Report

of the

Examination of

Districts Mutual Insurance

Madison, Wisconsin

As of December 31, 2011

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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February 27, 2013

Honorable Theodore K. Nickel
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

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

DISTRICTS MUTUAL INSURANCE
Madison, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Districts Mutual Insurance (DMI or the company) was conducted in 2008 as of December 31, 2007. The current examination covered the intervening period ending December 31, 2011, and included a review of such 2012 transactions as deemed necessary to complete the examination.

The examination was conducted using a risk-focused approach in accordance with the NAIC <u>Financial Condition Examiners Handbook</u>, which sets forth guidance for planning and performing an examination to evaluate the financial condition and identify prospective risks of an insurer. This approach includes the obtaining of information about the company including corporate governance, the identification and assessment of inherent risks within the company, and the evaluation of system controls and procedures used by the company to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation and management’s compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Territory and Plan of Operations
Growth of Company
Reinsurance
Financial Statements
Accounts and Records

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is 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.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 2004 under ch. 611, Wis. Stat., as an assessable municipal mutual insurance company, and commenced business on June 29, 2004. The company is only authorized to write business in Wisconsin.

The company provides insurance products for the 16 technical college districts in Wisconsin. Prior to the company's existence, most of the policyholders purchased insurance coverage through a group insurance program.

The company's products include coverage that appear on the following annual statement lines of business: worker's compensation, other liability – occurrence, inland marine, fire, commercial auto liability, allied lines, auto physical damage, and others. The company's policies are written effective July 1 to June 30 of the following year. Additionally, the policies are issued directly to the policyholder, which eliminates agents' commission expenses.

The company provides other valuable risk and loss control services without additional charges or fees. Some examples of these services include a monthly electronic newsletter, claims investigation kits, a contracted materials safety data sheet database, contracted TEGG electrical inspections, a contracted crisis management and disaster response call center, periodic campus visits and claims reviews, training literature, and hosting quarterly meetings for the members' risk managers to facilitate communication among members. These services were not available from the insurance carriers under previous group insurance program and were a key reason for DMI's formation.

DMI's original equity came from contributions from the member districts. The start-up business plan proposed that the technical college districts would continue to be charged the same dollar amounts that were paid to the former insurance carrier. A portion of those overall charges would be allocated to policy premiums and the excess would be treated as a contribution to surplus.

However, in aggregate more dollars were allocated to member premiums than expected, resulting in fewer dollars being allocated to start-up surplus. This was due to changes in the administered worker's compensation insurance rates, changes in the worker's compensation premium modification (claim experience), member payrolls being higher than expected and other factors. For some members, the higher premiums exceeded the total they had paid in the prior year, so their initial contribution to surplus was negative; other members contributed more surplus than expected because their premiums turned out to be lower than expected. In order to obtain an equitable position for each member with respect to their capital contributions, the board of DMI revised the company's business plan in 2007. According to the new plan, which was approved by this office in 2007, the third policy year capital contributions from the members were based on each member premium volume as a percentage of the total DMI premium. As a result of this revision, some members were required to pay additional contributions and some members received a portion of their contributions back.

Member premiums vary because the size of each member's exposure varies. To put the DMI premium into perspective of the technical colleges' budgets, the 2011-12 premium ranges from $138,460 to almost $1.1 million per member. Annual budgets range from $21 million to $183 million, resulting in insurance expense ranging from 0.4% to 0.8% of budgets per member.

Currently, individual member share of capital contributions range from $69,000 to $740,000. The ratio of direct premiums written to contributed surplus between members varies substantially. As a whole the company's ratio of direct premiums to surplus was 1.32 (based upon 2011-12 premium and year-end 2011 capital); however, for individual members this ratio ranged from 0.85 to 2.73. In its evaluation of allocation of capital contributions among individual members, the DMI board has considered all of the information above and accepted the current relationship between equity and premiums and determined that the membership is satisfied with the current range of direct premiums written to capital ratios.

