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Dept. of Commerce & Insurance
Company Examinations

# Report on Examination

of the

# McMinn County Farmers Mutual Insurance Company

Athens, TN

as of

December 31, 2011

Department of Commerce and Insurance

State of Tennessee

EXHIBIT

A

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STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
INSURANCE DIVISION
500 JAMES ROBERTSON PARKWAY - 7TH FLOOR
NASHVILLE, TENNESSEE 37243-1135

June 3, 2013

The Honorable Julie M. McPeak
Commissioner
Tennessee Department of Commerce and Insurance
500 James Robertson Parkway, 12th Floor
Nashville, Tennessee 37243

Commissioner McPeak:

Pursuant to your instructions and in accordance with Tennessee statutes and regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination has been made of the condition and affairs of

**McMinn County Farmers Mutual Insurance Company**
403 West Madison Avenue
Athens, Tennessee 37303

(Company) as of December 31, 2011, and a report thereon is hereby respectfully submitted.

## INTRODUCTION

This examination was called by the Tennessee Department of Commerce and Insurance (TDCI) on July 5, 2012. Examination work commenced on May 30, 2012, with the initial information request being sent to the Company. The Company was authorized to write business only in the state of Tennessee and therefore the examination was not classified as an Association Examination under NAIC Guidelines. The examination was conducted at the Company's office located at 403 West Madison Avenue, Athens, Tennessee 37303 and at the office of the TDCI. The examination was performed by duly authorized representatives of the TDCI.

## SCOPE OF EXAMINATION

This examination report covers the period from January 1, 2007, to the close of business on December 31, 2011, and includes any material transactions and events occurring during the course of the examination and subsequent events noted from January 1, 2012, to the date of this report.

This full scope financial examination was conducted in accordance with guidelines and procedures contained in the NAIC's *Financial Condition Examiners Handbook* (Handbook). During the course of examination, assets were verified and valued and liabilities were determined and estimated in accordance with Tennessee Code Annotated and the Compilation of Rules and Regulations of the State of Tennessee. The financial condition of the Company and its degree of solvency were thereby established. Test checks were made of income and disbursement items for selected periods and a general review was made of the Company's operations, practices, and compliance with applicable statutes and regulations. All asset and liability items contained in the financial statement of this report were examined and verified with relative emphasis according to their amount, inherent risks and potential impact on solvency. Also, limited market conduct procedures were performed.

In addition, the following topics were examined:

Status of Prior Examination Findings
Company History
Charter and Bylaws
Management and Control
Compensation Expense Ratio – Tenn. Comp. R. & Regs. 0780-1-78-.03
Pecuniary Interest - Tenn. Code Ann. § 56-3-103
Corporate Records
Statutory Deposit
Fidelity Bond and Other Insurance
Territory
Plan of Operation
Market Conduct Activities
Reinsurance
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Loss Experience
Dividends
Accounts and Records
Subsequent Events
Financial Statement

## STATUS OF PRIOR EXAMINATION FINDINGS

The previous examination of the Company was made as of December 31, 2006, by an examiner employed by the TDCI. The prior Report of Examination was dated June 2, 2008, and covered the period from January 1, 2002, through December 31, 2006. The Commissioner issued two (2) directives as set forth in the June 24, 2008 "Order Adopting Examination Report With Directives No. 08-117." A summary of each directive and the corrective actions taken by the Company is as follows:

Directive # 1 Agency Operations:
The Company was directed to comply with Tenn. Code Ann. § 56-22-109(a)(4) by excluding premiums collected on behalf of other insurance companies from annual statements filed with the Division as required under NAIC accounting procedures.

Corrective Action: The Company disclosed premiums collected and held on behalf of other insurance companies pursuant to Tenn. Code Ann. § 56-22-109(a)(4) on its Statement of Income in its 2007 through 2011 Annual Statements submitted to the TDCI. However, the Company did not disclose in its 2011 Annual Statement liability premium collected by the Company on behalf of Farmers Mutual of Tennessee. This issue is noted in the Analysis of Changes in Financial Statement and Comments Resulting from Examination and the Recommendations Section of this examination report.

Directive # 2 Premiums Receivable:
The Company was directed to comply with Tenn. Code Ann. § 56-22-109(a)(4) by reporting all uncollected premium balances over ninety (90) days past due as non-admitted assets on annual statements filed with the TDCI in accordance with NAIC accounting procedures.

Corrective Action: The Company disclosed in its 2007 through 2011 Annual Statements submitted to the TDCI that all uncollected premium receivable balances on page 2, line 8 over ninety (90) days past due were classified as non-admitted assets on page 2, line 18. This methodology complied with Tenn. Code Ann. § 56-22-109(a)(4) and the NAIC and Annual Statement Instructions for Tennessee County Mutual Insurance Companies issued by the TDCI.

## HISTORY OF THE COMPANY

The Company was incorporated on December 21, 1908, as an association with the Tennessee Secretary of State under the provisions of the Tennessee Business Corporation Act. The Company was organized as a county mutual fire insurance company (county mutual) pursuant to Tennessee Code Annotated Title 56, Chapter 22, for the purpose of insuring loss or damage to property due to fire or lightning to residents of McMinn County in the state of Tennessee. The Company's Charter was registered with the McMinn County, Tennessee Court Clerk on December 21, 1908. The Company commenced business in 1908.

The previous Certificate of Authority issued by the TDCI was dated April 12, 1993. The current Certificate of Authority issued by the TDCI was dated June 12, 2009, and authorized the transaction of the business of Fire; Lightning; Hail; Extended Coverage and Tornado in McMinn County and all those counties contiguous to McMinn County. The Certificate of Authority is valid until suspended or revoked.

Since 1995, Ms. Vicki Anderson Moore has been the Company's General Manager and has been the Company's General Agent since May 1, 1991.

The Company operates as a mutual company and, therefore, reports no authorized or issued common stock.

The Company's surplus position shown in the 2011 Annual Statement was as follows:

| | |
|---|---|
| Policyholders' surplus | $514,157 |

The following exhibit depicts certain aspects of the growth and financial history of the Company since the previous examination according to annual statements filed with the TDCI.

| Date | *Earned Premium | Net Incurred Losses | Admitted Assets | **Liabilities | Policyholders' Surplus | Net Income |
|---|---|---|---|---|---|---|
| 12/31/2007 | $178,407 | $16,441 | $589,054 | $6,329 | $582,725 | $79,882 |
| 12/31/2008 | 161,359 | 76,373 | 565,141 | 29,764 | 535,377 | (14,834) |
| 12/31/2009 | 175,896 | 75,092 | 584,148 | 42,201 | 541,947 | 9,513 |
| 12/31/2010 | 174,908 | 32,332 | 627,357 | 39,610 | 587,747 | 48,655 |
| 12/31/2011 | 189,372 | 163,658 | 550,720 | 36,564 | 514,157 | (85,288) |

* Earned premium is actually accounted for as net premiums by the Company. This issue is noted in the Recommendations Section of this Examination Report.

** The Company did not include an amount for unearned premium.

| Date | Gross In Force Business | Written or Renewed | Expirations or Cancels | ***Amount Reinsured | Net In Force Business | Policy Count |
|---|---|---|---|---|---|---|
| 12/31/2007 | $26,356,614 | $3,223,970 | $3,231,825 | $0 | $26,348,759 | 551 |
| 12/31/2008 | 26,356,614 | 2,567,272 | 3,225,600 | 0 | 25,698,286 | 517 |
| 12/31/2009 | 25,698,286 | 3,131,249 | 2,234,000 | 0 | 26,595,535 | 512 |
| 12/31/2010 | 26,595,535 | 3,314,652 | 3,190,899 | 0 | 26,719,288 | 498 |
| 12/31/2011 | 26,719,288 | 4,730,826 | 933,208 | 0 | 30,516,906 | 549 |

*** The Company had specific, aggregate excess of loss reinsurance and facultative reinsurance but reported this amount as zero dollars ($0) as shown in the above table.

## CHARTER AND BYLAWS

### Charter:

The Company's original Charter, dated December 21, 1908, was filed and recorded with the Tennessee Secretary of State on December 28, 1908. The original Charter indicated the Company's original name was "McMinn County Farmers Fire Insurance Company." The original Charter also disclosed a perpetual existence and established an association to insure its Members against loss by fire and lightning. Changes to statutes in Tennessee Law now allow the Company to offer additional extended coverage including wind, hail, and smoke insurance.

The Charter was amended as presented below:

| Effective Date of Amendment | Primary Purpose of Amendment |
| --- | --- |
| March 18, 1983 | To change the name of the Company from Farmers Mutual Fire Insurance Company, McMinn County to McMinn County Farmers Mutual Fire Insurance Company. |

An Amended and Restated Charter was submitted to the Company's Members and Board of Directors and was approved on January 27, 2007.

| Effective Date of Amendment | Primary Purpose of Amendment |
| --- | --- |
| January 27, 2007 | (1) To change the name of the Company from McMinn County Farmers Mutual Fire Insurance Company to McMinn County Farmers Mutual Insurance Company.<br><br>(2) To change the address of the principal office of the Company from 201 Washington Avenue to 403 West Madison Avenue, Athens, TN 37303 |

### ByLaws:

The Company's current Bylaws were assembled by the General Agent at the request of the President, Vice President, and Secretary – Treasurer and ratified by the Board of Directors (BOD) on January 23, 1993. Since January 23, 1993, the Company's Bylaws have been amended on six (6) different occasions by the Company's BOD.

