Report

of the

Examination of

Merrimac Lodi Mutual Insurance Company

Prairie du Sac, Wisconsin

As of December 31, 2009

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**State of Wisconsin** / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 7, 2010

Honorable Sean Dilweg
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, 2009, of the affairs and financial condition of:

MERRIMAC LODI MUTUAL INSURANCE COMPANY
Prairie du Sac, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Merrimac Lodi Mutual Insurance Company (the company) was made in 2005 as of December 31, 2004. The current examination covered the intervening time period ending December 31, 2009, 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 was organized as a town mutual insurance company in November 1873, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Merrimac Mutual Farmer's Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

Effective October 1, 2008, Merrimac Mutual Insurance Company merged with Lodi Mutual Insurance Company. The surviving company was named Merrimac Lodi Mutual Insurance Company. Under the merger agreement the new board of directors consisted of five members from Merrimac Mutual Insurance Company and four members from Lodi Mutual Insurance Company. All employees and agents stayed with the merged company. The merged company used the Merrimac underwriting and rates for policyholders. Company operations were moved to an office building in Prairie du Sac.

During the period under examination, there were two amendments to the articles of incorporation. The articles of incorporation were amended to change the number of directors from six members to nine members at the time of the merger and to include the counties of Richland and Juneau as authorized territories.

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:

| | |
|---|---|
| Columbia | Juneau |
| Dane | Richland |
| Iowa | Sauk |

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 three years with premiums payable on the advance premium basis. The company charges a policy fee of $5 per installment. The company also charges a $15 policy fee to reinstate a cancelled policy.

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

| **Type of Policy** | **Compensation** |
|---|---|
| All Lines | 10% |

Agents have no authority to adjust losses on their own. The manager of the company adjusts the small non-complex losses. An outside adjuster handles losses that require significant expertise due to magnitude or complexity. All liability losses are adjusted by Wisconsin Adjusting Services, Inc.

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

**Board of Directors**

The board of directors consists of 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 |
|---|---|---|---|
| Brian Gasser | President/Farmer | Lodi, WI | 2013 |
| Alan Albers* | Vice President | Plain, WI | 2012 |
| William Been | Teacher | Spring Green, WI | 2013 |
| Timothy Colby | Farmer | North Freedom, WI | 2011 |
| Craig Sandmire | Sales & Farmer | North Freedom, WI | 2012 |
| Keith Yanke | Farmer | Prairie du Sac, WI | 2011 |
| Vicki Kearney* | Secretary/Treasurer | Lodi, WI | 2012 |
| Patrick Lochner | Farmer | Lodi, WI | 2011 |
| Ronald Kohn* | Farmer | Lodi, WI | 2013 |

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $75 for a full day and $50 for a half day for each meeting attended and mileage reimbursement at the Federal Standard Mileage Rate for travel expenses.

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

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

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

The company is in compliance with these requirements.

## Officers

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

| Name | Office | 2009 Compensation |
|---|---|---|
| Brian Gasser | President | $ 275 |
| Alan Albers | Vice-President | 74,203 |
| Vicki Kearney | Secretary/Treasurer | 60,480 |

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:

**Adjusting Committee**
Craig Sandmire
Keith Yanke
William Been

**Claims Committee**
Brian Gasser
Alan Albers
Vicki Kearney
William Been
Tim Colby
Patrick Lochner
Ronald Kohn
Craig Sandmire
Keith Yanke

**Growth of Company**

The growth of the company since the previous examination as compiled from its filed annual statements was as follows (the information for 2008-09 is as filed for the merged company; for purposes of comparison the information for 2004-07 shows combined information for Lodi Mutual and Merrimac Mutual, which filed separate financial statements for those years):

| Year | Net Premiums Earned | Policies In Force | Net Income | Admitted Assets | Policyholders' Surplus |
|---|---|---|---|---|---|
| 2009 | $573,648 | 1,785 | $ 88,947 | $3,540,298 | $2,972,468 |
| 2008 | 560,902 | 1,791 | (230,833) | 3,441,319 | 2,824,125 |
| 2007 | 548,193 | 1,870 | 120,055 | 3,738,006 | 3,165,496 |
| 2006 | 540,181 | 1,890 | (175,382) | 3,564,524 | 2,971,766 |
| 2005 | 529,957 | 1,884 | (189,272) | 3,768,996 | 3,157,241 |
| 2004 | 489,142 | 1,829 | 79,130 | 3,746,911 | 3,291,256 |

