

Report of the Examination of
Badger Mutual Insurance Company
Milwaukee, Wisconsin
As of December 31, 2022

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January 12, 2024

Honorable Nathan D. Houdek
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:

BADGER MUTUAL INSURANCE COMPANY
Milwaukee, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Badger Mutual Insurance Company (BMIC or the company) was conducted in 2018 as of December 31, 2017. The current examination covered the intervening period ending December 31, 2022, and included a review of subsequent transactions 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 the examination of an insurance company to evaluate the financial condition, assess corporate governance, identify current and prospective risks (including those that might materially affect the financial condition, either currently or prospectively), and evaluate system controls and procedures used to mitigate those risks.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating 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."

Emphasis was placed on those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination.

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 concerning the alternative or additional examination steps performed during the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's loss and loss adjustment expense reserves and the adequacy of the company's pricing practices. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1887 as Der Deutsche Gegenseitige Feuer Unterstuetzungs Verein (The German Mutual Fire Insurance Society). It was founded by a group of Lutherans interested in acquiring affordable property damage coverage for their churches after many insurance companies introduced restrictions and high rates for some types of property coverage as a result of the great Chicago fire that occurred in 1881. The company was incorporated in Wisconsin on June 6, 1891, as Badger Mutual Fire Insurance Company. The present name, Badger Mutual Insurance Company, was adopted in 1948.

In 2022, the company wrote direct premium in the following states:

Wisconsin	\$ 65,697,749	42.4%
Illinois	25,923,642	16.7
Minnesota	23,746,812	15.3
Nevada	13,426,807	8.7
Arizona	8,713,276	5.6
All others	<u>17,337,610</u>	<u>11.2</u>
Total	<u>\$154,845,896</u>	<u>100.0%</u>

The company is currently licensed in Arizona, Idaho, Illinois, Iowa, Michigan, Minnesota, Nevada, Utah, Wisconsin, and Wyoming. In late 2022, the company announced plans to discontinue operations and withdraw its licenses in Idaho, Utah, and Wyoming. Those three states accounted for approximately 6.8% of the company's direct premium written in 2022.

The major products marketed by the company include homeowners and commercial multiple peril, private passenger auto liability and auto physical damage, fire, allied lines, worker's compensation, and other liability. The major products are marketed through 365 independent agencies with approximately 4,050 licensed agents as of December 31, 2022.

The following table is a summary of the net insurance premiums written by the company in 2022. 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
Fire	\$ 1,543,707	\$	\$ 297,989	\$ 1,245,718
Allied lines	790,277		13,917	776,360
Homeowners multiple peril	55,005,033		11,075,092	43,929,941
Commercial multiple peril (non-liability portion)	29,307,131		10,039,793	19,267,338
Commercial multiple peril (liability portion)	17,550,861		5,984,674	11,566,187
Workers' compensation	3,707,483		696,580	3,010,903
Other liability – occurrence	1,268,367			1,268,367
Private passenger auto no-fault (personal injury)	427,381			427,381
Other private passenger auto liability	23,854,760		507,667	23,347,092
Private passenger auto physical damage	21,390,896		643,983	20,746,913
Reinsurance – non-proportional assumed liability		<u>144,539</u>		<u>144,539</u>
Total All Lines	<u>\$154,845,895</u>	<u>\$144,539</u>	<u>\$29,259,696</u>	<u>\$125,730,738</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. Directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting.

Currently, the board of directors consists of the following persons:

Name	Principal Occupation	Term Expires
Santino Cicero River Hills, Wisconsin	Retired	2024
Doralice Graff Saddlebrook, Arizona	Retired	2025
Scott Henkel Waterford, Wisconsin	Certified Public Accountant Partner, Chortek, LLP	2024
Steven Klima Oconomowoc, Wisconsin	Retired	2025
Vincent Lyles Wauwatosa, Wisconsin	System Vice President Community Relations at Advocate Aurora Health	2025
Daniel Nigro Richfield, Wisconsin	President and Chief Executive Officer Badger Mutual Insurance Company	2025
Joseph Packee Delafield, Wisconsin	Managing Director RW Baird	2026
Lori Stortz Delafield, Wisconsin	Chief Audit Executive University of Wisconsin System	2026
Stephen Streff Red Wing, Minnesota	Vice President, Consulting Actuary Streff Insurance Services Corp.	2024

