

Carolina Mutual Insurance, Inc.

High Point, North Carolina

Report on Examination

As of December 31, 2015

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September 1, 2016

Honorable Wayne Goodwin
Commissioner of Insurance
State of North Carolina
Raleigh, North Carolina

Sir:

Pursuant to your instructions and in accordance with Section (“§”) 58-2-131 of the General Statutes of North Carolina (“GS”), the North Carolina Department of Insurance (“Department”) conducted an examination of the records, business affairs and financial condition of

Carolina Mutual Insurance, Inc.

(hereinafter referred to as the “Company”), at its main administrative office located at 1820 Eastchester Drive, High Point, North Carolina, 27265. The Company’s statutory home office is located at the same address. The following report on examination is respectfully submitted.

SCOPE OF THE EXAMINATION

We performed a full-scope statutory examination of the Company. This examination covers the period from January 1, 2013 to December 31, 2015, including any material transactions and events occurring subsequent to the examination date and noted during the course of this examination. The Department’s most recent prior examination of the Company was as of December 31, 2012.

The purpose of this examination was to assess the financial condition and controls of the Company and set forth findings of fact (together with citations of pertinent laws, regulations, and rules) with regard to any material adverse findings disclosed by the examination.

We conducted our examination in accordance with auditing standards established by the Department and the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause the Company’s surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process and the following key functional activities were identified:

**Reserving
Premiums & Underwriting
Reinsurance Ceding
Claims Handling
Investing**

This may include assessing significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with GS Chapter 58, and evaluating management's compliance with Statutory Accounting Principles. This examination does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately from the Company's financial statements.

This examination report includes significant findings of fact and general information about the Company and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to the Company.

The Company's Annual Statements, work papers, and the independent audit work papers were reviewed and relied upon whenever possible. A trial balance reconciliation of the Annual Statement ("AS") was performed, as were a verification of ownership and valuation of assets, determination of liabilities and reserves, and an analysis and review of such accounts and records as deemed necessary by the examination team. A management representation letter attesting to the Company's ownership of assets, the nonexistence of unrecorded liabilities and contingent liabilities was received from Company management.

The books and records of the Company are audited annually by independent certified public accountants in accordance with GS § 58-10-185. Dixon Hughes Goodman LLP ("DHG") of High Point, North Carolina, the designated independent public accountant of the Company, issued an unqualified opinion for the years 2014 through 2015. The books and records of the Company were audited by Cherry Bekaert LLP in Charlotte, North Carolina for year-end December 31, 2013.

The statutory reserves and related items for 2015 were reviewed and certified by the Company's Appointed Actuary, Simon Wong, FCAS, ASA, MAAA of Milliman, Inc.

SUMMARY OF SIGNIFICANT FINDINGS

PRIOR EXAMINATION

1. Comments, Recommendations and Directives

- a. The Company improperly included premium deposits totaling \$551,742 in the reserve for unearned premiums for policies with effective dates subsequent to the year ended 2012. Premium deposits received by the Company in advance of the effective date shall be reported as advanced premiums pursuant to SSAP No. 53, and, therefore, an examination adjustment is proposed to reclassify the amount. The Company is directed to comply with SSAP No. 53 in all future filings with the Department. This issue has been resolved.

CURRENT EXAMINATION

1. Analysis of Examination Adjustments

	December 31, 2015
Surplus as originally reported to the Department	\$38,040,558
a. Losses and loss adjustment expenses	2,800,000
Adjusted surplus	\$40,840,558

- a. To decrease the reserves for losses and loss adjustment expense for redundancies pursuant to SSAP No. 55. (Refer to Note 2.a.)

