Report

of the

Examination of

McMillan-Warner Mutual Insurance Company

Marshfield, Wisconsin

As of December 31, 2014

TABLE OF CONTENTS

Page

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

February 7, 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:

MCMILLAN-WARNER MUTUAL INSURANCE COMPANY
Marshfield, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of McMillan-Warner Mutual Insurance Company (the company) was conducted in 2010 as of December 31, 2009. The current examination covered the intervening period ending December 31, 2014, and included a review of such 2015 transactions as deemed necessary to complete the examination.

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

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.

II. HISTORY AND PLAN OF OPERATION

The company was organized as a town mutual insurance company on May 28, 1898, as McMillan Grange Mutual Fire Insurance Company. In 1982, the company merged with Warner Fire Town Mutual and changed the company's name to that presently used. On January 1, 2000, the company converted to a ch. 611, Wis. Stat., nonassessable mutual company. Effective January 1, 2005, the company entered into a merger agreement with Lindina Town Mutual Insurance Company. The surviving company was McMillan-Warner Mutual Insurance Company. As a result of the merger, a subsidiary was established, Lindina Insurance Agency, Inc. (the agency). Further information regarding the agency is provided under the "Affiliated Companies" section of this report.

Wisconsin is the only state in which the company is currently licensed and writes business. The major products marketed by the company are homeowner's and farmowner's policies. The company also writes commercial multi-peril and umbrella business. The company's products are marketed through approximately 255 independent agents operating out of 34 agencies.

The following table is a summary of the net insurance premiums written by the company in 2014. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Farmowner's multiple peril	$6,286,318	$	$2,167,786	$4,118,532
Homeowner's multiple peril	3,190,355		1,123,929	2,066,426
Commercial multiple peril	32,319		11,176	21,143
Other liability – occurrence	152,537		145,871	6,666
Boiler and machinery	80,474		80,474	
Total All Lines	$9,742,003	$0	$3,529,236	$6,212,767

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 $150 for a full-day meeting, $85 for a half-day meeting and $20 an hour for other duties as compensation for serving on the board, in addition to mileage reimbursement of $0.575 per mile. The board chair is paid a monthly fee of $100.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Keith Eibergen Granton, WI	Farmer	2018
Georgette Frazer Marshfield, WI	Retired Financial Planner	2018
Tom Drendel Marshfield, WI	Retired UW Research Farm Manager	2016
Jeffrey Kolstad Marshfield, WI	Commercial Loan Officer	2016
Paula Mader Abbotsford, WI	Independent Agent	2016
James Kolba Mauston, WI	Postal Worker	2017
Jana Lee Marden Neillsville, WI	Retired Agent	2017
Roman Schaefer Jr. Marshfield, WI	Retired Farmer	2017
Jeff Kluckhohn Marshfield, WI	Small Business Owner	2018

Officers of the Company

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

Name	Office	2014 Compensation
Jeffrey Kolstad	Chairman	$ 3,606
Keith Eibergen	Vice Chairman	2,795
Roman Schaefer Jr.	Treasurer	3,485
Jana Lee Marden	Secretary	3,585
Scott Krum	CEO	124,799

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:

Executive Committee
Jeffrey Kolstad, Chair
Jana Lee Marden
Roman Schaefer Jr.
Keith Eibergen

Finance Committee
Jeffrey Kolstad, Chair
Jana Lee Marden
Roman Schaefer Jr.
Keith Eibergen
James Kolba
Georgette Frazer

Nominating Committee
Paula Mader, Chair
Jeff Kolstad
Tom Drendel

Expense Committee
Keith Eibergen, Chair
James Kolba
Jeff Kluckhohn

Reinsurance Committee
Paula Mader, Chair
Roman Schaefer
James Kolba

Building and Maintenance Committee
Jeff Kluckhohn, Chair
Paula Mader
Jana Lee Marden
Roman Schaefer

