

Report  
of the  
Examination of  
Southeast Mutual Insurance Company  
Burlington, Wisconsin  
As of December 31, 2018

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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July 18, 2019

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Honorable Mark V. Afable  
Commissioner of Insurance  
State of Wisconsin  
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Commissioner:

In accordance with your instructions, an examination has been performed as of  
December 31, 2018, of the affairs and financial condition of:

SOUTHEAST MUTUAL INSURANCE COMPANY  
Burlington, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Southeast Mutual Insurance Company (the company) was made in 2012 as of December 31, 2011. The current examination covered the five-year period beginning January 1, 2014 and ending December 31, 2018, 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 a compilation engagement covering preparation of the statutory financial statements, depreciation schedules, and adjusting journal entries. On August 19, 2016, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

The company was organized as a town mutual insurance company on September 6, 1875, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Farmers Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of incorporation and no amendments to the bylaws. Article I of the articles of incorporation was amended to change the principal office for the transaction of business, which was relocated to rented office space in Burlington, Wisconsin. Article III was amended to change the structure of the board of directors which was changed from nine directors to not less than five and not more than nine directors.

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

Kenosha	Walworth
Racine	Waukesha

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year with premiums payable on the advance premium basis, with two automatic renewals. The company also charges a policy fee equal to \$5 per year for semi-annual billing and \$10 per year for quarterly billing.

Business of the company is acquired through two agents, one of whom is a director of the company. Agents are presently compensated at 15% on all lines of business (new and renewal business).

Agents have authority to adjust losses up to \$2,000; however, most losses are adjusted by outside adjusters. Agent adjusters receive \$40 for each claim adjusted plus \$0.50 per mile for travel allowance.

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 seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

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

<b>Name</b>	<b>Principal Occupation</b>	<b>Residence</b>	<b>Expiry</b>
Robert Bork	Farmer	Burlington, WI	2021
Mary Daniels*	Insurance Agent	Burlington, WI	2022
Jennifer Ehlen	Sales / Farmer	Burlington, WI	2021
Jerome Ketterhagen	Realtor	Burlington, WI	2022
Jeremy Krusemark	Police	Burlington, WI	2020
Joseph Patla	Police K-9 Officer	Burlington, WI	2020
Mark Wilson	Farmer	Burlington, WI	2020

\*This director is also a current agent and treasurer of the company.

Members of the board currently receive \$75, with the exception of the secretary who receives \$200 for each meeting attended and \$0.50 per mile 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	2018 Compensation
Jerome Ketterhagen	President	\$ 4,752
Mark Wilson	Vice-President	1,400
Mary Daniels	Treasurer	59,380
Joseph Patla	Secretary	1,350
Robin Kasuboski	Office Manager	45,875

Reported compensation is the total compensation paid by the insurer for the year and includes salary, commissions, director fees and rental income as applicable.

## Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The company had one committee at the time of the examination as listed below:

### Executive Committee

Jerome Ketterhagen, Chair  
Mark Wilson  
Mary Daniels  
Joseph Patla

The Executive Committee is appointed at the annual meeting to act as the Adjusting Committee.

## Growth of Company

The growth of the company during the examination period as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2018	\$337,952	737	\$(110,748)	\$1,593,945	\$1,219,052
2017	260,918	768	(267,177)	1,668,655	1,338,902
2016	194,609	787	(68,267)	1,779,184	1,504,171
2015	195,686	764	(201,071)	1,783,569	1,442,624
2014	164,165	751	(58,504)	1,913,547	1,640,300
2013	184,225	724	(16,040)	1,798,042	1,564,916

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

Year	Gross Premiums Written	Net Premiums Written	Policyholders' Surplus	Writings Net	Ratios Gross
2018	\$669,472	\$373,429	\$1,219,052	31%	55%
2017	596,259	307,935	1,338,902	23	45
2016	603,307	202,683	1,504,171	13	40
2015	574,560	196,331	1,442,624	14	40
2014	532,629	174,880	1,640,300	11	32
2013	489,256	183,142	1,564,916	12	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	Composite Ratio
2018	\$248,142	\$216,047	\$337,952	73%	58%	131%
2017	344,536	201,635	260,918	132	65	198
2016	119,176	153,720	194,609	61	76	137
2015	253,984	142,865	195,686	130	73	203
2014	128,094	114,807	164,165	78	66	144
2013	114,095	117,354	184,225	62	64	126

The company reported a cumulative decrease in surplus of 22% over the last five years.

