Report

of the

Examination of

Homestead Mutual Insurance Company

Larsen, Wisconsin

As of December 31, 2013

TABLE OF CONTENTS

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, *Governor*
Theodore K. Nickel, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: ociinformation@wisconsin.gov
Web Address: oci.wi.gov

June 11, 2014

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

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2013, of the affairs and financial condition of:

HOMESTEAD MUTUAL INSURANCE COMPANY
Larsen, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Homestead Mutual Insurance Company (Homestead or the company) was made in 2009 as of December 31, 2008. The current examination covered the intervening time period ending December 31, 2013, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

In addition to auditing, the public accounting firm performs non-auditing services for the company including assistance with complex transactions such as accounting for income taxes, making year-end adjusting entries, and compilation of the annual statement. On December 15, 2010, an exemption was granted by the Commissioner, pursuant to s. Ins 50.08 (5), Wis. Adm. Code, permitting the independent auditor to perform this non-audit work for the company.

Homestead Mutual Insurance Company was originally organized as a town mutual insurance company named Vinland Town Mutual Insurance Company (Vinland) on June 25, 1873, under the provisions of the then existing Wisconsin Statutes. The company has gone through three mergers since its inception.

The first company to merge with Vinland was Winchester Mutual Insurance Company (Winchester), which was originally organized as a town mutual insurance company on February 20, 1875. On June 17, 1999, Vinland and Winchester applied to the Wisconsin Commissioner of Insurance for approval to merge pursuant to s. 612.21, Wis. Stat., and to change the name of the surviving corporation to Homestead Mutual Insurance Company effective September 1, 1999.

The second company merged was Nekimi Mutual Insurance Company (Nekimi), which was originally organized as a town mutual insurance company on January 29, 1884. On February 7, 2000, Homestead and Nekimi applied to the Wisconsin Commissioner of Insurance for approval to merge pursuant to s. 612.21, Wis. Stat., effective May 1, 2000, with the surviving corporation being Homestead.

The third company merged was Mt. Calvary Mutual Insurance Company (Mt. Calvary), which was originally organized as a town mutual insurance company on February 2, 1874. On June 15, 2006, Homestead and Mt. Calvary applied to the Wisconsin Commissioner of Insurance for approval to merge pursuant to s. 612.21, Wis. Stat., effective October 1, 2006, with the surviving corporation being Homestead.

During the period under examination, there were no amendments to the articles of incorporation and no amendments to the bylaws.

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

Brown	Portage
Calumet	Shawano
Dodge	Sheboygan
Fond du Lac	Washington
Green Lake	Waupaca
Manitowoc	Waushara
Marquette	Winnebago
Outagamie	

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year with premiums payable on the advance premium basis. The company also charges a policy fee equal to $15 for premiums less than $500, $30 for premiums between $501 and $1,000, and $45 for premiums in excess of $1,000.

Business of the company is acquired through 74 agents, 4 of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
New business - all agents	17%
Renewal business	
Non-employee agents	13
Employee agents	12

Agents do not have authority to adjust losses. The majority of losses are adjusted by the company's in-house adjuster. Losses in excess of $5,000 are approved by the company manager. The company manager also adjusts a small percentage of losses each year, usually the more complex losses or any losses with possible legal issues. The in-house adjuster receives $0.565 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

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

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

Name	Principal Occupation	Residence	Expiry
George Tipler*	General Manager and Agent	Oshkosh, Wisconsin	2014
Jack Zeller	Farmer	Oshkosh, Wisconsin	2014
Dale Wilde	Farmer	Oshkosh, Wisconsin	2015
Dallas Niemuth*	Underwriter and Agent	Larsen, Wisconsin	2014
Darwin Krenke*	Agent	Fremont, Wisconsin	2016
Karen Stahmann*	Policy Processing and Agent	Van Dyne, Wisconsin	2016
Terry Treu	Farmer	Berlin, Wisconsin	2014
Alan Simon	Retired	Malone, Wisconsin	2015
John Schmitz	Retired	St. Cloud, Wisconsin	2015

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $125.00 for each meeting attended and the IRS mileage reimbursement rate, currently $0.565 per mile, for travel expenses.

