Report

of the

Examination of

Newark Mutual Insurance Company

Beloit, Wisconsin

As of December 31, 2010

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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January 17, 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, 2010, of the affairs and financial condition of:

NEWARK MUTUAL INSURANCE COMPANY
Beloit, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Newark Mutual Insurance Company (the company) was made in 2008 as of December 31, 2007. The current examination covered the intervening time period ending December 31, 2010, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on selected 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.

This was a limited scope examination. Examination testing covered the following areas:

- Compliance with Prior Exam Recommendations
- Underwriting/Inspections
- Controls over Cash Disbursements
- Management & Control

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

In addition to auditing, the public accounting firm performs non-auditing services for the company, including compilation and tax return preparation services. On January 3, 2011, 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.

The company was organized as a town mutual insurance company on March 16, 1875, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Newark Mutual Fire 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 were no amendments to the articles of incorporation or the bylaws.

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

Dane	Racine
Green	Rock
Lafayette	Walworth

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 premiums payable on the advance premium and assessment basis. The company also charges policy and installment fees. Policy fees are $25, $35, or $45 depending upon the amount of the annual premium. Installment fees are $8 per billing period. Further discussion about policy and installment fees can be found in the “Summary of Examination Results” section of this report under “Policy Fees.”

Business of the company is acquired through 22 agents, none of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
Farm, farmowner, mobile home/trailer	10%
Homeowner's, residential, commercial	15%

Agents do not have authority to adjust losses. An outside adjusting firm receives $54.00/hour, $1.00/photo, $0.60/mile, plus miscellaneous expenses 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 meetings 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
Karen Johnson	Retired	Milton, WI	2012
Robert Wildermuth	Farmer	Clinton, WI	2012
Laverne Hays	Farmer	Orfordville, WI	2013
Michelle Ponkauskas	Banker	Beloit, WI	2013
Frederick Yaun	Farmer	Orfordville, WI	2013
John Perkins	Sales Manager	Clinton, WI	2014
Gary Tews	Farmer	Orfordville, WI	2014

Members of the board currently receive $50.00 for each meeting attended and $0.555/mile for travel expenses. Directors who help with clerical functions in the office are compensated at $16.00/hour.

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 s as of December 31, 2010, were as follows:

Name	Office	2010 Compensation
John Perkins	President	$ 450
Frederick Yaun	Vice President	2,119
Karen Johnson	Treasurer	450
LaVerne Hays	Secretary	1,341
Amber Bennett	Manager	31,405

The officers do not receive any salary. Reported compensation included director's fees, travel reimbursement and compensation for clerical help at the company's office as applicable. For the manager, the reported compensation included her salary as manager.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The Adjusting Committee, comprised of the full board, was the only committee at the time of the examination.

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
2010	$ 32,787	952	$145,570	$714,934	$455,547
2009	358,009	1,012	(59,849)	686,734	277,886
2008	407,926	1,082	(78,744)	799,744	411,686
2007	427,895	1,238	(9,422)	842,197	454,220

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

Year	Gross Premiums Written	Net Premiums Written	Policyholders' Surplus	Writings Ratios Net	Writings Ratios Gross
2010	$543,858	$(226,788)	$455,547	(50)%	119%
2009	590,584	345,945	277,886	124	212
2008	644,813	382,944	411,686	93	157
2007	701,022	445,420	454,220	98	154

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Com-posite Ratio
2010	$ 2,827	$ (82,781)	$ 32,787	9%	37%	46%
2009	275,085	173,358	358,009	77	50	127
2008	324,955	201,676	407,926	80	53	133
2007	239,245	247,789	427,895	56	56	112

The company’s assets and surplus declined significantly in 2008-2009, as a result of a net loss of $78,744 and $59,849, and unrealized capital losses of $74,145 in 2009. This decline brought the company’s December 31, 2009, surplus to $277,886, which approaches the $200,000 minimum surplus required by s. Ins 13.06 (4), Wis. Adm. Code.

This prompted the company to enter into a 100% quota share arrangement with Wisconsin Reinsurance Corporation (WRC) for 2010 to prevent further surplus deterioration. This 100% quota share arrangement was continued for 2011. The quota share contract pays a 35% commission on property business and a 15% commission on liability business ceded. In 2010, the company ceded all premiums written in 2010 plus the unearned premium reserve as of January 1, 2010, to the reinsurer, resulting in negative premiums written and negative underwriting expenses in 2010.