In 2015, several hailstorms and heavy windstorms caused many claims and a corresponding increase in losses incurred. This also contributed to the second largest net loss in the five-year exam period.

In 2017, a series of major thunderstorms, which resulted in wind and hail claims, were a contributing factor to the largest net loss for the company in the five-year exam period. Policies in force increased for the first three years of the exam period, but ended up declining over the last two years, with a net gain of only 2% in policies in force over the five-year period. While net premiums earned have increased 83% over the five year exam period, admitted assets have declined 11% in that same period, mainly due to underwriting and net losses sustained by the company. Gross and net writings ratios increased over the exam period from 31% to 55% and 12% to 31%, respectively.

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty with six (6) coverage sections. 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:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2019
Termination provisions:	Either party may terminate this Contract of Reinsurance as of 12:01 a.m. Central Standard Time on any January 1 <sup>st</sup> by giving to the other party at least ninety (90) days advance notice in writing

The coverages provided under this treaty are summarized as follows:

- |                      |  |
|----------------------|--|
| Type of contract:    | Class A – Casualty Excess of Loss Reinsurance  |
| Lines reinsured:     | All business written by the company classified as casualty or liability business   |
| Company's retention: | \$5,000 each and every loss occurrence including loss adjustment expenses  |
| Coverage:            | 100% of loss in excess of \$5,000 each and every loss occurrence subject to the following limits: <ol style="list-style-type: none"><li>\$1,000,000 per occurrence, single limit, combined injury and property damage liability</li><li>\$1,000,000 split limits, in any combination of bodily injury and property damage liability</li><li>\$25,000 for medical payments, per person</li><li>\$25,000 medical payments, per accident for personal lines</li></ol> |
| Reinsurance premium: | 60% of net premium   |
| Ceding commission:   | None   |
- |                      |  |
|----------------------|--|
| Type of contract:    | Class B – First Surplus Reinsurance  |
| Lines reinsured:     | All business written by the company classified as property business  |
| Company's retention: | First surplus retention is \$400,000. The company may cede on a pro-rata basis (in excess of retention) up to \$2,000,000<br><br>In addition, any location which is in excess of \$2,500,000 property coverage may be submitted to the reinsurer for special acceptance. The reinsurer may accept or reject each such risk submitted |



Coverage:	Pro rata portion of every loss, including loss adjustment expense, corresponding to the amount of risk ceded
Reinsurance premium:	Pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of each risk ceded hereunder
Ceding commission:	20% of the premium ceded and 15% profit commission based on the reinsurer's net profit on business reinsured under this contract
3. Type of contract:	Class C-1 – First Per Risk Excess of Loss Layer
Lines reinsured:	All business written by the company classified as property business
Company's retention:	\$40,000 per risk per loss occurrence
Coverage:	100% of each and every loss, including loss adjustment expense, in excess of retention of \$40,000 per risk, in respect to each and every risk resulting from one loss occurrence up to \$80,000
Reinsurance premium:	13.38% of the company's net premium
Ceding commission:	None
4. Type of contract:	Class C-2 – Second Per Risk Excess of Loss Layer
Lines reinsured:	All business written by the company classified as property business
Company's retention:	\$120,000 per risk per loss occurrence
Coverage:	100% of each and every loss, including loss adjustment expense, in excess of retention of \$120,000 per risk, in respect to each and every risk resulting from one loss occurrence up to \$280,000
Reinsurance premium:	5.00% of the company's net premium written
Ceding commission:	None
5. Type of contract:	Class D-1 – First Aggregate Excess of Loss
Lines reinsured:	All business written by the company
Company's retention:	70% of company's net premium written
Coverage:	100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 70% of the company's net premiums written, up to 65% of net premiums written
Reinsurance premium:	6.50% of the company's net premium written
Ceding commission:	None

6. Type of contract:	Class D-2 – Second Aggregate Excess of Loss Reinsurance
Lines reinsured:	All business written by the company
Company's retention:	135% of company's net premium written
Coverage:	100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 135% of the company's net premiums written
Reinsurance premium:	2.00% of the company's net premium
Ceding commission:	None

### **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, 2018, 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."

