

Report  
of the  
Examination of  
Southeast Mutual Insurance Company  
Burlington, Wisconsin  
As of December 31, 2011

## TABLE OF CONTENTS

	<b>Page</b>
I. INTRODUCTION .....	1
II. REINSURANCE.....	6
III. FINANCIAL DATA .....	9
IV. SUMMARY OF EXAMINATION RESULTS.....	13
V. CONCLUSION.....	24
VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS .....	25
VII. ACKNOWLEDGMENT.....	26



# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, Governor  
Theodore K. Nickel, Commissioner

Wisconsin.gov

June 22, 2012

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](mailto:ociinformation@wisconsin.gov)  
Web Address: [oci.wi.gov](http://oci.wi.gov)

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, 2011, of the affairs and financial condition of:

SOUTHEAST MUTUAL INSURANCE COMPANY  
Burlington, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Southeast Mutual Insurance Company (the company) was made in 2007 as of December 31, 2006. The current examination covered the intervening time period ending December 31, 2011, 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 has an exemption from providing audited financial statements as defined in s. Ins 50.02 (3), Wis. Adm. Code; however, the company's financial statements are compiled annually by an accounting firm. An integral part of this compliance examination was the review of the 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 and are included in the examination work papers.

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

During the period under examination, there were no amendments to the articles of incorporation or 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:

Kenosha	Walworth
Racine	Waukesha

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of three years, except commercial policies which are for a term of one year, with premiums payable on the advance premium basis. The company also charges a policy fee equal to \$1.00 for both semiannual and quarterly payments.

Business of the company is acquired through five agents, one of whom is a director of the company. Agents are presently compensated for their services as follows:

<b>Type of Policy</b>	<b>Compensation</b>
All lines of business, new and renewal	15%

Agents have authority to adjust losses up to \$1,000. Losses in excess of this amount are adjusted by the agent with the assistance of one of the board members. Adjusters receive \$35.00 for each loss adjusted plus \$.40 per mile for travel allowance.

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

## Board of Directors

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

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

<b>Name</b>	<b>Principal Occupation</b>	<b>Residence</b>	<b>Expiry</b>
Willard Noble	Retired	Burlington, WI	2014
Jerome Ketterhagen	Realtor	Burlington, WI	2013
B. Jean Schaal*	Insurance Agent	Waterford, WI	2015
Elizabeth Weis	Retired	Burlington, WI	2013
Earl Squire	Maintenance and Farmer	Burlington, WI	2013
Mark Wilson	Farmer	Burlington, WI	2014
Michael Nolan	Retired	Kansasville, WI	2015

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

Members of the board currently receive \$50.00 for each meeting attended and \$.40 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 not in compliance with part (1) of these requirements. See the comments in the section of this report entitled "Current Examination Results."

## 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	2011 Compensation
Willard Noble	President	\$ 3,000
Jerome Ketterhagen	Vice-President	500
B. Jean Schaal	Secretary	21,207*
Elizabeth Weis	Treasurer	5,600

\* Jennifer Wilson was elected as Secretary effective May 21, 2012.

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

## Committees of the Board

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

### Executive Committee

Willard Noble, Chair  
Jerome Ketterhagen  
B. Jean Schaal  
Elizabeth Weis

The Executive Committee is appointed at the annual meetings to act as the Adjusting Committee and meets only when necessary.

## 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
2011	\$172,274	660	\$ (34,378)	\$1,852,938	\$1,641,307
2010	189,925	634	75,058	1,890,165	1,690,572
2009	186,716	641	125,049	1,825,135	1,569,102
2008	194,454	647	(126,645)	1,733,600	1,436,478
2007	205,611	652	64,901	1,841,404	1,605,556
2006	216,376	666	108,998	1,766,433	1,548,068

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 Net	Ratios Gross
2011	\$445,874	\$175,292	\$1,641,307	10.7%	27.2%
2010	408,692	184,069	1,690,572	10.9	24.2
2009	426,111	185,654	1,569,102	11.8	27.2
2008	432,909	198,104	1,436,478	13.8	30.1
2007	421,463	197,825	1,605,556	12.3	26.3
2006	419,405	225,248	1,548,068	14.6	27.1