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 | Writings Ratios Gross |
|---|---|---|---|---|---|
| 2009 | $1,111,625 | $569,788 | $2,972,468 | 19% | 37% |
| 2008 | 1,112,798 | 559,546 | 2,824,125 | 20 | 39 |
| 2007 | 1,154,666 | 556,894 | 3,165,496 | 18 | 36 |
| 2006 | 1,145,010 | 563,283 | 2,971,766 | 19 | 39 |
| 2005 | 1,105,261 | 591,021 | 3,157,241 | 19 | 35 |
| 2004 | 948,010 | 477,698 | 3,291,256 | 15 | 29 |

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 |
|---|---|---|---|---|---|---|
| 2009 | $241,057 | $312,700 | $573,648 | 42% | 55% | 97% |
| 2008 | 518,570 | 332,919 | 560,902 | 92 | 59 | 151 |
| 2007 | 229,104 | 287,831 | 548,193 | 42 | 52 | 94 |
| 2006 | 529,448 | 287,941 | 540,181 | 98 | 51 | 149 |
| 2005 | 562,697 | 258,369 | 529,957 | 106 | 44 | 150 |
| 2004 | 270,402 | 226,793 | 489,142 | 55 | 47 | 102 |

On a combined results basis, the company had a net loss in three of the last five years. Admitted assets and surplus both decreased 6% since the prior examination. Net premiums earned have increased each year under examination from $529,957 in 2005 to

$573,648 in 2009. Policies in force have declined 5% to 1,785 members in 2009 from 1,884 members in 2005. Loss ratios in 2005 and 2006 were higher mainly due to hail losses.

## 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 |
| Effective date: | January 1, 2010 |
| Termination provisions: | Either party may terminate as of January 1st by giving at least 90 days' written notice to the other party |

The coverages provided under this treaty are summarized as follows:

| | | |
|---|---|---|
| 1. | Type of contract: | Class AX1 Casualty Excess of Loss |
| | Lines reinsured: | All casualty or liability business |
| | Company's retention: | $2,500 each and every loss occurrence |
| | Coverage: | 100% of each and every loss occurrence, including loss adjustment expense, in excess of the company's retention subject to the maximum policy limits of:<br>a. $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability<br>b. $1,000,000 split limits, in any combination of bodily injury and property damage liability<br>c. $25,000 for medical payments, per person; $25,000 per accident |
| | Reinsurance premium: | 65% of premium written<br>Annual deposit premium = $135,200 |
| 2. | Type of contract: | Class B First Surplus |
| | Lines reinsured: | All property business |
| | Company's retention: | If net retention is $350,000 or more on a risk, the company may cede on a pro rata basis, and the reinsurer is obligated to accept up to $800,000. If net retention is $350,000 or less on a risk, the company may cede on a pro rata basis, and the reinsurer is obligated to accept up to 50% of such risk |
| | Coverage: | Pro rata share of each and every loss, including loss adjustment expense, corresponding to the amount of the risk ceded |

| | | |
|---|---|---|
| | Reinsurance premium: | The pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of each risk ceded |
| | Ceding commission: | Commission allowance: 15% of the premium paid<br>Profit commission: 15% of the net profit |
| 3. | Type of contract: | Class C-1 First Layer of Excess of Loss |
| | Lines reinsured: | All property business |
| | Company's retention: | $50,000 per loss per occurrence |
| | Coverage: | $100,000 excess of retention including loss adjusting expenses |
| | Reinsurance premium: | The rate in effect shall be determined by taking the sum of the four years' losses incurred by the reinsurer divided by the total of the net premiums written for the same period, multiplied by the factor 100/80ths. Current rate is 6.50%<br><br>Minimum rate = 6.50%<br>Maximum rate = 20.00%<br>Annual deposit premium = $46,267 |
| 4. | Type of contract: | Class C-2 Second Layer of Excess of Loss |
| | Lines reinsured: | All property business |
| | Company's retention: | $150,000 per loss per occurrence |
| | Coverage: | $200,000 excess of retention including loss adjustment expenses for each and every loss occurrence |
| | Reinsurance premium: | The rate for each annual period shall be determined by multiplying the rate by the company's net written premium. The current rate is 4.5%.<br><br>Current rate = 4.5%<br>Annual deposit premium = $32,031 |
| 5. | Type of contract: | Class DE-1 First Aggregate Excess of Loss Reinsurance |
| | Lines reinsured: | All business written by the company |
| | Company's retention: | 75% of net premium written |
| | Coverage: | 65% of annual aggregate losses, including loss adjustment expenses, exceeding 75% of net premium written and in excess of the company's retention |
| | Reinsurance premium: | The rate for each annual period shall be determined by multiplying the rate by the company's net written premium. The current rate is 7.06%. |

| | | |
|---|---|---|
| | | Minimum rate = 7.0%<br>Maximum rate = 15.0%<br>Annual deposit premium = $55,393<br>Estimated attachment point = $588,450 |
| 6. | Type of contract: | Class DE-2 Second Aggregate Excess of Loss Reinsurance |
| | Lines reinsured: | All business written by the company |
| | Company's retention: | 75% of net premium written |
| | Coverage: | 100% of annual aggregate losses, including loss adjustment expenses, exceeding 140% of net premium written and in excess of the company's retention |
| | Reinsurance premium: | The rate for each annual period shall be determined by multiplying the rate by the company's net written premium. The current rate is 3.00%.<br><br>Rate = 3.00%<br>Annual deposit premium = $23,538<br>Attachment point = 140.00% |

## 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, 2009, 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."

**Merrimac Lodi Mutual Insurance Company**
**Statement of Assets and Liabilities**
**As of December 31, 2009**

| Assets | Ledger | Nonledger | Not Admitted | Net Admitted |
|---|---|---|---|---|
| Cash on hand | $ 200 | $ | $ | $ 200 |
| Cash in checking | 112,175 | | | 112,175 |
| Cash deposited at interest | 644,580 | | | 644,580 |
| Bonds | 1,607,866 | | | 1,607,866 |
| Stocks and mutual fund investments | 1,017,403 | | | 1,017,403 |
| Premiums, agents' balances and installments: | | | | |
| In course of collection | 47,723 | | 2,015 | 45,708 |
| Deferred and not yet due | 52,115 | | | 52,115 |
| Investment income accrued | | 26,815 | | 26,815 |
| Reinsurance recoverable on paid losses and LAE | 20,582 | | | 20,582 |
| Electronic data processing equipment | 11,674 | | | 11,674 |
| Fire dues recoverable | 1,180 | | | 1,180 |
| Furniture and fixtures | 10,830 | | 10,830 | |
| Totals | $3,526,328 | $26,815 | $12,845 | $3,540,298 |

**Liabilities and Surplus**

| | |
|---|---|
| Net unpaid losses | $ 26,000 |
| Unpaid loss adjustment expenses | 1,500 |
| Commissions payable | 19,767 |
| Federal income taxes payable | 5,344 |
| Unearned premiums | 423,390 |
| Reinsurance payable | 27,474 |
| Payroll taxes payable (employer's portion) | 657 |
| Other liabilities: | |
| Expense-related: | |
| Accounts payable | 364 |
| Nonexpense-related: | |
| Premiums received in advance | 63,334 |
| Total liabilities | 567,830 |
| Policyholders' surplus | 2,972,468 |
| Total Liabilities and Surplus | $3,540,298 |

**Merrimac Lodi Mutual Insurance Company**
**Statement of Operations**
**For the Year 2009**

| | | |
|---|---|---|
| Net premiums and assessments earned | | $573,648 |
| Deduct: | | |
| Net losses incurred | $192,768 | |
| Net loss adjustment expenses incurred | 48,289 | |
| Net other underwriting expenses incurred | 312,700 | |
| Total losses and expenses incurred | | 553,757 |
| Net underwriting gain (loss) | | 19,891 |
| Net investment income: | | |
| Net investment income earned | 88,607 | |
| Net realized capital gains (losses) | (14,769) | |
| Total investment gain (loss) | | 73,838 |
| Other income (expense): | | |
| Miscellaneous | 10,718 | |
| Total other income | | 10,718 |
| Net income (loss) before federal income taxes | | 104,447 |
| Federal income taxes incurred | | 15,500 |
| Net Income (Loss) | | $ 88,947 |

**Merrimac Lodi Mutual Insurance Company**
**Reconciliation and Analysis of Surplus as Regards Policyholders**
**For the Five-Year Period Ending December 31, 2009**

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 (statements for 2008-09 are as filed for the merged company, for comparison purposes the statements for 2005-07 are combined as Lodi Mutual and Merrimac Mutual filed separate statements for those years):

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Surplus, beginning of year | $2,824,125 | $3,165,496 | $2,971,766 | $3,157,241 | $3,291,256 |
| Net income | 88,947 | (230,833) | 120,055 | (175,382) | (189,272) |
| Net unrealized capital gain or (loss) | 43,165 | (118,976) | 54,018 | 43,395 | 57,778 |
| Change in nonadmitted assets | 16,231 | 8,438 | 19,657 | (53,488) | (2,521) |
| Surplus, End of Year | $2,972,468 | $2,824,125 | $3,165,496 | $2,971,766 | $3,157,241 |

In 2008, Merrimac Mutual Insurance Company merged with Lodi Mutual Insurance Company. The company's financial statements were restated to reflect the merger as if it happened in 2007.

## Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2009, 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. Underwriting—It is suggested that the company periodically review and update its underwriting guide, including maintenance of current rates and require photographs of all insured risks in order to have better supporting documentation of the condition of the risks.

   Action—Compliance.

2. Accounts and Records—It is recommended that the company comply with s. Ins 13.05 (4) (d), Wis. Adm. Code, by transferring its bank reconciliation function to a person other than the Treasurer.

   Action—Compliance.

3. Business Continuity Plan—It is suggested that the company expand its business continuity plan to address all types of disasters and develop an office procedure manual for the cross-training of employees.

   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 do not include language indicating the agent will represent the company's interests "in good faith." It is recommended that the company execute formal written agreements with its agents that include language indicating that 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 | $ 250,000 |
| Worker's compensation: | |
| Employee injury | Statutory |
| Employee liability: | |
| Each accident | 100,000 |
| Each employee | 100,000 |
| Policy limit | 500,000 |
| General liability: | |
| General aggregate | 2,000,000 |
| Products aggregate | 2,000,000 |
| Personal and advertising injury | 1,000,000 |
| Each occurrence | 1,000,000 |
| Damage to premises | 100,000 |
| Medical limit each person | 5,000 |
| Property: | |
| Building contents | 25,000 |
| Combined professional liability and Directors and officers liability: | |
| Each claim | 2,000,000 |
| In aggregate | 2,000,000 |
| Deductible each claim | 10,000 |
| Insurance agents' and brokers' liability: | |
| Each claim | 3,000,000 |
| In aggregate | 3,000,000 |
| Deductible each claim | 5,000 |

**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. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

**Claims Adjusting**

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

## Accounts and Records

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

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

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2009.

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 either kept in a fire proof safe and/or taken off the premises.

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

## Business Continuity Plan

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

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

**Invested Assets**

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

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

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

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

The company is not in compliance with these requirements. The company's custodial agreement is outdated. The agreement has the custodian's name as LaSalle Bank. As a result of subsequent mergers, U.S. Trust is the company's current custodian. It is recommended that the company update its custodial agreement to reflect the custodian's name change.

It was noted, that the company still held some assets in the name of Merrimac Mutual Insurance Company or Lodi Mutual Insurance Company, rather than the company's post merger name. It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

**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 | $867,830 |
| 2. | Liabilities plus 33% of gross premiums written | 934,666 |
| 3. | Liabilities plus 50% of net premiums written | 852,724 |
| 4. | Amount required (greater of 1, 2, or 3) | 934,666 |
| 5. | Amount of Type 1 investments as of 12/31/2009 | 2,208,985 |
| 6. | Excess or (deficiency) | 1,274,319 |

The company has sufficient Type 1 investments.

The company has been granted permission to hold 30% of net admitted assets in common stocks and like securities. It has also been granted permission to hold Wisconsin Reinsurance common stock and NAMIC stock.

## ASSETS

**Cash and Invested Cash** **$756,955**

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

| | |
|---|---|
| Cash in company's office | $ 200 |
| Cash deposited in banks—checking accounts | 112,175 |
| Cash deposited in banks at interest | 644,580 |
| Total | $756,955 |

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

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in 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 18 deposits in 9 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 2009 totaled $24,528 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.797% to 4.972%. Accrued interest on cash deposits totaled $4,856 at year-end.

**Book Value of Bonds** **$1,607,866**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2009. Bonds owned by the company are held in a custodial account with U.S. Trust.

Bonds were verified to applicable company investment custodial statement records, as documented in the independent CPA’s work papers. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2009 on bonds amounted to $78,397 and was traced to cash receipts records.  Accrued interest of $21,961 at December 31, 2009, was checked and allowed as a nonledger asset.

**Stocks and Mutual Fund Investments** **$1,017,403**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2009.  Stocks owned by the company are located in a safety deposit box at a local bank or under a safekeeping agreement

Stock certificates held in a safety deposit box 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.

Dividends received during 2009 on stocks and mutual funds amounted to $29,310 and were traced to cash receipts records.  There was no accrued dividend receivable balance at December 31, 2009.

**Premiums, Agents' Balances in Course of Collection** **$45,708**

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

**Premiums Deferred and Not Yet Due** **$52,115**

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** **$26,815**

Interest due and accrued on the various assets of the company at December 31, 2009, consists of the following:

| | |
|---|---|
| Accrued interest on cash deposited at interest | $ 4,854 |
| Accrued interest on bonds | 21,961 |
| Total | $26,815 |

**Reinsurance Recoverable on Paid Losses and LAE** **$20,582**

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, 2009. A review of year-end accountings with the reinsurer verified the above asset.

**Electronic Data Processing Equipment** **$11,674**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2009. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted.

**Fire Dues Recoverable** **$1,180**

This asset represents the amount overpaid to the state of Wisconsin for 2009 fire dues. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Furniture and Fixtures** **$0**

This asset consists of $10,830 of office equipment owned by the company at December 31, 2009. 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** **$26,000**

This liability represents losses incurred on or prior to December 31, 2009, 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, 2009, with incurred dates in 2009 and prior years. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

| | Company Estimate | Examiners' Development | Difference |
|---|---|---|---|
| Incurred but unpaid losses | $42,577 | $33,701 | $8,876 |
| Less: Reinsurance recoverable on unpaid losses | 16,577 | 12,492 | 4,085 |
| Net Unpaid Losses | $26,000 | $21,209 | $4,791 |

The above difference of $4,791 was not considered material for purposes of this examination; therefore, no adjustment was made to surplus.

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** **$1,500**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2009, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is estimation based on prior year adequacy and open losses.

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

**Commissions Payable** **$19,767**

This liability represents the commissions payable to agents as of December 31, 2009. The examiners reviewed the company’s subsequent commission payments and found the liability to be reasonably stated.

**Federal Income Taxes Payable** **$5,344**

This liability represents the balance payable at year-end for federal income taxes incurred prior to December 31, 2009. The examiners reviewed the company's 2009 tax return and verified amounts paid to cash disbursement records to verify the accuracy of this liability.

**Unearned Premiums** **$423,390**

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** **$27,474**

This liability consists of amounts due to the company's reinsurer at December 31, 2009, relating to transactions which occurred on or prior to that date.

| | |
|---|---|
| Class AX1 | $ (573) |
| Class B | 9,131 |
| Class B Commissions | (10,175) |
| Class C-1 | 2,770 |
| Class C-2 | 1,128 |
| Class D/E-1 | 1,667 |
| Class D/E-2 | 673 |
| Deferred Reinsurance Payable | 22,853 |
| Total | $ 27,474 |

**Payroll Taxes Payable** **$657**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2009, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

**Accounts Payable** **$364**

This liability represents the company's escheatable funds. The company reported their escheatable funds as accounts payable, rather than filing an Unclaimed Property Report with the state of Wisconsin. It is recommended that the company file Unclaimed Property Reports as required by ch. 177, Wis. Stat, and maintain copies of these filings.

**Premiums Received in Advance** **$63,334**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2009. The examiners reviewed 2009 premium and cash receipt records to verify the accuracy of this liability.

## V. CONCLUSION

Effective October 1, 2008, Merrimac Mutual Insurance Company merged with Lodi Mutual Insurance Company. The surviving company was named Merrimac Lodi Mutual Insurance Company.

The company reported assets of $3,540,298, liabilities of $567,830 and policyholders' surplus of $2,972,468 at year-end 2009. The company reported net income of $88,947 and underwriting gains of $19,891.

On a combined results basis, the company had a net loss in three of the last five years. Admitted assets and surplus both decreased 6% since the prior examination. Net premiums earned have increased each year under examination from $529,957 in 2005 to $573,648 in 2009. Policies in force have declined 5% to 1,785 members in 2009 from 1,884 members in 2005. Loss ratios in 2005 and 2006 were higher mainly due to hail losses.

The examination did not result in any changes to surplus. All three of the prior recommendations were complied with. The current examination resulted in four recommendations as summarized in the following section.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 15 - Corporate Records—"It is recommended that the company execute formal written agreements with its agents that include language indicating that the agent will represent the company's interests "in good faith."

2. Page 18 - Invested Assets—It is recommended that the company update its custodial agreement to reflect the custodian's name change.

3. Page 18 - Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

4. Page 25 - Accounts Payable—It is recommended that the company file Unclaimed Property Reports as required by ch. 177, Wis. Stat, and maintain copies of these filings.

## VII. ACKNOWLEDGMENT

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

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

Respectfully submitted,

Terry Lorenz
Examiner-in-Charge