**Southeast Mutual Insurance Company**  
**Statement of Assets and Liabilities**  
**As of December 31, 2018**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash deposited in checking	\$ 101,146	\$	\$	\$ 101,146
Bonds	538,855			538,855
Stocks and mutual fund investments	870,793			870,793
Premiums, agents' balances and installments:				
In course of collection	775			775
Deferred and not yet due	67,228			67,228
Investment income accrued		4,066		4,066
Other expense related assets:				
Reinsurance commission receivable	<u>11,082</u>	<u>          </u>	<u>          </u>	<u>11,082</u>
Totals	<u>\$1,589,879</u>	<u>\$4,066</u>	<u>\$          </u>	<u>\$1,593,945</u>

**Liabilities and Surplus**

Net unpaid losses	\$ 39,000
Loss adjustment expenses unpaid	2,600
Commissions payable	8,156
Fire department dues payable	990
Unearned premiums	253,448
Reinsurance payable	55,252
Amounts withheld for the account of others	1,822
Nonexpense related:	
Premiums received in advance	<u>13,625</u>
Total Liabilities	374,893
Policyholders' Surplus	<u>1,219,052</u>
Total Liabilities and Surplus	<u>\$1,593,945</u>

**Southeast Mutual Insurance Company**  
**Statement of Operations**  
**For the Year 2018**

Net premiums and assessments earned		\$ 337,952
Deduct:		
Net losses incurred	\$220,620	
Net loss adjustment expenses incurred	27,522	
Net other underwriting expenses incurred	<u>216,047</u>	
Total losses and expenses incurred		<u>464,189</u>
Net underwriting gain (loss)		(126,237)
Net investment income:		
Net investment income earned	6,287	
Net realized capital gains (losses)	<u>7,669</u>	
Total investment gain (loss)		13,956
Other income (expense):		
Miscellaneous	1,533	
Total other income (expense)		<u>1,533</u>
Net income (loss) before policyholder dividends and before federal income taxes		<u>(110,748)</u>
Net income (loss) before federal income taxes		(110,748)
Net Income (Loss)		<u><u>\$(110,748)</u></u>

**Southeast Mutual Insurance Company  
Reconciliation and Analysis of Surplus as Regards Policyholders  
For the Five-Year Period Ending December 31, 2018**

The following schedule is a reconciliation of surplus as regards policyholders during the last five years as reported by the company in its filed annual statements:

	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Surplus, beginning of year	\$1,338,902	\$1,504,171	\$1,442,624	\$1,640,300	\$1,564,916
Net income (loss)	(110,748)	(267,177)	(68,267)	(201,071)	(58,504)
Net unrealized capital gain or (loss)	<u>(9,102)</u>	<u>101,908</u>	<u>129,814</u>	<u>3,395</u>	<u>133,888</u>
Surplus, End of Year	<u>\$1,219,052</u>	<u>\$1,338,902</u>	<u>\$1,504,171</u>	<u>\$1,442,624</u>	<u>\$1,640,300</u>

**Reconciliation of Policyholders' Surplus**

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2018, 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. Board of Directors—It is recommended that the company increase the size of its board of directors to at least nine directors or have only one company employee or company representative on its board of directors.

Action—Compliance.

2. EDP Environment—It is recommended that the company establish a procedure to back up its computer system on a weekly basis and store this backed-up data in a secure off-site location.

Action—Compliance.

3. Invested Assets—It is recommended the company have its custodian provide a statement with an accurate account balance at the end of the reporting period and compare this balance to its investment broker statement at least quarterly.

Action—Compliance.

## **Current Examination Results**

### **Audit Engagement Letter**

A review of the engagement letter submitted to the company by its independent certified public accounting firm in anticipation of the external audit as of December 31, 2018, found that the engagement letter included a clause which is designed to limit the CPA firm's liability. The clause indicates that any legal action by the insurer against the CPA firm must be started within 24 months of the date of delivery of the audit report. If 24 months passes, the insurer is forever barred from starting a lawsuit or obtaining any legal or equitable relief or recovery. Further, the clause indicates that the 24-month period applies even if the insurer is not aware of the existence of a potential dispute.