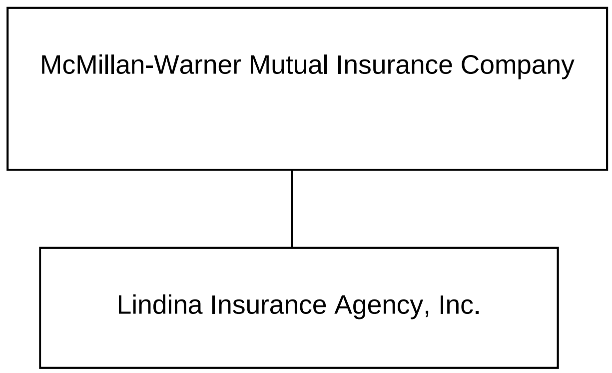
Scholarship Committee
Paula Mader, Chair
Georgette Frazer
Keith Eibergen
Jana Lee Marden

Annual Meeting/Advertising
Jana Lee Marden, Chair
Georgette Frazer
Keith Eibergen
Paula Mader

IV. AFFILIATED COMPANIES

McMillan-Warner Mutual Insurance Company is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates follows the organizational chart.

Organizational Chart
As of December 31, 2014



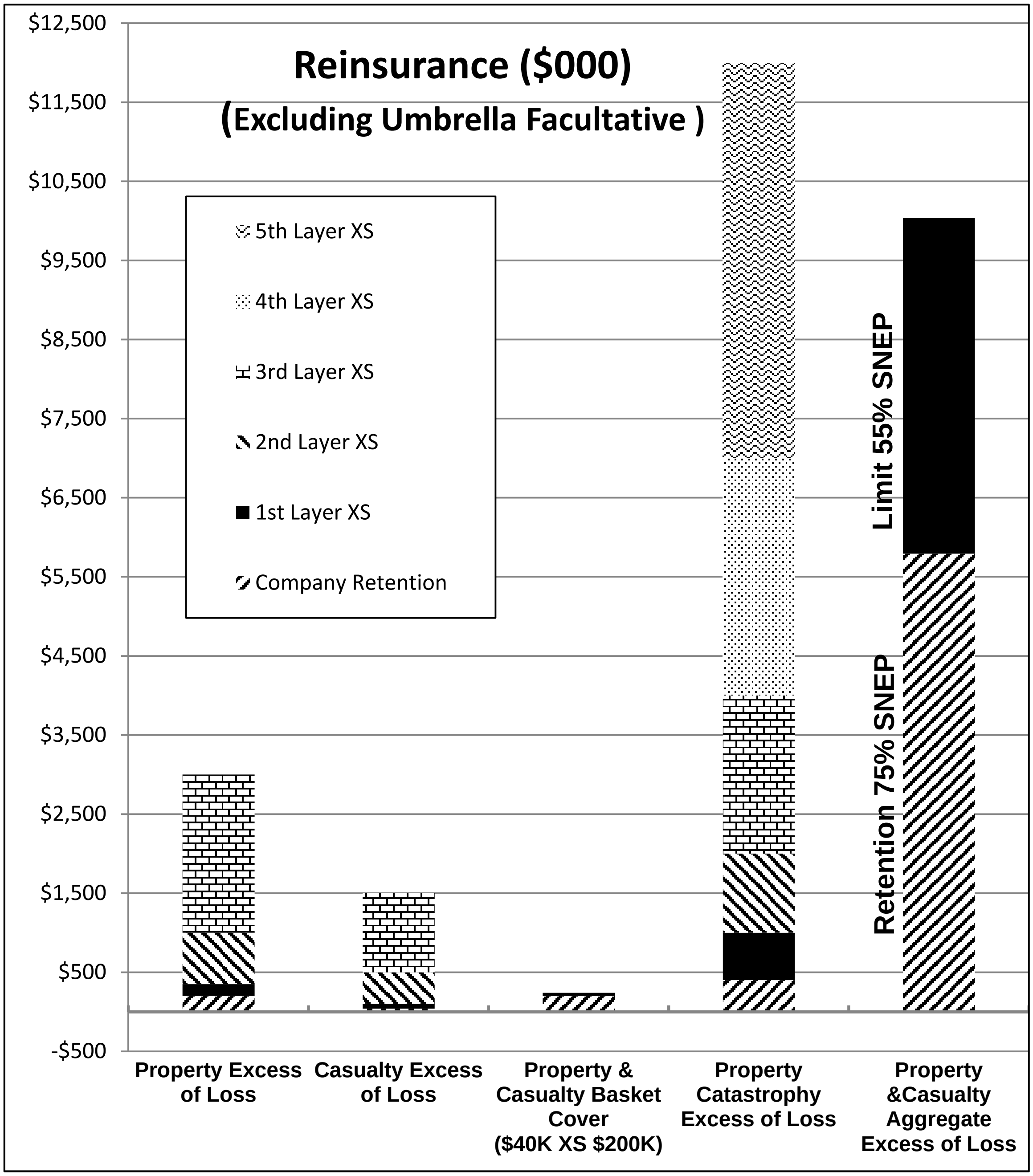
Lindina Insurance Agency, Inc.

