

Report
of the
Examination of
Policyholders Mutual Insurance Company
DeForest, Wisconsin
As of December 31, 2014

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, Governor
Theodore K. Nickel, Commissioner

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February 10, 2016

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Honorable Theodore K. Nickel
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
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Commissioner:

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

POLICYHOLDERS MUTUAL INSURANCE COMPANY
DeForest, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Policyholders Mutual Insurance Company (PMIC or the Company) was conducted in 2011 as of December 31, 2010. 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 was conducted using a risk-focused approach in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. This approach sets forth guidance for planning and performing 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 does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately at the end of the "Financial Data" section in the area captioned "Reconciliation of Surplus per Examination."

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 exempt from being audited by an independent public accounting firm pursuant to applicability limitations in s. Ins 50.02 (1), Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's compilation work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

The Company is exempt from a Statement of Actuarial Opinion as confirmed by a letter from the Commissioner's office dated February 14, 2011. Within that letter it was noted that the Company meets the criteria for exemption from filing a Statement of Actuarial Opinion. That

status was internally re-affirmed by the Office of the Commissioner of Insurance (OCI) Policy and Claim Reserve Specialist on October 26, 2015.

II. HISTORY AND PLAN OF OPERATION

The Company was organized in 1988 as Policyholders Mutual Insurance Company. The Company is currently authorized only in the state of Wisconsin to transact the business of insurance as an assessable mutual under ch. 611, Wis. Stat.

Prior to 1989, the predecessor to the Company was the Policyholders' Protection Fund, which was established for the purpose of assuring that policyholders of a covered town mutual would not be subject to financial hardship in the event of its insolvency. Member companies paid a fee to participate in the fund and, in turn, the fund purchased insurance coverage to cover the insolvency of a member town mutual.

During 1988, the Wisconsin Association of Town Mutual Insurance Companies (WATMIC) sponsored the formation of the Company. [WATMIC changed its name to Wisconsin Association of Mutual Insurance Companies (WAMIC) on March 29, 1993.] The Company's purpose is the same as the predecessor fund, i.e., to ensure that policyholders of the subscribing companies would not be subject to financial hardship in the event of the insolvency of a town mutual. The current board members of WAMIC also serve as directors for the Company.

The Company has a stop-loss agreement with Wisconsin Reinsurance Corporation and Grinnell Mutual Insurance Company. The Company's limit of assessability of participating mutuals is 2% of the members' gross written premium for any calendar year.

Each Wisconsin assessable mutual is eligible to become a participating policyholder upon two qualifications:

1. Being a member of WAMIC.
2. Payment of a \$500 annual membership fee.

Currently, all but two town mutual insurers are members of WAMIC and the Company.

A group insurance policy is issued to WAMIC, for and on behalf of its members, which provides insolvency coverage for all association members.

As a condition to making a claim, a participating mutual must first satisfy each of the following:

1. Be insolvent or about to become insolvent and an order to liquidate shall have been issued by a court of competent jurisdiction.

2. Notification to the company in writing as a: NOTIFICATION OF INTENT TO MAKE A CLAIM.
3. Canceled all policies in accordance with s. 645.43 (1) (a), Wis. Stat.

In the event that the above conditions are met, the payment will be made provided that:

1. The Company shall have no duty or liability with respect to any claim filed with the liquidator under s. 645.61, Wis. Stat., after the date for filing specified by the liquidator under s. 645.47 (2), Wis. Stat., unless the liquidator considers the claim to have been timely filed.
2. The Company shall have no duty or liability with respect to any claim which otherwise would have been covered under the policy, but for which the liquidator does not cause the applicant to cooperate under Article 7 of the policy.
3. Upon payment of any claim, the Company is subrogated to the claimant's full right of recovery against the mutual and, to the same extent the mutual would have been subrogated, against any liquidator and any third party. PMIC shall have no obligation with respect to any claim unless and until the liquidator notifies PMIC that, upon its payment of such claim, it will be entitled to receive its pro rata distribution of assets under s. 645.68 (3), Wis. Stat., with regard to such payment.

In the event the mutual has knowledge that it may be insolvent and may make a claim on this policy, the mutual or the liquidator shall, as soon as reasonably possible, notify the Company and WAMIC in writing of its intent to make a claim hereunder.

At this point, the Company would levy an assessment on participating mutuals. The assessment is limited to 2% of each member's annual gross written premium. Were the insolvent member's deficit to exceed \$1,000,000, the Company could make a claim on its reinsurers for the excess. Coverage provided by the reinsurers shall not exceed \$5,000,000 in the aggregate in any calendar year. The reinsurance agreement states that the Company shall assess its members in succeeding years to repay the reinsurers. Assessments may be levied to pay claims or administrative expenses of the Company.

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 |
|--|-----------------------|----------------------------|--------------------------|--------------------|
| Write-ins for other lines of business: | | | | |
| Membership dues | <u>\$19,950</u> | <u>\$0</u> | <u>\$5,000</u> | <u>\$14,950</u> |
| Total All Lines | <u>\$19,950</u> | <u>\$0</u> | <u>\$5,000</u> | <u>\$14,950</u> |

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of eight members. Three or two directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The current board members of WAMIC also serve as directors for the Company. The board members do not receive a per diem for meetings and they do not receive any reimbursement for travel expenses.

Currently the board of directors consists of the following persons:

| Name and Residence | Principal Occupation | Term Expires |
|---------------------------------------|--|---------------------|
| Judy Bickel Lebanon, WI | Manager of Lebanon-Clyman Mutual Insurance Company | 2015 |
| Sandy Seifert Vesper, WI | General Manager of Seneca-Sigel Mutual Insurance Company | 2015 |
| Penny Boyle Darlington, WI | Manager of Darlington Mutual Ins. Co. | 2016 |
| Denis Fuerstenberg Friesland, WI | Manager of South Central Mutual Ins. Co. | 2016 |
| Charles Schriber Monticello, WI | Sales Agent and Director for Mt. Pleasant- Perry Mutual Ins. Co. | 2016 |
| Gary Krumenauer Chippewa Falls, WI | Manager, Secretary, and Treasurer of Eagle Point Mutual Insurance Company | 2017 |
| April Tarras New Holstein, WI | Manager of Calumet Equity Mutual Ins. Co. | 2017 |
| Gregg Westigard Frederic, WI | Board Member of Trade Lake Mutual Ins. Co. | 2017 |

Officers of the Company

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

| Name | Office |
|-----------------|---------------------|
| Gregg Westigard | Chairman |
| Gary Krumenauer | Vice-Chairman |
| Penny Boyle | Secretary-Treasurer |

None of the board members or officers of the Company are compensated.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. As of the time of the current examination, the company had not established any committees of the board of directors other than an executive committee comprised of the board chair, vice chair, and secretary-treasurer. The executive committee does not formally meet but the members review quarterly and annual statements before signing.

IV. AFFILIATED COMPANIES

The Company is affiliated with WAMIC through common management and facilities. The Company pays \$2,400 per year to WAMIC for staff, rental of facilities, and office supplies.

Wisconsin Association of Mutual Insurance Companies

WAMIC is an association of mutual insurance companies. WAMIC's principal objectives are to improve loss prevention programs, to promote adequate loss protection service, to sponsor legislation for the benefit of mutual insurance companies, and to promote the general welfare of mutual insurance companies. WAMIC offers classes for loss prevention, claim adjusting, forms education, and continuing education for agents.

Currently, WAMIC is a member of the American Association of Insurance Services (AAIS) and pays fees to AAIS for membership and program services. Mutuals that are members of WAMIC are allowed to use AAIS copyrighted forms and are provided access to other AAIS services. WAMIC is licensed by the state of Wisconsin to act as a rate service organization.

As of December 31, 2014, the compiled financial statement for WAMIC reported assets of \$176,883, liabilities of \$95,004, and capital and surplus of \$81,879. Operations for 2014 produced net income of \$18,523.

V. REINSURANCE

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

Nonaffiliated Ceding Contracts

1. Type: Stop-loss Reinsurance
- Reinsurers: Wisconsin Reinsurance Corporation and Grinnell Mutual Reinsurance Company
- Scope: All liability business written by the Company to cover WAMIC's members
- Retention: \$1,000,000
- Coverage: 100% of aggregate losses in excess of \$1,000,000, up to \$5,000,000, each annual period
- Premium: \$5,000 annually, disbursed to the reinsurers in accordance with the percentage assumed by each reinsurer

(Currently, Wisconsin Reinsurance Corporation assumes 2/3 of the coverage and premium and Grinnell Mutual Reinsurance Company 1/3.)
- Effective date: January 1, 1989, continuous
- Termination: As of any January 1, by either party giving 90 days' prior written notice

In the event that a loss is paid under this contract, the Company shall repay the loss to the reinsurers plus interest at the prime rate plus 1.0%. Such repayment shall be made by payments in successive years immediately following the year in which the loss payment is made in amounts up to but not exceeding 2.0% of gross written premium of the mutual insurance company members of the Company for the preceding calendar year. In the event of a loss, the Company agrees that it will assess its members each year for the full 2.0% of said gross written premium until the entire amount of the loss repayment as described above has been repaid to the reinsurers.

The contract is designed to provide early access to funds for claimants of a covered mutual. Under this arrangement, the Company would eventually return all the reinsurance claim payments to the reinsurers through assessments levied on its member companies.

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.

Policyholders Mutual Insurance Company
Assets
As of December 31, 2014

| | Assets | Nonadmitted Assets | Net Admitted Assets |
|---|-------------------------|-------------------------------|------------------------------------|
| Bonds | \$147,795 | \$ | \$147,795 |
| Stocks: | | | |
| Preferred stocks | | | |
| Common stocks | 22,083 | | 22,083 |
| Cash, cash equivalents, and short-term investments | 100,032 | | 100,032 |
| Investment income due and accrued | <u>2,004</u> | — | <u>2,004</u> |
| Total Assets | <u>\$271,914</u> | <u>\$</u> | <u>\$271,914</u> |

Policyholders Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2014

| | | |
|---------------------------------------|----------------|-------------------------|
| Advance premium | | \$ <u>18,000</u> |
| Total liabilities | | 18,000 |
| Gross paid in and contributed surplus | \$ 48,500 | |
| Unassigned funds (surplus) | <u>205,414</u> | |
| Surplus as regards policyholders | | <u>253,914</u> |
| Total Liabilities and Surplus | | <u>\$271,914</u> |

Policyholders Mutual Insurance Company
Summary of Operations
For the Year 2014

| | | |
|--------------------------------------|-------------------|------------------------|
| Underwriting Income | | |
| Premiums earned | | \$14,950 |
| Deductions: | | |
| Other underwriting expenses incurred | \$11,390 | |
| Total underwriting deductions | | <u>11,390</u> |
| Net underwriting gain (loss) | | 3,560 |
| Investment Income | | |
| Net investment income earned | 5,449 | |
| Net realized capital gains (losses) | <u> </u> | |
| Net investment gain (loss) | | 5,449 |
| Net Income | | <u>\$ 9,009</u> |

Policyholders Mutual Insurance Company
Cash Flow
For the Year 2014

| | | |
|---|-----------------|------------------|
| Premiums collected net of reinsurance | | \$ 21,050 |
| Net investment income | | <u>6,552</u> |
| Total | | 27,602 |
| Commissions, expenses paid, and aggregate write-ins for deductions | <u>\$11,390</u> | |
| Total deductions | | <u>11,390</u> |
| Net cash from operations | | 16,212 |
| | | |
| Proceeds from investments sold, matured, or repaid: | | |
| Bonds | <u>\$23</u> | |
| Net cash from investments | | <u>23</u> |
| | | |
| Reconciliation: | | |
| Net change in cash, cash equivalents, and short-term investments | | 16,235 |
| Cash, cash equivalents, and short-term investments: | | |
| Beginning of year | | <u>83,797</u> |
| End of Year | | <u>\$100,032</u> |

**Policyholders Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2014**

| | | |
|---|------------|------------------|
| Assets | | <u>\$271,914</u> |
| Adjusted surplus | | 253,914 |
| Annual premium: | | |
| Lines other than accident and health | \$14,950 | |
| Factor | <u>20%</u> | |
| Compulsory surplus (subject to a minimum of \$100,000) | | <u>100,000</u> |
| Compulsory Surplus Excess (or Deficit) | | <u>\$153,914</u> |
| Adjusted surplus (from above) | | \$253,914 |
| 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%) | | <u>140,000</u> |
| Security Surplus Excess (or Deficit) | | <u>\$113,914</u> |

**Policyholders Mutual Insurance Company
Analysis of Surplus
For the Four-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 |
|---|------------------|------------------|------------------|------------------|
| Surplus, beginning of year | \$239,511 | \$233,392 | \$230,443 | \$223,582 |
| Net income | 9,009 | 5,338 | 5,997 | 6,050 |
| Change in net unrealized capital gains/losses | <u>5,394</u> | <u>781</u> | <u>(3,048)</u> | <u>811</u> |
| Surplus, End of Year | <u>\$253,914</u> | <u>\$239,511</u> | <u>\$233,392</u> | <u>\$230,443</u> |

**Policyholders Mutual Insurance Company
Insurance Regulatory Information System
For the Four-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 |
|--|-------------|-------------|-------------|-------------|
| #1 Gross Premium to Surplus | 8% | 6% | 6% | 7% |
| #2 Net Premium to Surplus | 6 | 4 | 4 | 4 |
| #3 Change in Net Premiums Written | 57* | (5) | 0 | (5) |
| #4 Surplus Aid to Surplus | 0 | 0 | 0 | 0 |
| #5 Two-Year Overall Operating Ratio | 44 | 46 | 40 | 39 |
| #6 Investment Yield | 2.1* | 2.2* | 2.6* | 2.5* |
| #7 Gross Change in Surplus | 6 | 3 | 1 | 3 |
| #8 Change in Adjusted Surplus | 6 | 3 | 1 | 3 |
| #9 Adj. Liabilities to Liquid Assets | 7 | 5 | 3 | 5 |
| #10 Agents' Balances to Surplus | 0 | 0 | 0 | 0 |
| #11 One-Year Reserve Development to Surplus | 0 | 0 | 0 | 0 |
| #12 Two-Year Reserve Development to Surplus | 0 | 0 | 0 | 0 |
| #13 Estimated Current Reserve Deficiency to Surplus | 0 | 0 | 0 | 0 |

Ratio No. 3 measures the percentage change in net premium written from the prior year. The exceptional results in 2014 were due to an increase in fees (which are in effect premium) to \$500 per member for 2014 from \$350 in 2013. The increase was approved by the board on November 13, 2013.

Ratio No. 6 measures the average return on the Company's investments. The exceptional results in 2011 through 2014 were due to the low interest rate environment and the Company's strategy of having a conservative portfolio consisting mainly of cash, short-term securities and bonds.

Growth of Policyholders Mutual Insurance Company

| Year | Admitted Assets | Liabilities | Surplus as Regards Policyholders | Net Income |
|------|-----------------|-------------|----------------------------------|------------|
| 2014 | \$271,914 | \$18,000 | \$253,914 | \$9,009 |
| 2013 | 251,411 | 11,900 | 239,511 | 5,338 |
| 2012 | 240,142 | 6,750 | 233,392 | 5,997 |
| 2011 | 242,193 | 11,750 | 230,443 | 6,050 |
| 2010 | 231,582 | 8,000 | 223,582 | 8,402 |

| Year | Gross Premium Written | Net Premium Written | Premium Earned | Loss and LAE Ratio | Expense Ratio | Combined Ratio |
|------|-----------------------|---------------------|----------------|--------------------|---------------|----------------|
| 2014 | \$19,950 | \$14,950 | \$14,950 | 0% | 76.2% | 76.2% |
| 2013 | 14,500 | 9,500 | 9,500 | 0 | 107.5 | 107.5 |
| 2012 | 15,000 | 10,000 | 10,000 | 0 | 102.1 | 102.1 |
| 2011 | 15,000 | 10,000 | 10,000 | 0 | 99.6 | 99.6 |
| 2010 | 15,500 | 10,500 | 10,500 | 0 | 92.6 | 92.6 |

During the period under examination, the Company's admitted assets increased by 17% and surplus increased by 14%. The increase in the invested asset base and surplus was attributable primarily to the overall profitability of the Company and continuing investment gains. Gross and net premiums written increased by 29% and 42%, respectively, during the same period. The increase in premium was due to an increase in fees (which are in effect premium) to \$500 per member for 2014 from \$350 in 2013. The Company has never incurred a claim, because none of its participating companies have been liquidated since the Company began. The sharp drop in the combined ratio was due to the increase in net premium written for 2014.

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.

Examination Reclassifications

| | Debit | Credit |
|---------------------------------|-------------------|-----------------|
| Bonds | \$47,063 | \$ |
| Cash and short-term investments | <u> </u> | <u>47,063</u> |
| Total Reclassifications | <u>\$47,063</u> | <u>\$47,063</u> |

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There was one specific recommendation in the previous examination report. The recommendation contained in the last examination report and action taken by the Company is as follows:

1. Board of Directors—It is recommended that the Company amend its bylaws to require one director per district or fill the open board vacancy to be in compliance with its current bylaws.

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.

Affiliated Transactions

The Company is part of a holding company system through common management with WAMIC. WAMIC provides certain services to the Company including staff, office space, and office equipment and supplies. However, the examination finds that no written agreement describing terms and conditions has been executed by the parties to the agreement. According to Statement of Statutory Principle (SSAP) No. 25 of the NAIC Accounting Practices and Procedures Manual, agreements between affiliates must be in writing. Further, according to s. Ins 40.04 (2) (d), Wis. Adm. Code, all management and cost-sharing agreements must be reported to this office and are subject to the Commissioner disapproval. It is recommended that the Company place the administrative agreement with WAMIC in writing as required by SSAP No. 25, and submit the written, signed agreement to the Office of the Commissioner of Insurance for non-disapproval as specified in s. Ins 40.04 (2) (d), Wis. Adm. Code.

Cash and Short-Term Investments

\$52,969

The above balance represents a decrease of \$47,063 from the balance reported by the Company as of December 31, 2014, due to a reclassification. This reclassification is reflected in the section of this report under the heading "Examination Reclassifications." The examination found that the Company incorrectly included in this asset a certificate of deposit with a maturity of more than one year. The Company reported a \$47,063 investment in a certificate of deposit with a maturity date of November 13, 2019, as cash. According to SSAP No. 26, certificates of deposit that have a fixed schedule of payment and a maturity date in excess of one year from the date of acquisitions are to be classified as bonds and reported in Schedule D, Part 1. It is recommended that the company classify its investments in long-term certificates of deposit in accordance with SSAP No. 26 in all future financial statements.

Bonds**\$194,858**

The above balance was increased from \$147,795 to \$194,858 as a result of the reclassification described above under the heading "Cash and Short-Term Investments."

VIII. CONCLUSION

The Company was organized in 1988 as Policyholders Mutual Insurance Company. The Company is currently authorized only in the state of Wisconsin to transact the business of insurance as an assessable mutual under ch. 611, Wis. Stat. The Company has a stop-loss agreement with Wisconsin Reinsurance Corporation and Grinnell Mutual Insurance Company. The Company's limit of assessability of participating mutuals is 2% of its members' gross written premium for any calendar year.

During the period under examination, the Company's admitted assets increased 17%, net premiums written increased 42%, and surplus increased by 14%. The Company's admitted assets consisted of bonds, common stocks, cash and investment income due and accrued. The increase in the invested asset base and surplus was attributable primarily to the overall profitability of the Company and continuing investment gains. The Company produced a significant underwriting gain in 2014 in addition to the investment gain. The increase in premiums was due to an increase in the membership dues for 2014.

The Company has never incurred a claim because none of its participating companies have been liquidated since the Company began.

The examination resulted in two recommendations, one of which involves reclassification of account balances. No adjustments to surplus were made.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 19 - Affiliated Transactions—It is recommended that the Company place the administrative agreement with WAMIC in writing as required by SSAP No. 25, and submit the written, signed agreement to the Office of the Commissioner of Insurance for non-disapproval as specified in s. Ins 40.04 (2) (d), Wis. Adm. Code.
2. Page 19 - Cash and Short-Term Investments—It is recommended that the company classify its investments in long-term certificates of deposit in accordance with SSAP No. 26 in all future financial statements.

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 |
|----------------|----------------|
| John Litweiler | ACL Specialist |
| Tom Houston | IT Specialist |

Respectfully submitted,

John Ebsen
Examiner-in-Charge