The surplus decline was preceded by above average loss and underwriting expense ratios from 2007 – 2009, as depicted below:

	2007 - 2009 (average)	
	Newark Mutual	Town Mutual Composite
Gross Loss Ratio	97%	59%
Net Loss & LAE Ratio	71%	57%
Expense Ratio	53%	44%
Composite Ratio	124%	101%

The high Gross and Net Loss and LAE Ratios are indicative of an elevated level of risk in the company's book of business relative to its peers. The high Expense Ratio is due, in part, to higher than average reinsurance premiums (due to significant losses paid by WRC in prior years). The Expense Ratio is also a reflection of the company's small size relative to its peers, as the company does not generate sufficient premium volume to achieve the economy of scale necessary to fully absorb its fixed overhead costs. (For example, the Town Mutual Composite average for net premiums written and policies in force for 2009 were $626K and 1,424, respectively, vs. $346K and 1,012 for Newark.)

During the period from 2003 – 2009, the company did not earn an underwriting gain; the underwriting gain in 2010 was due to the 100% quota share contract with a large ceding commission. Investment income has been negative, due to allocated costs exceeding gross earnings, due to a lack of income producing invested assets (dominated by WRC common stock). Although policy fees have contributed to the bottom line, these fees have generally been insufficient to overcome the underwriting losses. The underwriting losses began to worsen in 2005, which resulted in a five-year period of net losses. The company's average net loss from 2005 – 2009 was $42K.

As of December 31, 2010, the company's investment in WRC common and preferred stock comprised 105% of the company's surplus and 67% of the company's assets. (The company received the common stock in WRC's demutualization in 1991.) This investment is not liquid, so the company will need to identify other resources to pay its claim and administrative expenses going forward if the company decides to reduce its ceding percentage below 100%.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained proper insolvency clauses and 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 1, with 90 days' advance notice
1.	Type of contract:	Casualty Quota Share
	Lines reinsured:	Liability
	Company's retention:	None
	Coverage:	100% of all losses
	Reinsurance premium:	100% of net written premium
	Ceding commission:	15% of premium paid
2.	Type of contract:	Property Quota Share
	Lines reinsured:	All property business written by the company
	Company's retention:	None
	Coverage:	100% of all losses
	Reinsurance premium:	100% of net written premium (for 2010, this included 100% of unearned premium reserve as of January 1, 2010)
	Ceding commission:	35% of premium paid

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2010, 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."

Newark Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2010

Assets	**Ledger**	**Nonledger**	**Not Admitted**	**Net Admitted**
Cash on hand	$ 150	$	$	$ 150
Cash in checking	31,195			31,195
Cash deposited at interest	86,040			86,040
Stocks and mutual fund investments	505,267			505,267
Real estate	12,375			12,375
Premiums, agents' balances and installments:				
In course of collection	8,340		1,202	7,138
Deferred and not yet due	64,257			64,257
Investment income accrued		302		302
Reinsurance recoverable on paid losses and LAE	7,987			7,987
Fire dues recoverable	223			223
Totals	$715,834	$302	$1,202	$714,934

Liabilities and Surplus

Net unpaid losses	$ 0
Commissions payable	12,071
Reinsurance payable	233,374
Amounts withheld for the account of others	612
Payroll taxes payable (employer's portion)	306
Other liabilities:	
Expense-related:	
Accounts payable	622
Nonexpense-related:	
Premiums received in advance	12,402
Total liabilities	259,387
Policyholders' surplus	455,547
Total Liabilities and Surplus	$714,934

Newark Mutual Insurance Company
Statement of Operations
For the Year 2010

Net premiums and assessments earned		$ 32,787
Deduct:		
Net losses incurred	$ (7,645)	
Net loss adjustment expenses incurred	10,472	
Net other underwriting expenses incurred	(82,781)	
Total losses and expenses incurred		(79,954)
Net underwriting gain (loss)		112,741
Net investment income:		
Net investment income earned		(4,668)
Other income (expense):		
Fees	34,320	
Other income	3,117	
Total other income		37,497
Net Income (Loss)		$145,570

Newark Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the 3-Year Period Ending December 31, 2010

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:

	2010	**2009**	**2008**
Surplus, beginning of year	$277,886	$411,686	$454,220
Net income	145,570	(59,849)	(78,744)
Net unrealized capital gain or (loss)	32,765	(74,145)	35,863
Change in nonadmitted assets	(674)	194	347
Surplus, End of Year	$455,547	$277,886	$411,686

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2010, is accepted.