The agency was formed on January 1, 2005, as a result of the merger agreement with Lindina Town Mutual Insurance Company. In 2009, the company sold the agency's marketing and renewal rights to approximately 150 policyholders to an unaffiliated agency.

The agency was also previously used to allow company agents to become sub-producers for Rockford Mutual Insurance Company (Rockford Mutual) in order to allow them to write auto insurance. Since the reinsurance relationship with Rockford Mutual has ended, the agency is no longer licensed to write Rockford Mutual auto insurance. The company is keeping the agency active primarily for future partnership opportunities. Currently there are no policies being written. Terminated agents can apply and be allowed to use the agency to service current active policies written by the company. The agency receives commissions on about 50 policies. As of December 31, 2014, the company reported the value of the agency as $1,000.

V. REINSURANCE

The company's reinsurance portfolio and strategy is illustrated below. A description of the contracts and companies involved follows.



Ceding Contracts

The company's reinsurance portfolio and strategy is described below, including a list of the companies that have a significant amount of reinsurance in force at the time of the examination. The contracts contained proper insolvency provisions.

The company made significant changes to its reinsurance program during the years covered by the exam. Prior to January 1, 2014, the company maintained a reinsurance program that complied with statutes and rules applicable to town mutual insurers, including obtaining unlimited aggregate stop loss coverage. This coverage was purchased through Rockford Mutual Insurance Company. As the company has grown to exceed $3 billion total risk insured, the availability of unlimited stop loss coverage became difficult to procure and prohibitively expensive. In response to these conditions, the company requested that OCI allow them to buy reinsurance through the reinsurance broker market and not be subject to the town mutual restrictions, including purchasing unlimited aggregate stop loss coverage. Starting in 2014, the company has been allowed to purchase reinsurance through the reinsurance broker market, but is required to obtain two catastrophe models on an annual basis, purchase property per risk and catastrophe excess of loss reinsurance coverage, and purchase an aggregate reinsurance cover to provide reinsurance protection for losses above the catastrophe reinsurance program.

1. Type: Multiple Line Excess of Loss

		Participation		
		1st X/S	2nd X/S	3rd X/S
Reinsurer:	Allied World Insurance Company	17.5%	17.5%	17.5%
	Catlin Underwriting, Inc. (OBO Lloyd's No. 2003)	5.0	5.0	5.0
	Hannover Rück SE	7.5	7.5	7.5
	Swiss Reinsurance America Corporation	70.0	70.0	70.0
	Total	100.0%	100.0%	100.0%

Scope: Includes property business and casualty business, excluding risks having a total insurable value of more than $250,000,000. Classes of business reinsured under this contract are deemed to include:

1. Coverages required for nonresident drivers under the motor vehicle financial responsibility law or the motor vehicle compulsory insurance law or any similar law of any state or province, following the provisions of the company's policies when they include or are deemed to include so-called "Out of State Insurance" provisions;
2. Coverages required under Sections 29 and 30 of the Motor Carrier Act of 1980 and/or any amendments thereto.