Section 612.13 (1m), Wis. Stat., requires:

(1) If a town mutual has fewer than nine directors, no more than one director may be an employee or representative of the town mutual, and

(2) Employees and representatives of a town mutual may not constitute a majority of its board.

The company is in compliance with these requirements.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2013 Compensation
George Tipler	Secretary and General Manager	$87,203
Jack Zeller	President	3,069
Dale Wilde	Vice President	2,414
Dallas Niemuth	Treasurer and Underwriter	60,415

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

Committees of the Board

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

Underwriting Committee
Dallas Niemuth, Chair
Jack Zeller
George Tipler
Karen Stahmann
John Schmitz

Loss Committee
George Tipler, Chair
Dallas Niemuth
Jack Zeller
Dale Wilde

Investment Committee
Jack Zeller, Chair
George Tipler
Dale Wilde
Dallas Niemuth

Compensation Committee
Jack Zeller, Chair
Dale Wilde
John Schmitz
Darwin Krenke
Terry Treu
Alan Simon

Growth of Company

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

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2013	$1,518,577	3,308	$ (25,214)	$6,773,509	$5,259,546
2012	1,386,545	3,294	(387,198)	6,469,604	5,129,135
2011	1,392,119	3,358	(489,672)	7,214,658	5,956,527
2010	1,404,668	3,309	(327,302)	7,670,422	6,548,163
2009	1,387,776	3,317	283,438	7,892,375	6,628,809
2008	1,453,656	3,381	(264,320)	7,536,082	6,330,811

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

Year	Gross Premiums Written	Net Premiums Written	Policyholders' Surplus	Writings Ratios	
				Net	Gross
2013	$2,558,373	$1,570,126	$5,259,546	30%	49%
2012	2,409,691	1,410,555	5,129,135	28	47
2011	2,385,600	1,473,630	5,956,527	25	40
2010	2,259,315	1,408,064	6,548,163	22	35
2009	2,257,355	1,395,182	6,628,809	21	34
2008	2,258,415	1,432,658	6,330,811	23	36

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Com-posite Ratio
2013	$1,043,756	$723,637	$1,518,577	69%	46%	115%
2012	1,499,344	701,841	1,386,545	108	50	158
2011	1,444,795	719,179	1,392,119	104	49	153
2010	1,330,540	696,402	1,404,668	95	49	144
2009	669,919	708,185	1,387,776	48	51	99
2008	1,264,702	725,480	1,453,656	87	51	138

The company had mostly unfavorable operating results over the past five years. The company's surplus decreased approximately 21% to $5,259,546. The company reported a net income of $283,438 in 2009; however, a net loss was reported during each of the subsequent years. The net losses were primarily attributable to poor underwriting results caused from significant storm activity which, in turn, increased reinsurance rates. The company's average net and gross loss ratio was 85% and 77%, respectively, for the period under examination. The company's expense ratio during 2013 was both below the average for a town mutual and is at its lowest point in more than ten years; the five-year average is 49%, which is the average for town mutuals.

Gross premium written increased approximately 13% to $2,558,373 compared to 2008, while the policy count decreased by nine to 3,308.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation (WRC)
Effective date:	January 1, 2014
Termination provisions:	Either party may terminate this contract by giving the other party at least 90 days' advance notice in writing

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Exhibit AX1 – Casualty Excess of Loss Reinsurance
	Lines reinsured:	All casualty business written by the company
	Company's retention:	$10,000 in respect to each and every loss occurrence
	Coverage:	100% of each and every loss occurring on the business covered by this contract, including loss adjustment expenses in excess of the retention, subject to maximum policy limits of $1,000,000 per occurrence, $1,000,000 split limits, $25,000 for medical payments, per person; $25,000 per accident for personal lines
	Reinsurance premium:	47% of casualty premium written for each and every policy issued. Annual deposit premium of $192,700.
2.	Type of contract:	Exhibit B1 – First Surplus Reinsurance
	Lines reinsured:	All property business written by the company
	Company's retention:	$1,000,000 per ceded risk
	Coverage:	Up to $2,000,000 on a pro rata basis, company may apply for facultative coverage on single location policies in excess of $2,500,000
	Reinsurance premium:	Pro rata share of all premiums and fees charged by the company corresponding to the amount of each risk ceded. Annual deposit premium of $130,000.
	Ceding commission:	15%, plus 15% profit commission
3.	Type of contract:	Exhibit C1 – Excess of Loss - First Layer
	Lines reinsured:	All property business written by the company