The following table is a summary of the net insurance premiums written by the company in 2011. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$ 338,535	$0	$ 228,634	$ 109,901
Allied lines	261,594		176,671	84,923
Inland marine	400,083		270,201	129,882
Worker's compensation	3,434,917		683,518	2,751,399
Other liability – occurrence	801,420		220,735	580,685
Commercial auto liability	386,534		106,463	280,071
Auto physical damage	205,525			205,525
Burglary and theft	15,387		10,392	4,995
Boiler and machinery	61,986	0	63,626	(1,640)
Total All Lines	$5,905,981	$0	$1,760,240	$4,145,741

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of five members. One or two directors are elected annually, depending on the year, to serve a three-year term and can serve a maximum of two consecutive terms. Officers are elected at the board's annual meeting. The board members do not receive compensation for serving on the board, but reasonable out-of-pocket expenses incurred by the directors for attending meetings are reimbursed by the company.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Jane Kittel* Wausau, WI	Chief Financial Officer, Northcentral Technical College	2013
Barbara Keiffer Appleton, WI	Director, Compensation and Benefits – Fox Valley Technical College	2015
Thomas Eckert Janesville, WI	President, Blackhawk Technical College	2015
James Rehagen Pewaukee, WI	Manager of Executive Operations, Waukesha County Technical College	2013
James Blumreich Green Bay, WI	Chief Financial Officer, Northeast Wisconsin Technical College	2014

* Jane Kittel was appointed Chief Financial Officer effective January 2012 to replace Mark Zlevor who resigned at the end of 2011.

Officers of the Company

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

Name	Office	2011 Compensation
James Blumreich*	President	$ 0
James Rehagen**	Secretary and Treasurer	0
Steven Stoeger-Moore	Executive Vice President	137,900

* James Blumreich was appointed President in 2012 replacing Barb Keiffer.
** James Rehagen was appointed Treasurer following Mark Zelvor's resignation at the end of 2011.

Committees of the Board

The company's bylaws allow for the formation of ad hoc committees by the board of directors which consist of at least three directors. There were no ad hoc committees at the time of the examination.

IV. REINSURANCE

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

Nonaffiliated Ceding Contracts

1.	Type:	Excess of Loss
	Reinsurer:	General Reinsurance Corporation
	Scope:	General liability, auto liability, and educator's legal liability
	Retention:	$25,000 for school violent acts each incident per member
		$350,000 each occurrence for all other losses
	Coverage:	$225,000 excess of the company's retention for school violent acts each incident and per member with an aggregate limit of $250,000
		$5,650,000 excess of the company's retention each occurrence for auto liability on a 25-passenger bus at one of the schools
		$4,650,000 excess of the company's retention each occurrence for all other losses
		Additional $1,000,000 excess $6,000,000 each occurrence for auto liability on a 25-passenger bus at one of the schools
	Premium:	For automotive liability, a rate of $132.80 per power unit (estimated at 746 power units for the current term), subject to an annual deposit of $99,069 which shall be payable in quarterly installments
		For general liability and educator's legal liability, an annual reinsurance premium determined by applying a rate of $2.592 per student (estimated at 82,365 for the current term), subject to an annual deposit of $213,490 which shall be payable in four quarterly installments
		A flat annual reinsurance premium of $1,500 for the additional $1,000,000 excess $5,000,000 layer for the 25-passenger bus at one of the schools
		For school violent acts policy, an annual reinsurance premium determined by applying a rate of $.20 per student (estimated at 74,542 students for the current term), subject to an annual deposit of $14,908 which shall be payable in four quarterly installment
	Effective date:	July 1, 2012