Retention:	A. Property: First Layer: $200,000 per risk Second Layer: $350,000 per risk Third Layer: $1,000,000 per risk	
	B. Casualty: First Layer: $40,000 Second Layer: $100,000 Third Layer: $500,000	
	C. Basket Cover – Property and Casualty: First Excess Layer only: $200,000 per loss occurrence	
Coverage:	A. Property: First Layer: $150,000 in excess of $200,000 per loss, per risk, subject to a limit of $450,000 per any one occurrence Second Layer: $650,000 in excess of $350,000 per loss, per risk, subject to a limit of $1,950,000 per any one occurrence Third Layer: $2,000,000 in excess of $1,000,000 per loss, per risk, subject to a limit of $4,000,000 per any one occurrence	
	B. Casualty: First Layer: $60,000 in excess of $40,000 per loss occurrence Second Layer: $400,000 in excess of $100,000 per loss occurrence Third Layer: $1,000,000 in excess of $500,000 per loss occurrence	
	C. Basket Cover – Property and Casualty: First Excess Layer only: $40,000 in excess of $200,000 per loss occurrence	
Reinstatement:	Free and unlimited	
Premium:	First Excess: 5.150% of net earned premium with a minimum premium of $405,576 and annual deposit of $506,970 Second Excess: 4.954% of net earned premium with a minimum premium of $390,140 and annual deposit of $487,675 Third Excess: 1.457% of net earned premium with a minimum premium of $390,140 and annual deposit of $487,675.	
Effective date:	January 1, 2015, to January 1, 2016	
Termination:	At expiration or cancellation of the agreement subject to a maximum run-off period of 12 months	

2. Type: Five Layer Property Catastrophe Excess of Loss

		1st Layer	2nd+ Layers
Reinsurer:	Allied World Insurance Company	17.5%	17.5%
	Arch Reinsurance Company	2.5	5.0
	R+V Versicherung AG	5.0	7.5
	Swiss Reinsurance America Corporation	65.0	70.0
	Total	90.0%	100.0%

Scope: Includes property excess liability

Retention:	First Excess: $400,000, per loss occurrence Second Excess: $1,000,000, per loss occurrence Third Excess: $2,000,000, per loss occurrence Fourth Excess: $4,000,000, per loss occurrence Fifth Excess: $7,000,000, per loss occurrence
Coverage:	First Excess: $600,000 excess of $400,000 per loss occurrence with an aggregate limit of $1,200,000 (90% subscribed) Second Excess: $1,000,000 excess of $1,000,000 per loss occurrence with an aggregate limit of $ 2,000,000 Third Excess: $2,000,000 excess of $2,000,000 per loss occurrence with an aggregate limit of $4,000,000 Fourth Excess: $3,000,000 excess of $4,000,000 per loss occurrence with an aggregate limit of $6,000,000 Fifth Excess: $5,000,000 excess of $7,000,000 per loss occurrence with an aggregate limit of $ 10,000,000
Reinstatement:	The amount of coverage can be reinstated from the time of loss occurrence one time subject to additional premium at 50% of the original rate
Premium:	First Excess: 3.994% of net earned premium with a minimum premium of $233,760 and annual deposit of $292,200 Second Excess: 2.952% of net earned premium with a minimum premium of $172,800 and annual deposit of $216,000 Third Excess: 2.733% of net earned premium with a minimum premium of $160,000 and annual deposit of $200,000 Fourth Excess: 2.050% of net earned premium with a minimum premium of $120,000 and annual deposit of $150,000 Fifth Excess: 1.708% of net earned premium with a minimum premium of $100,000 and annual deposit of $125,000
Effective date:	January 1, 2015, to January 1, 2016
Termination:	At expiration or cancellation of the agreement. If terminated while a covered loss is in progress, the reinsurer's liability is determined as if the entire loss had occurred prior to the termination date, provided that no part of such loss occurrence is claimed against any renewal or replacement of this contract.

3. Type: Aggregate Excess of Loss

Reinsurer:

Allied World Insurance Company	17.5%
Farmers Mutual Hail Insurance Co Iowa	2.5
R+V Versicherung AG	10.0
Swiss Reinsurance America Corporation	70.0
Total	100.0%

Scope:	Property and casualty excess liability, excluding risks having a total insurable value of more than $250,000,000
Retention:	75% of subject net earned premium, retention estimated at $5,792,081
Coverage:	Applies after ultimate net loss exceeds 75% of subject net earned premium, coverage not to exceed 55% of net subject earned premium, coverage estimated at $4,247,526

Reinstatement:	None
Premium:	9.30% of net earned premium with a minimum premium of $574,574 with an annual deposit of $718,218.
Effective date:	January 1, 2015, to January 1, 2016
Termination:	At expiration or cancellation of the agreement subject to a maximum run-off period of 12 months.