The Bylaws were such as generally found in corporations of this type. The Bylaws may be amended by a majority of the Directors at any regular meeting.

## MANAGEMENT AND CONTROL

Members:

The Company is equally owned by its Members that consist of the policyholders with the Company. The Company has never issued any shares of capital stock or established guaranteed capital. The Company's Charter states the corporation was organized to engage in and carry on the business of a mutual insurance company pursuant to Chapter 22, Title 56, of the Tennessee Code Annotated.

The Bylaws state the following:

> The annual meeting of Members shall be held at the principal office of the Company at 10:00 AM, on the fourth Saturday of January, each year, for the purpose of electing Directors of the Company and for the purpose of transacting such other business as may be properly brought before the meeting.

Special meetings of the Members "may be held at the call of the President or on the written request of five Members."

The Bylaws provide that each Member is entitled to "one (1) vote only irrespective of the number of policies owned by such a Member. No policy shall be entitled to more than one (1) vote whether such policy is held individually, jointly or otherwise. No Members shall vote by proxy."

Five percent (5%) of the Members entitled to vote, represented in person or by ballot, shall constitute a quorum at meetings of Members.

The Company's Members held five (5) annual meetings and no special meetings during the examination period.

Board of Directors:

The Amended and Restated Charter requires the Board of Directors to consist of not less than six (6) or more than fifteen (15) Members and may include two (2) non-Members. The Company's Bylaws state, "The business and affairs of the Company shall be managed by the Board of Directors or by such executive or other committees as the Board may establish." Pursuant to the Company's Bylaws, Directors were elected at the annual meeting of the Members during the period of examination and all Directors were Members. Each Director elected shall hold office for three (3) years. A majority of Directors constitutes a quorum as defined by the Amended and Restated Charter.

The following persons were duly elected by the Members to serve on the Board of Directors as of December 31, 2011:

| Director | Home City and State | Principal Affiliation |
|---|---|---|
| John Middleton | P. O. Box 333,<br>Englewood, TN 37303 | Director and President of the Company. |

| | | |
|---|---|---|
| Jimmy Small | 714 Cartwright Street, Athens, Tennessee 37303 | Director and Vice President of the Company. |
| Horace P. Moore II | 265 County Road 267, Niota, Tennessee 37826 | Director and Secretary / Treasurer of the Company. |
| Edward Cate | 181 County Road 703, Russellville, Tennessee 37303 | Director of the Company. |
| Hazel Dake | 139 County Road 164, Athens, Tennessee 37303 | Director of the Company. |
| Alan Dyke | 805 County Road 750, Athens, Tennessee 37303 | Director of the Company. |
| John Gambill | 386 County Road 420, Athens, Tennessee 37303 | Director of the Company. |
| David Dilbeck | 101 Hilltop Drive, Niota, Tennessee 37826 | Director of the Company. |
| Nellie Kyker Sliger | 890 County Road 218, Niota, Tennessee 37826 | Director of the Company. |

For the period under examination, annual BOD meetings were held on the same day as the Members' meeting dates as required by the Company's Bylaws. The Bylaws do not permit the payment of a salary to the BOD, but by resolution of the BOD, a fixed sum plus expenses to attend meetings was authorized.

Executive Committee:

Article V Section 3 of the Bylaws established an Executive Committee authorized to conduct the business of the Company under the authority of and subject to the BOD. During the period of examination, this committee consisted of the Company's President, Vice President, and Secretary pursuant to the Bylaws.

Building Committee:

On October 23, 2004, the BOD appointed a Building Committee to explore the possibility of purchasing or renting another office building for use by the Company. Four (4) Directors were appointed to the Building Committee and the Vice President was selected as the Chairman. The minutes of the BOD during the period of examination mention the actions of the Building Committee.

Officers:

Article VI Section 1 of the Bylaws states, "The Board of Directors shall elect a President, Vice President, Secretary and Treasurer" after each annual meeting of the Members. All of the Officers were Members of the BOD as of December 31, 2011.

At December 31, 2011, the following persons were duly elected to and were serving in the positions indicated:

| | |
|---|---|
| President | John Middleton |
| Vice President | Jimmy Small |
| Secretary / Treasurer | Horace P. Moore II |

Investments:
Tenn. Code Ann. § 56-3-408(b)(1) states that, "No investment or loan, except premium finance loans, shall be made by any such insurance company, unless the investment or loan has first been authorized by the board of directors or by a committee appointed by the board and charged with the duty of supervising the investment or loan."

A review of the meeting minutes of the BOD during the period of examination revealed the Building Committee appointed by the BOD was given the power, on October 24, 2007, to proceed with the purchase of the Company's current home office building located at 403 West Madison Avenue, Athens, TN pursuant to Tenn. Code Ann. § 56-3-408(b)(1). The purchase transaction involving the Company's office building was consummated on October 31, 2007.

However, in February 2011 the Company acquired property located at 619 Georgia Avenue in Etowah, TN that was previously owned by a former policyholder in an effort to partially offset the cost of the claim. The 2011 and 2012 BOD Meeting Minutes did not mention this property acquisition. The Company's General Manager confirmed that prior approval by the Company's BOD was not given before the acquisition of this property. This was a violation of Tenn. Code Ann. § 56-3-408(b)(1). This issue is noted in the Recommendations section of this Examination Report.

These real estate investments were the only investments made by the Company that required approval by the Company's BOD or a committee appointed by the BOD during the period of examination.

Pecuniary Interest:
The Directors and Officers of the Company complied with the provisions of Tenn. Code Ann. § 56-3-103. The statute prohibits Officers and Directors from having a pecuniary interest in investment or disposition of Company funds.

Conflicts of Interest:
The Company's BOD, Officers, General Manager and Customer Service Representative, were not required by the Company to complete any type of "Conflicts of Interest Disclosure Form.

## HOLDING COMPANY SYSTEM

The Company is licensed as a "county mutual insurance company" owned by its Members who are the policyholders. It does not meet the definition of a holding company system defined by Tenn. Code Ann. § 56-11-201.[1]

## COMPENSATION EXPENSE RATIO TENN. COMP. R. & REGS. 0780-1-78-.03

Tenn. Code Ann. § 56-22-107 and Tenn. Comp R. & Regs. 0780-1-78-.03 establishes legal requirements regarding compensation for Directors and Officers as follows:

> (1) No county mutual insurance company's compensation expense ratio may exceed thirty percent (30%) for any given year.
>
> (2) Any county mutual insurance company whose compensation expense ratio exceeds thirty percent (30%) for any given year shall be considered to be operating in a hazardous financial condition.

| Year | Policy Count | *Gross Premium | Total Compensation Expense | Compensation** Expense Ratio |
|---|---|---|---|---|
| 2007 | 551 | $201,096 | $71,723 | 35.7% |
| 2008 | 517 | 181,290 | 77,894 | 43.0% |
| 2009 | 512 | 195,078 | 77,173 | 39.6% |
| 2010 | 498 | 200,135 | 76,940 | 38.4% |
| 2011 | 549 | 245,305 | 82,627 | 33.7% |

* The Company disclosed gross premium received not gross premium written.

** The Compensation Expense Ratio for the years 2007 through 2010 was calculated using amounts disclosed in the Company's Annual Statements. The 2011 Compensation Expense Ratio was determined using the examination adjusted 2011 totals in the Financial Statement section of this report.

The Company did not borrow any money during the period under examination.

## CORPORATE RECORDS

The minutes of the annual meetings of the Company's Members during the period of examination were provided to the Examiner. An annual meeting of Members was held in

[1] **Former part 2, §§ 56-11-201—56-11-215, was redesignated as part 1, §§ 56-11-101—56-11-115, by the code commission in 2008.**

January of each year. The Members' primary function was to elect the Board of Directors annually and pay their premiums.

The minutes provided a brief summary of the actions of the Company's BOD. Attachments and exhibits provided to the Board of Directors were maintained with the minutes. During the period of examination, there were eighteen (18) regular board meetings and five (5) annual meetings of Members. Minutes of the referenced meetings were reviewed and appeared to reflect the acts of the respective Board of Directors.

## STATUTORY DEPOSIT

County Mutual insurance companies are not required to make a statutory deposit in accordance with Tenn. Code Ann. § 56-2-112.

## FIDELITY BOND AND OTHER INSURANCE

The Company as of year-end 2011 maintained insurance coverage as follows:

Insurance Company Combined Professional Liability and Directors and Officers Liability

The Company's "Insurance Company Combined Professional Liability and Directors & Officers Liability Insurance" coverage was underwritten by NAMIC Insurance Company, Inc. of Indianapolis, Indiana. The fidelity bond policy had an occurrence/aggregate limit of one million dollars ($1,000,000) and a five thousand dollar ($5,000) retention. The minimum range recommended by the NAIC for a Company of this size was seventy-five thousand dollars ($75,000) to one hundred thousand dollars ($100,000). Therefore, the Company had fidelity coverage that exceeded the minimum fidelity coverage recommended by the NAIC.

NAMIC Insurance Company, Inc. was an approved foreign surplus lines carrier in the state of Tennessee as of the date of this examination.

Commercial General Liability and Business Owners Property Policy

The Company's combination Commercial General Liability and Business Owners Property coverage was underwritten by Westfield Insurance Company of Westfield Center, Ohio.

Westfield Insurance Company was a licensed property and casualty carrier in the state of Tennessee as of the date of this examination.

Insurance Agents' and Brokers' Liability Insurance Policy

The Company's Insurance Agents' and Brokers' Liability Insurance coverage was underwritten by NAMIC Insurance Company, Inc. of Indianapolis, Indiana. This policy had an occurrence/aggregate limit of one million dollars ($1,000,000) and a one thousand five hundred dollar ($1,500) retention.

## TERRITORY

As of December 31, 2011, and as of the date of this examination report, the Company was licensed to transact business in the state of Tennessee with approval to write coverage in McMinn County and those counties contiguous to McMinn County pursuant to Tenn. Code Ann. § 56-22-106(f)(1).

Premiums received by Tennessee County in 2011 were as follows:

| County | Premiums |
|---|---|
| Loudon | $1,150 |
| McMinn | 117,178 |
| Meigs | 17,672 |
| Monroe | 15,102 |
| Polk | 8,020 |
| Total | $213,121 |

## PLAN OF OPERATION

The Company provided insurance against loss by fire, hail, lightning and extended coverage on structures, farm equipment, and livestock in McMinn County and its contiguous counties as allowed by statute.

Policies were typically written for at least 80% of the replacement value of the property insured, subject to policy limits of thirty-five thousand dollars ($35,000) per specific loss. The Company was allowed to cover a single risk up to thirty-seven thousand, six hundred thirty-two dollars ($37,632) for the 2011 policy year in accordance with Tenn. Code Ann. § 56-22-106(c)(1). All policies that exceeded thirty-five thousand dollars ($35,000) were reinsured pursuant to Tenn. Code Ann. § 56-22-106(d). The largest single gross risk insured in 2011 was four hundred seventy–one thousand dollars ($471,000).

The Company only issued policies with three (3) year terms. Policyholders had the option to pay premiums annually, semi-annually, quarterly, or monthly. All premiums were due beginning in January. There was a two hundred fifty dollar ($250) deductible on all policies issued by the Company.

The Company provided its Members with coverage on dwelling homes (single & multi-family) (brick, frame & masonry), rental homes (single & multi-family) (brick, frame & masonry), modular homes, mobile homes (owner or tenant), personal property, farm buildings, livestock, farm personal property, farm machinery, churches and commercial property in case of loss due to fire, wind, hail, lightning, explosion, theft and vandalism.

The Company offers four (4) different types of liability policies through Farmers Mutual of Tennessee (Knoxville, TN) as follows: 1) Owner, Landlord & Tenant 2) Farm Comprehensive Personal Liability, and 3) Comprehensive Personal Liability 4) Church Liability.

The Company writes business through three (3) licensed in-house agents. The Company's Agents visually inspect and photograph each property prior to the issuance of a policy. The Company and its appointed agents complied with the Tenn. Code Ann. § 56-22-113 regarding agent licensing requirements.

The Company's agents determine the value of the property. A policy is bound after the Company president approves the policy issuance and the policyholder has completed and signed the application that is accompanied with the initial premium payment.

## MARKET CONDUCT ACTIVITIES

A market conduct review was made of the Company as of December 31, 2011, in conjunction with this examination. The following items were reviewed:

### Policy Forms and Underwriting Practices

The Company's Board of Directors approved a three percent (3%) increase in premium rates effective January 1, 2010. The Property & Casualty Rating Section of the TDCI approved all current premium rates on December 9, 2009, and approved all current policy forms and underwriting guidelines on December 7, 2006.

### Advertising

The Company's advertising during the period of examination consisted of a sign located on the Company's office building, calendars, county maps and pens distributed to the general public, local radio station advertisements and advertisements placed in the local phone book.

### Cancellation Policy

The following excerpts from the Company's most recently amended and re-stated Bylaws as of November 18, 2006, pertain to past due policy premium and policy cancellation procedures:

Article XII. – Section 1 Cancellation states, "The policyholder may cancel this policy by returning the policy to the Company or by giving the Company written notice and stating at what future date coverage should stop. The Company may cancel this policy by written notice to the policyholder at the address shown on the Declaration Page. During the first 60 days, a policy is in effect the Company can cancel for any reason. After the policy has been in effect 60 days or more, the Company will only cancel on the anniversary date. In cases of non-payment of premium, or the policy was obtained by fraud material misrepresentation or omission of fact or during the policy term there has been a material change or increase in hazard of the risk the Company may cancel the policy prior to the anniversary date. The Company sends a past due notice approximately 30 days after the premium due date and then 60 days after the premium due date (policy anniversary date). "If we cancel this policy for non-payment of premium we will give you notice at least ten (10) days for Mortgaged properties and five (5) days for Non-mortgaged properties before cancellation is effective."

The current Bylaws do not specifically state that the Company will cancel a policy for non-payment of premium. It only states that the Company may cancel a policy for non-payment of premium.

As of year-end 2011, there were policyholders with policies in-force that had past due premium balances that were over 90 days that had not been sent cancellation notices by the Company. Also, as of November 14, 2012, the Company had not sent any cancellation notices to policyholders during the 2012 calendar year.

According to the Company's General Manager, the Company considers financial hardship of the policyholder as an acceptable reason to refrain from canceling a policy as an effort is made to pay some of the premium on a regular basis. In addition, the Company will pay a claim on a policy with past due premium and then deduct the past due premium from the claim payment.

The Company adheres to the non-renewal provisions contained in Tenn. Code Ann. § 56-7-1901 and Tenn. Code Ann. § 56-7-1902 in accordance with Tenn. Code Ann. § 56-22-109(b)(2) that relate to the notice of intention to non-renew and the reason for non-renewal.

**Claims Review:**

A sample of paid claim files reviewed during the examination indicated claims were paid in accordance with policy provisions and settlements were made upon receipt of proper evidence of the Company's liability.

The Company had three (3) open claims at December 31, 2011, that were incurred in 2011 and reported in 2011. These three (3) open claims were all settled by February 10, 2012.

The Company had two (2) open claims at December 31, 2011, that were incurred in 2011 and reported in January 2012. These two (2) open claims were settled on February 10, 2012.

**Policyholder Complaints:**

Inquiries made to the various sections within the TDCI indicated no specific regulatory concerns with the Company during the period under examination. No unusual practices, transactions, or items warranting significant concern with regard to the Company were noted.

**Privacy of Non-Public Personal Information**

The Company's policy for the disclosure of privacy of non-public personal information was reviewed. The examiners noted no instances of non-compliance with Tenn. Comp. R. & Regs. 0780-1-72, "Privacy of Consumer Information Regulations."

## REINSURANCE

Effective January 1, 2007, thru year-end 2011, the Company ceded risk through an Excess of Loss Reinsurance Agreement with Farmers Mutual of Tennessee (FMT) headquartered in Knoxville, Tennessee, as follows:

Type: Exhibit A – Combination Per Risk and Aggregate Layer

Coverage: Part 1 – Property Risk Excess of Loss: covers each loss in excess of the Company's $35,000 maximum retention up to the Reinsurers $80,000 maximum per risk, each loss occurrence.

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 75% of the Company's gross net premium income or $120,600 and shall not exceed 100% of the lesser of 50% of the Company's gross premium income or $120,000.

Type: Exhibit B – Second Aggregate Layer

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 75% of the Company's gross net assessment and / or premium income or $120,000 plus the lesser of 50% of gross net assessment and / or premium income or $120,000 and shall not exceed 100% of the lesser of 125% of the Company's gross assessment and / or premium income or $300,000.

Type: Exhibit C – Third Aggregate Layer

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 250% of the Company's gross assessment and / or premium income or $400,000 and shall not exceed 100% of the lesser of 750% of the Company's gross assessment and / or premium income or $1,800,000.

The Company experienced losses in 2007 and 2011 that exceeded the thirty-five thousand dollar ($35,000) specific retention. During the period of examination, the Company's losses have not exceeded the amount necessary to trigger the First, Second or Third Aggregate Layer of reinsurance coverage. FMT is licensed as a "Domestic Property and Casualty Insurer" by the TDCI.

The "Excess of Loss Reinsurance Agreement" in effect as of December 31, 2011, was standard in form and contained acceptable clauses for insolvency, arbitration, and termination. The agreement effected proper transfer of risk in accordance with NAIC SSAP # 62 – Property and Casualty Reinsurance and did not create any commission equity.

In addition to the aforementioned coverage, the Company had also had a verbal Specific Risk Facultative Reinsurance Agreement with Farmers Mutual of Tennessee (FMT). Any Company policy insuring a property for more than one hundred fifteen thousand dollars ($115,000) was underwritten and reinsured by FMT on a facultative basis.

