

STATE OF MISSOURI



DEPARTMENT OF COMMERCE & INSURANCE

P.O. Box 690, Jefferson City, Mo. 65102-0690

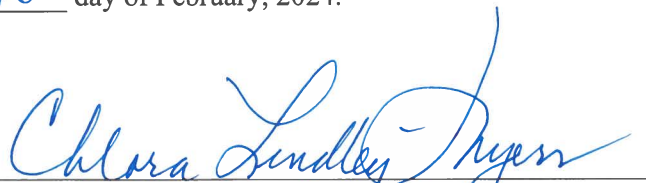
ORDER

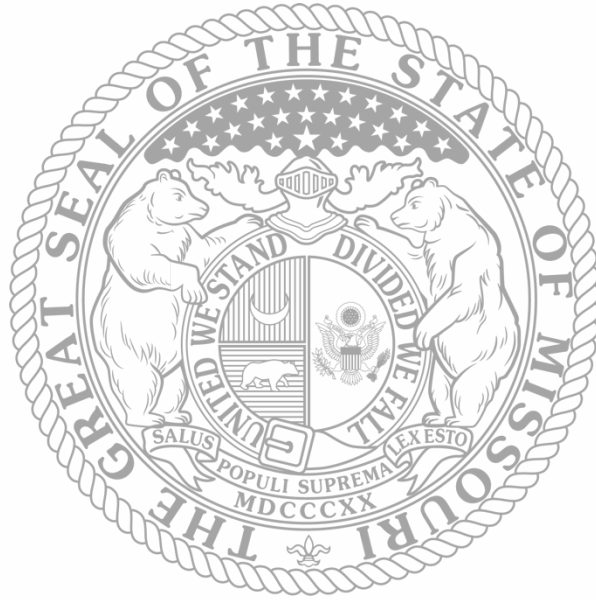
After full consideration and review of the report of the financial examination of CFM Insurance, Inc. ("CFM") for the period ended December 31, 2022, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, Chlora Lindley-Myers, Director, Missouri Department of Commerce and Insurance pursuant to section 380.491, RSMo, adopt such report. I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order: scope of examination, summary of significant findings, company history, management and control, employee benefits, territory and plan of operation, growth of company and loss experience, reinsurance, accounts and records, financial statements, comments on financial statement items, financial statement changes resulting from examination, summary of recommendations, and subsequent events.

Based on such findings and conclusions, I hereby ORDER CFM to take the following action or actions which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed in such report: (1) implement and verify compliance with each item mentioned in the Comments on the Financial Statement and Summary of Recommendations sections of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions; and (3) submit a signed copy of the minutes of the meeting which reflect a corporate resolution to the effect the examination report has been reviewed and accepted. In consideration of the response submitted by CFM, the unique circumstances surrounding its acquisition of Cornerstone National Insurance Company, and the fact that the Director controls the repayment of principal and payment of interest of surplus notes pursuant to 20 CSR 200-1.070, CFM may continue to include the surplus note amount of \$5,470,112 identified in the examination report as a departure from Generally Accepted Accounting Principles in the stock value of Innovated Holdings, Inc. reported on CFM's financial statements through January 1, 2025, but only so long as this order and the report of the financial examination of CFM for the period ended December 31, 2022 are available to the public and the \$5,470,112 departure is disclosed on CFM's financial statements.

So ordered, signed and official seal affixed this 13th day of February, 2024.




Chlora Lindley-Myers, Director
Department of Commerce and Insurance



REPORT OF
FINANCIAL EXAMINATION OF

CFM INSURANCE, INC.

AS OF
DECEMBER 31, 2022

STATE OF MISSOURI
DEPARTMENT OF COMMERCE & INSURANCE

JEFFERSON CITY, MISSOURI

TABLE OF CONTENTS

SCOPE OF EXAMINATION	1
PERIOD COVERED.....	1
PROCEDURES.....	1
SUMMARY OF SIGNIFICANT FINDINGS	2
COMPANY HISTORY	3
GENERAL.....	3
MERGERS, ACQUISITIONS, AND MAJOR CORPORATE EVENTS	4
DIVIDENDS AND CAPITAL CONTRIBUTIONS	5
MANAGEMENT AND CONTROL	5
BOARD OF DIRECTORS	5
SENIOR OFFICERS	6
PRINCIPAL COMMITTEES	7
CONFLICT OF INTEREST.....	7
CORPORATE RECORDS.....	8
HOLDING COMPANY, SUBSIDIARIES, AND AFFILIATES.....	8
ORGANIZATIONAL CHART	8
INTERCOMPANY TRANSACTIONS	9
EMPLOYEE BENEFITS	11
TERRITORY AND PLAN OF OPERATION	11
GROWTH OF COMPANY AND LOSS EXPERIENCE	11
REINSURANCE	12
GENERAL.....	12
ASSUMED REINSURANCE	12
CEDED REINSURANCE.....	12

