Report

of the

Examination of

Heartland Mutual Insurance Company

Ettrick, Wisconsin

As of December 31, 2011

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, *Governor*
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May 4, 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, 2011, of the affairs and financial condition of:

HEARTLAND MUTUAL INSURANCE COMPANY
Ettrick, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Heartland Mutual Insurance Company f/k/a Ettrick Mutual Insurance Company (the company) was made in 2006 as of December 31, 2005. The current examination covered the intervening time period ending December 31, 2011, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all 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.

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 taxes and preparation of the annual financial report. On November 23, 2010, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

The company was originally organized as a town mutual insurance company on April 1, 1877, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Ettrick Scandinavian Mutual Insurance Company.

On December 4, 2010, the policyholders of Shelby Farmers' Mutual Insurance Company (hereinafter Shelby Farmers') and the company's policyholders voted to approve a Plan of Merger and change the company name to Heartland Mutual Insurance Company. On January 1, 2011, the merged company was renamed Heartland Mutual Insurance Company.

During the period under examination, Articles I, II, III, and V of the Articles of Incorporation were amended as follows: a) the company changed its name to Heartland Mutual Insurance Company; b) the company added Clark and Vernon Counties to its authorized territory; c) the company shall be managed by a board of directors of not less than nine members or more than fifteen members; and d) the company shall hold the annual meeting on the 1st Saturday in April of each year. There were no amendments to the company's bylaws during the period under examination.

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

Buffalo	La Crosse
Clark	Monroe
Eau Claire	Trempealeau
Jackson	Vernon
Juneau	

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements on an annual basis, with installments available for terms of one month, three months, or six months. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 23 agents, 2 of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
Property	15%
Nonproperty	15%

Most losses are adjusted by independent adjusters who bill the company for their services. The company’s manager, who is also an insurance agent, has authority to adjust losses and is paid a mileage reimbursement equal to the Internal Revenue Service (IRS) mileage reimbursement rate. There is no additional compensation to the company manager for adjusting losses. The company's inspector/loss controller receives $12.50 per hour, plus the IRS mileage reimbursement rate. Agents do not have authority to adjust losses.

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 meeting of the company 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 fifteen 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. Since the previous examination, three new directors were added in the years 2006, 2007, and 2008, respectively, to replace three directors who either retired or resigned. As a result of the completed merger on December 4, 2010, there were six new directors added.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Timothy D. Rand*	Insurance Agent/Manager	Ettrick, Wisconsin	2014
David O. Mahlum	Retired Farmer	Ettrick, Wisconsin	2014
Mark Tranberg	Manager, Westfalia Surge	Ettrick, Wisconsin	2014
Sylvester Clements	Retired Business Owner	West Salem, Wisconsin	2014
Fred Pederson	Retired	West Salem, Wisconsin	2014
DeLayne E. Rand	Retired Agent	Ettrick, Wisconsin	2013
Michael O. Kittleson	Healthcare Administrator	Ettrick, Wisconsin	2013
Rhonda Simonson*	Insurance Agent	Wilton, Wisconsin	2013
John L. Sander	Farmer	Galesville, Wisconsin	2013
Jean Klos	Retired	LaCrosse, Wisconsin	2013
Arthur L. Ofsdahl	Retired Farmer	Galesville, Wisconsin	2012
Gerald Blaken	Retired Farmer/Barber	Melrose, Wisconsin	2012
David Ofsdahl	Trane Company, CPA	Ettrick, Wisconsin	2012
Donald Bay	Retired	La Crosse, Wisconsin	2012
Herbert Wehling	Retired	Chaseberg, Wisconsin	2012

Directors who are also agents are identified with an asterisk. Donald Bay is a director-agent, who writes only property coverage and is exempt from licensing requirements pursuant to s. 628.05 (1), Wis. Stat.

Members of the board are paid $60 for each meeting attended or a per diem of $60 per day when services are provided and the current IRS reimbursement rate for travel expenses.