	Company's retention:	$125,000 per occurrence, plus an annual aggregate deductible of $50,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $125,000, subject to a limit of liability to the reinsurer of $125,000
	Reinsurance premium:	Rate: 7.0% of the company's net premiums in respect to the business covered Annual premium deposit: $144,900
4.	Type of contract:	Exhibit C-2 – Excess of Loss - Second Layer
	Lines reinsured:	All property business written by the company
	Company's retention:	$250,000 per occurrence
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $250,000, subject to a limit of liability to the reinsurer of $250,000
	Reinsurance premium:	5.0% of the company's net premiums in respect to the business covered Annual premium deposit: $103,500
5.	Type of contract:	Exhibit C-3 – Excess of Loss - Third Layer
	Lines reinsured:	All property business written by the company
	Company's retention:	$500,000 per occurrence
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $500,000, subject to a limit of liability to the reinsurer of $500,000
	Reinsurance premium:	2% of the company's net premiums in respect to the business covered Annual premium deposit: $41,400
6.	Type of contract:	Exhibit D1 – First Aggregate Excess of Loss Reinsurance
	Lines reinsured:	All business written by the company
	Company's retention:	70% of net written premium (estimated at $1,601,110)
	Coverage:	100% of the amount by which the aggregate of the company's losses exceed the retention with a limit of 60% of NWP (losses from 70% to 130% of NWP), loss adjustment expenses shall be recoverable on a proportionate basis
	Reinsurance premium:	Rate: 9.38% Annual premium deposit: $214,549 Estimated attachment point: $1,601,110

7.	Type of contract:	Exhibit D2 – Second Aggregate Excess of Loss Reinsurance
	Lines reinsured:	All business written by the company
	Company's retention:	130% of net written premium
	Coverage:	100% of the amount by which the aggregate of the company's losses exceed the retention. Loss adjustment expenses shall be recoverable on a proportionate basis.
	Reinsurance premium:	Rate: 3.0% Annual premium deposit: $68,619

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2013, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Homestead Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2013

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash on hand	$ 100	$	$	$ 100
Cash in checking	162,866			162,866
Cash deposited at interest	88,163			88,163
Bonds	2,852,346			2,852,346
Stocks and mutual fund investments	2,969,476			2,969,476
Real estate	266,246			266,246
Premiums, agents' balances and installments:				
In course of collection	18,425			18,425
Deferred and not yet due	336,950			336,950
Investment income accrued		63,962		63,962
Reinsurance recoverable on paid losses and LAE	4,867			4,867
Electronic data processing equipment	15,908		5,800	10,108
Furniture and fixtures	20,580		20,580	
Totals	$6,735,927	$63,962	$26,380	$6,773,509

Liabilities and Surplus

Net unpaid losses	$ 136,407
Unpaid loss adjustment expenses	3,850
Commissions payable	41,944
Fire department dues payable	897
Unearned premiums	1,155,194
Reinsurance payable	112,081
Payroll taxes payable (employer's portion)	567
Other liabilities:	
Expense-related:	
Accounts payable	15,478
Accrued property taxes	
Return commissions due reinsurers	
Deferred compensation	14,816
Nonexpense-related:	
Premiums received in advance	32,729
Total Liabilities	1,513,963
Policyholders' surplus	5,259,546
Total Liabilities and Surplus	$6,773,509

Homestead Mutual Insurance Company
Statement of Operations
For the Year 2013

Net premiums and assessments earned		$1,518,577
Deduct:		
Net losses incurred	$918,024	
Net loss adjustment expenses incurred	125,732	
Net other underwriting expenses incurred	723,637	
Total losses and expenses incurred		1,767,393
Net underwriting gain (loss)		(248,816)
Net investment income:		
Net investment income earned	59,135	
Net realized capital gains (losses)	64,894	
Total investment gain (loss)		124,029
Other income (expense):		
Installment and policy fees		99,573
Net income (loss) before federal income taxes		(25,214)
Federal income taxes incurred		0
Net Income (Loss)		$ (25,214)