Section Ins 50.08 (1) (am), Wis. Adm. Code, provides that the Commissioner may rule that an accountant is not qualified to express an opinion on an audited financial statement if, among other things, the accountant has "either directly or indirectly entered into an agreement of indemnification with respect to the audit of the insurer." Section Ins 50.01 (4m), Wis. Adm. Code, defines indemnification as "an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing or other misrepresentations made by the insurer or its representatives."

The clause included in the engagement letter creates a contractual limit of liability, with the intent to limit the liability of the CPA firm for failure to adhere to auditing standards. It is recommended that the company enter into future audit engagements with independent certified public accountants that are compliant with all requirements under s. Ins 50.08 (1), Wis. Adm. Code.

### **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 for the subsequent period. Starting with the minutes for the March 14, 2017, board session and continuing through the remaining meetings in 2017 and through all minutes of 2018, the company stopped reporting attendance. This lack of attendance reporting made it impossible for the examiners to



determine if the officers and directors were fulfilling their individual corporate governance responsibilities under the company's bylaws and articles of incorporation. It is recommended that the company document the officers and directors present at each meeting of the board of directors so that it may be determined whether officers and directors are fulfilling their responsibilities under the company's articles of incorporation and bylaws.

Article V of the company's articles of incorporation requires 10 members in attendance at the annual meeting in order to constitute a quorum. Without a quorum present, the required business of the annual meeting may not be conducted. The annual meeting minutes of 2017 and 2018 did not list the number of members who were present. The annual meeting minutes of 2014, 2015, and 2016 listed a total of policyholders, directors, and agents present but did not specifically mention the total number of members at the meeting in order to determine if a quorum was present. It is recommended that the company document the number of policyholders present at each annual meeting so it can be determined whether a quorum was present.

The examination team found that the company failed to submit the biographical affidavits of four directors over the last five years. Pursuant to s. Ins. 6.52 (5), Wis. Adm. Code, biographical information shall be provided by each domestic insurer with respect to the appointment or election of any new director or officer elected or appointed within 15 days after such appointment or election. It is recommended that the company report biographical data relating to officers and directors in accordance with the provisions of Ins. 6.52 (5), Wis. Adm. Code.

The examination team reviewed all 2018 and 2019 active agent agreements for proper execution. Of the six agreements that were reviewed, only one of them was properly executed. Five of the six agreements were missing the signature of a company officer. Three of the six agreements were missing an effective date. The contracts did include language indicating the agent will represent the company's interests "in good faith." It is recommended that a company officer properly execute all agency agreements and that all agency agreements include the appropriate effective dates. Four of the six agents subject to these agreements have since terminated their agency relationships with the company.

## Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for disclosing to its board of directors 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 the position. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

## 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:

<b>Type of Coverage</b>	<b>Coverage Limits</b>
Fidelity bond	\$ 100,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Policy limit	500,000
Professional liability:	
Each claim	3,000,000
Policy limit, all claims in period	3,000,000
Commercial business owners:	
Per occurrence	1,000,000
Limit	2,000,000
Medical expense	5,000
Directors & officers liability:	
Each claim/aggregate	1,000,000

## Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. All new policies are inspected by an outside inspection firm within 60 days. Southeast Mutual reserves the right to cancel the policy, within the first 60 days of the policy's effective date, by written notice to

the insured per s. 631.36 (2), Wis. Stat. Renewal inspections are done every three years by the agent and must include photographs, a completed inspection form, and be received 65 to 90 days before the renewal date. The full board functions as an underwriting committee and reviews new and renewal applications during board meetings on an as-needed basis. Board review may involve questions about property condition, over or under-insured properties, and/or frequency of claims.

### **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. The executive committee functions as the adjusting committee for the company.