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 at the present time are as follows:

Name	Office	2011 Compensation
DeLayne E Rand	President	$ 2,100
Michael Kittleson	Vice President	100
Timothy D. Rand	Secretary/Treasurer/Manager	96,208

The reported compensation is the total compensation paid by the company for the year and includes salary, commissions, director fees and rental income as applicable. Directors are paid $60 for each meeting attended or a per diem of $60 per day when services are provided.

Subsequent to this examination, on April 20, 2012, Michael Kittleson was elected President replacing DeLayne Rand. David Ofsdahl was elected Vice President replacing Michael Kittleson. Timothy Rand was elected Secretary and Manager. Mark Tranberg was elected Treasurer replacing Timothy Rand.

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:

Adjusting Committee	**Investment Committee**
DeLayne E. Rand	DeLayne E. Rand
Michael Kittleson	Michael Kittleson
Timothy D. Rand	Timothy D. Rand
	Sylvester Clements
	Mark Tranberg
	David Ofsdahl
	Donald Bay

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
2011	$748,421	1,480	$(391,605)	$1,489,504	$ 842,285
2010	461,420	977	54,664	1,332,056	857,101
2009	498,089	1,005	(17,220)	1,223,819	794,821
2008	509,862	1,026	84,406	1,090,544	800,196
2007	518,712	1,095	82,362	1,015,849	739,639
2006	496,383	1,134	(101,976)	935,876	665,684
2005	481,836	1,217	41,338	1,010,935	768,952

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	Gross
2011	$1,161,927	$749,720	$ 842,285	89%	138%
2010	732,917	460,611	857,101	44	24
2009	877,240	623,086	794,821	59	46
2008	763,854	500,699	800,196	48	34
2007	804,325	522,047	739,639	49	32
2006	812,358	498,948	665,684	89	88
2005	809,498	487,436	768,952	53	31

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
2011	$734,062	$413,655	$748,421	98%	55%	153%
2010	204,396	240,318	461,420	44	52	96
2009	296,236	241,697	498,089	59	39	98
2008	246,338	209,691	509,862	48	42	90
2007	254,511	222,026	518,712	49	43	92
2006	441,327	195,573	496,383	89	39	128
2005	253,919	214,332	481,836	53	44	97

* Note that the company merged with Shelby Farmers' Mutual Insurance Company on January 1, 2011. Financial results for 2007 through 2010 reflect the balances of the company alone.

The period from 2005 to 2010 was a period of significant underwriting efforts at the company. The policy count declined 19.7%, from 1,217 at year-end 2005 to 977 at year-end

2010. During the same period, by comparison, gross premiums written declined only 9.5%. In five of the six calendar years from 2005 to 2010, the company experienced an underwriting profit. From 2005 to 2010, policyholders' surplus increased 11.5%.

The company experienced the worst loss in its history in 2011 with gross claims paid of $917,832 less reinsurance recoveries of $258,351 (which includes $74,573 in reinsurance recoverable on unpaid losses as a result of the company reaching its stop-loss attachment point with reinsurer in December 2011) resulting in net losses incurred of $659,481. Net loss adjustment expenses for the current year were $74,581.

Several factors that contributed to the company's exceptional loss experience were: a) strong storms across northern and western Wisconsin produced hail storms on April 10, 2011; b) a severe storm cell on May 22, 2011, produced several tornados across western and central Wisconsin; c) several damaging windstorms; d) two large dwelling fires; and e) the poor loss history from the acquired Shelby Farmers' block of business through the described merger. These factors produced a net loss of $391,605, a composite ratio of 153%, a decline in policyholders' surplus of 31.65% or $390,094 for the year ended 2011.

Other underwriting expenses incurred increased $105,597 over 2010 as a result of higher than expected operating expenses due to the merger with Shelby Farmers'. The company discovered severe rate adequacy problems with the Shelby Farmers' policies, primarily due to excessive use of credits. The company began re-rating Shelby Farmers' entire book of business and anticipates that this will be completed by May 31, 2012. The company has taken additional measures by implementing rate increases that will begin June 1, 2012, along with restructuring its 2012 reinsurance contract with the reinsurer in an effort to minimize reinsurance costs.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause 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: Grinnell Mutual Reinsurance Company