## LITIGATION, CONTINGENT LIABILITIES AND REGULATORY ACTION

Based upon data provided during the course of this examination, there were no matters at law in which the Company was involved during the period under review. Also, the examiners did not note any agreements or pending matters of a contingent nature that would materially affect its financial position or operating results as of December 31, 2011.

There was no regulatory action taken by TDCI against the Company during the period under review except for minor issues related to late payment of premium taxes or late filing of its Annual Statement.

## DIVIDENDS OR DISTRIBUTIONS

No dividends or distributions were paid during the period under examination.

## ACCOUNTS AND RECORDS

The Company accounted for its assets, liabilities, cash receipts, and disbursements using PeachTree Software during the five (5) year period of examination. However, the computer-generated statutory trial balances, detailed general ledgers, aged premium receivable reports, and cash receipts journals produced by the accounting software were inaccurate. The Company also used policy summary cards, paper policy files, and computerized spreadsheets to account for insurance in-force, policy premium, and claims. Most general ledger computer generated trial balance accounts provided to the examiner did not reconcile to the Annual Statements until they added hand written adjustments to computer generated reports. Spreadsheets were made in order to agree to the balance sheet and income statement items reported in the Annual Statements.

During the period of examination, a limited segregation of duties existed. The Company's General Manager prepared the Annual Statements, and accounted for all reinsurance activities, bank reconciliations, cash disbursements, policy information data, and tax return filings.

The General Manager also collected and recorded most of the premium income, assisted with claims adjusting duties, designed and negotiated reinsurance agreements and, as a licensed agent in TN, made recommendations to the President for the issuance of new policies or renewal of policies.

In light of the Company's accounting system deficiencies and limited segregation of duties, the Examiner performed tests and audit procedures that were considered necessary to verify the balance sheet and income statement item balances as of year-end 2011, including substantial verification of supporting documentation.

During the course of the examination, the Examiner became aware of premium, investment, reinsurance, real estate, and liability accounting deficiencies. Therefore, the Company's Annual Statements reflected inaccuracies in these areas of financial reporting. Variances from generally accepted insurance accounting practices as prescribed by the NAIC, Tennessee county mutual annual statement instructions, Tennessee Statutes and

Rules are noted below or otherwise commented upon in the section marked Analysis of Changes in Financial Statement and Comments Resulting From Examination, Comments and Recommendations.

The 2007, 2008, and 2009 Annual Statements originally submitted to the TDCI were each amended and resubmitted once due to errors and omissions.

**Audited Financial Statements**

The Company met the filing exemption allowed under Tenn. Comp. R. & Regs. 0780-1-65-.03 due to having less than 1,000 policyholders during each year under examination.

**Management Discussion and Analysis**

County Mutual Insurance Companies were not required to file a Management Discussion and Analysis Report with the TDCI pursuant to Tenn. Comp. R. & Regs. 0780-1-37-.04(1).

**Risk Based Capital Report**

The Company was exempt from filing a Risk Based Capital (RBC) Report pursuant to Tenn. Code Ann. § 56-46-110.

**Actuarial Opinion**

Tenn. Code Ann. § 56-1-501(d) required every property and casualty insurer doing business in Tennessee to file an opinion by a qualified actuary with their Annual Statement with the Commissioner on or before March 1. However, the Company met the exemption requirements set forth in the Actuarial Opinion Section of the NAIC Annual Statement Instructions for Property and Casualty Companies.

## SUBSEQUENT EVENTS

Charter Amendment

The Company's Board of Directors, on October 31, 2012, approved an amendment to point number 9 under the heading "The General Powers of Said Corporation," which states, "All dues or premiums shall be made annually upon all property insured according to its classification and according to the amount insured." Previously, the Company's Charter at point number 9 under the heading "The General Powers of Said Corporation" required that all dues or premiums should be paid on a pro-rata basis.

Bylaw and Underwriting Change

(1) Article XI, Section 5 of the Company's Bylaws in effect as of year-end 2011 did not allow the Company to issue coverage under the terms of a commercial insurance policy in excess of two hundred thousand dollars ($200,000). The Company's BOD during its 2012 Annual Meeting on January 28, 2012, unanimously approved the removal of the two hundred thousand dollar ($200,000) limitation from Article XI, Section 5. Currently, the Company's reinsurance contracts with Farmers Mutual of Tennessee determine the Company's commercial policy limits.

(2) Article II of the Company's Bylaws was amended by the Company's BOD on October 31, 2012, in order to define extended coverage. Currently Article II of the Company's Bylaws states, "The object of this Company shall be to mutually insure the property of its Members against loss of damage by fire, lightning, explosion, extended coverage (including wind & hail), tornadoes, theft, vandalism, malicious mischief."

Excess of Loss Reinsurance Agreement

Beginning effective January 1, 2012, the Company ceded risk through an Excess of Loss Reinsurance Agreement with FMT as follows:

Type: Exhibit A – Combination Per Risk and Aggregate Layer

Coverage: Part 1 – Property Risk Excess of Loss: covers each loss in excess of the Company's $35,000 maximum retention up to the Reinsurer's $80,000 maximum per risk, each loss occurrence.

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 75% of the Company's gross net premium income or $120,000 and shall not exceed 100% of the lesser of 50% of the Company's gross premium income or $120,000.

Type: Exhibit B – Second Aggregate Layer

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 75% of the Company's gross net assessment and / or premium income or $120,000 plus the lesser of 50% of gross net assessment and / or premium income or $120,000 and shall not exceed 100% of the lesser of 125% of the Company's gross assessment and / or premium income or $300,000.

Type: Exhibit C – Third Aggregate Layer

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 250% of the Company's gross assessment and / or premium income or $400,000 and shall not exceed 100% of the lesser of 750% of the Company's gross assessment and / or premium income or $1,800,000.

In addition to the aforementioned coverage, Exhibit A, Section 2, Part 1, of the Excess of Loss Reinsurance Agreement provided the Company facultative coverage for specific risks. The facultative attachment point was one hundred fifteen thousand dollars ($115,000) for each specific loss occurrence up to the reinsurer's one hundred thousand dollars ($100,000) maximum per risk.

## FINANCIAL STATEMENT

There follows a statement of assets, liabilities, surplus, and statement of income at December 31, 2011, as established by this examination:

## ASSETS

| | Current Year |
|---|---|
| Common Stock | $6,611 |
| Real Estate (Properties Occupied by the Company) | 177,218 |
| Real Estate (Investment Real Estate) | 6,886 |
| Cash, Cash Equivalents and Short-Term Investments | 462,638 |
| Investment Income Due and Accrued | 0 |
| Premium Receivables & Agents Balances (Including Installments Booked but Not Yet Due) | 69,208 |
| Reinsurance Recoverable on Paid Losses and Loss Adjustment Expenses | 0 |
| Furniture, Equipment and Supplies | 5,899 |
| Electronic Data Processing Equipment and Software | 8,255 |
| Gross Assets | $736,715 |
| DEDUCT ASSETS NOT ADMITTED | |
| Premium Receivables & Agents Balances Over 90 Days Past Due | (21,673) |
| Furniture, Equipment and Supplies | (5,899) |
| Electronic Data Processing Equipment and Software | (8,255) |
| Non-Admitted Assets Due to Investment Limitation (Excess Of Net Book Value of Real Estate Over 10% of Admitted Assets) | (119,798) |
| Aggregate Write-Ins For Other Assets Non-Admitted | (6,886) |
| Total Assets Non-Admitted | ($162,511) |
| Total Admitted Assets | $574,204 |

## LIABILITIES & POLICYHOLDERS' SURPLUS

| | Current Year |
|---|---|
| Gross Losses and Claims Reported, Unpaid | $5,337 |
| Gross Losses and Claims Incurred But Not Reported | 8,220 |
| Reinsurance Recoverable on Unpaid Losses and Claims | 0 |
| Total Unpaid Claims and Losses Net of Reinsurance | 13,557 |
| Loss Adjustment Expenses | 675 |
| Unearned Premiums | 121,825 |
| Advance Premiums | 30,201 |
| Ceded Reinsurance Premium Payable | 23,373 |
| Commissions Payable, Contingent Commissions and Other Similar Charges | 2,245 |
| Accounts Payable and Accrued Expense Payable | 2,290 |
| Taxes, Licenses and Fees (Excluding Federal Income Taxes) | 3,207 |
| Federal Income Taxes Payable | 2,101 |
| Amounts Withheld or Retained by Company for Account of Others | 3,878 |
| Total Liabilities | 203,352 |
| Policyholders' Surplus | 370,852 |
| Total Liabilities and Policyholders' Surplus | $574,204 |