Homestead Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2013

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2013	**2012**	**2011**	**2010**	**2009**
Surplus, beginning of year	$5,129,135	$5,956,527	$6,548,163	$6,628,809	$6,330,811
Net income	(25,214)	(387,198)	(489,672)	(327,302)	283,438
Net unrealized capital gain or (loss)	147,902	(431,600)	(107,052)	241,538	11,659
Change in nonadmitted assets	7,723	(8,594)	5,088	5,118	2,901
Surplus, End of Year	$5,259,546	$5,129,135	$5,956,527	$6,548,163	$6,628,809

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders’ surplus. The amount reported by the company as of December 31, 2013, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Accounts and Records—It is recommended that the company adhere to its policy regarding check signatures in compliance with s. 13.05 (4) (b), Wis. Adm. Code.

   Action—Compliance.

2. Accounts and Records—It is recommended that the company amend its authorized signature policy to require that any checks made payable to an authorized signer be signed by one of the other authorized signers.

   Action—Compliance.

3. Stocks and Mutual Funds—It is recommended that the company divest of any mutual fund within three years if the mutual fund's rating does not increase to four or five stars. If the mutual fund's rating does increase to four or five stars, the company should keep documentation to show the increased rating and the date in accordance with s. Ins 6.20, Wis. Adm. Code.

   Action— Compliance.

4. Losses—It is recommended that the company follow the procedures outlined in its Loss Adjustment Manual regarding the timely handling of outstanding claims in compliance with s. 628.46, Wis. Stat.

   Action—Compliance.

5. EDP Equipment—It is again recommended that the company depreciate its EDP equipment in accordance with SSAP 16.

   Action—Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

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

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

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

Type of Coverage	Coverage Limits
Fidelity bond	$ 500,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Business owners	
Liability coverages:	
Commercial liability per occurrence	1,000,000
Commercial liability aggregate	2,000,000
Non-owned and hired auto liability	1,000,000
Fire legal liability	50,000
Medical payments per occurrence	1,000
Property coverages:	
Building	300,000
Commercial personal property	75,000
Inland marine/lighted sign	12,000
Scheduled property	13,500
Combined professional liability and directors & officers liability	
Each claim	7,000,000
Aggregate limit	7,000,000

Underwriting

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

The company has a formal inspection procedure for both new and renewal business. The company has an in-house inspector who inspects all new business, and renewal business on a three-year rotation; inspections may be done more frequently if the company determines it necessary. In addition to salary, the in-house inspector receives $0.565 per mile for travel allowance.

Claims Adjusting

The company has an adjusting committee (which it calls the Loss Committee) consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. During the examination it was noted that the Loss Committee does not actively meet. The entire board reviews claim payments at each board meeting.

Accounts and Records

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

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

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2013.

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

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computers is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept off-site.

The company has manuals documenting the use of its software and outlining the steps to complete specific tasks. The manuals assist in the continuity of operations by providing instructions for seldom-used applications or when staff turnover occurs. The examination determined that the level of documentation contained in the manuals was reasonable.

Business Continuity Plan

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

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

Invested Assets

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

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

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

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

The company is in compliance with these requirements.

Investment Rule Compliance

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

1.	Liabilities plus $300,000	$1,813,963
2.	Liabilities plus 33% of gross premiums written	2,358,226
3.	Liabilities plus 50% of net premiums written	2,299,026
4.	Amount required (greater of 1, 2, or 3)	2,358,226
5.	Amount of Type 1 investments as of December 31, 2013	3,170,124
6.	Excess or (deficiency)	$ 811,898

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$251,129**

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

Cash in company's office	$ 100
Cash deposited in banks—checking accounts	162,866
Cash deposited in banks at interest	88,163
Total	$251,129

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

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

Cash deposited in banks represents the aggregate of two deposits in two depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2013 totaled $1,335 and was verified to company cash records. The rate of interest earned on cash deposits was .25%. Accrued interest on cash deposits was immaterial at year-end.

Book Value of Bonds **$2,852,346**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2013. Bonds owned by the company are held by the custodial bank under a custodial safekeeping agreement.