Effective date: January 1, 2011

Termination provisions: The contract may be terminated at the end of any calendar year by either party giving to the other party not less than 90 days' notice in writing

1. Type of contract: First Occurrence of Loss Excess

Lines reinsured: Fire, lightning and extended coverages (other than windstorm and hail), an individual occurrence of losses excess is defined as:

a) The total of losses (other than windstorm and hail) occurring at one location arising out of one event, insured on one or more policies
b) All losses covered under back up of sewer endorsements, up to a limit of $5,000 per endorsement, arising from the same atmospheric disturbances and occurring during any continuous period of 24 hours

Windstorm and hail, an individual occurrence of losses excess is defined as:

a) The total of losses occurring at one location arising out of one windstorm or hailstorm, insured on one or more policies; and/or
b) The total of losses occurring on items insured on one policy at multiple locations arising out of one windstorm or hailstorm.

Company's retention: $100,000

Coverage limit: $100,000

Coverage: Layer of coverage for an individual loss. Losses under this layer are experience rated based on a 5-year loss ratio in excess of the company's retention, up to the policy limit of $1,000,000.

Reinsurance premium: Premiums are calculated based on the monthly rate of $0.0072 multiplied by Adjusted Gross Fire Risk in Force per $1,000 at the end of each month during the contract year

Rates:

Monthly rate:	$0.0072	Annual rate:	$0.0856
Minimum rate:	$0.0856	Developed rate:	$0.0757
Maximum rate:	$0.5188		

Coverage provisions:	If First Occurrence of Loss Excess is dropped, the 5-year pure loss ratio will be determined as follows: if the 5-year pure loss ratio is equal to or less than 100%, then all premiums and losses will be assigned to the Individual Occurrence of Loss lines of business (fire and wind). The Individual Occurrence of Loss line will then go to whatever surcharge level is indicated by the addition of these premiums and losses (without the application of established Individual Occurrence of Loss surcharge level rule). A pure loss ratio in excess of 100% will be reviewed.

2. Type of contract: Individual Occurrence of Loss Excess

Lines reinsured: Fire, lightning and extended coverages (other than windstorm and hail), an individual occurrence of losses excess is defined as:

a) The total of losses (other than windstorm and hail) occurring at one location arising out of one event, insured on one or more policies
b) All losses covered under back up of sewer endorsements, up to a limit of $5,000 per endorsement, arising from the same atmospheric disturbances and occurring during any continuous period of 24 hours

Windstorm and hail, an individual occurrence of losses excess is defined as:

a) The total of losses occurring at one location arising out of one windstorm or hailstorm, insured on one or more policies; and/or
b) The total of losses occurring on items insured on one policy at multiple locations arising out of one windstorm or hailstorm.

Company's retention: $200,000

Coverage: 100% for an individual loss. Losses under this layer are experience rated based on a 5-year loss ratio in excess of the company's retention, up to the policy limit of $1,000,000.

Reinsurance premium: Premiums are calculated based on the monthly rate of $0.0138 multiplied by the Adjusted Gross Fire Risk in Force per $1,000 at the end of each month during the contract year

Rates:

Annual base rate fire:	$0.0828
Annual base rate wind:	$0.0205
Adjusted annual rate fire:	$0.1449
Adjusted annual rate wind:	$0.0205
Total annual rate:	$0.1654
Total monthly rate:	$0.0138
Indiv. occurr. of loss (credit)/debit:	75%

3. Type of contract: Aggregate Excess Reinsurance

Lines reinsured: Provides a stop loss for net reinsured losses retained by the reinsured which occur during the contract year. Losses under this layer are experience rated based on a 5-year loss ratio.

	Company's retention:	Annual attachment point, being the product of the adjusted gross fire risks in force, the 10-year gross fire ratio, the individual occurrence of loss credit, and the load factor. The attachment point for 2011 is $655,831.
	Coverage:	100% of unlimited losses above retention
	Rates:	Adjusted annual rate: $0.4955 Monthly rate: $0.0413
	Reinsurance premium:	Premiums are calculated based on the monthly rate of $0.0413 multiplied by the Adjusted Gross Fire Risk in Force per $1,000 reported at the end of each month during the contract year
4.	Type of contract:	Facultative Reinsurance
	Lines reinsured:	All property risks specifically ceded
	Coverage:	Exposures that exceed policy limits of $1,000,000, subject to application and approval
	Rates:	Eligible risk determined on an individual basis, subject to disclosure requirements of eligible risk
5.	Type of contract:	Reinsured Liability Agreement
	Lines reinsured:	All liability coverages written by the company
	Company's retention:	$0
	Coverage:	100% of liability losses ceded
	Reinsurance premium:	100% of liability premiums ceded
	Ceding commission:	20% of liability premiums ceded

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, 2011, 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."

Heartland Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2011

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 50	$ 0	$ 0	$ 50
Cash in checking	148,784			148,784
Cash deposited at interest	613,874			613,874
Bonds	14,198			14,198
Stocks and mutual fund investments	372,415			372,415
Real estate	85,834			85,834
Premiums, agents' balances and installments:				
In course of collection	588			588
Deferred and not yet due	216,991			216,991
Investment income accrued		4,408		4,408
Reinsurance recoverable on paid losses and LAE	14,477			14,477
Electronic data processing equipment	3,842			3,842
Fire dues recoverable	4,168			4,168
Other expense-related assets:				
Reinsurance commission receivable	9,875			9,875
Furniture and fixtures	417	0	417	0
Totals	$1,485,513	$4,408	$417	$1,489,504

Liabilities and Surplus

Net unpaid losses	$ 3,200
Unpaid loss adjustment expenses	3,300
Commissions payable	54,969
Federal income taxes payable	1,257
Unearned premiums	482,725
Reinsurance payable	66,641
Amounts withheld for the account of others	4,092
Payroll taxes payable (employer’s portion)	2,041
Other liabilities:	
Expense-related:	
Accounts payable	6,043
Nonexpense-related:	
Premiums received in advance	22,951
Total liabilities	647,219
Policyholders' surplus	842,285
Total Liabilities and Surplus	$1,489,504

Heartland Mutual Insurance Company
Statement of Operations
For the Year 2011

Net premiums and assessments earned		$ 748,421
Deduct:		
Net losses incurred	$659,481	
Net loss adjustment expenses incurred	74,581	
Net other underwriting expenses incurred	413,655	
Total losses and expenses incurred		1,147,717
Net underwriting gain (loss)		(399,296)
Net investment income:		
Net investment income earned	(3,367)	
Net realized capital gains (losses)	(47)	
Total investment gain (loss)		(3,414)
Other income (expense):		
Miscellaneous	1,316	
Billing charges	12,446	
Total other income		13,762
Net income (loss) before policyholder dividends and before federal income taxes		(388,948)
Net income (loss) before federal income taxes		(388,948)
Federal income taxes incurred		2,657
Net Income (Loss)		$ (391,605)

Heartland Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2011

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:

	2011	**2010**	**2009**	**2008**	**2007**
Surplus, beginning of year	$ 857,101	$794,821	$800,196	$739,639	$665,684
Net income	(391,605)	54,664	(17,220)	84,406	82,362
Net unrealized capital gain or (loss)	(348)	4,690	8,912	(26,038)	(10,978)
Change in nonadmitted assets	1,859	2,926	2,933	2,189	2,571
Effect of merger	375,278	0	0	0	0
Surplus, End of Year	$ 842,285	$857,101	$794,821	$800,196	$739,639

* Note that the company merged with Shelby Farmers' Mutual Insurance Company on January 1, 2011. Financial results for 2007 through 2010 reflect the balances of the company alone.

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2011, 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. Accounts and Records—It is recommended that the company follow its procedures concerning the signature requirements approved by the company's board of directors.

   Action—Compliance

2. Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards to custody and control of its invested assets.

   Action—Compliance

3. Stocks and Mutual Fund Investments—It is recommended that the company only purchase mutual funds with a minimum of a 4-star rating from Morningstar Mutual Funds, Inc., pursuant to s. Ins 6.20 (6) (d) 3. c., Wis. Adm. Code, and in accordance with the company's investment policy statement. It is further recommended that the company sell its shares of mutual funds that were noncompliant at the time of purchase with s. Ins 6.20 (6) (d) 3. c. or 6.20 (6) (d) 5., Wis. Adm. Code, within 90 days of the adoption of this examination report.