Officers of the Company

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

Name	Office
Daniel Nigro	President and Chief Executive Officer
Darrin Groendal	Chief Financial Officer, Vice President and Treasurer
Kathy Bubeck	Vice President of Claims and Secretary
Laura Michna	Assistant Vice President of Administration
Andrew Thiede	Vice President of Information Technology
Brian Wiza	Vice President of Underwriting

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:

Finance Committee

Santino Cicero, Chair
Vincent Lyles
Daniel Nigro
Joseph Packee

Audit Committee

Steven Klima, Chair
Doralice Graff
Scott Henkel
Lori Stortz
Stephen Streff

Compensation Committee

Santino Cicero, Chair
Doralice Graff
Scott Henkel
Steven Klima
Vincent Lyles
Joseph Packee
Lori Stortz
Stephen Streff

IV. REINSURANCE

The company's reinsurance portfolio and strategy at the time of the examination are described below. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

Multiple Line Excess of Loss

BMIC entered into a multiple line excess of loss (XOL) reinsurance contract effective January 1, 2023. The XOL contract consists of two layers of coverage up to \$7 million, as well as a \$1 million annual aggregate deductible. BMIC's retention for property claims on the first layer is \$400,000 for each loss for each risk, for casualty claims is \$400,000 for each loss occurrence, and for property and casualty claims is \$400,000 for each loss occurrence. In addition, the company retains the first \$2 million of aggregate excess loss. BMIC's retention on the second layer of the XOL contract is \$1 million for each loss occurrence for casualty claims and \$1 million for each loss each risk for property claims. The first layer allows for free and unlimited reinstatement. The second layer allows for one reinstatement at 25% and four free reinstatements.

Property Catastrophe

BMIC entered into a property catastrophe reinsurance program effective January 1, 2023. The catastrophe program consists of six layers, a \$6 million retention and additional \$4 million retention of ultimate net loss which would otherwise be recoverable, coverage up to \$60 million, and a \$4 million annual aggregate deductible. The first layer provides coverage of \$4 million, excess of retention of \$6 million. The second layer provides coverage of \$8 million, excess of retention of \$10 million. The third layer provides coverage of \$12 million, excess of retention of \$18 million. The fourth layer provides coverage of \$25 million, excess of retention of \$30 million. The fifth layer provides coverage of \$1 million, excess of retention of \$55 million. The final layer provides coverage of \$4 million, excess of retention of \$56 million. The contract allows for one reinstatement at 100% on each of the six layers.

Other Contracts

BMIC entered into a worker's compensation and casualty clash excess of loss reinsurance contract, a property per risk excess of loss reinsurance contract, and a cyber liability quota share reinsurance contract effective January 1, 2023. The worker's compensation and casualty clash excess of

loss contract and the property per risk excess of loss contract are additional layers above the multiple line excess of loss contract.

The worker's compensation and casualty clash excess of loss contract consists of a retention of \$7 million ultimate net loss for each occurrence and a limit of \$6 million for each loss occurrence. This contract allows for one reinstatement at 100%.

The property per risk excess of loss contract consists of a retention of \$7 million ultimate net loss for each loss for each risk and a \$10 million limit for each loss for each risk. This contract allows for free and unlimited reinstatement. For the cyber liability quota share reinsurance contract, the company cedes 100% share of the business reinsured and receives a 30% commission of premium ceded under the agreement. Per the addendum to the reinsurance contract effective October 1, 2023, the company's cyber liability endorsement cannot exceed \$200,000 in the aggregate for any one endorsement as respects policies issued in the state of Nevada and \$100,000 in the aggregate for any one endorsement as respects all other policies. The reinsurance contract states that Badger shall cede to the reinsurer \$67 for each cyber liability endorsement with a \$50,000 limit and \$100 for each cyber liability endorsement with a \$100,000 limit.

BMIC maintains two separate reinsurance contracts with The Hartford Steam Boiler and Insurance Company. The first contract is for Employment Practices Liability, the second is for Equipment Breakdown Coverage. Both contracts include a 30% commission.