Bonds were traced to the company’s custodial investment statement by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices.

Interest received during 2013 on bonds amounted to $120,546 and was traced to cash receipts records. Accrued interest of $30,367 at December 31, 2013, was checked and allowed as a nonledger asset.

During review of the company's bond holdings on Schedule C, Section 1, it was noted that several bonds included incorrect characteristics such as the incorrect CUSIP number, maturity date, or actual cost. It is recommended the company accurately complete Schedule C, Section 1, according to the Town Mutual Annual Statement Instructions.

The company's bond portfolio includes a number of securities issued by banks and other financial corporations, which were designed and packaged as debt securities but with floating rates that appeared to aid the issuer in hedging its own risks or those of clients. In these cases the floating rates cause the cash flows of the securities to be unpredictable because the interest payments are based on specified variables such as market or consumer indexes, rates, or other variables. The floating rates can be subject to wide fluctuation based on changing economic conditions or other circumstances.

The volume of floating rate corporate bonds issued in the United States fluctuates from year to year. From 1996 to 2013, the percentage of corporate bonds that have been issued on a floating rate basis has ranged from 4.9% to 48.9% of corporate bond issuance, with the average for the period amounting to 23.8% of corporate bond issuance. The following table was drawn from data made available to the public from the Web site of the Securities Industry and Financial Markets Association, with the source attributed to Thomson Reuters.

U.S. Corporate Bond Issuance* 1996 – 2013
Callable and Non-Callable by Coupon Type
(Billions in U.S. Dollars)

	Callable		Non-Callable		Total %
	Fixed Rate	**Floating Rate**	**Fixed Rate**	**Floating Rate**	**Floating Rate**
1996	$ 79.1	$ 4.3	$ 200.3	$ 60.0	18.7%
1997	131.4	5.9	232.9	95.9	21.8
1998	240.5	7.8	228.0	134.4	23.3
1999	211.8	5.0	248.8	163.7	26.8
2000	196.6	16.1	166.1	208.6	38.3
2001	400.3	7.5	232.7	135.5	18.4
2002	283.4	2.7	187.8	162.8	26.0
2003	360.4	23.1	177.4	215.0	30.7
2004	238.6	31.7	207.8	302.6	42.8
2005	233.5	59.0	152.3	307.9	48.7
2006	348.3	88.0	192.4	430.2	48.9
2007	420.9	99.0	251.6	356.0	40.4
2008	352.4	57.7	185.7	111.4	23.9
2009	618.3	5.6	236.2	41.1	5.2
2010	575.2	7.8	413.2	66.7	7.0
2011	582.9	8.2	306.4	114.6	12.1
2012	882.8	13.2	415.7	53.3	4.9
2013	800.8	22.3	418.8	131.8	11.2
Totals	$6,9,57.3	$464.9	$4,454.0	$3,091.4	23.8%

* Includes all non-convertible corporate debt, medium-term notes, and Yankee bonds, but excludes all issues with maturities of one year or less and CDs.

Town mutual insurers are considered restricted insurers under s. 620.03 (1), Wis. Stat., and s. Ins 6.20 (6) (a), Wis. Adm. Code, and, as such, are subject to limitation over their investments. This office has imposed and may impose additional special investment restrictions for town mutual insurers if the investment creates additional risk which may compromise their financial position and ability to pay policyholders' claims in full and in a timely manner. Furthermore, pursuant to s. 620.04 (1), Wis. Stat., this office may impose reasonable and temporary restrictions upon the investments of an individual insurer, including prohibition or divestment of a particular asset. This office concludes that the company's investment strategy presents an unreasonable amount of risk to the company and is not appropriate for a town mutual insurance company at this time. The basis for this conclusion and the company's action required by this office is described below.

For instance, for each interest payment on the John Hancock Life Ins. Co. security, the interest rate is calculated monthly as the annual change in the Consumer Price Index plus

165 basis points with the minimum interest rate being 0.0%. This means that the company would not receive interest payments on the security for months when the annual change in the Consumer Price Index is -1.65% or lower. The absence of interest payments would likely have a negative impact on the security's market value. Furthermore, during prolonged economic conditions that unfavorably affect interest payments of the security, the security may trade, if at all, at a significant discount to its purchase price.