   Action—Compliance

4. Unpaid Loss Adjustment Expenses—It is again recommended that the company develop a methodology for estimating and reporting unpaid loss adjusting expenses.

   Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period. It was observed by the examiners’ review of the board of directors meeting minutes that the company's directors did not always abstain on issues where a conflict of interest either exists or the potential for a conflict of interest may arise. It is recommended that directors with conflicts of interest properly abstain from voting on matters affecting their interest and that the minutes clearly indicate it pursuant to s. 612.18, Wis. Stat.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has not executed formal written agreements with certain of its agents. The contracts include language indicating the agent will represent the company's interests "in good faith." It is recommended that the company execute formal written agreements with all of its agents.

The examiners obtained a listing of agent's appointments and terminations from the company and compared it to the agent appointments and terminations filed with the Office of the Commissioner of Insurance (OCI). It was discovered that several agents who had terminations as of December 31, 2011, were still being reported as appointed agents by the company. There were also agents listed with OCI that were not listed as agents by the company.

An insurer shall report to the Commissioner at such intervals as the Commissioner establishes by rule all appointments, including renewals of appointments, and all terminations of appointments of insurance agents to do business in this state. It is recommended that the company properly report to the Commissioner at such intervals all appointments, including renewals of appointments, and all terminations of appointments of insurance agents doing business in this state pursuant to s. 628.11, Wis. Stat.

Conflicts of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons.

The company has not adopted such a procedure to ensure proper disclosure of potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination. The examiners noted that one of the director's conflict of interest statements was not provided for the year 2010.

The examiners also noted that, of the conflict of interest statements provided, several directors did not accurately complete their conflict of interest statements. Several directors who answered yes to the question "Have you or any of your affiliated persons purchased and or provided services or property to Heartland Mutual in the past year?" and did not disclose the nature of their or others affiliation.

Several directors answered yes to "Please indicate whether you or any of your affiliated persons had any direct or indirect interest in any business transactions in the past year to which Heartland Mutual was or is a party." and did not disclose the direct or indirect interest involving business transactions with the company or an affiliated party.

It is recommended that each of the company's officers, directors, and key employees annually make conflict of interest disclosures to the company and that the company retain the disclosures in the company's records from examination to examination, in compliance with the directive of the Commissioner of Insurance dated March 9, 1989.

It is recommended that the directors note all possible conflicts of interest on their conflict of interest statements in accordance with the directive of the Commissioner of Insurance dated March 9, 1989.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 100,000
Workers compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Business liability	
Per occurrence	1,000,000
Aggregate	2,000,000
Professional liability	
Each claim	1,000,000
Aggregate	1,000,000
Directors & officers liability	
Each claim	1,000,000
Aggregate	1,000,000
Commercial employment practices liability	
Aggregate	100,000
Medical expenses	100,000
Per person	5,000
Products-completed operations	
Aggregate	2,000,000
Damages to premises rented to you	
Per occurrence	100,000

Underwriting

The company does not have a formal inspection policy for both new and renewal business. A sampling of new applications and renewal business indicated that inspections are not reviewed by directors who are independent of the risk under consideration and review. It is recommended that the company develop a formal inspection policy and that a sampling of the inspections be reviewed and approved annually by directors who are independent of the risk under consideration and review.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained.
2. A proper cash receipts journal is maintained.
3. A proper cash disbursements journal is maintained.
4. A proper general journal is maintained.
5. A proper general ledger is maintained.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2011.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept off-site. The company has manuals documenting the use of its software and outlining the steps to complete specific tasks. The manuals assist in the continuity of operations by providing instructions for seldom-used applications or when staff turnover occurs.

The examination determined that the level of documentation contained in the manuals was reasonable.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building.

