

Farmers Mutual Fire Insurance Company of Cleveland County

Shelby, North Carolina

Report on Examination

As of December 31, 2017

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April 29, 2019

Honorable Mike Causey
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

Farmers Mutual Fire Insurance Company of Cleveland County

(hereinafter referred to as the “Company”), at its main administrative and statutory home office located at 102 N. Washington Street, Shelby, North Carolina 28150. 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, 2017, 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 is 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 an insurer’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:

Investments
Premiums and Underwriting
Losses and Reserves
Capital and Surplus
Reinsurance

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 Statement of 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 insurer 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 are 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 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(a). Cobb Ezekiel Loy and Company, the designated independent public accountant of the Company, issued an unqualified opinion for each year subsequent to the Department's prior examination through, and including, the year ended December 31, 2017.

The Company is exempt from filing a Statement of Actuarial Opinion on the Company's statutory reserves and related items for the years under examination.

SUMMARY OF SIGNIFICANT FINDINGS

CURRENT EXAMINATION

1. The Company's investment transactions were not reviewed and approved by its Board of Directors ("Board") as required by GS § 58-7-168. The Company is directed to comply with GS § 58-7-168 regarding Board review and approval of its investment transactions and to maintain meeting minutes documenting the Board's approval.
2. Conflict of interest forms were not executed annually by all directors of the Company. Pursuant to North Carolina Administrative Code Title 11 Chapter 11C.0117, the Company is directed to execute conflict of interest forms annually for all directors of the Company.

COMPANY HISTORY

Farmers Mutual Fire Insurance Company of Cleveland County commenced business in 1906 and was incorporated on January 1, 1994. The Company is a mutual company owned by its policyholders.

MANAGEMENT AND CONTROL

CORPORATE GOVERNANCE

Board of Directors

The business of the Company is conducted by its three employees and is subject to review by the Board. The bylaws specify that the number of directors shall be ten. Directors are elected annually, at the annual meeting of members or by the written consent of the members, and each director elected shall hold office until a successor is elected and qualified.

The following individuals served as directors as of December 31, 2017:

Name	Location	Principal Occupation
Michael Spake	Shelby, NC	President
Max J. Hamrick	Boiling Springs, NC	Mayor of Boiling Springs, NC
Phillip Greene	Shelby, NC	Dairy Farmer
E.A Bingham Jr.	Shelby, NC	Retiree from Lutz Oil
Jeffrey Crotts	Shelby, NC	Fruit Producer
Ed Goforth	Shelby, NC	Mechanical Breakdown Analyst
Bobby Downs	Casar, NC	Poultry Farmer
Nelson Biggers	Shelby, NC	Self-employed Machinist
Brent Elmore	Lawndale, NC	Duke Energy employee
Eddie Harrill	Shelby, NC	Self-employed rental properties agent

The Board established an Audit Committee to act on its behalf and the following individuals served on the Audit Committee as of December 31, 2017:

Audit Committee

Michael Spake, Chair
Max J. Hamrick
Brent Elmore
Bobby Downs

Officers

The bylaws provide that the Board will elect the officers of the Company. The officers of the Company consist of a president, a secretary, a treasurer and any other officers deemed necessary by the Board. All officers shall hold office, 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, 2017:

Name	Title
Michael Spake	President
Max J. Hamrick	Vice President
Barbara W. Davis	Secretary and Treasurer

CODE OF CONDUCT AND CONFLICT OF INTEREST

The Company has established policies and procedures 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 did not act in accordance with its policies and procedures for disclosure of conflicts of interest. (See Summary of Significant Findings).

CORPORATE RECORDS

We reviewed the minutes of the meetings of the Board and its committees for the period under examination. Based on our review, it appears that the minutes documented the Company's significant transactions and events, and that the directors approved these transactions and events.

The Company's articles of incorporation and bylaws were reviewed for any changes during the period under examination. Based on our review, it appears there have been no changes to the articles of incorporation or bylaws for the Company during the period under examination.

FIDELITY BONDS AND OTHER INSURANCE

The Company is the named insured under a Commercial Protector Policy which provides employee dishonesty coverage up to a limit of \$50,000, which is adequate based on the minimum recommended by the NAIC.

TERRITORY AND PLAN OF OPERATION

The Company operates as a county farm mutual and is authorized to write fire and allied lines coverages within the following North Carolina counties: Cleveland, Rutherford, Lincoln, Gaston, Catawba, and Burke. The Company is not licensed to operate in other counties or states.

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 2017:

Year	Total Net Admitted Assets	Capital and Surplus	Gross Premiums Written	Net Earned Premiums	Net Income(loss)
2017	\$2,585,793	\$2,042,796	\$396,658	\$352,533	(\$91,280)
2016	\$2,611,888	\$2,088,316	\$386,514	\$333,961	(\$138,443)
2015	\$2,652,106	\$2,127,966	\$400,039	\$362,406	\$106,629
2014	\$2,704,086	\$2,189,394	\$390,424	\$373,831	\$160,532
2013	\$2,581,837	\$2,059,339	\$132,541	\$173,350	(\$164,451)

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.