The risk that the market for trading these securities may not necessarily exist or be maintained in the future is substantially exacerbated by the very small size of the variable rate corporate debt issues that the company has purchased. Large issues tend to trade more frequently than small issues and investors may have greater awareness about a larger issue because it is widely held and analyzed. An issue size of $250 million represents an approximate lower boundary for a bond issue to attract significant institutional interest when liquidity is a concern. For example, the minimum par amount outstanding for a bond issue's inclusion in the Barclays U.S. Corporate Index is $250 million. The minimum par amount outstanding for a bond issue's inclusion in the Barclays U.S. Floating Rate Note Index is $300 million. A review of the company's variable rate corporate bond portfolio revealed that three of the bonds had par amounts outstanding ranging from $4,177,000 to $85,000,000.

The objectives of investment regulations as defined in s. 620.01, Wis. Stat., include, in part, to provide for the safety of principal and, to the extent consistent therewith, maximum yield and growth and to provide sufficient liquidity to avoid the necessity in reasonably expected circumstances for selling assets at undue sacrifice. The interest rate on some of these bonds could drop to 0% for a prolonged period of time, which could significantly impair the value of the bond and prevent the company from earning a reasonable return on their investment. There also may not be a trading market for the security rendering the investment illiquid. In the event that the company may need to dispose of the bond in order to pay claims, there may be no readily available market. It is recommended that, if the company invests in any variable rate corporate debt security, such security must have the following characteristics:

a. the reference for setting the interest rate must be a U.S. Dollar London Interbank Offered Rate of a single specified duration; and

b. the interest rate must have a floor in excess of zero percent; and
c. the total outstanding principal amount of the security at the time of issuance must equal or exceed $250 million.

For the avoidance of any doubt, in investing in any variable rate corporate debt security, the company:

a. may assume that any U.S. Dollar London Interbank Offered Rate will exceed zero percent; and
b. may invest in a security that specifies some increment of interest in excess of a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
c. may invest in a security that is leveraged relative to a U.S. Dollar London Interbank Offered Rate of a single specified duration, provided that there is no basis point reduction in the index provided by the interest rate formula (for example, 125% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while 125% of the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable); and
d. may not invest in a security that specifies some increment of interest less than a U.S. Dollar London Interbank Offered Rate of a single specified duration, unless such increment is expressed as a percentage of the index (for example, 80% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable).

It is the responsibility of the board of directors to supervise and direct all investments acquired and held by the company pursuant to s. 6.20 (6) (h), Wis. Adm. Code. This section requires the company's investment strategies and practices are commensurate with its technical and administrative capabilities and expertise with regard to investments. Investments whose interest rate payment is based on complex conditions tied to the results of multiple indices fall outside the area of expertise of town mutual insurers. Further, the board may not delegate its responsibility for overseeing the company's investments to a third-party contractor, pursuant to ss. 612.16 and 611.67, Wis. Stat. The company's board is responsible to oversee the company's investments and the actions of the investment advisor and must understand the details of its investments. The review of the company's bonds also disclosed that the company did not have information on file concerning how interest was computed on its variable rate corporate debt securities. It is recommended that the company maintain evidence on file as to how interest is computed on its current investments in variable rate corporate debt securities.

It is recommended that the board of directors modify its written investment policy to specify, in accordance with the instructions included in this report, acceptable characteristics of the investments in variable rate corporate debt securities and provide this office with a copy of the revised investment policy within 60 days of the adoption of this report.

Stocks and Mutual Fund Investments **$2,969,476**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2013. Stocks owned by the company are held by the custodial bank under a custodial safekeeping agreement or are kept in the company's safe deposit box.

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

During the review of the company's mutual fund holdings, it was noted that the company held seven exchange traded funds (ETFs) that were reported as mutual funds on Schedule D, Section 1, Part 2. ETFs should be reported as common stocks on Schedule D, Section 1, Part 3. It is recommended that the company report ETFs as common stock on Schedule D, Section 1, Part 3, on the annual statement.