The company has developed a business continuity plan. The company's business continuity plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

> (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
>
> (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$ 947,219
2.	Liabilities plus 33% of gross premiums written	1,030,655
3.	Liabilities plus 50% of net premiums written	1,022,079
4.	Amount required (greater of 1, 2, or 3)	1,030,655
5.	Amount of Type 1 investments as of 12/31/2011	944,086
6.	Excess or (deficiency)	$ (86,569)

The company does not have sufficient Type 1 investments.

The investment rule prescribes that a town mutual shall divest of any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. Currently the company has no investments which are not in compliance with the investment rule.

Since the inception of the investment rule in 1996, the company has made additional Type 2 investments without having an adequate amount of Type 1 investments. It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$762,708**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 50
Cash deposited in banks—checking accounts	148,784
Cash deposited in banks at interest	613,874
Total	$762,708

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in two banks. Verification of checking account balances was made by obtaining confirmations directly from the depositor and reconciling the amounts shown thereon to company records.

During the examiners review of outstanding checks for the period under examination, it was observed that three checks dated July 5, 2006, totaling $48.71 were older than five years from the issue date and presumed abandoned property. Chapter 177, Wis. Stat., provides that certain forms of abandoned property be forwarded to the custody of the state. All intangible property that is held, issued or owing in the ordinary course of a holder’s business and that has remained unclaimed by the owner for more than five years after it became payable or distributable is presumed abandoned. It is recommended that the company file Unclaimed Property Reports as required by ch. 177, Wis. Stat, and maintain copies of these filings.

Cash deposited in banks at interest represents the aggregate of 12 deposits in 10 depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2011 totaled $15,220 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.280% to 4.64%. Accrued interest on cash deposits totaled $89 at year-end.

Book Value of Bonds **$14,198**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2011. Bonds owned by the company are held in an account in the custody of Community Bank and Trust which, in turn, maintains the securities in an account with Financial Fiduciaries, LLC.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2011 on bonds amounted to $2,868 and was traced to cash receipts records. Accrued interest of $491 at December 31, 2011, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$372,415**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2011. Stocks owned by the company are held in an account in the custody of Community Bank and Trust which, in turn, maintains the securities in an account with Financial Fiduciaries, LLC.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was not in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Please see the section of this report captioned “Investment Rule Compliance.”

Dividends received during 2011 on stocks and mutual funds amounted to $8,371 and were traced to cash receipts records. Accrued dividends of $3,828 at December 31, 2011, were checked and allowed as a nonledger asset.

Book Value of Real Estate **$85,834**

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2011. The company's real estate holdings consisted of an office building located in West Salem, Wisconsin, and the company's main office building located in Ettrick, Wisconsin.

The required documents supporting the validity of this asset were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted in the section of this report captioned, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Premiums, Agents' Balances in Course of Collection **$588**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

Premiums Deferred and Not Yet Due **$216,991**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company’s detailed list of deferred premiums verified the accuracy of this asset.

Investment Income Accrued **$4,408**

Interest due and accrued on the various assets of the company at December 31, 2011, consists of the following:

Cash deposited at interest	$ 89
Bonds	491
Stocks and mutual funds	3,828
Total	$4,408

Reinsurance Recoverable on Paid Losses and LAE **$14,477**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2011. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$3,842**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2011. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Fire Dues Recoverable **$4,168**

This asset represents the amount overpaid to the state of Wisconsin for 2011 fire dues. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Reinsurance Commission Receivable **$9,875**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2011, under its contract with the reinsurer. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$3,200**

This liability represents losses incurred on or prior to December 31, 2011, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2011, with incurred dates in 2011 and prior years. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$77,774	$92,118	$(14,344)
Less: Reinsurance recoverable on unpaid losses	74,574	91,070	(16,496)
Net Unpaid Losses	$ 3,200	$ 1,048	$ 2,152

The above difference of $2,152 was not considered material for purposes of this examination.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and claims that were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$3,300**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2011, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is a paid-to-paid ratio applied over a five-year period.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$54,969**

This liability represents the commissions payable to agents as of December 31, 2011. The examiners reviewed the company's commission calculation along with reviewing subsequent commission payments and found the liability to be reasonably stated.