## STATEMENT OF INCOME & POLICYHOLDERS' SURPLUS ACCOUNT

| | |
|---|---|
| UNDERWRITING INCOME | |
| Net Premiums and Assessments Earned | $211,611 |
| DEDUCTIONS: | |
| Net Losses Incurred | 180,001 |
| Loss Expenses Incurred Including Claims Adjustment Expenses | 3,375 |
| Other Underwriting Expenses Incurred: | |
| Commissions and Brokerage: | |
| Directors and Officers Compensation and Allowances | 0 |
| Agents Compensation and Allowances | 1,615 |
| Non-Employee Compensation and Allowances | 9,726 |
| Net Commissions and Brokerage | 11,341 |
| Salaries and Related Items | |
| Employees' Salaries | 40,383 |
| Directors' and Officers' Salaries | 26,457 |
| Payroll Taxes | 15,348 |
| Total Salaries and Related Items | 82,187 |
| Directors Fees | 440 |
| Advertising and Subscriptions | 14,094 |
| Boards, Bureaus and Association Dues | 2,177 |
| Insurance and Fidelity Bonds | 3,662 |
| Travel and Travel Items | 1,141 |
| Equipment | 470 |
| Cost or Depreciation of EDP Equipment or Software | 1,745 |
| Postage, Telephone and Telegraph | 2,796 |
| Taxes, Licenses and Fees: | |
| State and Local Insurance Taxes | 2,769 |
| Insurance Department Licenses and Fees | 215 |
| All Other (Excluding Federal Income Tax and Real Estate | 24 |
| Total Taxes, Licenses and Fees | 3.008 |
| Real Estate Expenses and Repairs | 9,505 |
| Real Estate Taxes | 1,394 |
| Aggregate Write-Ins for Underwriting Expenses | 133,774 |
| Total Underwriting Expenses Incurred | 267,734 |
| Total Underwriting Deductions | 451,110 |
| Net Underwriting Gain or (Loss) | (239,499) |
| INVESTMENT INCOME | |
| Net Investment Income Earned | 10,182 |
| Net Realized Capital Gains (Losses) | (10,000) |
| Net Investment Gain (Loss) | 182 |
| OTHER INCOME | |
| Finance and Service Charges Not Included In Premium | 0 |

| | |
|---|---|
| Aggregate Write-Ins For Miscellaneous Income | 151,904 |
| Total Other Income | 151,904 |
| Net Income Before Dividends To Policyholders, After Capital Gains Tax and Before All Other Federal and Foreign Income Taxes | (87,413) |
| Dividends To Policyholders | 0 |
| Net Income After Dividends To Policyholders, After Capital Gains Tax and Before All Other Federal and Foreign Income Taxes | (87,413) |
| Federal and Foreign Income Taxes Incurred | 1,200 |
| Net Income (Loss) | (88,613) |

CAPITAL AND SURPLUS ACCOUNT

| | |
|---|---|
| Surplus as Regards Policyholders, December 31 Prior Year | 587,747 |
| Net Income (Loss) | (88,613) |
| Change In Net Unrealized Capital Gains (Losses) | 1,136 |
| Change In Non-Admitted Assets From Prior Year | (17,848) |
| Cumulative Effect of Changes In Accounting Principles | 0 |
| Aggregate Write-Ins For Gains and Losses in Surplus (Examination Adjustment) | (111,570) |
| Surplus As Regards Policyholders as of December 31, 2011 | $370,852 |

## Analysis of Changes in Financial Statement and Comments Resulting From Examination

## Assets

**Common Stock** **$6,611**

The above balance is the same amount reflected by the Company on line 2.2 of the Assets Page in its 2011 Annual Statement.

The Company did not follow NAIC Statutory Accounting Practices and Procedures (SSAP # 30) or Annual Statement Instructions for Tennessee County Mutual insurance companies pertaining to the disclosure of unrealized losses incurred by the Company in its investment in Affinity Financial Corp. (Affinity). The Company's 2007 through 2009 Annual Statements do not reflect any unrealized losses on Column 9 on Schedule D – Part 2 – Section 2; on Column 5 on the Underwriting and Investment Exhibit – Part 1B, Capital Gains and (Losses) on Investments; or Line 19 on the Statement of Income and Policyholders' Surplus Account.

The Company determined the decline in fair value of their common stock investment in Affinity was permanent prior to the preparation of its 2010 Annual Statement. However, the Company did not follow NAIC SSAP # 30 or Annual Statement Instructions for Tennessee County Mutual insurance companies pertaining to the disclosure of a realized loss incurred in its investment in Affinity. The Company's 2010 and 2011 Annual Statements do not reflect a Realized Loss on Column 9 on Schedule D – Part 2 – Section 2; on Column 1 on the Underwriting and Investment Exhibit – Part 1B, Capital Gains and (Losses) on Investments; or Line 8 on the Statement of Income and Policyholders' Surplus Account.

Therefore, the Statement of Income & Policyholders' Surplus Account disclosed in this Examination Report reflects an entry described as Net Realized Capital Gains or (Losses) From Sale or Maturity of Assets showing the total realized loss of ten thousand dollars ($10,000) incurred by the Company pertaining to its original investment in NAMIC Bank, which was acquired by National City Bancorp and ultimately acquired by Affinity.

**Real Estate – Properties Occupied by the Company** **$177,218**

The above balance is ninety thousand, eight hundred fifty dollars ( $90,850) more than the eighty-six thousand, three hundred sixty-eight dollar ($86,368) amount shown by the Company on line 4.1 of the Assets Page in its 2011 Annual Statement. Based on the examination procedures performed, the Examiner made the following determinations:

(1) Documentation provided by the Company showed the total cost of building improvements made by the Company in 2007 through 2011 differed from the total costs of building improvements shown on the Company's 2007 through 2011 Annual Statements and the Company's Depreciation Schedule as of year-end 2010 and year-end 2011.

(2) The Company made errors calculating the depreciated book value of building improvements made in 2007 through 2011. Also, the Company's depreciation schedule did

not accurately reflect the estimated useful life of thirty (30) years for the 2009 and 2010 building improvements.

(3) As stated above the Company on Line 4.1 on Page 2, in its 2011 Annual Statement, disclosed a total value of eighty-six thousand, three hundred sixty-eight dollars ($86,368) for "Properties Occupied by the Company. "Also, the Company, on Line 4.2 on Page 2, in its 2011 Annual Statement disclosed a total value of eighty-six thousand, three hundred sixty-eight dollars ($86,368)_ for "Investment Real Estate." The Company as of year-end 2011 rented approximately 48% of the Company's office building to a religious group and the remaining 52% of the Company's office building was occupied and utilized by the Company's Directors, Officers, and employees.

Because more than 50% of the Company's office building was occupied and utilized by the Company's Directors, Officers and employees as of year-end 2011, the Company's office building should be considered "Property Occupied By Company."

Therefore, in accordance with NAIC SSAP – 40 (Real Estate Investments) and the 2011 Annual Statement Instructions for Tennessee County Mutual insurance companies, the Company's office located at 403 West Madison Avenue, Athens, TN 37303 is considered Property Occupied by Company for purposes of this Company's examination.

**Real Estate – Investment Real Estate ........ $6,886**

The above balance is seventy-nine thousand, four hundred eighty-two dollars ($79,482) less than the eighty-six thousand, three hundred sixty-eight dollar ($86,368) amount shown by the Company on line 4.2 of the Assets Page in its 2011 Annual Statement.

Documentation provided by the Company showed the Company, in February 2011, acquired real estate property located in Etowah, TN. However, the Company did not disclose this property on Schedule A – Part 1 (Page 9), Schedule A – Part 2 – Real Estate Acquired During Year (Page 10) or on Page 2 (Assets), Line 4.2 (Investment Real Estate) in its 2011 Annual Statement.

The Examiner determined the Book Value Less Encumbrances as of December 31, 2011, for the property acquired by the Company in 2011 was six thousand eight hundred eight-six dollars ($6,886).

For purposes of this examination as of December 31, 2011, and pursuant to NAIC SSAP # 40 – Real Estate Investments and 2011 Annual Statement Instructions for Tennessee County Mutual insurance companies, this real estate asset is classified as Investment Real Estate on the Assets Section of the Financial Statement disclosed in this Company's Examination Report.

However, this real property asset was non-admitted pursuant to Tenn. Code Ann. § 56-3-405(5)(A). See the explanation presented below under the heading Aggregate Write-Ins for Other Assets Non-Admitted.

**Non-Admitted Assets Due To Investment Limitation - Real Estate** **$119,798**

The above balance is two thousand, one hundred thirty- five dollars ($2,135) more than the amount shown by the Company on line 28 of the Assets Page in its 2011 Annual Statement.

The Company's investment in real estate is limited to 10% of admitted assets pursuant to Tenn. Code Ann. §56-3-405(1). Therefore, the excess is required to be reported as a non-admitted asset in Annual Statement filings with the Tennessee Department of Commerce and Insurance.

As a result of examination procedures performed, admitted assets, including real estate, were determined to be five hundred seventy-four thousand, two hundred four dollars ($574,204). The Examiner calculated the combined book value of properties occupied by the Company and the Company's investment real estate acquired in 2011 to be one hundred eighty-four thousand, one hundred four dollars ($184,104) as of December 31, 2011. However, the six thousand, eight hundred eighty-six dollar ($6,886) amount of Investment Real Estate determined as a result of this examination was completely non-admitted pursuant to Tenn. Code Ann. §56-3-405(5)(A). See the explanation presented below under the heading " Aggregate Write-Ins for Other Assets Non-Admitted."