2. Comments, Recommendations and Directives

- a. The Company materially overstated its loss and loss adjustment expenses reserves by a minimum of \$2.8 million and a maximum of \$6.8 million at December 31, 2015. Based on the Department's actuarial review, there were significant redundancies noted in the Company's reported loss and loss adjustment expense reserves which totaled \$31,502,932 at yearend. The Company reported favorable development in its reported loss and loss adjustment expense reserves over the past five years on its 2015 AS Schedule P with redundancies between \$2 million and \$6.8 million each year, with an average of approximately \$4.7 million per year. An examination adjustment is proposed to decrease the Company's loss and loss adjustment expense reserves by the minimum redundancy of \$2.8 million at December 31, 2015. The Company is directed to review its reserving methodology to ensure that its reported loss and loss adjustment expense reserves are adequate but not excessive pursuant to SSAP 55.
- b. The Company's Board of Directors ("Board") did not approve the investments of the Company for the period under examination as required by GS § 58-7-168 which states, "An insurer shall not make any investment or loan, other than a policy loan or annuity contract loan of a life insurer, unless the investment or loan is authorized or approved by the insurer's board of directors or by a

committee authorized by the board and charged with the supervision or making of the investment or loan. The minutes of any such committee shall be recorded and regular reports of the committee shall be submitted to the board of directors.” The Company is directed to comply with GS § 58-7-168.

- c. The Company’s designated independent accountant, DHG, did not present their annual audit findings directly to the Audit Committee as required by GS § 58-10-245 (g)(1), which states, “The audit committee shall require the accountant that performs for an insurer any audit required by this Part to timely report to the audit committee in accordance with the requirements of Statement on Auditing Standards No. 61 of the AICPA Professional Standards, Communication with Audit Committees...”. The Company is directed to comply with GS § 58-10-245 (g)(1).
- d. The Company has a Board member who is compensated for serving on its Audit Committee and also receives compensation from the Company for providing accounting services (i.e. prepares the Company’s statutory quarterly and annual statements, provides suggested journal entries for recording on the Company’s books and records, and prepares the Company’s federal and state income tax returns). According to GS § 58-10-245(d), “In order to be considered independent for purposes of this section, a member of the audit committee shall not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory, or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary of the entity.” The Company is directed to comply with GS § 58-10-245(d).
- e. The Company improperly reported uncollected premiums over 90 days past due as admitted assets in violation of GS § 58-7-162(6). No examination adjustment is proposed as the amount is considered to be immaterial. The Company is directed to comply with GS § 58-7-162(6).
- f. The Company understated the amount reported as premiums written in North Carolina on its 2015 AS Schedule T by \$147,601. This understatement resulted in the Company paying less premium taxes than the amount due to the North Carolina Department of Revenue for 2015. An examination adjustment was not proposed to increase the liability for taxes, licenses and fees at December 31, 2015, as the amount is considered to be immaterial. The Company is directed to comply with GS § 58-2-165(c) and to provide accurate financial reporting in future filings with the Department.
- g. The Company’s MGA agreement with iSurety states that, “from the service fee, the Managing General Agent Agreement (“MGA”) shall bear the expense of all bookkeeping, accounting, and routine financial reporting; provided that the fees and expenses of the insurer outside accountants and actuaries shall be borne by the insurer.” Based on our review, Shelton Nelson and Associates, P.A. (“SNA”) is providing bookkeeping, accounting and routine financial reporting services for which the related expense appears to be the responsibility of iSurety, Inc. (“iSurety”) pursuant to the terms of the MGA agreement. During our examination, it was noted that the Company paid SNA directly for routine accounting services in addition to the service fee paid to iSurety. The Company has indicated that an amended MGA agreement will be filed with the Department to clarify the provision regarding the responsibility for expenses related to routine bookkeeping, accounting and financial reporting services. The Company is directed to execute a services agreement with SNA and to file it along with an amended MGA agreement with the Department for review and approval in accordance with GS § 58-34-10 and GS § 58-34-2, respectively.

- h. The Company did not file audited financial statements for its MGA with the Department for the years 2013 and 2014, as required by GS § 58-34-2(e), which states, “an insurer shall have on file by June 1 of each year an audited financial report of each MGA with which it is doing business.” The Company is directed to comply with GS § 58-34-2(e).
- i. The Company’s MGA had fidelity bond coverage totaling \$100,000 at December 31, 2015, which was less than the \$500,000 minimum recommended by the NAIC. We recommend that the Company maintain fidelity bond coverage for no less than the minimum recommended by the NAIC.

COMPANY HISTORY

North Carolina Mutual Employers Fund (“NCMEF”) was incorporated on December 13, 1993, and was organized to establish and maintain a program of workers’ compensation insurance coverage for small and mid-sized businesses in the state of North Carolina. The Company was incorporated on June 15, 2011, solely for the purpose of merging with NCMEF. The Company was licensed on July 1, 2011, and completed a statutory merger, upon approval of the Department, with NCMEF effective November 1, 2011. The Company’s corporate structure is in the formation of a mutual insurance company under GS § 58-7-75(7)(a) and is, therefore, owned by the policyholders. The Company has approximately 2,418 policyholders as of the examination date.

MANAGEMENT AND CONTROL

CORPORATE GOVERNANCE

Board of Directors

The business of the Company is conducted by its management team and is subject to review by the Board. The bylaws specify that the number of directors shall be no less than seven and no more than nine. The Board currently consists of eight directors. The directors shall annually elect officers of the Company, which shall at a minimum include a president, secretary, and treasurer. The presence, in person, of a majority of the Board constitutes a quorum. Special meetings may be called by the president or chairman at any time or by the secretary when requested in writing by a majority of the Board.

The following individuals served as directors as of December 31, 2015:

Name	Location	Principal Occupation
Brad C. Bedsaul, Chairman	Sparta, NC	Chief Executive Officer of Truline Truss, Inc.
Clint F. Bedsaul	Sparta, NC	President of Truline Truss, Inc.
Sam T. Gianopoulos	Winston-Salem, NC	Owner of Sammy G's Tavern
Gary N. Lail	Hickory, NC	President/Owner of Quaker Furniture, Inc.
Jorge A. Lagueruela	Trinity, NC	President/Owner of Trinity Furniture, Inc.
Gary L. Harold	Mount Airy, NC	President/Owner of H&W Trucking, Inc.
Mark K. Nelson	Greensboro, NC	Member/Owner Shelton & Nelson Associates, P.A.

The Board has the authority to establish committees. These committees have the power and duties deemed appropriate by the Board; however, their power cannot exceed the power of the Board. The Board has established an Audit Committee, a Membership Committee, and a Compensation Committee to act on behalf of the Board.

The following individuals served on Board committees as of December 31, 2015:

Audit Committee

Jorge A. Lagueruela, Chair
 Gary N. Lail
 Mark K. Nelson

Membership Committee

Jorge A. Lagueruela
 Brad C. Bedsaul
 Gary N. Lail

Compensation Committee

Gary N. Harold
 Clint F. Bedsaul
 Brad C. Bedsaul
 Sammy T. Gianopoulos

Officers

The bylaws provide that the Board will elect the officers of the Company. The officers of the Company consist of a president, secretary and a treasurer and one or more vice presidents. All officers are elected annually and subject to removal at any time by the Board, until their successors are elected and qualified. Any two offices may be held by the same person.

The following individuals served as officers of the Company as of December 31, 2015:

Name	Title
Brad C. Bedsaul	President
Sam T. Gianopoulos	Secretary
Gary N. Lail	Treasurer
Clint F. Bedsaul	Vice President

MANAGING GENERAL AGENT

The Company has no employees. Under an MGA agreement with iSurety, Inc., the Company assigns the responsibility for conducting its daily operations to iSurety. The agreement may be terminated in accordance with the provisions as specified in the agreement. In the event the contract is terminated for cause, the Company would become responsible for claims administration on all unsettled claims incurred during the period the agreement was in effect.

CODE OF CONDUCT AND CONFLICT OF INTEREST

The Company has an established policy and procedure to identify existing or potential conflicts of interest and to report the same to the Board. Annually, the Company requires a signed statement from each director and officer disclosing any conflict of interest. A review of the signed conflict of interest statements for the examination period revealed that the Company acted in accordance with its policy and procedures for disclosure of conflicts of interest.

CORPORATE RECORDS

The minutes of the meetings of the Board and the Audit Committee were reviewed for the period under examination. Based on our review, the Board did not approve the Company's investments as stipulated by GS 58-7-168. (Refer to Note 2.b)

STATUTORY DEPOSITS

Statutory deposits are maintained as required by insurance regulatory agencies for doing business in such jurisdictions. The Company's 2015 AS, Schedule E, Part 3 contains a complete description and listing of the Company's statutory deposits by state.

ACCOUNTS AND RECORDS

The Company's books and records are maintained at its administrative office at 1820 Eastchester Drive, High Point, North Carolina 27265.

Due to the size of the Company, most Information Technology ("IT") operations have been outsourced to third parties. The Company utilizes two IT providers, one of which provides daily support for the Company's hardware and software systems and another provides support for the Company's policy and claims system. The IT Manager at iSurety oversees the outsourced IT functions and any contracts with third party service providers. Outsourced IT functions include managed IT services such as desktop, server, and infrastructure support and maintenance, 24x7 Helpdesk support, a Chief Information Technology Officer, project management, backup services, network administration and monitoring. All of the Company's applications and software are "out-of-the-box" packages developed by others. The Company retains ownership of the hardware.

FIDELITY BONDS AND OTHER INSURANCE

At December 31, 2015, the Company's MGA, iSurety, is insured under a fidelity bond which provides coverage of \$100,000. This amount of coverage was not sufficient based on the \$500,000 minimum recommended by the Handbook as of the examination date; however, the MGA subsequently increased its coverage to \$500,000. (Refer to Note 2.i)

EMPLOYEE BENEFITS AND PENSION PLANS

The Company has no employees.

RELATED PARTY AGREEMENTS

The Company has an MGA agreement with iSurety, Inc., effective April 17, 2013, whereby the Company is provided claims, marketing, underwriting, administrative, accounting and management services for a fee equal to 15% of the Company's normal earned premium. Under this agreement, the Company paid management fees totaling \$4,227,354 and \$3,933,230 in 2015 and 2014, respectively.

The Company's MGA agreement with iSurety creates a related party relationship based on SSAP No. 25, paragraph 3(g), which states that related parties exist when entities have common interests by contract and includes "a party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity."

TERRITORY AND PLAN OF OPERATION

The Company is a single-line non-assessable mutual insurer that writes workers compensation insurance primarily to small and medium sized businesses located in North Carolina, Georgia and Virginia. The Company is licensed to write workers compensation insurance in the State of Kentucky, however, no policies have been written as of December 31, 2015. In March 2016, the Company also became licensed in Tennessee.

The Company utilizes iSurety for the distribution of its product and solicitation of business. All policies are issued annually. Insureds may elect to pay on an installment basis.

TRENDS OF THE COMPANY

The following data, obtained from annual statements filed with the Department, illustrates the trends of the Company for the five year period ended December 31, 2015:

Year	Net Admitted Assets	Surplus	Gross Premiums Written	Net Earned Premiums	Net Income
2015	\$84,938,571	\$38,040,558	\$31,625,200	\$18,120,542	\$5,226,954
2014	\$79,886,623	\$33,331,681	\$29,298,613	\$15,463,403	\$2,683,217
2013	\$76,072,211	\$31,379,574	\$25,789,137	\$13,890,461	\$4,101,756
2012	\$69,693,890	\$27,327,815	\$21,254,900	\$10,494,222	\$3,239,531
2011	\$64,508,292	\$23,994,285	\$17,472,602	\$9,666,727	\$1,338,030

ACTUARIAL OPINION

Every property and casualty insurance company doing business in this State, unless otherwise exempted by the Commissioner, shall annually submit the opinion of an appointed actuary and an actuarial opinion summary in accordance with GS § 58-10-150 and GS § 58-10-155.

The statutory reserves and related items for 2015 were reviewed and certified by the Company's Appointed Actuary Simon Wong, FCAS, ASA, MAAA of Milliman, Inc. Actuarial opinions regarding the Company's reserves for loss and loss adjustment expenses were issued by an appointed actuary for all years in the examination period. The appointed actuary evaluated the data provided by the Company for reasonableness and consistency of the loss and loss adjustment expense reserves. According to the actuarial opinions, the Company's reserves on loss and loss adjustment expenses met the requirements of the insurance laws of North Carolina; were consistent with reserves computed in accordance with accepted actuarial standards and principles; and made a reasonable provision for all loss and loss adjustment expense obligations of the Company.

REINSURANCE PROGRAM OVERVIEW

REINSURANCE CONTRACTS

The Company has an excess of loss contract for 2015 and 2014, which provides coverage up to a maximum of \$100.0 million of the net liability in excess of \$1.0 million per accident on its workers' compensation losses.

The Company participates in the National Workers' Compensation Reinsurance Pool ("Pool"), a residual market reinsurance mechanism for servicing carriers of workers' compensation assigned risk plans administered by the National Council on Compensation Insurance, Inc. ("NCCI").

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Department and present the financial condition of the Company for the period ending December 31, 2015. The supporting exhibits present the information required to be included, in conformity with reporting practices prescribed by the Department. The financial statements and supporting schedules as of December 31, 2014, are unexamined and are presented for comparative purposes only.

Carolina Mutual Insurance, Inc.
Statutory Statement of Admitted Assets
December 31,

	2015	2014 <i>(unexamined)</i>
Bonds	\$63,866,476	\$59,271,057
Common Stocks	275,012	275,002
Cash and short-term investments	9,488,278	9,910,905
Total cash and invested assets	73,629,766	69,456,964
Investment income due and accrued	419,614	378,109
Uncollected premiums and agents' balances	817,424	673,889
Deferred premiums and agents' balances	8,271,767	7,217,661
Net deferred tax asset	1,800,000	2,160,000
Total Admitted Assets	\$84,938,571	\$79,886,623

Carolina Mutual Insurance, Inc.
Statutory Statement of Liabilities and Surplus
December 31,

	2015	2014 <i>(unexamined)</i>
Losses	\$27,635,237	\$29,124,587
Loss adjustment expenses	3,867,695	4,260,000
Commissions payable	627,328	228,865
Other expenses	396,286	419,502
Taxes, licenses and fees	88,784	39,329
Current federal income taxes	1,022,883	201,069
Unearned premiums	12,794,641	11,177,988
Advance premium	766,611	914,212
Ceded reinsurance premiums payable	(301,452)	189,390
Total Liabilities	\$46,898,013	\$46,554,942
Unassigned funds	38,040,558	33,331,681
Surplus as regards policyholders	38,040,558	33,331,681
Total Liabilities and Surplus	\$84,938,571	\$79,886,623

Carolina Mutual Insurance, Inc.
Statutory Statement of Operations
December 31,

	2015	2014 <i>(unexamined)</i>
Underwriting Income		
Premiums earned	\$ 28,245,609	\$ 26,560,939
Deductions		
Losses incurred	11,602,374	14,885,022
Loss adjustment expenses incurred	1,375,662	1,283,471
Other underwriting expenses incurred	8,255,588	7,180,407
Total underwriting deductions	21,233,624	23,348,900
Net underwriting gain	7,011,985	3,212,039
Investment Income		
Net investment income earned	898,820	924,235
Net realized capital gains	16,888	
Net investment gain	915,708	924,235
Net income before taxes	7,927,693	4,136,274
Federal income taxes incurred	2,700,739	1,453,057
Net Income	\$5,226,954	\$2,683,217

Carolina Mutual Insurance, Inc.
Statutory Statement of Surplus
December 31,

Surplus Account	2015	2014 <i>(unexamined)</i>
Surplus, beginning of year	\$33,331,681	\$31,379,574
Surplus increases (decreases):		
Net Income	5,226,954	2,683,217
Change in net deferred income tax	(768,600)	167,711
Change in non-admitted assets	364,000	89,000
Cumulative effect of changes in accounting principles		(987,821)
SSAP No. 3 corrections related to rating errors	(113,477)	
Change in surplus as regards policyholders for the year	4,708,877	1,952,107
Surplus, end of year	\$38,040,558	\$33,331,681

Carolina Mutual Insurance, Inc.
Statutory Statement of Cash Flow
December 31,

	2015	2014 <i>(unexamined)</i>
Cash From Operations		
Premiums collected net of reinsurance	\$27,912,701	\$26,476,061
Net investment income	1,385,631	1,389,501
Total	29,298,332	27,865,562
Benefit and loss related payments	13,091,724	15,101,756
Commissions, expenses paid and aggregate write-ins	9,598,853	8,582,861
Federal income taxes paid	1,878,925	1,225,000
Total	24,569,502	24,909,617
Net cash from operations	4,728,830	2,955,945
Cash Used By Investments		
Proceeds from investments sold, matured, or repaid	32,382,453	16,827,805
Cost of investments acquired	37,533,910	20,936,330
Net cash used by investments	(5,151,457)	(4,108,525)
Reconciliation of Cash and Short-Term Investment		
Net change in cash, cash equivalents and short-term investments	(422,627)	(1,152,580)
Cash and short-term investments, beginning of year	9,910,905	11,063,485
Cash and short-term investments, end of year	<u>\$9,488,278</u>	<u>\$9,910,905</u>

COMMENTS ON FINANCIAL STATEMENTS

Department examiners recommend an adjustment to surplus and a balance sheet reclassification related to the Company's 2015 financial statements as a result of the Company's improper reporting of loss and loss adjustment expense reserves. (Refer to the Current Examination Note on page 3)

Basis of Presentation and Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the basis of the accounting practices prescribed or permitted by the Department.

The more significant accounting policies followed by the Company are as follows:

Bonds: Carried at amortized cost using the scientific method. Bonds with lower credit ratings are carried at the lower of amortized cost or NAIC market value. Bonds not backed by other loans are stated at amortized cost using the scientific method.

Common stocks: Carried at fair value except investments in stock of subsidiaries, which are carried at a value determined under the equity method.

Cash and short-term investments: Carried at amortized cost (which approximates fair value) and includes money market instruments and debt securities with maturities of less than one year.

Premiums: Insurance premiums, net of premiums ceded to reinsurers, are earned over the terms of the policies. The portion of direct premiums written applicable to the unexpired terms of the policies is recorded as unearned premium. Premiums are earned on a daily pro rata basis.

Reinsurance: Premiums, commissions, expense reimbursements, and reserves are reported for on a basis consistent with the original policies issued and the terms of the reinsurance agreements. Premiums ceded are reported as a reduction of premium income. Losses and loss adjustment expenses are reported as reductions of those items.

Reserves for loss & loss adjustment expenses: Includes amounts determined from individual case estimates and loss reports and amounts, based on experience, for losses incurred but not reported. Estimated amounts of salvage and subrogation and reinsurance recoverable are deducted from the reserve for losses and loss adjustment expenses.

Analysis of Assets:

The following represents an analysis of the Company's net admitted assets as of December 31, 2015:

	Assets	Assets not Admitted	Net Admitted Assets
Bonds	\$63,866,476		\$63,866,476
Common Stocks	275,012		275,012
Cash and short-term investments	9,488,278		9,488,278
Total cash and invested assets	73,629,766		73,629,766
Investment income due and accrued	419,614		419,614
Uncollected premiums and agents' balances	817,424		817,424
Deferred premiums and agents' balances	8,271,767		8,271,767
Net deferred tax asset	2,032,000	232,000	1,800,000
Total Assets	\$85,170,571	\$232,000	\$84,938,571

Reinsurance:

The Company has an excess of loss reinsurance contract to minimize its exposure to losses. Reinsurance contracts do not relieve the Company of its primary obligation to policyholders. Failure of the reinsurers to discharge their obligations could result in losses to the Company. The Company utilizes Atlantic Intermediaries as a reinsurance intermediary to negotiate and obtain reinsurance contracts on its behalf for specifically identified risks.

Direct and ceded premiums written and earned are as follows:

	2015	2014
Direct and assumed written	\$31,625,200	\$29,298,613
Ceded written	(1,762,938)	(1,440,441)
Net written	29,862,262	27,858,172
Direct and assumed earned	30,008,545	28,001,380
Ceded earned	(1,762,938)	(1,440,441)
Net earned	\$28,245,607	\$26,560,939

The reinsurer shares in the risks at different levels as specified in the reinsurance contract. The contract, retention limits and insurance coverage is described below.

Reinsurance Ceded

Excess of Loss Coverage

The Company has an excess of loss contract with Arch Insurance Company, effective October 31, 2014. In 2015 and 2014, the Company ceded premiums of approximately \$1,762,938 and \$1,440,441 under the contract, respectively.

Reinsurance Assumed

The Company participates in the Pool, which is a residual market reinsurance mechanism for servicing carriers of workers compensation assigned risk plans administered by NCCI. As a participant, the Company assumes premiums, losses, costs, and other expenses arising from coverage provided under authorized insurance plans written through a servicing carrier. The business assumed from the Pool is the Company's proportionate share of the total voluntary market for workers' compensation in the state. During 2015 and 2014, the Company assumed approximately \$1,793,442 and \$1,220,227, respectively, in premiums from the Pool.