Federal Income Taxes Payable **$1,257**

This liability represents the balance payable at year-end for federal income taxes incurred prior to December 31, 2011.

The examiners reviewed the company's 2011 tax return and verified amounts paid to cash disbursement records to verify the accuracy of this liability.

Unearned Premiums **$482,725**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$66,641**

This liability consists of amounts due to the company's reinsurer at December 31, 2011, relating to transactions which occurred on or prior to that date.

Amounts Withheld for the Account of Others **$4,092**

This liability represents employee payroll deductions in the possession of the company at December 31, 2011. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$2,041**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2011, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$6,043**

This liability represents the company's operational expenses incurred prior to December 31, 2011, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$22,951**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2011. The examiners reviewed 2011 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

The company reported admitted assets of $1,489,504, liabilities of $647,219, policyholders' surplus of $842,285, and a net loss of $391,605 for the year ending December 31, 2011.

The period from 2005 to 2010 was a period of significant underwriting efforts at the company. The policy count declined 19.7%, from 1,217 at year-end 2005 to 977 at year-end 2010. During the same period, by comparison, gross premiums written declined only 9.5%. In five of the six calendar years from 2005 to 2010, the company experienced an underwriting profit. From 2005 to 2010, policyholders' surplus increased 11.5%.

The company experienced the worst loss in its history in 2011 with gross claims paid of $917,832. Several factors that contributed to the company's exceptional loss experience were: a) strong storms across northern and western Wisconsin produced hail storms on April 10, 2011; b) a severe storm cell on May 22, 2011, produced several tornados across western and central Wisconsin; c) several damaging windstorms; d) two large dwelling fires; and e) the poor loss history from the acquired Shelby Farmers' block of business through the described merger. As a result of these described factors, there was a decline in policyholder's surplus of 31.65% or $390,094 for the year ended 2011.

Other underwriting expenses incurred increased $105,597 over 2010 to $413,655 as a result of higher than expected operating expenses due to the merger with Shelby Farmers'. The company discovered severe rate adequacy problems with the Shelby Farmers' policies, primarily due to excessive use of credits.

Subsequent to the current examination period, the company has taken the following cost savings initiatives: a) began re-rating Shelby Farmers' entire book of business and anticipates that this will be completed by May 31, 2012, b) implementing rate increases that will begin June 1, 2012, c) closing the West Salem office as of March 31, 2012, and d) restructuring its 2012 reinsurance contract in an effort to minimize reinsurance costs.

The company has complied with the previous examination recommendations. For the current year under examination, this examination made eight recommendations with three being related to corporate records and two being related to conflict of interest.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 16 - Corporate Records—It is recommended that directors with conflicts of interest properly abstain from voting on matters affecting their interest and that the minutes clearly indicate it pursuant to s. 612.18, Wis. Stat.

2. Page 16 - Corporate Records—It is recommended that the company execute formal written agreements with all of its agents.

3. Page 16 - Corporate Records—It is recommended that the company properly report to the Commissioner at such intervals all appointments, including renewals of appointments, and all terminations of appointments of insurance agents doing business in this state pursuant to s. 628.11, Wis. Stat.

4. Page 17 - Conflict of Interest—It is recommended that each of the company's officers, directors, and key employees annually make conflict of interest disclosures to the company and that the company retain the disclosures in the company's records from examination to examination, in compliance with the directive of the Commissioner of Insurance dated March 9, 1989.

5. Page 17 - Conflict of Interest—It is recommended that the directors note all possible conflicts of interest on their conflict of interest statements in accordance with the directive of the Commissioner of Insurance dated March 9, 1989.

6. Page 18 - Underwriting—It is recommended that the company develop a formal inspection policy and that a sampling of the inspections be reviewed and approved annually by directors who are independent of the risk under consideration and review.

7. Page 21 - Investment Rule Compliance—It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

8. Page 22 - Cash and Invested Cash—It is recommended that the company file Unclaimed Property Reports as required by ch. 177, Wis. Stat, and maintain copies of these filings.

VII. ACKNOWLEDGMENT

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

In addition to the undersigned, Michael E. Miller of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

DuWayne A Kottwitz
Examiner-in-Charge