Therefore, the Examiner non-admitted the one hundred nineteen thousand, seven hundred ninety-eight dollar ($119,798) excess of depreciated book value of Real Estate Properties Occupied by the Company over Admitted Assets pursuant to Tenn. Code Ann. §56-3-405(1). For purposes of this examination, the admitted, depreciated book value of Real Estate was calculated to be fifty-seven thousand, four hundred twenty dollars ($57,420).

**Premium Receivable and Agents Balance** **$69,208**

The above balance is twenty-eight thousand, six hundred twenty-two dollars ($28,622) more than the amount shown by the Company on line 8 of the Assets Page in its 2011 Annual Statement as explained below.

Based on the examination procedures performed the Examiner verified a total of forty-three thousand, ninety-four dollars ($43,094) for all past due premium receivables as of December 31, 2011.

The Examiner determined that the net aggregate total of premium receivables <u>over</u> 90 days past due that should be non-admitted, net of unearned premium, in accordance with NAIC Accounting Practices and Procedures - SSAP # 6 was nineteen thousand, three hundred fifty-nine dollars ($19,359).

The net admitted examination total for "Premium Receivables and Agents Balances" less than 90 days past due as of December 31, 2011, was eight thousand , two hundred forty dollars ($8,240).

Additionally, the Company did not account for installment premium receivable as an asset on the Assets Page (page 2, line 8) in their 2007 through 2011 Annual Statements.

Uncollected installment premium balances meet the definition of an asset pursuant to NAIC SSAP # 4 – Assets and Nonadmitted Assets.

The Examiner verified a total amount of twenty-six thousand, one hundred fifteen dollars ($26,115) for installment premium billed but not yet due as of December 31, 2011. The Examiner non-admitted a total of two thousand, three hundred fourteen dollars ($2,314) in premium billed but not yet due pursuant to NAIC Accounting Practices and Procedures - SSAP # 6 and determined that a total of twenty-three thousand, eight hundred one dollars ($23,801) in "premium billed but not yet due" amounts as of December 31, 2011, was admitted for purposes of this examination and added to the admitted total of past due premium receivable as determined by the Examiner.

The Examiner established a sixty-nine thousand, two hundred eight dollar ($69,208) total for past due premium receivable and billed but not yet due premium as of December 31, 2011. The Examiner found that past due premium receivable and billed but not yet due premium in the amount of twenty-one thousand, six hundred seventy-three dollars ($21,673) should be non-admitted in accordance with NAIC Accounting Practices and Procedures - SSAP # 6. Therefore, for purposes of this examination, the net admitted examination asset total for "Premium Receivables and Agents Balances" is forty-seven thousand, five hundred thirty-five dollars ($47,535).

**Premium Receivable and Agents Balance Over 90 Days Past Due ............ $21,673**

The above balance is twelve thousand, two hundred thirty-one dollars ($12,231) less than the amount shown by the Company on line 18 of the Assets Page in its 2011 Annual Statement.

See the explanation presented above under the heading Premium Receivable and Agents Balance.

**Reinsurance Recoverable on Paid Losses and L. A. E. $0**

The above balance is nineteen thousand, seven hundred eighteen dollars ($19,718) less than the nineteen thousand, seven hundred eighteen dollar ($19,718) amount reported by the Company on line 9 of the Assets Page in its 2011 Annual Statement. The Company was not eligible for an aggregate excess of loss reinsurance recovery from its reinsurer.

Based upon documentation provided by the Company, the total cost of all claims incurred in 2011 and paid in 2011 was one hundred sixty-nine thousand, three hundred sixty-nine dollars ($169,369), (including LAE of two thousand, nine hundred twenty-five dollars ($2,925)). The Company calculated this asset item using 75% of 2010 gross premium written instead of 75% of 2011 gross premium written pursuant to the terms of the Company's Excess of Loss Reinsurance Agreement in effect during 2011.

The Company's minimum retention for the first aggregate layer of reinsurance coverage was one hundred eighty-three thousand, nine hundred seventy-nine dollars ($183,979) as determined by this examination. Documentation provided by the Company revealed the total aggregate cost of all claims incurred in 2011 and paid in 2011 and 2012 was one hundred eighty-three thousand, three hundred seventy-six dollars ($183,376), (including

LAE of three thousand, three hundred seventy-five dollars ($3,375)), or five hundred three dollars ($503) less than the Company's minimum retention for the first aggregate layer of reinsurance coverage.

**Aggregate Write-Ins for Other Assets Non-Admitted** **$6,886**

The Examiner determined the book value, less encumbrances, as of December 31, 2011, for the real estate property located in Etowah, TN, acquired by the Company in 2011 was six thousand, eight hundred eighty-six dollars ($6,886) in accordance with NAIC SSAP # 40 – Real Estate Investments.

However, this real property asset was not improved and did not produce income for the Company and was non-admitted pursuant to Tenn. Code Ann. §56-3-405(5)(A).

## Liabilities

**Reinsurance Recoverable on Unpaid Losses and Claims** **$0**

The above balance is thirteen thousand, five hundred fifty-seven dollars ($13,557) less than the thirteen thousand, five hundred fifty-seven dollar ($13,557) amount reported by the Company on line 1.3 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement. The Company was not eligible for an aggregate excess of loss reinsurance recovery from its reinsurer.

Based upon documentation provided by the Company, the total amount of gross losses and claims reported and unpaid as of year-end 2011 and the total amount of gross losses and claims incurred but not reported as of year-end 2011 was thirteen thousand, five hundred fifty-seven dollars ($13,557) (not including LAE of four hundred fifty dollars ($450). The Company calculated this asset item using 75% of 2010 gross premium written instead of 75% of 2011 gross premium written pursuant to the terms of the Company's Excess of Loss Reinsurance Agreement in effect during 2011.

The Company's minimum retention for the first aggregate layer of reinsurance coverage was one hundred eighty-three thousand, nine hundred seventy–nine dollars ($183,979) as determined by this examination. Documentation provided by the Company revealed the total aggregate cost of all claims incurred in 2011 and paid in 2011 and 2012 was one hundred eighty-three thousand, three hundred seventy-six dollars ($183,376) (including LAE of three thousand, three hundred seventy-five dollars ($3,375)) or five hundred three dollars ($503) less than the Company's minimum retention for the first aggregate layer of reinsurance coverage.

**Unearned Premiums** **$121,825**

The above total is one hundred twenty-one thousand, eight hundred twenty-five dollars ($121,825) more than the zero dollar ($0) amount reflected by the Company on line 3 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

The Company during the period of examination did not account for Unearned Premium for each individual policy and did not post an amount for Unearned Premiums in its 2007 through 2011 Annual Statements pursuant to Annual Statement Instructions for a Tennessee County Mutual and NAIC SSAP # 53 – Property Casualty Contracts - Premiums.

Based on individual policy written premium data provided by the Company, the Examiner determined that the total amount of unearned premium as of December 31, 2011, was one hundred twenty-one thousand, eight hundred twenty-five dollars ($121,825).

**Advance Premiums** **$30,201**

The above total is five hundred twenty-two dollars ($522) more than the twenty-nine thousand, six hundred seventy-nine dollar ($29,679) amount reflected by the Company on line 4 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

Using the electronic copy of the 2011 "Cash Receipts Journal" provided by the Company, the Examiner determined the total of Advance Premiums as of December 31, 2011, was thirty thousand, two hundred one dollars ($30,201).

**Ceded Reinsurance Premiums Payable** **$23,373**

The above total is twenty-three thousand, three hundred seventy–three dollars ($23,373) more than the zero dollar ($0) amount reflected by the Company on line 5 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

The Company paid Farmers Mutual of Tennessee sixteen thousand, two hundred ninety-seven dollars ($16,297) and seven thousand seventy-six dollars ($7,076) on April 27, 2012, for the remainder of 2011 reinsurance premium owed in accordance with the terms of the Company's Excess of Loss Reinsurance Agreement and facultative reinsurance premium owed in accordance with the terms of the Company's verbal specific risk Facultative Reinsurance Agreement, respectively.

Therefore, the Company should have established a liability for unpaid excess of loss reinsurance premium and unpaid facultative reinsurance premium at year-end 2011 in the amount of twenty-three thousand, three hundred seventy-three dollars ($23,373) pursuant to NAIC SSAP # 62 – Property & Casualty Reinsurance, Section 43 – Ceded Reinsurance.

**Accounts Payable and Accrued Expenses Payable** **$2,290**

The above total is two thousand, two hundred ninety dollars ($2,290) more than the zero dollar ($0) amount reflected by the Company on line 7 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

The Company did not accrue a liability for Social Security, Medicare and Income Tax payments made in January and March 2012 that applied to December 2011 employee compensation payments. Also, the Company paid a local radio station and a local electric power distributor in January 2012 for services received in 2011, and the Company made two (2) credit card payments in January 2012 for purchases made in November and December 2011.

**Taxes Licenses and Fees (Excluding F. I. T.)** **$3,207**

The above total is two thousand, one hundred seventeen dollars ($2,117) more than the one thousand, ninety dollar ($1,090) amount reflected by the Company on line 8 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

When establishing this liability the Company did not include the payment of 2011 city and county taxes and Tennessee unemployment tax in 2012 prior to the filing of the Company's 2011 Annual Statement.