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

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Composite Ratio
2011	\$140,186	\$108,462	\$172,274	81.4%	61.9%	143.3%
2010	43,927	111,073	189,925	23.1	60.3	83.4
2009	3,599	108,434	186,716	1.9	58.4	60.3
2008	265,094	114,958	194,454	136.3	58.0	194.3
2007	71,635	115,846	205,611	34.8	58.6	93.4
2006	42,055	121,342	216,376	19.4	53.9	73.3

Gross premiums written fluctuated but were up 6.3% over the five-year period as net premiums written decreased almost every year and were down 22.2% overall. Net income fluctuated and was positive in each year except for 2011 and 2008—years with higher weather-related losses. The loss ratio fluctuated over the five-year period, while expense ratio increased moderately. Admitted assets increased 4.9% to \$1,852,938 and surplus increased 6.0% to \$1,641,307, as the company's financial position has improved since the prior examination.

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty with five coverage sections. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. The treaty contains an amendment specifically warranting compliance with ss. Ins 13.06 and 13.09, Wis. Adm. Code, and with ss. 612.31 and 612.32 (2), Wis. Stat.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2012
Termination provisions:	January 1, 2013, or any subsequent January 1, by either party giving at least 90 days' advance written notice

The coverages provided under this treaty are summarized as follows:

- |                      |  |
|----------------------|--|
| Type of contract:    | Class A – Excess of Loss   |
| Lines reinsured:     | All casualty business written  |
| Company's retention: | \$1,000 each and every loss occurrence including loss adjustment expenses up to an annual aggregate of retention equal to the lesser of \$200,000 or 20% of the prior year policyholder surplus  |
| Coverage:            | 100% of loss in excess of \$1,000 each and every loss occurrence subject to the following limits: <ol style="list-style-type: none"><li>\$1,000,000 per occurrence, single limit, combined injury and property damage liability</li><li>\$1,000,000 split limits, in any combination of bodily injury and property damage liability</li><li>\$25,000 for medical payments, per person; \$25,000 per accident</li></ol> |
| Reinsurance premium: | 75% of written liability premium   |
| Ceding commission:   | None   |
- |                      |  |
|----------------------|--|
| Type of contract:    | Class B – First Surplus  |
| Lines reinsured:     | All property business written  |
| Company's retention: | <ol style="list-style-type: none"><li>When net retention is \$250,000 or more in respect to a risk, the company may cede on a pro rata basis up to \$750,000</li><li>When net retention is \$250,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of risk</li><li>Annual aggregate deductible of 10% of losses and LAE which would otherwise be ceded under the contract. This is waived if the ultimate net loss of the</li></ol> |

company exceeds the combination of Excess of Loss retention and any Excess of Loss annual aggregate deductible specified in the C-1 First Layer Excess of Loss.

- Coverage: Pro rata portion of every loss, including loss adjustment expense corresponding to the amount of risk ceded
- Reinsurance premium: Pro rata portion of all premiums, fees and assessments charged by the company corresponding to the amount of risk ceded hereunder
- Ceding commission: 15% of the premium ceded and 15% profit commission based on the reinsurer's net profit on business reinsured under this contract
3. Type of contract: Class C-1 – Excess of Loss First Layer
- Lines reinsured: All property business
- Company's retention: \$40,000 per risk per loss occurrence
- Coverage: 100% of any loss in excess of retention up to \$80,000, including LAE
- Reinsurance premium: Net premium written multiplied by the sum of the prior four years' losses incurred by the reinsurer, divided by the total net premiums written for the same period, multiplied by 100/80
- Rate for the current annual period is 13.36%
- Ceding commission: None
4. Type of contract: Class C-2 – Excess of Loss Second Layer
- Lines reinsured: All property business
- Company's retention: \$120,000 per risk per loss occurrence
- Coverage: 100% of any loss, including LAE, in excess of \$120,000 per risk, subject to a limit of \$130,000 in respect to one loss occurrence
- Reinsurance premium: 7% of property net premium written rounded to the nearest \$100
- Ceding commission: None
5. Type of contract: Class D/E – First Aggregate Excess of Loss
- Lines reinsured: All business written
- Company's retention: 80% of company's net premium written