	Termination:	July 1, 2013
2.	Type:	Excess of Loss
	Reinsurer:	United Wisconsin Insurance Company
	Scope:	Worker's compensation not including industrial aid aircraft
	Retention:	$350,000 each occurrence
	Coverage:	$1,150,000 each occurrence
	Premium:	$0.29/$1,000 of total payroll; estimated premium of $206,257 payable in four quarterly installments
	Effective date:	July 1, 2012
	Termination:	July 1, 2013
3.	Type:	Excess of Loss
	Reinsurer:	Safety National Casualty Corporation
	Scope:	Worker's compensation, including coverage for aviation occupational accident non-concurrent to indemnify the company for losses paid for business classified as statutory worker's compensation
	Retention:	$1,500,000 each accident $1,500,000 each employee for disease $3,250,000 each accident for aircraft
	Coverage:	100% of statutory excess of $1,150,000 underlying coverage excess of the $350,000 each accident 100% of statutory excess of $1,150,000 underlying coverage excess of the $350,000 each employee for disease 100% of statutory excess of $3,000,000 underlying coverage excess of the $250,000 each accident for aircraft
	Premium:	$506,337 deposit premium adjustable at $0.0716 rate per $100 of annual remuneration subject to a minimum reinsurance premium of $506,337
	Effective date:	July 1, 2012
	Termination:	July 1, 2013
4.	Type:	Casualty Facultative
	Reinsurer:	Lloyd's of London Syndicate #2003 on behalf of Catlin Underwriting, Inc.

	Scope:	Aviation occupational accident non-concurrent to indemnify the company for losses paid for business classified as statutory worker's compensation
	Retention:	$250,000 each occurrence and statutory excess of $3,250,000 each occurrence
	Coverage:	$3,000,000 excess of the company's retention each occurrence Maximum any one life: $1,000,000 to the layer
	Premium:	$23,400 flat net premium annual for Fox Valley Technical College $11,340 flat net premium annual for Gateway Technical College
	Effective date:	July 1, 2012
	Termination:	July 1, 2013
5.	Type:	Quota Share
	Reinsurer:	Hartford Steam Boiler Inspection Company
	Scope:	Equipment breakdown
	Retention:	None
	Coverage:	100%
	Premium:	$64,309 - $.002 per $100 of total insurable values for each policy covered hereunder (except for referral risks)
	Effective date:	July 1, 2012
	Termination:	The agreement may be terminated by either party giving the other six months prior notice in writing. The reinsurer shall continue to cover all losses on policies in force at the effective date of expiration on a "runoff" basis until natural expiry of the policies.

Beginning in 2008, the company changed its coverage for commercial property from a reinsurance contract to an excess insurance policy (outlined below). Further discussion of this contract is included in the section of this report captioned "Summary of Current Examination Results."

6.	Type:	Excess of Loss
	Reinsurer:	The Travelers Indemnity Company
	Scope:	Property
	Retention:	The first $250,000 of ultimate net loss any one occurrence.

Coverage:	100% of $350,000,000 any one occurrence in excess of the company's retention
Premium:	$805,000
Effective date:	July 1, 2012
Termination:	July 1, 2013

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2011, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Districts Mutual Insurance
Assets
As of December 31, 2011

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$13,860,441	$	$13,860,441
Stocks:			
Common stocks	1,449,150		1,449,150
Cash, cash equivalents, and short-term investments	3,711,421		3,711,421
Investment income due and accrued	145,406		145,406
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	31,116		31,116
Reinsurance:			
Amounts recoverable from reinsurers	233,617		233,617
Write-ins for other than invested assets:			
Prepaid expense	7,888	7,888	
Miscellaneous receivable	1,911		1,911
Total Assets	$19,440,949	$7,888	$19,433,061

Liabilities, Surplus, and Other Funds
As of December 31, 2011

Losses	$ 4,676,131
Loss adjustment expenses	1,367,756
Other expenses (excluding taxes, licenses, and fees)	201,144
Unearned premiums	2,151,751
Ceded reinsurance premiums payable (net of ceding commissions)	826,338
Total liabilities	9,223,120
Surplus as regards policyholders	10,209,941
Total Liabilities and Surplus	$19,433,061

Districts Mutual Insurance
Summary of Operations
For the Year 2011

Underwriting Income		
Premiums earned		$4,231,026
Deductions:		
Losses incurred	$2,002,328	
Loss adjustment expenses incurred	981,589	
Other underwriting expenses incurred	938,171	
Total underwriting deductions		3,922,088
Net underwriting gain (loss)		308,938
Investment Income		
Net investment income earned	473,308	
Net realized capital gains (losses)	(10,491)	
Net investment gain (loss)		462,817
Net Income		$ 771,755