BMIC is required to maintain Mine Subsidence Residence and Other Structure coverage in certain counties in Illinois. This coverage protects against damages caused by ground movement as a result of failures of man-made underground mines.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the commissioner of insurance in the December 31, 2022, 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 and the compulsory and security surplus calculation.

Badger Mutual Insurance Company
Assets
As of December 31, 2022

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$150,847,258	\$	\$150,847,258
Stocks:			
Preferred stocks	534,108		534,108
Common stocks	10,471,639		10,471,639
Mortgage loans on real estate:			
First liens	3,197,609		3,197,609
Other than first liens	0		0
Real estate:			
Properties held for the production of income	3,528,981		3,528,981
Cash, cash equivalents, and short-term investments	(2,198,368)		(2,198,368)
Other invested assets	3,746,868		3,746,868
Receivables for securities	68,790		68,790
Investment income due and accrued	753,472		753,472
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	283,610	9,754	273,856
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	24,034,978	23,500	24,011,478
Reinsurance:			
Amounts recoverable from reinsurers	1,889,558		1,889,558
Current federal and foreign income tax recoverable and interest thereon	2,921,868		2,921,868
Net deferred tax asset	7,256,221		7,256,221
Electronic data processing equipment and software	115,076		115,076
Furniture and equipment, including health care delivery assets	1,271,646	1,271,646	0
Write-ins for other than invested assets:			
Corporate Owned Life Insurance	5,957,101		5,957,101
Prepaid Pension	3,265,979	3,265,979	0
Rent Receivable	17,069	0	17,069
Amounts W/H FSA	62,443	62,443	
State Income Tax Recoverable	<u>540,064</u>	<u> </u>	<u>540,064</u>
Total Assets	<u>\$218,565,969</u>	<u>\$4,633,322</u>	<u>\$213,932,647</u>

Badger Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2022

Losses		\$ 62,119,005
Loss adjustment expenses		9,870,785
Commissions payable, contingent commissions, and other similar charges		3,805,553
Other expenses (excluding taxes, licenses, and fees)		1,752,895
Taxes, licenses, and fees (excluding federal and foreign income taxes)		734,393
Unearned premiums		67,021,344
Advance premium		2,460,422
Dividends declared and unpaid:		
Policyholders		54,574
Ceded reinsurance premiums payable (net of ceding commissions)		2,002,018
Funds held by company under reinsurance treaties		961,049
Amounts withheld or retained by company for account of others		4,200
Remittances and items not allocated		95,083
Write-ins for liabilities:		
Escheats		232,771
Pension Payable		<u>2,476,697</u>
 Total Liabilities		 153,590,791
 Unassigned funds (surplus)	 <u>\$60,341,856</u>	
 Surplus as Regards Policyholders		 <u>60,341,856</u>
 Total Liabilities and Surplus		 <u>\$213,932,647</u>

Badger Mutual Insurance Company
Summary of Operations
For the Year 2022

Underwriting Income		
Premiums earned		\$117,232,937
Deductions:		
Losses incurred	\$106,227,450	
Loss adjustment expenses incurred	11,466,006	
Other underwriting expenses incurred	<u>34,362,844</u>	
Total underwriting deductions		<u>152,056,300</u>
Net underwriting gain (loss)		(34,823,362)
Investment Income		
Net investment income earned	2,872,472	
Net realized capital gains (losses)	<u>174,465</u>	
Net investment gain (loss)		3,046,937
Other Income		
Net gain (loss) from agents' or premium balances charged off	(254,021)	
Finance and service charges not included in premiums	280,486	
Write-ins for miscellaneous income:		
Corporate-Owned Life Insurance	(1,172,881)	
Muzinich Partnership Distribution	205,041	
Misc. Income	<u>306,291</u>	
Total other income		<u>(635,084)</u>
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		(32,411,509)
Dividends to policyholders		<u>162,952</u>
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		(32,574,462)
Federal and foreign income taxes incurred		<u>(2,629,097)</u>
Net Income (Loss)		<u><u>\$(29,945,365)</u></u>