Coverage:	100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 80% of the company's net premiums written, up to 60% of net premiums written
Reinsurance premium:	8.64% of net premium written
Ceding commission:	None
6. Type of contract:	Class D/E – Second Aggregate Excess of Loss
Lines reinsured:	All business written
Company's retention:	140% of company's net premium written
Coverage:	100% of the company's aggregate net losses, including loss adjustment expenses, which exceed 140% of the company's net premiums written
Reinsurance premium:	2.0% of net premium written
Ceding commission:	None

### **III. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2011, annual statement.

Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**Southeast Mutual Insurance Company  
Statement of Assets and Liabilities  
As of December 31, 2011**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash deposited at interest	\$ 208,192	\$	\$	\$ 208,192
Bonds	1,052,957			1,052,957
Stocks and mutual fund investments	522,353			522,353
Premiums, agents' balances and installments:				
In course of collection	3,370			3,370
Deferred and not yet due	53,152			53,152
Investment income accrued		12,013		12,013
Reinsurance recoverable on paid losses and LAE	<u>901</u>	<u>          </u>	<u>          </u>	<u>901</u>
<b>Totals</b>	<b><u>\$1,840,925</u></b>	<b><u>\$12,013</u></b>	<b><u>\$          </u></b>	<b><u>\$1,852,938</u></b>

**Liabilities and Surplus**

Net unpaid losses	\$ 14,500
Unpaid loss adjustment expenses	1,600
Commissions payable	7,933
Fire department dues payable	275
Unearned premiums	151,975
Reinsurance payable	31,623
Other liabilities:	
Expense-related:	
Accounts payable	87
Other liabilities:	
Nonexpense-related:	
Premiums received in advance	<u>3,638</u>
Total liabilities	211,631
Policyholders' surplus	<u>1,641,307</u>
<b>Total Liabilities and Surplus</b>	<b><u>\$1,852,938</u></b>

**Southeast Mutual Insurance Company  
Statement of Operations  
For the Year 2011**

Net premiums and assessments earned		\$172,274
Deduct:		
Net losses incurred	\$125,429	
Net loss adjustment expenses incurred	14,757	
Net other underwriting expenses incurred	<u>108,482</u>	
Total losses and expenses incurred		<u>248,668</u>
Net underwriting gain (loss)		(76,394)
Net investment income:		
Net investment income earned	31,140	
Net realized capital gains (losses)	<u>(349)</u>	
Total investment gain (loss)		30,791
Other income (expense):		
Total other income		<u>11,225</u>
Net Income (Loss)		<u>\$ (34,378)</u>

**Southeast Mutual Insurance Company  
Reconciliation and Analysis of Surplus as Regards Policyholders  
For the Five-Year Period Ending December 31, 2011**

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:

	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Surplus, beginning of year	\$1,690,572	\$1,569,102	\$1,436,478	\$1,605,556	\$1,548,068
Net income	(34,378)	75,058	125,049	(126,645)	64,901
Net unrealized capital gain or (loss)	(14,887)	45,704	7,255	(42,786)	(7,877)
Change in nonadmitted assets	<u>                    </u>	<u>          708</u>	<u>          320</u>	<u>          353</u>	<u>          464</u>
Surplus, End of Year	<u>\$1,641,307</u>	<u>\$1,690,572</u>	<u>\$1,569,102</u>	<u>\$1,436,478</u>	<u>\$1,605,556</u>

**Reconciliation of Policyholders' Surplus**

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2011, 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. Corporate Records—It is again recommended that the company submit biographical data of all company officers and directors pursuant to s. Ins 6.52, Wis. Adm. Code.

Action—Compliance.

2. Corporate Records—It is suggested that the company amend the agreements with its agents to include language indicating that the agent will represent the company's interests "in good faith."

Action—Compliance.

3. Accounts and Records—It is recommended that the company deposit cash receipts at least every week in compliance with s. Ins 13.05 (4) (a), Wis. Adm. Code.

Action—Compliance.