### **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, 2018.

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

During the examination walk-through of cash receipts procedures, it was learned that premium receipt checks and remittance advices are accumulated and stored in an unlocked file drawer until it is time to enter the checks into the general ledger system and physically bring the checks to the bank for deposit. The number of deposits varies by month, but deposits are not made

consistently on a daily or weekly basis. For example, in December 2018 there were two deposits made during the entire month. One deposit included 38 premium checks and the other included 49 premium checks. According to s. Ins. 13.05 (4) (a), Wis. Adm. Code, all cash receipts shall be deposited at least weekly. If the deposit checks were lost or destroyed the company would have to determine which policyholders had made payments and request duplicate payments. There is a risk that a policyholder loss could occur before payment could be made again or that it would be difficult to determine which policyholders had made premium payments. It is recommended that the company comply with the requirement of s. Ins. 13.05 (4) (a), Wis. Adm. Code, and deposit all cash receipts at least weekly. It is further recommended that it store premium checks received and awaiting deposit in a secure, fireproof manner at the company.

### **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 computer. An automated process backs up the computers nightly and the backed-up data is kept both on site and in a cloud-based data vault.

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.

### **Unclaimed Funds**

It was noted that the company does not remit unclaimed funds to the Wisconsin Department of Revenue in compliance with ch. 177, Wis. Stat. (Uniform Unclaimed Property Act). Current company practice is to wait six months for a check to be cashed. If the check is not cashed, the recipient is contacted by mail and given sixty days to cash the check. If the check is not cashed after sixty days, the check is voided and the money is retained by the company. This practice is not in compliance with ch. 177, Wis. Stat., which states that after five years an original payment becomes abandoned property and requires that all unclaimed property be reverted to the state. Checks should be accounted for as outstanding until such time as they are cashed by the payee or are remitted to

the state as unclaimed property. The examiners were not able to determine the number of transactions that were voided and retained by the company. It is recommended that the company remit property presumed abandoned to the Wisconsin Department of Revenue in accordance with the requirement of s. 177.17, Wis. Stat.

### **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 Approval and Supervision**

All investments of a town mutual company shall be acquired and held under the supervision and direction of the board of directors pursuant to s. Ins. 6.20 (6) (h), Wis. Adm. Code. According to the company's investment policy, the company's board of directors must approve all investment decisions presented by the finance committee, and the president is responsible for

investment recommendations based on the investment policy statement guidelines. It also states that the president of the company shall report investment activity to the board at their next regularly scheduled meeting. Currently, the company does not have a board finance committee, and the president does not appear to be involved in investment approvals and reporting to the board. Instead, these duties appear to be carried out by the treasurer. During board minute review, it was noted that the board approves the treasurer's report as read. Three treasurer's report examples were obtained and reviewed by the exam team. There was limited investment information presented in two of the reports. None of the reports included information on investment policy compliance or investment manager performance and/or benchmarks. Further, a review of the board minutes did not provide any evidence that the company's board of directors approved investment transactions, reviewed and evaluated performance of its investment manager or evaluated the company's portfolio against appropriate benchmarks. It is recommended that the company's board of directors review and authorize all investment activities of the company, including performance review of its investment manager and compliance with its investment policy, in accordance with s. Ins. 6.20 (6) (h), Wis. Adm. Code.

There was a provision in the investment advisor agreement that requires the company to review confirmations and statements within 10 days of receipt and give notice of unauthorized transactions or omissions. If notice is not given in 10 days, improper or unauthorized transactions appear to be binding. It is recommended that the company adopt a policy to review all investment confirmations and statements within 10 days of receipt, in order that the 10-day notice requirement for incorrect transaction corrections referenced in the investment advisor agreement can be met.

The examiners also reviewed the company's investment advisor agreements, as provided by the investment advisor. The company is subject to two separate agreements: a discretionary agreement, with fees charged based on assets under management, which applies to the equity portfolio, and a non-discretionary agreement, with commissions charged per transaction, which applies to the bond portfolio. The agreements provided by the investment advisor did not contain certain appropriate provisions considered to be necessary for the protection of the company. There was no documented linkage between the company's investment policy and the investment advisor

discretionary agreements, none of the agreements specified the standards of conduct of the investment advisor, and no references were made to investment portfolio performance ongoing evaluation. It is recommended that the company enter into and maintain written agreements with the investment advisor which shall be approved by the board of directors. A separate agreement should be entered into for each specific arrangement. Each agreement shall include, at a minimum: (1) a description of the scope and nature of the services to be provided, (2) the standard of care to be provided, (3) how or whether the investment strategy (including asset allocations, and any applicable limitations) incorporates the board approved investment policy, (4) the level of authority the advisor exercises over the insurer's portfolio (discretionary or non-discretionary), (5) a description of all types of compensation to the investment advisor, and (6) a description as to how investment transactions, holdings, and portfolio performance will be communicated to the company's board of directors, including the frequency, content and means of reporting. A copy of the executed agreement, along with evidence of board approval, shall be submitted to the Office of the Commissioner of Insurance within 60 days of the date of this report. It is further recommended that the company provide the investment advisor with a copy of its adopted investment policy statement.