Districts Mutual Insurance
Cash Flow
For the Year 2011

Premiums collected net of reinsurance			$4,756,606
Net investment income			543,986
Total			5,300,592
Benefit- and loss-related payments		$1,526,123	
Commissions, expenses paid, and aggregate write-ins for deductions		1,582,649	
Total			3,108,772
Net cash from operations			2,191,820
Proceeds from investments sold, matured, or repaid:			
Bonds	$2,167,734		
Total investment proceeds		2,167,734	
Cost of investments acquired (long-term only):			
Bonds	2,392,214		
Stocks	1,399,834		
Total investments acquired		3,792,048	
Net cash from investments			(1,624,314)
Cash from financing and miscellaneous sources:			
Other cash provided (applied)		7,444	
Net cash from financing and miscellaneous sources			7,444
Reconciliation:			
Net change in cash, cash equivalents, and short-term investments			574,950
Cash, cash equivalents, and short-term investments:			
Beginning of year			3,136,471
End of Year			$3,711,421

Districts Mutual Insurance
Compulsory and Security Surplus Calculation
December 31, 2011

Assets		$19,433,061
Less liabilities		9,223,120
Adjusted surplus		10,209,941
Annual premium:		
Lines other than accident and health	$4,145,741	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		829,148
Compulsory Surplus Excess (or Deficit)		$ 9,380,793
Adjusted surplus (from above)		$10,209,941
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		1,160,807
Security Surplus Excess (or Deficit)		$ 9,049,134

Districts Mutual Insurance
Analysis of Surplus
For the Five-Year Period Ending December 31, 2011

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

	2011	2010	2009	2008	2007
Surplus, beginning of year	$ 9,396,758	$8,092,537	$7,005,697	$6,135,115	$5,207,525
Net income	771,755	1,304,221	1,171,865	955,608	674,508
Change in net unrealized capital gains/losses	49,316				
Change in non-admitted assets	(7,888)				1,276
Surplus adjustments:					
Paid in			(85,026)	(85,026)	251,806
Surplus, End of Year	$10,209,941	$9,396,758	$8,092,537	$7,005,697	$6,135,115

Districts Mutual Insurance
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2011

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	2011	2010	2009	2008	2007
#1	Gross Premium to Surplus	58%	66%	75%	74%	77%
#2	Net Premium to Surplus	41	47	54	51	49
#3	Change in Net Premiums Written	-6	0	23	19	-1
#4	Surplus Aid to Surplus	0	0	0	0	0
#5	Two-Year Overall Operating Ratio	75	69	71	72	76
#6	Investment Yield	2.7*	2.7*	2.0*	3.9	5.1
#7	Gross Change in Surplus	9	16	16	14	18
#8	Change in Adjusted Surplus	9	16	17	16	13
#9	Liabilities to Liquid Assets	48	45	48	46	47
#10	Agents' Balances to Surplus	0	1	0	0	-1
#11	One-Year Reserve Development to Surplus	-11	-13	-10	-15	-16
#12	Two-Year Reserve Development to Surplus	-20	-14	-12	-21	-49
#13	Estimated Current Reserve Deficiency to Surplus	-26	-15	-1	-20	-34

The exceptional results for Ratio No. 6, "Investment Yield," from 2009 to 2011 can be attributed to the low interest rate environment of recent years and the company's very conservative investment strategies.