4. Invested Assets—It is recommended that the Board properly review and approve investments made by the investment broker in compliance to the Board's standards, limitations, and objectives pursuant to s. Ins 6.20 (6) (h), Wis. Adm. Code. It is further recommended that a reasonable summary of the discussion pertaining to the review and approval of investments be included in the minutes of the Board meetings to provide evidence of compliance with the above requirements.

Action—Compliance.

5. Invested Assets—It is recommended that the company enter into a written agreement with the investment broker.

Action—Compliance.

6. Book Value of Bonds—It is recommended that Type 2 bonds should be reported in the annual statement at lower of amortized cost or market value as defined in the NAIC Securities Valuation Office and in compliance to s. Ins 6.20 (10), Wis. Adm. Code.

Action—Compliance.

7. Prepaid Insurance—It is recommended that the company classify prepaid insurance under nonadmitted assets in compliance with the Town Mutual Annual Statement Instructions.

Action—Compliance.

8. Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Action—Compliance.

## **Current Examination Results**

### **Board of Directors**

Southeast Mutual Insurance Company has a board of seven directors of whom one is an agent of the company. Another director is the Treasurer, who performs consistent work for the company and is considered an employee with a salary over \$5,000 per year. This is in violation of s. 612.13 (1m), Wis. Stat., which requires that a town mutual with fewer than nine directors may have no more than one director who is an employee or representative of the company. It is recommended that the company increase the size of its board of directors to at least nine directors or have only one company employee or company representative on its board of directors.

### **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. The questionnaires noted that the company's primary agents are not exclusive to the company.

## **Fidelity Bond and Other Insurance**

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

<b>Type of Coverage</b>	<b>Coverage Limits</b>
Fidelity bond	\$ 100,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Commercial general liability:	
General aggregate	200,000
Products aggregate	200,000
Per occurrence	100,000
Personal injury	100,000
Fire legal	100,000
Medical payments	5,000
Combined professional and directors and officers liability	1,000,000

## **Underwriting**

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

Photographs are submitted with all new applications, and these risks are inspected on a case-by-case basis within 30 days. Inspections are also done by the company's Secretary for every tenth renewal policy of the three-year policy period. Inspection reports are filed in an inspection binder and reviewed by the board during quarterly meetings.

## **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, 2011.

The company is exempt from the requirement for an annual audit due to its premium volume.

#### **EDP Environment**

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily and the backed-up data is kept on-site by the company in a fireproof safe. However, there is no off-site storage of backed-up data. It is recommended that the company establish a procedure to back up its computer system on a weekly basis and store this backed-up data in a secure off-site location.

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 in compliance with these requirements. However, it was noted that the December custodial statement was inaccurate in that it agreed to the November 30, 2011, balance reported on the statement provided by the company's investment broker—not the December 31, 2011, balance. It is recommended the company have its custodian provide a statement with an accurate account balance at the end of the reporting period and compare this balance to its investment broker statement at least quarterly.

### **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	\$ 511,631
2. Liabilities plus 33% of gross premiums written	358,769
3. Liabilities plus 50% of net premiums written	299,277
4. Amount required (greater of 1, 2, or 3)	511,631
5. Amount of Type 1 investments as of 12/31/2011	<u>1,316,396</u>
6. Excess or (deficiency)	<u>\$ 804,765</u>

The company has sufficient Type 1 investments.

## ASSETS

**Cash and Invested Cash** **\$208,192**

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

Cash deposited in banks at interest—checking	\$ 8,192
Cash deposited in banks at interest	<u>200,000</u>
Total	<u>\$208,192</u>

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

The company's single certificate of deposit was held by its custodian bank and was confirmed with the investment broker. Total interest received on cash deposited at interest during the year 2011 was \$4,028 and was verified to company cash records. Rates of interest earned on cash deposits were .10% and 2.0% for the company's checking account and lone certificate of deposit, respectively. Accrued interest on cash deposits totaled \$0 at year-end.

**Book Value of Bonds** **\$1,052,957**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2011. Bonds owned by the company are located in a custodial account.

During the annual statement review, it was noted that the company held investments in two bonds which exceeded the 3% of admitted assets in violation of s. Ins 6.20 (6) (d), Wis. Adm. Code. The company divested of these bonds and provided brokers' advices for the sales prior to examination fieldwork. Other bond purchases and sales for the period under examination were checked to brokers' invoices and advices during fieldwork. It was determined that 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 2011 on bonds amounted to \$40,052 and was traced to cash receipts records. Accrued interest of \$12,013 at December 31, 2011, was checked and allowed as a nonledger asset.

**Stocks and Mutual Fund Investments** **\$522,353**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2011. Stocks owned by the company are located in a custodial account or kept in a safety deposit box at the company's bank.

Stock certificates were physically examined by the examiners in the last examination and the current value was verified. 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 2011 on stocks and mutual funds amounted to \$9,317 and were traced to cash receipts records.

**Premiums, Agents' Balances in Course of Collection** **\$3,370**

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** **\$53,152**

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** **\$12,013**

Interest due and accrued on the various assets of the company at December 31, 2011, consists only of bonds accrued income of \$12,013.

**Reinsurance Recoverable on Paid Losses and LAE** **\$901**

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, 2011. A review of year-end accountings with the reinsurer verified the above asset.

## LIABILITIES AND SURPLUS

**Net Unpaid Losses** **\$14,500**

This liability represents losses incurred on or prior to December 31, 2011, 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, 2011, with incurred dates in 2011 and prior years. To the actual paid loss figure was added an estimated amount for 2011 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.

	<b>Company Estimate</b>	<b>Examiners' Development</b>	<b>Difference</b>
Incurred but unpaid losses	\$23,771	\$23,895	\$(124)
Less: Reinsurance recoverable on unpaid losses	<u>9,271</u>	<u>9,271</u>	<u>0</u>
<b>Net Unpaid Losses</b>	<b><u>\$14,500</u></b>	<b><u>\$14,624</u></b>	<b><u>\$(124)</u></b>

The above difference of \$124 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** **\$1,600**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2011, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is to use an estimate based on a three-year ratio of paid loss adjustment expenses to paid losses.

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

**Commissions Payable** **\$7,933**

This liability represents the commissions payable to agents as of December 31, 2011. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

**Fire Department Dues Payable** **\$275**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2011.

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

**Unearned Premiums** **\$151,975**

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** **\$31,623**

This liability consists of amounts due to the company's reinsurer at December 31, 2011, relating to transactions which occurred on or prior to that date. December invoices for Wisconsin Reinsurance Corporation were verified by the examiners in support of this account balance.

**Accounts Payable** **\$87**

This liability represents the total of printing and telephone expense received prior to year-end that were payable at December 31, 2011. Supporting documents were used to verify this balance.

**Premiums Received in Advance**

**\$3,638**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2011. The examiners reviewed 2011 premium and cash receipt records to verify the accuracy of this liability.

## **V. CONCLUSION**

Southeast Mutual Insurance Company is a town mutual insurer currently operating in a four-county area of southeastern Wisconsin. The company has been in business providing insurance to its policyholders for almost 137 years.

Gross premiums written fluctuated but were up 6.3% over the five-year period as net premiums written decreased almost every year and were down 22.2% overall. Net income fluctuated and was positive in each year except for 2011 and 2008—years with higher storm-related losses. The loss ratio fluctuated over the five-year period, while expense ratio increased moderately. Admitted assets increased 4.9% to \$1,852,938 and surplus increased 6.0% to \$1,641,307, as the company's financial position has improved since the prior examination.

The current examination resulted in three recommendations. The recommendations relate to the number of company representatives on the board, the custodial bank statement, and data backup procedures. The examination resulted in no adjustment to surplus.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Board of Directors—It is recommended that the company increase the size of its board of directors to at least nine directors or have only one company employee or company representative on its board of directors.
2. Page 16 - EDP Environment—It is recommended that the company establish a procedure to back up its computer system on a weekly basis and store this backed-up data in a secure off-site location.
3. Page 17 - Invested Assets—It is recommended the company have its custodian provide a statement with an accurate account balance at the end of the reporting period and compare this balance to its investment broker statement at least quarterly.

## **VII. ACKNOWLEDGMENT**

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

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

Respectfully submitted,

Karl K. Albert, CFE  
Examiner-in-Charge