Badger Mutual Insurance Company
Cash Flow
For the Year 2022

Premiums collected net of reinsurance		\$124,328,757
Net investment income		3,435,461
Miscellaneous income		<u>26,465</u>
Total		127,790,683
Benefit- and loss-related payments	\$93,377,890	
Commissions, expenses paid, and aggregate write-ins for deductions	48,102,879	
Dividends paid to policyholders	158,426	
Federal and foreign income taxes paid (recovered)	<u>270,080</u>	
Total deductions		<u>141,909,276</u>
Net cash from operations		(14,118,593)
Proceeds from investments sold, matured, or repaid:		
Bonds	\$30,714,465	
Stocks	1,429,455	
Mortgage loans	12,591	
Miscellaneous proceeds	<u>34,611</u>	
Total investment proceeds		32,191,122
Cost of investments acquired (long- term only):		
Bonds	23,180,758	
Stocks	216,083	
Mortgage loans	3,210,200	
Total investments acquired		<u>26,607,041</u>
Net cash from investments		5,584,080
Cash from financing and miscellaneous sources:		
Other cash provided (applied)	<u>711,898</u>	
Net cash from financing and miscellaneous sources		<u>711,898</u>
Reconciliation:		
Net Change in Cash, Cash Equivalents, and Short-Term Investments		
		(7,822,615)
Cash, cash equivalents, and short-term investments:		
Beginning of year		<u>5,624,247</u>
End of Year		<u>\$ (2,198,368)</u>

**Badger Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2022**

Assets		\$213,932,647
Less security surplus of insurance subsidiaries		
Less liabilities		<u>153,590,791</u>
Adjusted surplus		60,341,856
Annual premium:		
Lines other than accident and health	\$127,087,144	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>25,417,429</u>
Compulsory Surplus Excess (Deficit)		<u>\$ 34,924,427</u>
Adjusted surplus (from above)		\$60,341,856
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>34,821,878</u>
Security Surplus Excess (Deficit)		<u>\$ 25,519,978</u>

**Badger Mutual Insurance Company
Analysis of Surplus
For the Five-Year Period Ending December 31, 2022**

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

	2022	2021	2020	2019	2018
Surplus, beginning of year	\$86,929,920	\$79,141,857	\$73,504,911	\$70,033,807	\$69,909,530
Net income	(29,945,365)	4,005,612	7,981,213	3,340,859	1,016,707
Change in net unrealized capital gains/losses	(4,582,121)	1,283,729	764,371	1,212,286	(963,566)
Change in net deferred income tax	4,718,692	(90,737)	33,513	(747,885)	(971,556)
Change in nonadmitted assets	(264,246)	808,622	(2,401,794)	(432)	120,029
Change in provision for reinsurance	308,831	(308,831)			
Write-ins for gains and (losses) in surplus:					
Pension					
Valuation/Interest rate change	<u>3,176,142</u>	<u>2,089,668</u>	<u>(740,357)</u>	<u>(333,724)</u>	<u>922,662</u>
Surplus, End of Year	<u>\$60,341,853</u>	<u>\$86,929,920</u>	<u>\$79,141,857</u>	<u>\$73,504,911</u>	<u>\$70,033,807</u>

**Growth of
Badger Mutual Insurance Company**

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2022	\$213,932,647	\$153,590,791	\$60,341,856	\$(29,945,365)
2021	224,002,297	137,072,376	86,929,921	4,005,612
2020	209,247,628	130,105,770	79,141,857	7,981,213
2019	194,178,467	120,673,556	73,504,911	3,340,859
2018	185,379,888	115,346,081	70,033,807	1,016,707
2017	180,681,615	110,772,085	69,909,530	2,679,750

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2022	\$ 154,990,434	\$ 125,730,738	\$ 117,232,937	100.4%	27.8%	128.2%
2021	142,222,805	116,005,012	106,951,403	70.2	27.4	97.6
2020	131,800,748	105,498,929	102,276,689	68.3	27.7	96.0
2019	125,427,079	100,620,728	97,057,844	72.7	27.2	99.9
2018	114,184,839	91,420,008	87,908,578	72.4	28.9	101.3
2017	103,726,887	87,521,374	89,606,290	71.4	29.6	101.0

With regard to the period under examination, Badger experienced a period of consistent year-over-year growth from 2018 to 2021. From December 31, 2017, to December 31, 2021, the company's surplus increased by 24.4%. The company also saw consistent growth with regards to net admitted assets, gross premiums written, and premium earned. Even during years when the company saw underwriting losses, such as 2018, the company's investment income was able to offset losses and generate net income. This trend was consistent with what was seen during the prior period under examination.