In accordance with the NAIC Annual Statement Instructions, the Company applied for and was granted an automatic exemption from the annual requirement to obtain a Statement of Actuarial Opinion for each year subsequent to the Department's prior examination through, and including, the year ended December 31, 2017. The exemption is automatically granted if "an insurer has less than \$1,000,000 total direct plus assumed written premiums during a calendar year, and less than \$1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end."

REINSURANCE PROGRAM OVERVIEW

REINSURANCE CEDED

The Company has an aggregate excess of loss reinsurance contract, which is effective January 1, 2017. The reinsurance contract has various subscribing reinsurers ("Reinsurers"). A summary of the coverage provided under the contract is as follows:

Aggregate Excess of Loss Reinsurance

The Company retains an aggregate ultimate net loss equal to 90% of gross net earned premium income for the business written. The Reinsurers are liable for 95% of ultimate net loss in excess of the Company's

retention up to 90% of gross net Earned premium income, subject to a limit of liability to the Reinsurers of 95% of 400% of gross earned premium income. As of December 31, 2017, 90% of the net earned premiums was \$317,280. The Company ceded premiums totaling \$40,419 and \$53,027 under the contract in 2017 and 2016, respectively.

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, 2017. 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, 2016, are unexamined and are presented for comparative purposes only.

Farmer Mutual Fire Insurance Company of Cleveland County
Statutory Statement of Admitted Assets
December 31, 2017

	2017	2016 <i>(unexamined)</i>
Bonds	\$483,176	\$481,226
Common stocks	1,816,337	1,867,348
Real estate properties occupied by the Company	41,542	41,895
Cash and cash equivalents	171,901	221,099
Total cash and invested assets	\$2,512,956	\$2,611,568
Investment income due and accrued	54	91
Amounts recoverable from reinsurers	72,646	-
Electronic data processing equipment and software	137	229
Total admitted assets	\$2,585,793	\$2,611,888

Farmers Mutual Fire Insurance Company of Cleveland County
Statutory Statement of Liabilities, Policyholders' Surplus
December 31, 2017

	2017	2016 <i>(unexamined)</i>
Losses	\$49,351	\$28,350
Loss adjustment expenses	1,104	1,387
Other expenses	5,904	8,336
Taxes, licenses, and fees	1,423	1,535
Unearned premiums	217,927	214,221
Advance premium	264,735	267,028
Amounts withheld or retained by Company for account of others	2,553	2,715
Total Liabilities	542,997	523,572
Unassigned funds	2,042,796	2,088,316
Total Surplus	2,042,796	2,088,316
Total Liabilities and Surplus	\$2,585,793	\$2,611,888

Farmers Mutual Fire Insurance Company of Cleveland County
Statutory Statement of Operations
December 31, 2017

	2017	2016 <i>(unexamined)</i>
Underwriting Income		
Premiums earned	\$352,533	\$333,961
Deductions		
Losses incurred	361,664	274,728
Loss adjustment expenses incurred	41,858	35,050
Other underwriting expenses incurred	208,292	209,658
Total underwriting deductions	611,814	519,436
Net underwriting (loss)	(259,281)	(185,475)
Investment Income		
Net investment income earned	78,291	54,788
Net realized capital gains	89,710	(7,755)
Net investment gain	168,001	47,033
Net (Loss)	\$(91,280)	\$(138,443)

Farmers Mutual Fire Insurance Company of Cleveland County
Statutory Statement of Policyholders' Surplus
December 31, 2017

	2017	2016 <i>(unexamined)</i>
Surplus, beginning of year	\$2,088,316	\$2,127,966
Net income	(91,280)	(138,443)
Change in net unrealized capital gains(losses)	43,554	94,943
Change in non-admitted assets	2,206	3,850
Change in surplus as regards policyholders for the year	(45,520)	(39,650)
Surplus, end of year	\$2,042,796	\$2,088,316

Farmers Mutual Fire Insurance Company of Cleveland County
Statutory Statement of Cash Flow
December 31, 2017

	2017	2016 <i>(unexamined)</i>
Cash From (Used By) Operations		
Premiums collected net of reinsurance	\$353,946	\$340,546
Net investment income	78,398	54,802
Miscellaneous income	-	(1)
Total	432,344	395,347
Benefit and loss related payments	413,309	276,829
Commissions, expenses paid and aggregate write-ins	252,694	247,674
Total	666,003	524,503
Net cash (used by) operations	(233,659)	(129,156)
Cash From (Used By) Investments		
Proceeds from investments sold, matured, or repaid	387,834	380,922
Cost of investments acquired	205,509	361,777
Net cash from investments	182,325	19,145
Cash From (Used By) Financing and Miscellaneous Sources		
Other cash provided	2,136	2,218
Net cash from financing and miscellaneous sources	2,136	2,218
Reconciliation of Cash and Cash Equivalents		
Net change in cash and cash equivalents	(49,198)	(107,793)
Cash and cash equivalents, beginning of year	221,099	328,892
Cash and cash equivalents, end of year	\$171,901	\$221,099

COMMENTS ON FINANCIAL STATEMENTS

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: Reported at amortized cost or fair value based on their NAIC rating. Amortization is calculated using the straight-line method. Significant changes in estimated cash flows from the original purchase assumptions are accounted for using the prospective method.