4. Type: Umbrella Facultative

Reinsurer:

Alterra Reinsurance USA Inc.	10.00%
Aspen Insurance UK Limited	2.50
Berkley Insurance Company	5.00
Hannover Rück SE	10.00
QBE Reinsurance Corporation	2.50
Swiss Reinsurance America Corp	45.00
The Toa Re Co of America	25.00
Total	100.00%

Scope:	All personal, farm, and umbrella liability business written or renewed during the contract term
Retention:	5% of each policy's ultimate net loss, up to a net loss of $1,000,000 for any one occurrence, with a maximum retention of $100,000
Coverage:	Up to 95% of the first $1,000,000 and 100% of up to $4,000,000 in excess of the first $1,000,000, with an annual aggregate limit of $10,000,000 for all acts of terrorism
Premium:	95% of gross net written premium on the first $1,000,000 of quota share coverage and 100% of gross net written premium on coverage greater than $1,000,000
Commission:	31.5% ceding commission on gross net written premium ceded under this contract
Effective date:	January 1, 2015, to January 1, 2016
Termination:	At expiration or cancellation of the agreement subject to a maximum run-off period of 12 months plus 6 months odd time. Alternatively, there is a cut-off basis option available to the company.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2014, 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.

McMillan-Warner Mutual Insurance Company
Assets
As of December 31, 2014

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 5,527,257	$	$ 5,527,257
Stocks:			
Common stocks	4,563,219	1,000	4,562,219
Real estate:			
Occupied by the company	97,887		97,887
Cash, cash equivalents, and short-term investments	1,788,636		1,788,636
Investment income due and accrued	57,798		57,798
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	11,647		11,647
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	1,648,931		1,648,931
Reinsurance:			
Amounts recoverable from reinsurers	260,043		260,043
Net deferred tax asset	493,000	5,000	488,000
Electronic data processing equipment and software	3,181		3,181
Furniture and equipment, including health care delivery assets	78	78	0
Receivable from subsidiary	2,677		2,677
Write-ins for other than invested assets:			
State income tax recoverable	6,264		6,264
Vehicles	19,717	19,717	
Total Assets	$14,484,305	$25,795	$14,458,510

McMillan-Warner Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2014

Losses		$ 748,828
Loss adjustment expenses		146,654
Commissions payable, contingent commissions, and other similar charges		448,410
Other expenses (excluding taxes, licenses, and fees)		44,912
Taxes, licenses, and fees (excluding federal and foreign income taxes)		110
Current federal and foreign income taxes		0
Unearned premiums		4,687,312
Advance premium		263,423
Ceded reinsurance premiums payable (net of ceding commissions)		175,743
Amounts withheld or retained by company for account of others		1,131
Total liabilities		6,516,523
Unassigned funds (surplus)	$7,941,987	
Surplus as regards policyholders		7,941,987
Total Liabilities and Surplus		$14,458,510

McMillan-Warner Mutual Insurance Company
Summary of Operations
For the Year 2014

Underwriting Income		
Premiums earned		$ 6,318,673
Deductions:		
Losses incurred	$4,134,832	
Loss adjustment expenses incurred	750,646	
Other underwriting expenses incurred	2,601,467	
Total underwriting deductions		7,486,945
Net underwriting gain (loss)		(1,168,272)
Investment Income		
Net investment income earned	140,226	
Net realized capital gains (losses)	332,453	
Net investment gain (loss)		472,679
Other Income		
Write-ins for miscellaneous income:		
Billing fees	330,307	
Total other income		330,307
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		(365,286)
Federal and foreign income taxes incurred		(3,938)
Net Income		$ (361,348)

McMillan-Warner Mutual Insurance Company
Cash Flow
For the Year 2014

Premiums collected net of reinsurance			$6,481,590
Net investment income			246,546
Miscellaneous income			330,307
Total			7,058,443
Benefit- and loss-related payments		$3,554,352	
Commissions, expenses paid, and aggregate write-ins for deductions		3,499,787	
Federal and foreign income taxes paid (recovered)		16,032	
Total deductions			7,070,171
Net cash from operations			(11,728)
Proceeds from investments sold, matured, or repaid:			
Bonds	$1,714,869		
Stocks	2,682,043		
Total investment proceeds		4,396,912	
Cost of investments acquired (long-term only):			
Bonds	2,310,565		
Stocks	2,346,154		
Total investments acquired		4,656,719	
Net cash from investments			(259,807)
Cash from financing and miscellaneous sources:			
Other cash provided (applied)		41,940	
Net cash from financing and miscellaneous sources			41,940
Reconciliation:			
Net change in cash, cash equivalents, and short-term investments			(229,595)
Cash, cash equivalents, and short-term investments:			
Beginning of year			2,018,230
End of Year			$1,788,635

McMillan-Warner Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2014

Assets		$14,458,510
Less security surplus of insurance subsidiaries		0
Less liabilities		6,516,523
Adjusted surplus		7,941,987
Annual premium:		
Lines other than accident and health	$6,212,767	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		2,000,000
Compulsory Surplus Excess (or Deficit)		$ 5,941,987
Adjusted surplus (from above)		$ 7,941,987
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)		$ 5,141,987

McMillan-Warner Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2014

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

	2014	**2013**	**2012**	**2011**	**2010**
Surplus, beginning of year	$8,477,478	$7,278,056	$7,916,467	$8,253,647	$8,280,465
Net income (loss)	(361,348)	755,875	(833,889)	(96,737)	(61,258)
Change in net unrealized capital gains/losses	(303,235)	274,067	132,418	(333,950)	131,725
Change in net deferred income tax	110,000	(325,000)	293,300	(9,300)	76,000
Change in nonadmitted assets	19,092	494,480	(230,240)	102,807	(173,285)
Surplus, End of Year	$7,941,987	$8,477,478	$7,278,056	$7,916,467	$8,253,647

McMillan-Warner Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2014

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below.

	Ratio	**2014**	**2013**	**2012**	**2011**	**2010**
#1	Gross Premium to Surplus	123%	120%	132%	115%	98%
#2	Net Premium to Surplus	78	84	98	92	78
#3	Change in Net Premiums Written	(13)	0	(2)	12	5
#4	Surplus Aid to Surplus	0	0	0	0	0
#5	Two-Year Overall Operating Ratio	99	100*	108*	102*	97
#6	Investment Yield	1.2*	1.0*	1*	1.4*	1.7*
#7	Gross Change in Surplus	(6)	16	(8)	(4)	0
#8	Change in Adjusted Surplus	(6)	16	(8)	(4)	0
#9	Liabilities to Liquid Assets	41	41	43	36	34
#10	Agents' Balances to Surplus	0	1	1	0	0
#11	One-Year Reserve Development to Surplus	(3)	(1)	0	(1)	0
#12	Two-Year Reserve Development to Surplus	(1)	0	(1)	0	(1)
#13	Estimated Current Reserve Deficiency to Surplus	(6)	(8)	(4)	3	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 2011, 2012, and 2013. The exceptional results were caused by a combination of large fire losses and wind and hail catastrophe losses. In 2013, the company's underwriting results began to improve due to increased premium rates and a reduced number of wind and hail damage claims.

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 five years under examination. Over the five-year period covered for this examination the company has averaged an investment yield of 1.3% which is well below the lower bound of this ratio of 3%. During the five years under examination, the company's common stock holdings have increased from 20.8% to 57.4% of policyholders' surplus, resulting in less investment in bonds. The holdings classified as common stock consist primarily of diversified mutual funds and exchange traded funds. At December 31, 2014, the company's investment assets consisted of cash and short-term investments 15%, bonds 46%, equity interests 38%, and company real estate 1%. This equity heavy allocation, combined with the short maturity, high quality nature of the bond portfolio produced below peer investment yields.

Growth of McMillan-Warner Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income (Loss)
2014	$14,458,510	$6,516,523	$7,941,987	$(361,348)
2013	15,098,576	6,621,098	8,477,478	755,875
2012	13,206,101	5,928,045	7,278,056	(833,889)
2011	13,082,646	5,166,179	7,916,467	(96,737)
2010	13,236,098	4,982,451	8,253,647	(61,258)
2009	13,330,304	5,049,839	8,280,465	224,800

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2014	$ 9,742,003	$6,212,767	$6,318,673	77.3%	36.6%	113.9%
2013	10,213,625	7,109,790	7,040,750	54.4	36.4	90.8
2012	9,613,763	7,108,062	6,797,950	76.8	36.8	113.6
2011	9,088,902	7,262,210	6,833,910	72.6	34.0	106.6
2010	8,102,716	6,467,404	6,146,416	70.7	32.2	102.9
2009	7,522,830	6,139,131	5,831,766	66.4	31.1	97.5

The five years subject to this examination were difficult ones for the company, producing net losses in four of the last five years due to significant and frequent loss events and declining investment income resulting in a four percent decline in policyholders' surplus. The May 2012 wind/hail event was the largest single event in the company's history with $6.9 million in gross losses, and was part of three consecutive years of wind and hail catastrophe losses. There was also increased frequency and severity of large fire losses and claims from frozen pipes and roof collapses during the polar vortex winter of 2013-14. The company did recover a majority of losses through reinsurance but retained a greater percentage of losses than in the past due to a higher attachment point.

The company’s expense ratio has increased from 31.1% to 36.6% over the last five years due to several factors including increased claims adjusting expense in high catastrophe loss years, an ongoing loss control re-inspection program, and computer software and systems related expenses. The company has undertaken underwriting and expense reduction initiatives to improve results including a new quoting and processing system, completing a re-inspection and re-underwriting project to identify underpriced risks, and reviewing agent performance and terminating inefficient agents. These underwriting and pricing initiatives resulted in policy count reductions of 838 and 866 over 2013 and 2014, respectively. Total policies decreased 17% over the last two years, dropping from a high of 10,200 in 2012 to 8,496 at the end of 2014. While the underwriting initiatives, combined with an additional rate increase, are designed to improve operating results, the company's concentration of risks remain within several counties in Wisconsin and will continue to be subject to concentrated storm and weather activity in this market.

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, 2014, is accepted.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were three 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. Unclaimed Funds—It is again recommended that the company comply with ch. 177, Wis. Stat., as regards to unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

   Action—Compliance.

2. Fixed Assets—It is again recommended that the company depreciate its EDP equipment pursuant to SSAP No. 79, paragraph 3.

   Action—Compliance.

3. Uncollected Premiums in Course of Collection—It is recommended that the company nonadmit installment premiums that are over 90 days past due pursuant to SSAP No. 6, paragraph 9.

   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.

Cash Disbursements

The company has a policy of requiring two signatures on all checks. If a check is written for more than $5,000 one of the required signatures must be from a director of the company. Testing of cash disbursements during the examination identified a check payment over the required amount that only had one signature. It is recommended that the company adhere to its policy requiring two signatures on each check disbursement.

Investments

Custodial agreements of Wisconsin-domiciled companies must comply with guidelines contained in the NAIC's Financial Condition Examiners' Handbook. The review of the custodial agreement with Comerica Bank revealed that the agreement does not include all of the suggested clauses as contained in the NAIC's Financial Condition Examiners' Handbook to ensure proper controls and safeguards. The following items were missing from the agreement:

1. In the event the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability of loss to the securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the commissioner of insurance of the state of domicile may accept a liability applicable to the agent that is different from standard liability.

2. If the custodian agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within 3 business days of termination or withdrawal, to the insurers domiciliary commissioner.

3. During regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities if the custodian is given written instructions to that effect from an authorized officer of the insurance company.

4. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation, which the clearing corporation permits to be redistributed including reports

prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control.

5. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information.

6. The custodian shall provide upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian.

7. The custodian shall secure and maintain insurance protection in an adequate amount.

It is recommended that the company have the custodian revise the custodial agreement to include the guideline provisions contained in the NAIC's Financial Condition Examiners' Handbook.

Conflict of Interest Statements

Company policy requires directors, officers, and key employees to complete conflict of interest statements on an annual basis. During the course of the examination, the company was unable to locate signed conflict of interest statements for board members from 2010 and 2011. It is recommended that the company adhere to its policy of having directors, officers, and key employees sign conflict of interest statements and disclose any conflicts, and retain the signed statements at the company where they can be produced within a reasonable time.

Audit Engagement

A review of the engagement letter submitted to the company by its independent certified public accounting firm in anticipation of the external audit as of December 31, 2014, found that the engagement letter included a clause that releases the CPA firm from responsibility for any misstatements in the company's financial statement that the CPA firm failed to detect due to misrepresentation made by the company's management. Section Ins 50.08 (1) (am), Wis. Adm. Code, provides that the Commissioner may rule that an accountant is not qualified to express an opinion on an audited financial statement if, among other things, the accountant has "either directly or indirectly entered into an agreement of indemnification with respect to the audit of the insurer." Section Ins 50.01 (4m), Wis. Adm. Code, defines indemnification as "an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing or other misrepresentations made by the insurer or its representatives." The clause included in the engagement letter creates a contractual disclaimer of liability with the intent to limit the liability of the CPA firm for failure to adhere to auditing standards. It is recommended that the company enter into future audit engagements with independent certified public accountants that are in compliance with all requirements under s. Ins 50.08 (1), Wis. Adm. Code.

The company represented to the examination team that the indemnification clause was removed from the engagement letter for the audit as of December 31, 2015.

Fidelity Bond

The review of the company's insurance coverages and bonding program revealed that the fidelity bond of $200,000 is below the NAIC suggested minimum level of fidelity bond coverage for employees responsible for the safeguard of assets. The bonding levels are based on the amount of admitted assets and gross income. It is recommended that the company increase its bond amount at least to the minimum suggested level of $900,000 per the NAIC guidelines.

Disaster Recovery Plan

The examination revealed that the company has a reasonable Disaster Recovery and Business Continuity plan, but does not perform testing or walkthroughs of the plan. Regular testing of such plans allows employees to feel comfortable that they would be able to find and implement the disaster recovery plan if needed. It is recommended that the company conduct a test of the disaster recovery plan on a regular basis.

VIII. CONCLUSION

The company reported net losses in four of the five years under examination, while admitted assets increased 8%, premiums earned increased 8%, and surplus decreased by 4%. The growth in premium was attributable to rate increases, not increased policy count. The company endured three consecutive years of unusually high wind and hail catastrophe losses and large fire losses, and also frozen pipes and roof collapses due to the historic polar vortex winter of 2013-14. In response, the company has undergone underwriting and pricing improvement initiatives, and has begun to purchase reinsurance through the broker market. Common stock holdings, consisting primarily of diversified mutual funds and exchange traded funds, have increased substantially. There were no significant changes in the company's products since the previous examination. The examination determined that the company was in compliance with all three of the recommendations made by the previous examination.

The current examination resulted in six recommendations, with none repeated from the previous 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, 2014, is accepted.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Cash Disbursements—It is recommended that the company adhere to its policy requiring two signatures on each check disbursement.

2. Page 24 - Investments—It is recommended that the company have the custodian revise the custodial agreement to include the guideline provisions contained in the NAIC's Financial Condition Examiners' Handbook.

3. Page 24 - Conflict of Interest Statements—It is recommended that the company adhere to its policy of having directors, officers, and key employees sign conflict of interest statements and disclose any conflicts, and retain the signed statements at the company where they can be produced within a reasonable time.

4. Page 25 - Audit Engagement—It is recommended that the company enter into future audit engagements with independent certified public accountants that are in compliance with all requirements under s. Ins 50.08 (1), Wis. Adm. Code.

5. Page 25 - Fidelity Bond—It is recommended that the company increase its bond amount at least to the minimum suggested level of $900,000 per the NAIC guidelines.

6. Page 25 - Disaster Recovery Plan—It is recommended that the company conduct a test of the disaster recovery plan on a regular basis.

X. 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 Olson	Insurance Financial Examiner
Nicholas Hartwig	Insurance Financial Examiner
David Jensen	IT Specialist
Jerry DeArmond	ACL/Reserve Specialist

Respectfully submitted,

James Vanden Branden
Examiner-in-Charge