IV. 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. Underwriting—It is recommended that the company not discriminate against its policyholders by charging different premiums for the same coverage in accordance with s. 628.34 (3) (a), Wis. Stat.

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

2. Underwriting—It is recommended that the company review the underwriting files for each policy prior to the next annual renewal. For all policies where a signed undertaking cannot be found, the company should obtain a signed undertaking at the time of renewal as required by s. 612.52, Wis. Stat.

   Action—Compliance

3. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, including documentation of findings, and a procedure whereby a sampling of new applications and renewal business is inspected by the board of directors.

   Action—Noncompliance; see comments in the "Summary of Current Examination Results."

4. Claims Adjusting—It is recommended that the minutes of the board of directors clearly indicate board nomination of the Adjusting Committee as required by s. 612.13 (4), Wis. Stat.

   Action—Compliance

5. Policy and Installment Fees—It is recommended that the company change its policy and installment fee schedules so that these schedules equitably distribute policy and billing expenses among policyholders paying on an installment basis.

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

6. Accounts and Records—It is recommended that the company's board of directors demonstrate active involvement in the company's operations in order to establish control over business operations. Specifically, the board should: 1) review all bank reconciliations; 2) review cash disbursements and cash receipts records to ensure that the records are accurate and complete; 3) review the premium records to ensure that the records are complete; 4) ensure that checks are signed in accordance with the company's authorization and check signing procedure; 5) ensure that the company cedes first surplus reinsurance according to the reinsurance contract terms approved by the board.

   Action—Noncompliance; see comments in the "Summary of Current Examination Results."

7. Accounts and Records—It is recommended that the company immediately stop its current practice of issuing checks to “Newark Mutual Insurance Company” in order to establish better control over the company’s funds.

   Action—Compliance

8. EDP Environment—It is recommended that computer operation manuals specifying tasks unique to the company’s operations should be readily available for employees new to the system. The company’s employees should be trained in the use of the computer system.

   Action—Compliance

9. Net Unpaid Losses—It is recommended that the company establish specific criteria as regards the type and dollar amount of claims that require signed proof of loss statements and follow these guidelines in its claim adjusting process.

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

10. Unpaid Loss Adjustment Expenses—It is recommended that the company establish a method of determining unpaid loss adjustment expenses, including direct expenses, in order to determine a more adequate loss adjustment expense reserve.

    Action—Not applicable (since the company currently cedes 100% of losses and loss adjustment expenses, the company did not report any unpaid loss adjustment expenses on the 2010 annual statement).

11. Commission Payable—It is recommended that the company properly estimate its commission liability in accordance with the Town Mutual Instructions.

    Action—Compliance

12. Unearned Premium—It is recommended that the company properly utilize its premium records in order to establish the unearned premium balance.

    Action—Not applicable (since the company currently cedes 100% of its premiums written, the company did not report any unearned premium on the 2010 annual statement).

13. Accounts Payable—It is recommended that the company properly accrue a liability for general expenses incurred in the reporting year which have not been paid prior to the reporting date.

    Action—Compliance

14. Accrued Property Taxes—It is recommended that the company properly accrue a liability for property taxes incurred in the reporting year which have not been paid prior to the reporting date.

    Action—Compliance

Current Examination Results

Underwriting: Rate Discrimination – HO/FO Policies

Per s. 628.34 (3) (a), Wis. Stat.: "No insurer may unfairly discriminate among policyholders by charging different premiums or by offering different terms of coverage except on the basis of classifications related to the nature and the degree of the risk covered or the expenses involved…."

The company's underwriting guidelines for Homeowner/Farmowner (HO/FO) policies requires that the amount of coverage on farm buildings and (farm) personal property cannot exceed 50% of the coverage on the primary dwelling. In the prior examination report, it was noted that a significant percentage of the HO/FO policies were inappropriately rated, resulting in those policies improperly receiving the more favorable HO/FO (as opposed to Farmowner) rates.

Current examination testing of a sample of 30 HO/FO policies revealed that two of the policies tested were well over the 50% farm coverage limit (313% and 98%, respectively).. The fact that policies with similar coverage were charged different rates constitutes a violation of s. 628.34 (3) (a), Wis. Stat.