Common stocks: Reported at fair market value as published in the NAIC valuation of securities manual or other recognized exchanges.

Real Estate Occupied by the Company: Land is reported at cost. Real Estate is recorded at cost, net of accumulated depreciation. Depreciation on real estate is computed by the straight-line method over the useful lives of the properties.

Premiums: Earned over the terms of the related insurance policies and reinsurance contracts. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro rata method for direct business.

Loss and Loss Adjustment Expense Reserves: The reserves for unpaid losses and loss adjustment expenses represent the estimated ultimate net cost of all reported and unreported losses that are unpaid as of the balance sheet date, net of amounts recoverable pursuant to reinsurance agreements.

Analysis of Assets:

The following represents an analysis of the Company's net admitted assets at December 31, 2017:

	Assets	Assets not Admitted	Net Admitted Assets
Bonds	\$483,176		\$483,176
Common stocks	1,816,337		1,816,337
Real estate properties occupied by the company	41,542		41,542
Cash and cash equivalents	171,901		171,901
Total cash and invested assets	\$2,512,956		\$2,512,956
Investment income due and accrued	54		54
Amounts recoverable from reinsurers	72,646		72,646
Electronic data processing equipment and software	137		137
Furniture and equipment, including health care delivery assets	18,780	18,780	-
Total admitted assets	\$2,604,573	18,780	\$2,585,793

Reinsurance Activity:

The Company has an excess of loss contract to minimize its exposure to losses. The reinsurance contract does 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 Guy Carpenter as a reinsurance intermediary to negotiate and obtain reinsurance contracts on its behalf for specifically identified risks. The Company does not assume reinsurance business.

Direct and ceded premiums written and earned are as follows:

	2017	2016
Direct written	\$396,658	\$386,514
Ceded written	40,419	53,027
Net written	356,239	333,487
Direct earned	392,952	386,988
Ceded earned	40,419	53,027
Net earned	\$352,533	\$333,961

The reinsurers share in the risks at different levels as specified in the reinsurance contract. The type of contract and retention limit are described under the Reinsurance Program Overview.

Summary of Reserves:

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

	2017	2016
Reserve for losses and loss adjustment expenses, beginning of year	\$29,737	\$32,140
Add:		
Provision for losses and loss adjustment expenses, current year	415,000	320,000
Change in estimated losses and loss adjustment expenses, prior years	(11,478)	(10,222)
Total incurred	403,522	309,778
Deduct:		
Losses and loss adjustment expenses paid, current year	382,000	308,000
Losses and loss adjustment expenses paid, prior year	804	4,181
Total paid	382,804	312,181
Reserve for losses and loss adjustment expenses, end of year	50,455	29,737
Increase in reserve for losses and loss adjustment expenses	\$20,718	\$(2,403)

Reserves for losses and loss adjustment expenses are reported net of the amounts that are recoverable under the Company's reinsurance contracts. At December 31, 2017, and 2016, the liability for losses and loss adjustment expenses was reduced by \$11,478 and \$10,222, respectively.

Policyholders' Surplus:

The following, in conjunction with the Statutory Statement of Policyholders' Surplus, represents the changes in the Company's surplus since the Department's last examination as of December 31, 2012:

	2015	2014	2013
Surplus, beginning of year	\$2,189,394	\$2,059,339	\$2,115,295
Net income (loss)	106,629	160,532	(164,451)
Change in net unrealized capital gain (loss)	(143,221)	156,623	108,495
Change in net deferred income tax	-	(30,477)	-
Change in non-admitted assets	(24,836)	-	-
Change in surplus as regards policyholders for the year	(61,428)	130,055	(55,956)
Surplus, end of year	\$2,127,966	\$2,189,394	\$2,059,339

Contingencies and Commitments:

The Company does not have any pending legal proceedings arising from litigation, income taxes or other matters that could have a material effect on the financial position of the Company.

Farmers Mutual Fire Insurance Company of Cleveland County
DISTRIBUTION OF REPORT ON EXAMINATION
December 31, 2017

Barbara Davis, Secretary/Treasurer
102 N. Washington Street
Shelby, North Carolina 28150

Michael Spake, President
102 N. Washington Street
Shelby, North Carolina 28150

CONCLUSION

The examination procedures, described herein, revealed no material adverse findings or adjustments to surplus.

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 \$120,000.

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

Respectfully submitted,



Ke Xu, CPA, CFE
Chief Financial Examiner
North Carolina Department of Insurance

April 29, 2019

STATE OF NORTH CAROLINA

COUNTY OF WAKE

Kimmea Stevenson, North Carolina Department of Insurance, being first, duly sworn, deposes and says that this report on examination, subscribed by her, is true and correct to the best of her knowledge and belief.

Signature:

Kimmea Stevenson
Kimmea Stevenson

Date:

4/29/2019

Sworn and subscribed before me this 29th day of April, 2019.

Notary Public Signature:

Jamika N Bell

Notary Public Seal:

