 - Undertaking Retention—It is again recommended that the company take action to ensure that it has a signed undertaking for all policyholders in-house; an electronically stored image of the original signed undertaking is acceptable as long as it is readily available to the Commissioner and can be reproduced in hard copy in accordance with s. Ins 6.80, Wis. Adm. Code.

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
Levi A. Olson	Insurance Financial Examiner
Jerry C. DeArmond	Reserve Specialist
David A. Jensen	IT Specialist
Frederick H. Thornton	Exam Planning & Quality Control Specialist

Respectfully submitted,

John E. Litweiler
Examiner-in-Charge