During 2022, Badger's trend of generating net income and growing surplus was broken. From December 31, 2021, to December 31, 2022, the company saw a 30.6% reduction to surplus, as well as a 4.5% reduction to net admitted assets and a \$29,945,365 net loss. These losses appear to have been driven by a combination of factors. First, the inflationary environment in the United States during 2022 has resulted in significant increases in repair and replacement costs, especially with regards to homes and automobiles. Second, the company's area of operations saw unprecedented convective storm and catastrophic weather activity during 2022. As of December 31, 2022, approximately 80% of the company's written premium was concentrated in the Midwest. Additionally, the company's area of operations is shrinking. Due to worse-than-expected operating results, the company has chosen to withdraw its licenses in the Western states of Utah, Wyoming, and Idaho, which accounted for approximately 6% of direct premium written in 2022.

As a result of Badger's 2022 operating results, the company has engaged in numerous and ongoing efforts to improve operating results and rebuild surplus, while adhering to current strategic plans.

Subsequent Events

BMIC's trend of losses seen in 2022 has continued throughout 2023. As of September 30, 2023, the company has reported a net underwriting loss of \$30,052,587, a net loss of \$24,116,181, and a 43.7%, or \$26,352,021 reduction to policyholders' surplus. The losses seen so far in 2023 continue to be driven by a combination of high inflation, inadequate pricing, storm activity, and a hardened reinsurance market. The company has continued to develop its strategic plans for rebuilding surplus throughout 2023. However, many of the changes implemented by the company, such as rate increases, will take several months or years to materially affect the company's results.

Reconciliation of Surplus per Examination

No adjustments were made to the surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2022, is accepted.

Examination Reclassifications

No reclassifications were made as a result of the examination.

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

The were no specific comments or suggestions in the previous examination report.

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.

Underwriting Audit Procedures

A review of the company's internal underwriting audit program revealed that the company had only recently established formal internal procedures for auditing its underwriting function. Internal underwriting audits are a tool for evaluating and assessing the quality of the underwriting function and compliance with established underwriting standards and regulations. During the review, the examiner found deficiencies in the underwriting audit process. These deficiencies have been communicated to the company in the form of a confidential Management Comment Letter. It is recommended that the company strengthen its underwriting audit procedures.

VII. CONCLUSION

Badger Mutual Insurance Company is a mutual insurer writing both personal and commercial lines of insurance. During the period under examination, the company's net admitted assets have increased by 18.4%, liabilities have increased by 38.7%, and surplus has decreased by 13.7%. As of December 31, 2022, the company reported net admitted assets of \$213,932,647, liabilities of \$153,590,791, and policyholders' surplus of \$60,341,856.

The company's surplus had reached a high of \$86,929,921 as of December 31, 2021. The company's reduction to surplus a year later was a result of severe and unprecedented convective storm activity occurring within the company's area of operations. Losses seen as a result of this storm activity were exacerbated by the severe inflation seen in the United States during and following the COVID-19 pandemic. The company is taking numerous steps to return to profitability and rebuild surplus, focusing on attaining rate adequacy and active development of, and adherence to, underwriting standards.

The current examination resulted in no reclassifications or surplus adjustments. However, there was one recommendation made as a result of this examination.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Underwriting Audit Procedures—It is recommended that the company strengthen its underwriting audit procedures.

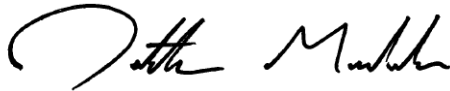
IX. ACKNOWLEDGMENT

The courtesy and cooperation extended by the officers and employees of the company during the course of the examination 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
Arron Kenseth	Insurance Financial Examiner
Pierce Varney	Insurance Financial Examiner
Zachary Duschack	Insurance Financial Examiner
Ana Careaga	Data Specialist
Junji Nartatez, CISA	IT Specialist
Nicholas Hartwig, AFE	Quality Control Specialist
Jerry DeArmond, CFE	Reserve Specialist

Respectfully submitted,



Jonathan Mundschau
Examiner-in-Charge