### **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	\$674,893
2. Liabilities plus 33% of gross premiums written	595,819
3. Liabilities plus 50% of net premiums written	561,608
4. Amount required (greater of 1, 2, or 3)	674,893
5. Amount of Type 1 investments as of 12/31/2018	<u>680,199</u>
6. Excess or (deficiency)	<u>\$ 5,306</u>

The company has sufficient Type 1 investments.

## **ASSETS**

<b>Cash and Invested Cash</b>	<b>\$101,146</b>
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The above asset is comprised of cash deposited in banks—checking accounts. Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depositor and reconciling the amounts shown thereon to company records.

<b>Book Value of Bonds</b>	<b>\$538,855</b>
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The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2018. Bonds owned by the company are located in a custodial account.

Bonds were verified by review of a confirmed custodian year-end statement of the company's investments. 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 regarding investments made by town mutual insurers.

Interest received during 2018 on bonds amounted to \$10,279 and was traced to cash receipts records. Accrued interest of \$3,447 at December 31, 2018, was checked and allowed as a nonledger asset.

<b>Stocks and Mutual Fund Investments</b>	<b>\$870,793</b>
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The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2018. Stocks owned by the company are primarily held in a custodial account, with two issues held in the company's safe.

Stocks and mutual funds held by the custodian were independently confirmed with the custodian. Stock certificates in the company safe were physically inspected 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 in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.



Dividends received during 2018 on stocks and mutual funds amounted to \$13,637 and were traced to cash receipts records. Accrued dividend income of \$619 at December 31, 2018, was checked and allowed as a nonledger asset.

**Premiums, Agents' Balances in Course of Collection** **\$775**

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** **\$67,228**

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** **\$4,066**

Interest due and accrued on the various assets of the company at December 31, 2018, consists of the following:

Bonds	\$3,447
Stocks and Mutual Funds	<u>619</u>
Total	<u>\$4,066</u>

**Reinsurance Commission Receivable** **\$11,082**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2018, 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

**\$39,000**

This liability represents losses incurred on or prior to December 31, 2018, 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, 2018, with incurred dates in 2018 and prior years. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. The examination team concluded that, although net unpaid losses determined by the examination team were greater than net unpaid losses reported by the company as of December 31, 2018, the difference was not material for the purpose of this examination.

	Company Estimate	Examiners' Development	Difference
Incurring but unpaid losses	\$58,391	\$75,750	\$(17,359)
Less: Reinsurance recoverable on unpaid losses	<u>19,391</u>	<u>21,309</u>	<u>(1,918)</u>
Net Unpaid Losses	<u>\$39,000</u>	<u>\$54,441</u>	<u>\$(15,441)</u>

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 enough investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

### Unpaid Loss Adjustment Expenses

**\$2,600**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2018, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is to use an estimate based on a three-year ratio of paid loss adjustment expenses to paid losses.

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** **\$8,156**

This liability represents the commissions payable to agents as of December 31, 2018. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

**Fire Department Dues Payable** **\$990**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2018.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Unearned Premiums** **\$253,448**

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. A recalculation of a sample from the company's detailed list of unearned premiums verified the accuracy of this asset.

**Reinsurance Payable** **\$55,252**

This liability consists of amounts due to the company's reinsurer at December 31, 2018, relating to transactions which occurred on or prior to that date. December invoices for Wisconsin Reinsurance Corporation were verified by the examiners in support of this account balance.

**Amounts Withheld for the Account of Others** **\$1,822**

This liability represents employee payroll deductions in the possession of the company at December 31, 2018. Supporting records and subsequent cash disbursements were verified by the examiners in support of this item.

**Premiums Received in Advance****\$13,625**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2018. The examiners reviewed 2018 premium and cash receipt records to verify the accuracy of this liability.

## **V. CONCLUSION**

Southeast Mutual Insurance Company is a town mutual insurer currently operating in a four-county area of southeastern Wisconsin. The company has been in business providing insurance to its policyholders for almost 143 years.

Gross premiums written fluctuated but were up 37% over the five-year period. Net premiums written also fluctuated but increased 104% overall during the same period. Income was negative every year in the five-year exam period, with the greatest loss in 2017 of \$267,177, and a loss of \$110,748 in 2018. The loss ratio fluctuated but there were two years, 2015 and 2017, that due to storms had a ratio equal to or greater than 130%. Admitted assets declined 11% and policyholders' surplus declined 22% as well.

The current examination resulted in 11 recommendations. The recommendations relate to the audit engagement letter, corporate records, accounts and records, unclaimed funds, and investment approval and supervision. The examination resulted in no adjustment to surplus.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Audit Engagement Letter—It is recommended that the company enter into future audit engagements with independent certified public accountants that are compliant with all requirements under s. Ins 50.08 (1), Wis. Adm. Code.
2. Page 15 - Corporate Records—It is recommended that the company document the officers and directors present at each meeting of the board of directors so that it may be determined whether officers and directors are fulfilling their responsibilities under the company's articles of incorporation and bylaws.
3. Page 15 - Corporate Records—It is recommended that the company document the number of policyholders present at each annual meeting so it can be determined whether a quorum was present.
4. Page 15 - Corporate Records—It is recommended that the company report biographical data relating to officers and directors in accordance with the provisions of Ins. 6.52 (5), Wis. Adm. Code.
5. Page 15 - Corporate Records— It is recommended that a company officer properly execute all agency agreements and that all agency agreements include the appropriate effective dates.
6. Page 18 - Accounts and Records—It is recommended that the company comply with the requirement of s. Ins. 13.05 (4) (a), Wis. Adm. Code, and deposit all cash receipts at least weekly. It is further recommended that it store premium checks received and awaiting deposit in a secure, fireproof manner at the company.
7. Page 19 - Unclaimed Funds—It is recommended that the company remit property presumed abandoned to the Wisconsin Department of Revenue in accordance with the requirement of s. 177. 17, Wis. Stat.
8. Page 20 - Investment Approval and Supervision—It is recommended that the company's board of directors review and authorize all investment activities of the company, including performance review of its investment manager and compliance with its investment policy, in accordance with s. Ins. 6.20 (6) (h), Wis. Adm. Code.
9. Page 20 - Investment Approval and Supervision—It is recommended that the company adopt a policy to review all investment confirmations and statements within 10 days of receipt, in order that the 10-day notice requirement for incorrect transaction corrections referenced in the investment advisor agreement can be met.
10. Page 21 - Investment Approval and Supervision—It is recommended that the company enter into and maintain written agreements with the investment advisor which shall be approved by the board of directors. A separate agreement should be entered into for each specific arrangement. Each agreement shall include, at a minimum: (1) a description of the scope and nature of the services to be provided, (2) the standard of care to be provided, (3) how or whether the investment strategy (including asset allocations, and any applicable limitations) incorporates the board approved investment policy, (4) the level of authority the advisor exercises over the insurer's portfolio (discretionary or non-discretionary), (5) a description of all types of compensation to the investment advisor, and (6) a description as to how investment transactions, holdings, and portfolio performance will be communicated to the company's board of directors, including the frequency, content and means of reporting. A copy of the executed

agreement, along with evidence of board approval, shall be submitted to the Office of the Commissioner of Insurance within 60 days of the date of this report.

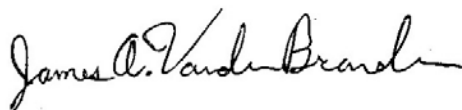
11. Page 21 - Investment Approval and Supervision—It is further recommended that the company provide the investment advisor with a copy of its adopted investment policy statement.

## VII. ACKNOWLEDGMENT

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

In addition to the undersigned, John A. Coyle of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "James A. Vanden Branden". The signature is written in a cursive style with a large, prominent initial "J".

James Vanden Branden  
Examiner-in-Charge