**Federal Income Taxes Payable and Interest Thereon** **$2,101**

The above total is two thousand, one hundred one dollars ($2,101) more than the zero dollar ($0) amount reflected by the Company on line 9 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

The Company filed Form 990T – Return of Organization Exempt From Income Tax for the 2011 tax year, and paid two thousand, one hundred one dollars ($2,101) on May 16, 2012. However, the Company did not establish a liability for "Federal Income Taxes Payable" in its 2011 Annual Statement.

**Amounts Withheld or Retained by Company for Account of Others** **$3,878**

The above total is one thousand, three dollars ($1,003) more than the two thousand, eight hundred seventy-five dollar ($2,875) amount reflected by the Company on line 10 of the Liabilities and Policyholders' Surplus Page in its 2011 Annual Statement.

The Company did not disclose in its 2011 Annual Statement liability premium held by the Company on behalf of Farmers Mutual of TN in the amount of one thousand, three dollars ($1,003).

## SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION" AS THEY AFFECT SURPLUS

| Item | Policyholders' Surplus | |
|---|---|---|
| | Increase | Decrease |
| Real Estate – Properties Occupied by the Company | $90,850 | |
| Real Estate – Investment Real Estate | | $79,482 |
| Non-Admitted Assets Due To Investment Limitation - Real Estate | | $2,135 |
| Premium Receivables and Agents Balances | $28,622 | |
| Premium Receivable and Agents Balance Over 90 Days Past Due | $12,231 | |
| Reinsurance Recoverable on Paid Losses and L. A. E. | | $19,718 |
| Aggregate Write-Ins for Other Assets Non-Admitted | | $6,886 |
| Reinsurance Recoverable on Unpaid Losses and Claims | | $13,557 |
| Unearned Premiums | | $121,825 |
| Advance Premiums | | $522 |
| Ceded Reinsurance Premiums Payable | | $23,373 |
| Accounts Payable and Accrued Expenses Payable | | $2,290 |
| Taxes Licenses and Fees (Excluding F. I. T.) | | $2,117 |
| Federal Income Taxes Payable and Interest Thereon | | $2,101 |
| Amounts Withheld or Retained by Company for Account of Others | | $1,003 |
| Totals | $131,703 | $275,009 |
| Net change in policyholders' surplus | | $143,306 |

## COMMENTS AND RECOMMENDATIONS

**Comments:**

The Examiner determined the Company was operating in Hazardous Financial Condition as defined under Tenn. Comp. R. & Regs. 0780-1-66-.03(1),(a), (h), and (k). The findings in this report indicate the Company misstated totals for premium accounts for the period under examination. The inability to account for multiple other transactions renders the 2011 Annual Statement to be materially misstated to the extent it requires refiling.

The TDCI should monitor the Company very closely by performing an examination of the 2012 Annual Statement followed by subsequent limited scope examinations until the Company is able to file accurate financial statements.

The Company reported three hundred seventeen thousand, one hundred seventy-seven dollars ($317,177) of surplus in the 2012 unaudited financial statements. This total supports the need for ongoing examination of the Company as the accounting errors and finding in this report would likely be found in 2012 and cause a further reduction to the 2012 reported surplus of three hundred seventeen thousand, one hundred seventy-seven dollars ($317,177) that is only one hundred seventeen thousand, one hundred seventy-seven dollars ($117,177) above the minimum surplus requirement of two hundred thousand dollars ($200,000).

The specific examination comments are as follows:

(1) The Company's total underwriting expenses, less premiums paid to other insurers, increased from ninety-two thousand, nine hundred seven dollars ($92,907) to one hundred fifty one thousand, four hundred fifteen dollars ($151,415) or 62.97% as disclosed in the 2006 and 2012 Annual Statements. Total reinsurance premiums ceded as shown in the Company's 2006 and 2012 Annual Statements increased from nineteen thousand, four hundred eighty dollars ($19,480) to sixty-eight thousand, five hundred dollars ($68,500) or 251.64%. 2012 reinsurance premium ceded was forty-two thousand, two hundred twenty-nine dollars ($42,229) more than 2011 reinsurance premium ceded due to significant 2011 storm losses. Also, the Company's facultative reinsurance premiums increased approximately 75% in 2013. Beginning in 2013 the Company's facultative reinsurance premiums increased to fourteen dollars ($14) per thousand and future facultative commission payments from the reinsurer would be based on the Company's retained coverage premiums.

Premium receipts increased from one hundred eighty-four thousand, forty-nine dollars ($184,049) to two hundred thirteen thousand, one hundred twenty-one dollars ($213,121) or 15.8% as disclosed in the Company's 2006 and 2011 Annual Statements. Also, as a percentage of premiums received, total underwriting expenses, less premiums paid to other insurers, increased from 50.80% to 66.49% as disclosed in the Company's 2006 Annual Statement and calculated by the Examiner for this examination report as of December 31, 2011.

The Company's total investment income received from cash and cash equivalents as shown in the 2007 and 2012 Annual Statements decreased from twenty-five thousand, two hundred thirty-nine dollars ($25,239) to two thousand, five hundred twenty-nine dollars ($2,529) or 89.98%.

Based on examination procedures performed, the Examiner determined policyholders' surplus was three hundred seventy thousand, eight hundred fifty-two dollars ($370,852) as of December 31, 2011. The Company reported policyholders' surplus was three hundred seventeen thousand, one hundred seventy-seven dollars ($317,177) in its 2012 Annual Statement or fifty-three thousand, six hundred seventy-five dollars ($53,675) less than the 2011 examination total.

If total reinsurance premiums ceded and total underwriting expenses, excluding premiums paid to other insurers, as a percentage of premiums continue to increase and investment income received from cash and cash equivalents remains low due to historically low interest rates, the Company's ability to maintain policyholders' surplus in excess of the two hundred thousand dollar ($200,000) minimum required surplus amount, pursuant to Tenn. Code Ann. § 56-22-105(c), in the future is unlikely.

(2) On October 14, 2011, the Company issued commercial insurance policy # 2858C with a total insured risk of four hundred seventy-one thousand dollars ($471,000). However, Article XI, Section 5 of the Company's Bylaws in effect as of year-end 2011 did not allow the Company to issue coverage under the terms of a commercial insurance policy in excess of two hundred thousand dollars ($200,000). Therefore, as of year-end 2011, the Company was in violation of Article XI, Section 5 of its Bylaws.

(3) As of year-end 2011, there were policyholders with policies in-force that had past due premium balances that were over 90 days that had not been sent cancellation notices by the Company. Also, as of November 14, 2012, the Company had not sent any cancellation notices to policyholders during the 2012 calendar year. Allowing policies to remain in-force with premium balances over 90 days past due increases the Company's risk of financial loss.

**Recommendations:**

**Approval of Investment Transactions**

The Company, in February 2011, acquired real estate property located in Etowah, TN, as part of a claim settlement. The 2011 and 2012 Board of Director Meeting Minutes did not mention this property acquisition and Executive Meeting Minutes were not provided to the Examiner. The Company's General Manager confirmed that prior approval by the Company's Board of Directors was not given before the acquisition of this property. This was a violation of Tenn. Code Ann. § 56-3-408(b)(1).

It is recommended that the Company's Board of Directors or a committee appointed by the Directors that is authorized to approve investment transactions approve all investment transactions prior to their execution pursuant to Tenn. Code Ann. § 56-3-408(b)(1).

**Common Stock Investment Transactions**

During the period of examination the Company did not follow NAIC SSAP # 30 – Investments in Common Stock or Annual Statement Instructions for Tennessee County Mutual insurance companies pertaining to the disclosure of realized or unrealized losses incurred by the Company in its common stock investment in Affinity Financial Corp.

It is recommended that the Company account for realized or unrealized gains or losses in its common stock investments in accordance with NAIC SSAP # 30 – Investments in Common Stock and Annual Statement Instructions for Tennessee County Mutual insurance companies. Tenn. Code Ann. § 56-22-109(a)(4) requires all county mutual insurance companies to prepare their annual statements according to the NAIC's *Accounting Practices and Procedures Manual* in effect for the period covered by the annual statement.

**Installment Premium Receivable**

During the period of examination, the Company did not account for installment premium receivable as an asset on the Assets Page (page 2, line 8) or as a non-admitted asset on page 2, line 18 in their 2007 through 2011 Annual Statements. Uncollected installment premium balances less than 90 days past due meet the definition of an asset pursuant to NAIC SSAP # 4 – Assets and Nonadmitted Assets. Installment premium balances over 90 days past due should be non-admitted as required by NAIC SSAP # 6 – Uncollected Premium Balances, Bills Receivable for Premiums and Amounts Due from Agents and Brokers.

It is recommended that the Company account for installment premium receivable in accordance with NAIC SSAP # 4, NAIC SSAP # 6 and Tenn. Code Ann. § 56-22-109(a)(4).

**Premium Accounting**

During the period of examination the Company did not maintain a detailed spreadsheet listing each policy written, the amount of insurance in-force, and the amount of premium written, earned or unearned, for each policy. The Company posted total "premium receipts" not gross written premium in Column 1 on the Underwriting and Investment Exhibit – Part 2A, Net Premiums Earned in its 2007 through 2011 Annual Statements. Also, the Company did not post an amount for Unearned Premiums in its 2007 through 2011 Annual Statements pursuant to Annual Statement Instructions for a Tennessee County Mutual and NAIC SSAP # 53 – Property Casualty Contracts - Premiums. This resulted in incorrect totals posted for "Net Premiums and Assessments Earned" on line 1, page 4.1 of the Statement of Income and Policyholders' Surplus Account and "Premiums Earned During Year" in Column 7 on the Underwriting and Investment Exhibit – Part 2A, Net Premiums Earned.

NAIC SSAP # 53 requires "written premiums ... shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired."

In the future it is recommended that the Company account for written, earned and unearned premium for each policy in accordance with NAIC SSAP # 53 in order to comply with annual statement instructions for Tennessee county mutual insurance companies and Tenn. Code Ann. § 56-22-109(a)(4). Also, it is recommended that the Company account for premium receivables over 90 days past due as non-admitted, net of unearned premium, in accordance with NAIC Accounting Practices and Procedures - SSAP # 6.

**Ceded Reinsurance Premium Accounting**

The Company, in April 2012, paid Farmers Mutual of Tennessee for the remainder of 2011 reinsurance premium owed in accordance with the terms of the Company's Excess of Loss Reinsurance Agreement and the Company's verbal specific risk Facultative Reinsurance Agreement, respectively.

The Company's 2011 Annual Statement did not reflect a liability for unpaid excess of loss reinsurance premium and unpaid facultative reinsurance premium. It is recommended that the Company account for ceded reinsurance premiums payable pursuant to NAIC SSAP # 62 – Property & Casualty Reinsurance, Section 43 – Ceded Reinsurance, the annual statement instructions for Tennessee county mutual insurance companies and Tenn. Code Ann. § 56-22-109(a)(4).

**Accounting for Accounts Payable**

The Company made payments in January and March 2012 for Social Security, Medicare, and Federal Income Taxes. Also, the Company, in January 2012, paid for goods or services acquired in 2011 from a local radio station, a local electric power distributor, and for credit card purchases. However, the Company did not record a liability for accounts payable in its 2011 Annual Statement as required by NAIC SSAP # 5R – Liabilities, Contingencies and Impairment of Assets, the annual statement instructions and Tenn. Code Ann. § 56-22-109(a)(4).

It is recommended that the Company account for accounts payable in future annual statement filings pursuant to NAIC SSAP # 5R, the annual statement instructions for Tennessee county mutual insurance companies and Tenn. Code Ann. § 56-22-109(a)(4).

**Accounting for Federal Income Taxes Payable**

The Company filed Form 990T – Return of Organization Exempt From Income Tax for the 2007 through 2011 tax years and paid taxes to the United States Department of the Treasury, Internal Revenue Service division. However, the Company did not establish a liability for "Federal Income Taxes Payable" in its 2007 through 2011 Annual Statements in accordance with NAIC SSAP # 10 and 10R – Income Taxes.

It is recommended that the Company account for federal income taxes payable in future annual statement filings pursuant to NAIC SSAP # 101 – Income Taxes, the annual statement instructions for Tennessee county mutual insurance companies and Tenn. Code Ann. § 56-22-109(a)(4). Beginning in 2012, NAIC SSAP # 101 replaces NAIC SSAP # 10R.

**Accounting for Amounts Withheld or Retained by Company for Account of Others**

The Company did not disclose in its 2011 Annual Statement liability premium held by the Company on behalf of Farmers Mutual of Tennessee as required by NAIC SSAP # 67 – Other Liabilities.

It is recommended that the Company account for premium held by the Company on behalf of other insurance companies in future annual statement filings pursuant to NAIC SSAP # 67, the annual statement instructions for Tennessee county mutual insurance companies and Tenn. Code Ann. § 56-22-109(a)(4).

**Information Requests**

During the course of examination, significant delays were experienced in receiving information from the Company. Also, instances existed in which the Company did not provide requested information related to individual policies in-force and premium receivable for specific policies. In general, the Company did not demonstrate the accounting knowledge necessary to file an accurate annual statement and must take actions to enhance the resources and knowledge to produce accurate statutory financial statements.

It is recommended that the Company comply with Tenn. Code Ann. § 56-1-411(b)(1) by providing free and convenient access to all books, records, securities, documents, and any and all papers relating to the property, assets, business, and affairs of the company.

**Expense Compensation Ratio**

The Company's Expense Compensation Ratio exceeded 30% for each year during the period of examination, based upon amounts disclosed in the Company's Annual Statements and amounts determined as a result of this examination. This was a violation of Tenn. Comp. R. & Regs. 0780-1-78-.03(2). This Rule states, "Any county mutual insurance company whose compensation expense ratio exceeds (30%) for any given year shall be considered to be operating in a hazardous financial condition."

It is recommended that the Company comply with Tenn. Comp. R. & Regs. 0780-1-78-.03.

**Statutory Accounting Procedures and Annual Statement Disclosure**

It is recommended the Company provide the TDCI with a plan to remediate their accounting processes and procedures in order to comply with Tenn. Code Ann. § 56-22-109(a)(4) and the NAIC *Accounting Practices and Procedures Manual*. The Company should re-file their 2012 Annual Statement in order to reflect the changes noted in this report.

**Going Concern Statement**

The Examiner believes the Company is unlikely to maintain the minimum capital and surplus required to continue business in the near future. Net premiums approximated an average of two hundred thousand dollars ($200,000) per year during the examination period, while surplus has declined to the point the Company must consider strategic alternatives or consider the increasing likelihood of stronger regulatory oversight.

Reported surplus declined from five hundred fourteen thousand, one hundred fifty-seven dollars ($514,157) in 2011 to three hundred seventeen thousand, one hundred seventy-seven dollars ($317,177) in the unaudited 2012 Annual Statement, representing a one-year decline of one hundred ninety-six thousand, nine hundred eighty dollars ($196,980).

However, the 2011 surplus reported by the Company was reduced from five hundred fourteen thousand, one hundred fifty-seven dollars ($514,157) to one hundred forty-three thousand, three hundred six dollars ($143,306) as a result of this examination report. The likelihood that the 2012 reported surplus is overstated is high given the unresolved errors and comments noted in this report.

The combination of declining surplus, possible material operating losses in the future, accounting deficiencies and nominal operating leverage to generate significant profits greatly diminishes the Company's ability to continue as a going concern. Therefore, the Board of Directors and the Tennessee Department of Commerce and Insurance should consider strategic alternatives to protect the policyholders.

## CONCLUSION

Insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of McMinn County Farmers Mutual Insurance Company of Athens, Tennessee.

In such manner, it was determined that, as of December 31, 2011, the Company had admitted assets of five hundred seventy-four thousand, two hundred four dollars ($574,204) and liabilities, exclusive of unassigned funds, of two hundred three thousand, three hundred fifty-two dollars ($203,352). Thus, there existed for the additional protection of the policyholders unassigned funds (surplus) of three hundred seventy thousand, eight hundred fifty-two dollars ($370,852).

The courteous cooperation of the President, Secretary / Treasurer, General Manager and employees of the Company extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner
State of Tennessee
Southeastern Zone, NAIC

## Examination Affidavit

The undersigned deposes and says that he has duly executed the attached examination report of the McMinn County Farmers Mutual Insurance Company, dated June 3, 2013, and made as of December 31, 2011, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information, and belief.

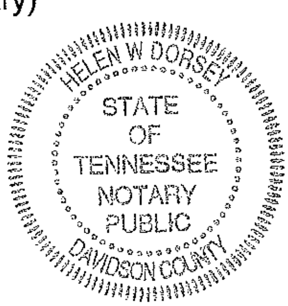
James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner
State of Tennessee
Southeastern Zone, NAIC

County Davidson
State Tennessee

Subscribed and sworn to before me
this 3rd day of
June, 2013

Helen W. Dorsey
(Notary)




03/03/2014

McMinn County Farmers Mutual
P.O. Box 321
403 W Madison Ave.
Athens, TN 37371-0321
423-745-4341 phone
423-745-9955 fax

June 13, 2013

Mr. James E. York, Jr., CFE ,AES
Insurance Examinations Director
State of Tennessee
Department of Commerce and Insurance
500 James Robertson Parkway, 7th floor
Nashville, TN 37243

Dear Mr. York,

We do not not wish to rebut this report on Financial Condition Examination report of McMinn County Farmers Mutual Insurance Company.

comment to Pg. 34

**Going Concern Statement**

The Examiner believes the Company is unlikely to maintain the minimum capital and surplus required to continue business in the near future. Net premums approximated an average of two hunred thousand dollars($200,000) per year during the examination period, while surplus has declined to the point the company must consider strategic alternatives or consider the increasing likelihood of stronger regulatory oversight.

The board of Directors met Thursday to discuss the financial affairs of the company, the Directors discussed ways to solve the many problems listed in this report. A written strategic plan was developed and voted on by the Board of Directors for submission .

Horace P. Moore II

Horace P Moore II
Secretary/Treasurer

EXHIBIT
B