Common stocks are limited to an investment of 3% of admitted assets in any one family. The company's combined investment Guggenheim Bulletshares, which is an exchange traded fund and therefore should be reported as a common stock, is valued at $300,014. The company's investment in Guggenheim Bulletshares exceeds the 3% threshold by $96,809. It is recommended that the company comply with investment limitations pursuant to s. Ins 6.20 (6) (f), Wis. Adm. Code.

Dividends received during 2013 on stocks and mutual funds amounted to $36,865 and were traced to cash receipts records. Accrued dividends of $33,595 at December 31, 2013, were checked and allowed as a nonledger asset.

Book Value of Real Estate **$266,246**

The above amount represents the company's investment in real estate, net of depreciation, as of December 31, 2013. The company's real estate holdings consisted of the company's home office building, which was purchased in 2007 and occupied in 2008.

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

Premiums, Agents' Balances in Course of Collection **$18,425**

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

The company is reporting the net amount of premiums in course of collection on the annual statement instead of reporting the total amount of premiums in the course of collection and nonadmitting any amount over 90 days past due. It is recommended the company report and properly nonadmit any amount over 90 days past due according to the Town Mutual Annual Statement Instructions.

Premiums Deferred and Not Yet Due **$336,950**

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

Investment Income Accrued **$63,962**

Interest due and accrued on the various assets of the company at December 31, 2013, consists of the following:

Bonds	$30,367
Stocks and mutual funds	33,595
Total	$63,962

Reinsurance Recoverable on Paid Losses and LAE **$4,867**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2013. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$10,108**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2013. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

Furniture and Fixtures **$0**

This asset consists of $20,580 of office furniture owned by the company at December 31, 2013. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$136,407**

This liability represents losses incurred on or prior to December 31, 2013, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2013, with incurred dates in 2013 and prior years. To the actual paid loss figure was added an estimated amount for 2013 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$193,929	$186,529	$ 7,400
Less: Reinsurance recoverable on unpaid losses	57,522	76,868	(19,346)
Net Unpaid Losses	$136,407	$109,661	$ 26,746

The above difference of $26,746 was not considered material for purposes of this examination.

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

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

Unpaid Loss Adjustment Expenses **$3,850**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2013, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is historically based estimates.

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

Commissions Payable **$41,944**

This liability represents the commissions payable to agents as of December 31, 2013. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

Unearned Premiums **$1,155,194**

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

Reinsurance Payable **$112,081**

This liability consists of amounts due to the company's reinsurer at December 31, 2013, relating to transactions which occurred on or prior to that date.

December 2013 reinsurer billings	$ 70,207
Deferred reinsurer premiums	41,874
Total	$112,081

The company is reporting the net amount of deferred reinsurance payable rather than recording the gross amount of deferred reinsurance payable and reinsurance commission receivable on the gross amount. Deferred reinsurer premiums listed above include $7,390 in commissions, but no reclassification is necessary because the balance is not considered material for purposes of this examination. It is recommended that the company report all reinsurance balances on the designated annual statement line rather than net reinsurance payable balances with other unrelated accounts in accordance with the Town Mutual Annual Statement Instructions.

Payroll Taxes Payable **$567**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2013, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$15,478**

This liability consists of amounts due to creditors for office and miscellaneous expenses at December 31, 2013. Supporting records and subsequent cash disbursements verified this item.

Deferred Compensation **$14,816**

This liability consists of the following items:

Payment due to one agent for the sale of his policies back to the company upon retirement	$10,000
Accrued vacation for employees	4,816
	$14,816

An analysis by the company's public accounting firm and supporting documentation verified this item.

Fire Department Dues Payable **$897**

This liability represents the fire department dues payable to the state of Wisconsin as of December 31, 2013.

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

Premiums Received in Advance **$32,729**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2013. The examiners reviewed 2013 premium and cash receipt records to verify the accuracy of this liability.

V. CONCLUSION

Homestead Mutual Insurance Company is a town mutual insurer with an authorized territory of 15 counties. The company, originally named Vinland Town Mutual Insurance Company, has been in business over 140 years providing property and liability insurance to its policyholders. The company has gone through three mergers in its history, most recently with Mt. Calvary Mutual Insurance Company in October 2006.

The company had mostly unfavorable operating results over the past five years. The company's surplus decreased approximately 21% to $5,259,546. The company reported a net income of $283,438 in 2009; however, a net loss was reported during each of the subsequent years. The net losses were primarily attributable to poor underwriting results caused from significant storm activity which, in turn, increased the company's reinsurance rates. The company's average net and gross loss ratio was 85% and 77%, respectively, for the period under examination. The company's expense ratio during 2013 was both below the average for a town mutual and is at its lowest point in more than ten years; the five-year average is 49%, which is the average for town mutuals.

The company was found to be in compliance with all prior exam recommendations and the current examination resulted in eight recommendations.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Book Value of Bonds—It is recommended the company accurately complete Schedule C, Section 1, according to the Town Mutual Annual Statement Instructions.

2. Page 23 - Book Value of Bonds—It is recommended that, if the company invests in any variable rate corporate debt security, such security must have the following characteristics:

   a. the reference for setting the interest rate must be a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
   b. the interest rate must have a floor in excess of zero percent; and
   c. the total outstanding principal amount of the security at the time of issuance must equal or exceed $250 million.

   For the avoidance of any doubt, in investing in any variable rate corporate debt security, the company:

   a. may assume that any U.S. Dollar London Interbank Offered Rate will exceed zero percent; and
   b. may invest in a security that specifies some increment of interest in excess of a U.S. Dollar London Interbank Offered Rate of a single specified duration; and
   c. may invest in a security that is leveraged relative to a U.S. Dollar London Interbank Offered Rate of a single specified duration, provided that there is no basis point reduction in the index provided by the interest rate formula (for example, 125% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while 125% of the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable); and
   d. may not invest in a security that specifies some increment of interest less than a U.S. Dollar London Interbank Offered Rate of a single specified duration, unless such increment is expressed as a percentage of the index (for example, 80% of the 3-month U.S. Dollar London Interbank Offered Rate is acceptable, while the 3-month U.S. Dollar London Interbank Offered Rate minus 0.10% is not acceptable).

3. Page 25 - Book Value of Bonds—It is recommended that the company maintain evidence on file as to how interest is computed on its current investments in variable rate corporate debt securities.

4. Page 25 - Book Value of Bonds—It is recommended that the board of directors modify its written investment policy to specify, in accordance with the instructions included in this report, acceptable characteristics of the investments in variable rate corporate debt securities and provide this office with a copy of the revised investment policy within 60 days of the adoption of this report.

5. Page 25 - Stocks and Mutual Fund Investments—It is recommended that the company report ETFs as common stock on Schedule D, Section 1, Part 3, on the annual statement.

6. Page 25 - Stocks and Mutual Fund Investments—It is recommended that the company comply with investment limitations pursuant to s. Ins 6.20 (6) (f), Wis. Adm. Code.

7. Page 26 - Premiums, Agents' Balances in Course of Collection—It is recommended the company report and properly nonadmit any amount over 90 days past due according to the Town Mutual Annual Statement Instructions.

8. Page 29 - Reinsurance Payable—It is recommended that the company report all reinsurance balances on the designated annual statement line rather than net reinsurance payable balances with other unrelated accounts in accordance with the Town Mutual Annual Statement Instructions.

VII. ACKNOWLEDGMENT

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

In addition to the undersigned, Terry Lorenz of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Levi Olson
Examiner-in-Charge

VIII. APPENDIX – SUBSEQUENT EVENTS

Subsequent to the examination date the company had a meeting with the Office of the Commissioner of Insurance (OCI) concerning the possibility of entering into an affiliation agreement with Mutual of Wausau Insurance Corporation. Mutual of Wausau Insurance Corporation is a small property and casualty insurer which converted from a town mutual to a domestic insurer under ch. 611, Wis. Stat., on January 1, 2011. It wrote approximately $8,760,000 in net premium in 2013 and has approximately $21,000,000 in assets. The affiliation agreement would be subject to approval from OCI and the policyholders of both companies.

As part of the affiliation agreement, the company would convert to a ch. 611, Wis. Stat., domestic insurer and would enter into a reinsurance pooling agreement with Mutual of Wausau Insurance Corporation. The two companies would pool premiums and share losses. The affiliation agreement would also allow the two companies to enter into various vendor agreements as one customer, which would result in volume discounts.