Summary of Reserves:

The following provides a reconciliation of the Company's reserves for losses and loss adjustment expenses:

	Current Year	Prior Year
Reserve for losses and loss adjustment expenses, beginning of year	33,384,587	\$32,592,000
Correction of Error:		(1,106,000)
Add:		
Provision for losses and loss adjustment expenses, current year	20,955,000	22,812,000
Change in estimated losses and loss adjustment expenses, prior years	(7,976,964)	(6,643,507)
Total incurred	12,978,036	16,168,493
Deduct:		
Losses and loss adjustment expenses paid, current year	5,549,000	6,349,000
Losses and loss adjustment expenses paid, prior year	9,310,691	9,318,000
Total paid	14,859,691	15,375,906
Reserve for losses and loss adjustment expenses, end of year	31,502,932	33,384,587
Decrease/Increase in reserve for losses and loss adjustment expenses	(\$1,881,655)	\$792,587

During 2015 and 2014, the Company collected amounts recoverable for reinsurance of approximately \$21,000 and \$71,000, respectively.

During 2014, the Company recorded a correction of an error after it was determined that the activity related to its 2012 and 2013 participation in the North Carolina and Virginia residual pools was incorrectly recorded on a net cash basis instead of an accrual basis.

Surplus:

The following, in conjunction with the Statutory Statement of Surplus (see page 14), represents the changes in the Company's surplus since December 31, 2010:

	2013	2012	2011
Surplus, beginning of year	\$27,327,818	\$23,994,287	\$22,701,257
Surplus increases (decreases):			
Net income	4,101,756	3,239,531	1,338,030
Change in net deferred income tax	(33,000)	121,000	(104,000)
Change in non-admitted assets	(17,000)	(27,000)	59,000
Change in surplus as regards policyholders for the year	(4,051,756)	3,333,531	1,293,030
Surplus, end of year	\$31,379,574	\$27,327,818	\$23,994,287

Contingencies and Commitments:

The Company is involved in routine legal and administrative proceedings incidental to the conduct of its business. While the outcome of these matters cannot be estimated with certainty, it is the opinion of management that the resolution of these matters will not have a material effect on the financial position of the Company.

SUBSEQUENT EVENTS

In June 2016, the Internal Revenue Service completed an audit of the Company's 2013 and 2014 federal tax returns. As a result of the IRS audit and paid additional income taxes totaling \$556,469 in June 2016.

Carolina Mutual Insurance, Inc.
DISTRIBUTION OF REPORT ON EXAMINATION
December 31, 2015

Mr. John Baker, Chief Executive Officer/Chief Financial Officer
iSurety, Inc.
1820 Eastchester Drive
High Point, NC 27265

Mr. Brad Bedsaul, President
Carolina Mutual Insurance, Inc.
1820 Eastchester Drive
High Point, NC 27265

Mr. Jorge Lagueruela, Chairman of the Audit Committee
Carolina Mutual Insurance, Inc.
1820 Eastchester Drive
High Point, NC 27265

Mr. Mark Nelson, Director
Carolina Mutual Insurance, Inc.
1820 Eastchester Drive
High Point, NC 27265

CONCLUSION

We conclude that the Company complies with the minimum capital and surplus requirements of GS § 58-7-75 for the kinds of insurance that the Company has been authorized to write, which is \$1,000,000.

The courteous cooperation and assistance extended by the officers and employees of the Company during the examination is hereby acknowledged.

Respectfully submitted,



Monique D. Smith, CPA, CFE
Chief Financial Examiner
North Carolina Department of Insurance

September 1, 2016

STATE OF NORTH CAROLINA

COUNTY OF WAKE

Herb Maltba, Examination Supervisor, North Carolina Department of Insurance, being first, duly sworn, deposes and says that this report on examination, subscribed by him, is true and correct to the best of his knowledge and belief.

Signature:

Herb Maltba
Herb Maltba

Date:

Oct. 3, 2016

Sworn and subscribed before me this 3 day of October, 2016

Notary Public Signature:

[Signature]

Notary Public Seal