Growth of Districts Mutual Insurance

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2011	$19,433,061	$9,223,120	$10,209,941	$ 771,755
2010	17,107,430	7,710,672	9,396,758	1,304,221
2009	15,474,052	7,381,515	8,092,537	1,171,865
2008	13,127,229	6,121,532	7,005,697	955,608
2007	11,578,049	5,442,934	6,135,115	674,508

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2011	$5,905,981	$4,145,741	$4,231,026	70.5%	22.6%	93.1%
2010	6,170,794	4,413,616	4,303,617	61.2	18.3	79.5
2009	6,107,506	4,403,769	4,117,218	59.7	17.7	77.4
2008	5,211,323	3,566,033	3,247,518	63.9	19.5	83.4
2007	4,693,068	3,000,028	2,938,294	72.2	22.9	95.1

The company's invested assets consist of cash, certificates of deposit, U.S. government securities, common stock mutual funds, and municipal and corporate bonds. Total admitted assets increased 68% from $11.6 million in 2007 to $19.4 million in 2011. Liabilities increased 87% from $5.4 million in 2007 to $9.2 million in 2011, and surplus increased 66% to $10.2 million during the same period. The company was originally capitalized with $1.3 million and received an additional $3.2 million of paid in surplus from its members from 2005 to 2009. The company reported net income in each year during the period under examination reflecting positive underwriting results.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2011, is accepted.

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were five specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Service Providers—It is recommend that the company amend the agreements with claims adjusting service providers in order to clearly establish the handling of the company's claim files upon the termination of the agreement.

   Action—Compliance.

2. Service Providers—It is recommended that the company obtain a SAS 70 report for each service provider for which one is available

   Action—Compliance.

3. Disaster Recovery—It is recommended that the company create a disaster recovery plan which would include, among other contingencies, the loss of a key employee or the loss of a key contractor.

   Action—Compliance.

4. Custody of Assets—It is recommended that the company implement controls to monitor compliance with s. 610.23, Wis. Stat.

   Action—Compliance.

5. Loss Reserves—However, it is recommended that the company develop procedures to ensure that all reported losses are reserved for at year end as required per SSAP 55.

   Action—Compliance.

Summary of Current Examination Results

Reinsurance Contracts

Beginning in 2008, the company changed its coverage for commercial property from a reinsurance contract to an excess insurance policy. This policy provides property coverage of $350 million in excess of the company's deductible of $250,000. District Mutual Insurance is the named insured on the policy. The detailed description of this policy is included in the section of this report captioned "Reinsurance." Beginning in 2008, DMI reported this policy as reinsurance ceded on its annual statements. According to Statutory Accounting Principle (SSAP) No. 62R, paragraph 8 of the NAIC Accounting Practices and Procedures Manual, no credit or deductions from liabilities shall be allowed by the ceding entity for reinsurance recoverable unless the agreement satisfies certain conditions, including the requirement that the agreement contain an acceptable insolvency clause. The policy does not contain any of the required provisions and any balance resulting from the application of this policy should not be reported as reinsurance. The examination concluded that no material misstatement of surplus resulted from reporting balances under this contact as reinsurance. It is recommended that the company not report the excess insurance policy as reinsurance as long as the contact does not satisfy the requirements for reinsurance contracts contained in SSAP No. 62R.

VII. CONCLUSION

The company was formed in 2004 as a municipal mutual insurance company serving the 16 technical college districts in Wisconsin. In addition to providing similar coverage to that previously provided through an insurance purchasing trust, the company focuses on providing additional risk and loss control services to increase the value for the policyholders.

The company was capitalized with $1.3 million and received an additional $3.2 million of paid in surplus from 2005 to 2009. The company recorded a large growth in surplus due to the favorable underwriting and net results during the examination period. Surplus increased 66% during the period under examination.

The current examination resulted in one recommendation and did not make any reclassification of account balances or adjustments to surplus as reported by the company in its year-end 2011 statutory financial statements. The examination determined that, as of December 31, 2011, the company had admitted assets of $19,433,061, liabilities of $9,223,120, and policyholders' surplus of $10,209,941.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Reinsurance Contracts—It is recommended that the company not report the excess insurance policy as reinsurance as long as the contact does not satisfy the requirements for reinsurance contracts contained in SSAP No. 62R.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Gene Renard	Insurance Financial Examiner
Thomas Houston	IT Specialist
Jerry DeArmond	Reserve Specialist

Respectfully submitted,

Satinderjit Basra
Examiner-in-Charge