It is again recommended that the company not discriminate against its policyholders by charging different premiums for the same coverage in accordance with s. 628.34 (3) (a), Wis. Stat.

It was noted that on December 6, 2011, the board of directors changed the underwriting rule for HO/FO policies to allow coverage on farm buildings and personal property to be 100% of the coverage on the primary dwelling (up from 50%). This change should address some of the problems noted by examiners, such as where a policy initially met the underwriting rule but subsequent endorsements increased the FO coverage above the authorized limit.

Underwriting: Inspection Plan

In the prior examination report, it was recommended that the company establish a formal inspection procedure whereby a sampling of new applications and renewal business is inspected by the board of directors.

During the current examination, the examiners could find no evidence that the company established formal inspection procedures specifying how policies will be prioritized and providing a timeline for inspections to be completed.

It is again recommended that the company establish formal inspection procedures, including an inspection program comprised of the following components:

- **<u>Inspection Plan</u>:** It is recommended that the company establish a formal inspection plan for new and renewal business, including the priority of policies to be inspected and a timeline for completion. This plan should be reviewed and approved by the board and formally documented in the board minutes as well as the Underwriting Manual. It is further recommended that the company review loss ratios by policy type, agent and agency on an annual basis, and track this data on a multi-year basis in a summary worksheet, to assist in prioritizing policies for inspection.

- **<u>Monitoring Inspection Results</u>:** To better monitor and follow up on completed inspections, it is recommended that the company maintain a list of policies inspected in each reporting year, including (at a minimum): the policy number, the agent, the type of policy, problems identified, and underwriting actions required as a result of the inspections (which should also be documented in the policy file). This list should be reviewed by the board at its regular meetings, with evidence of this review documented in the board minutes.

Underwriting Guidelines

In the prior examination report, it was recommended that the company's board of directors demonstrate active involvement in the company's operations in order to establish a better control environment. Underwriting was specifically cited as an area requiring greater board oversight.

Current examination testing revealed that, although the company has been proactive in strengthening underwriting requirements in various areas, these updated guidelines have not always been formally documented in the Underwriting Manual, resulting in inappropriate policy and underwriting decisions. For example:

- On September 30, 2009, the board approved the following revision to the cancellation provisions in the Policy Manual: "A ten-day notice will be sent allowing the policyowner to reinstate with a $40 late fee. Lapsed policies beyond 20 days will require a new, signed application."

  Review of the August 11, 2010, board minutes indicates that the policy manual had not been updated to reflect this change, necessitating a review of all policy cancellations since September 30, 2009, for compliance with the revised guidelines.

- On November 18, 2009, the board approved a moratorium on Artesian, Business Owners and Commercial policies.

Current examination testing revealed that at least one business owner and one artesian policy was issued after this date.

- On November 18, 2009, the board approved acceptance of new homeowner's business with board approval only.

  Review of the board minutes subsequent to November 18, 2009, produced no evidence that the board is formally reviewing and approving all new homeowner's policies.

It is recommended that the company take action to ensure that all board-approved revisions to the company's underwriting guidelines are reflected in the company's Underwriting Manual in a timely manner. In addition, it is recommended that the company review all inspection reports against the most current underwriting guidelines and formally document in the policy file actions taken by the company to bring the policy into compliance with those guidelines.

Policy Fees

Per s. 625.11 (4), Wis. Stat.: "One rate is unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the differences in expected losses and expenses." In the prior examination report, it was recommended that the company change its policy fee schedule to ensure that policy fees are equitably distributed amongst policyholders (regardless of payment mode).

Current examination testing revealed that the company continues to break out policy fees by installment. For example, if premium is paid on a quarterly basis, the policyholder would pay ¼ of the total policy fee with each installment (as opposed to paying the full fee with the first payment as would be the case for policyholders who pay on an annual basis). Since policy fees are considered to be fully earned at the time of policy issuance; these fees are not returned if the policy is cancelled mid-term (and conversely, no effort is made to collect the uncollected portion of the fee in these situations). This practice is discriminatory, as it does not equitably distribute policy fees amongst policyholders who pay on an annual vs. an installment basis.

It is again recommended that the company change its billing procedure to collect policy fees in full upfront (at policy inception) to ensure that all policyholders pay their full and equitable share of policy fees regardless of payment mode, in accordance with the non-discrimination provisions of s. 625.11 (4), Wis. Stat.

Proof of Loss

In the prior examination report it was noted that the company does not require signed proof of loss statements for all claims, nor does it define the type and dollar amount of the claims that require a signed proof of loss form.

During the current examination, a sample of ten claim files were reviewed. Six of the ten claim files (with claims ranging in dollar amount from $550 to $6,342.69) did not include a signed proof of loss statement. Based on these results, it was apparent that the company had not established formal criteria as to the types of claims and dollar thresholds that require a signed proof of loss statement.

It is again recommended that the company establish specific criteria as regards the type and dollar threshold of claims that require a signed proof of loss statement, and adhere to these guidelines in the claim adjustment process. These guidelines should be approved by the board, with evidence of approval documented in the board minutes, as well as in a company policy and procedures manual for future reference. (Note: Subsequent to the completion of examination fieldwork, the board approved a Proof of Loss Policy in the December 6, 2011, board meeting. This recommendation is now considered to be resolved.)

Accounts and Records – Bank Reconciliations

The prior examination report cited numerous errors and omissions in the company's records to the extent that the cash disbursement records were considered unreliable and included a recommendation that the board of directors demonstrate active involvement in the company's operations.

Although the current examination found no evidence of the cash disbursement control deficiencies cited in the 2007 examination report, there continues to be no evidence that the board is performing the recommended reviews of the company's operations. At a minimum, the company should implement controls to comply with s. Ins 13.05 (4) (d), Wis. Adm. Code, which states: "Whenever possible, bank reconciliations should be made or reviewed by an individual other than the individuals preparing and making the bank deposits, recording income and disbursements, and individuals signing company checks." Since the company's employees handle cash receipts and disbursements and record these transactions in the accounting records, it would be prudent to have the Treasurer, or other appropriate board member, review the bank reconciliations, and provide evidence of this review to the board.

It is recommended that the Treasurer, or other appropriate board member, review and initial the monthly bank reconciliations, and the board review a copy of the initialed bank reconciliations at its regular board meetings. This review should be documented in the board minutes as evidence that the company is complying with s. Ins 13.05 (4) (d), Wis. Adm. Code.

Check Signature Policy

Per s. Ins 13.05 (4) (b), Wis. Adm. Code: "…All disbursements over a specified amount shall be approved by more than one officer, director or employee of the company. Whenever possible, a person other than the person maintaining the company's cash disbursement journal or reconciling the bank accounts shall sign the checks."

During the current examination, the company was not able to provide a formal written check signature policy, approved by the board, specifying the criteria (i.e., type of disbursement, dollar threshold, etc.) as to when a second check signature is required.

It is recommended that the company develop a formal written check signature policy identifying the authorized signers and specifying that all disbursements over a specified dollar amount shall be approved by more than one officer, director or employee of the company, in accordance with s. Ins 13.05 (4) (b), Wis. Adm. Code. This policy should be reviewed and approved by the board and formally documented in the board minutes as well as in a company policy and procedures manual for future reference. (Note: Subsequent to the completion of examination fieldwork, the board approved a Check Signature Policy in the December 6, 2011, board meeting. This recommendation is now considered to be resolved.)

Annual Meetings – Quorum

Article V of the company's bylaws states that 10 members shall constitute a quorum at the company's annual (policyholder) meetings.

The examiner's review of the annual meeting minutes since the prior exam revealed that, although a quorum of at least 10 policyholders has been present at each of the last four annual meetings, the company is just meeting this threshold; the average annual meeting attendance over the last four years was 13 (including directors).

It is suggested that the company increase its promotional efforts to ensure a reasonable representation of policyholders at its annual meetings.

V. CONCLUSION

The company's assets and surplus declined significantly in 2008 – 2009, as a result of a net loss of $78,744 and $59,849, and unrealized capital losses of $74,145 in 2009. This decline brought the company's December 31, 2009, surplus of $277,886 very close to the $200,000 minimum surplus required by s. Ins 13.06 (4), Wis. Adm. Code. This prompted the company to enter into a 100% quota share arrangement with Wisconsin Reinsurance Corporation (WRC) for 2010 to prevent further surplus deterioration. This 100% quota share arrangement has continued in 2011.

During the period from 2003 – 2009, the company did not earn an underwriting gain; the underwriting gain in 2010 was due to the 100% quota share contract with a large ceding commission. Investment income has been negative, due to allocated costs exceeding gross earnings, due to a lack of income producing invested assets (dominated by WRC common stock). Although policy fees have contributed to the bottom line, these fees have generally been insufficient to overcome the underwriting losses. The underwriting losses started to worsen beginning in 2005, which resulted in a five-year period of net losses. The company's average net loss from 2005 – 2009 was $42K.

As of December 31, 2010, WRC common and preferred stock comprised 105% of the company's surplus and 67% of the company's assets. Since this investment is not liquid, the company will need to identify other resources to pay its claim and administrative expenses going forward if the company decides to reduce its ceding percentage below 100%.

The current examination was of limited scope, covering the period from 2008 – 2010, and included a review of significant subsequent events (including the hiring of a new Manager in April 2011). Examination testing targeted the following areas (with heavy emphasis placed on areas of concern identified in the 2007 examination):

- Compliance with Prior Examination Recommendations
- Underwriting/Inspections
- Controls over Cash Disbursements
- Management & Control

The current examination resulted in nine recommendations (including two repeats and three partial repeats from the prior examination), one suggestion and no examination adjustments to surplus. The recommendations spotlight opportunities to strengthen the company's oversight and controls in the areas of inspections/underwriting, and accounting records. It is also suggested that the company increase promotional efforts to ensure a reasonable representation of policyholders at its annual meetings.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Underwriting: Rate Discrimination – HO/FO Policies—It is again recommended that the company not discriminate against its policyholders by charging different premiums for the same coverage in accordance with s. 628.34 (3) (a), Wis. Stat.

2. Page 15 - Underwriting: Inspection Plan—It is recommended that the company establish a formal inspection plan for new and renewal business, including the priority of policies to be inspected and a timeline for completion. This plan should be reviewed and approved by the board and formally documented in the board minutes as well as the Underwriting Manual.

3. Page 15 - Underwriting: Inspection Plan—It is further recommended that the company review loss ratios by policy type, agent and agency on an annual basis, and track this data on a multi-year basis in a summary worksheet, to assist in prioritizing policies for inspection.

4. Page 15 - Underwriting: Monitoring Inspection Results—It is recommended that the company maintain a list of policies inspected in each reporting year, including (at a minimum): the policy number, the agent, the type of policy, problems identified, and underwriting actions required as a result of the inspections (which should also be documented in the policy file). This list should be reviewed by the board at its regular meetings, with evidence of this review documented in the board minutes.

5. Page 16 - Underwriting Guidelines—It is recommended that the company take action to ensure that all board-approved revisions to the company's underwriting guidelines are reflected in the company's Underwriting Manual in a timely manner. In addition, it is recommended that the company review all inspection reports against the most current underwriting guidelines and formally document in the policy file actions taken by the company to bring the policy into compliance with those guidelines.

6. Page 16 - Policy Fees—It is again recommended that the company change its billing procedure to collect policy fees in full upfront (at policy inception) to ensure that all policyholders pay their full and equitable share of policy fees regardless of payment mode, in accordance with the non-discrimination provisions of s. 625.11 (4), Wis. Stat.

7. Page 17 - Proof of Loss—It is again recommended that the company establish specific criteria as regards the type and dollar threshold of claims that require a signed proof of loss statement, and adhere to these guidelines in the claim adjustment process. These guidelines should be approved by the board, with evidence of approval documented in the board minutes, as well as in a company policy and procedures manual for future reference.

8. Page 18 - Accounts and Records – Bank Reconciliations—It is recommended that the Treasurer, or other appropriate board member, review and initial the monthly bank reconciliations, and the board review a copy of the initialed bank reconciliations at its regular board meetings. This review should be documented in the board minutes as evidence that the company is complying with s. Ins 13.05 (4) (d), Wis. Adm. Code.

9. Page 18 - Check Signature Policy—It is recommended that the company develop a formal written check signature policy identifying the authorized signers and specifying that all disbursements over a specified dollar amount shall be approved by more than one officer, director or employee of the company, in accordance with s. Ins 13.05 (4) (b), Wis. Adm. Code. This policy should be reviewed and approved by the board and formally documented in the board minutes as well as in a company policy and procedures manual for future reference.

10. Page 19 - Annual Meetings - Quorum—It is suggested that the company increase its promotional efforts to ensure a reasonable representation of policyholders at its annual meetings.

VII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Kristin L. Forsberg
Examiner-in-Charge