ACCOUNTS AND RECORDS	13
INDEPENDENT AUDITOR	13
INFORMATION SYSTEMS	13
KEY ACTIVITY REVIEW - EXPENSES.....	13
MANAGEMENT EXPENSES	13
KEY ACTIVITY REVIEW - INVESTMENTS.....	15
KEY ACTIVITY REVIEW – CAPITAL AND SURPLUS	18
FINANCIAL STATEMENTS.....	19
ASSETS.....	20
LIABILITIES, SURPLUS AND OTHER FUNDS.....	20
UNDERWRITING AND INVESTMENT EXHIBIT	21
RECONCILIATION OF CAPITAL AND SURPLUS	21
COMMENTS ON FINANCIAL STATEMENT ITEMS	22
FINANCIAL STATEMENT CHANGES RESULTING FROM EXAMINATION	22
SUMMARY OF RECOMMENDATIONS.....	23
SUBSEQUENT EVENTS.....	24
ACKNOWLEDGMENT	25
VERIFICATION.....	25
SUPERVISION	26

Concordia, MO
November 17, 2023

Honorable Chlora Lindley-Myers, Director
Missouri Department of Commerce and Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Director Lindley-Myers:

In accordance with your financial examination warrant, a full-scope financial examination has been made of the records, affairs, and financial condition of

CFM INSURANCE, INC.

hereinafter referred to as such, as CFM, or as the Company. Its administrative office is located at 1202 East 1st Street (P.O. Box 968), Concordia, MO 64020, telephone number (660) 463-2223. The fieldwork for this examination began on March 6, 2023, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The Missouri Department of Commerce and Insurance (Department) has performed a single-state financial examination of CFM Insurance, Inc. The last examination of the Company by the Department covered the period of January 1, 2012, through December 31, 2016. The current examination covers the period of January 1, 2017, through December 31, 2022, as well as a review of any material transactions and events occurring subsequent to the examination period through the date of this report.

Procedures

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook (Handbook)*, except where practices, procedures, and applicable regulations of the Department or statutes of the state of Missouri prevailed. 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 the identification and evaluation of significant risks that could cause the Company's surplus to be materially misstated, both on a current and prospective basis.

This examination also included a review of significant estimates made by management and evaluation of management's compliance with Statutory Accounting Principles. The 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 following the Company's financial statements.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. Those activities considered in the examination as key to CFM included Capital and Surplus, Claims & Reserves, Expenses, Investments, Premiums & Underwriting, Reinsurance, and Related Parties. The examination also included a review and evaluation of information technology general controls.

The examination was also conducted concurrently with the examination of the Company's Missouri domiciled affiliate, Cornerstone National Insurance Company (Cornerstone).

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 are separately communicated to other regulators and/or the Company.

SUMMARY OF SIGNIFICANT FINDINGS

1. Management Expenses (Page 13)

Numerous management expenses are not in compliance with the Company's Business Travel Expense Policy. The Policy stipulates that expenses are to be limited to reasonable amounts.

Significant out-of-state travel expenses were incurred by Company officers. CFM is licensed as an Extended Missouri Mutual Company under Sections 380.201-380.611, RSMo. Section 380.231, RSMo stipulates companies "may do business throughout the state of Missouri but may not do business outside this state." The Company's explanations for out-of-state travel include meetings with reinsurance brokers, attending insurance association and legislative meetings, and meetings to expand affiliations and partnerships. In addition, the travel also could have been accomplished at significantly lower costs to the Company.

Controls over expenses were not adequate. The Company did not keep adequate documentation to support a business purpose for all travel. The Company did not keep charter flight passenger manifests to document for whom the Company purchased air travel. The Company did not keep a supporting receipt for all purchases shown on the credit card statement as required by the Company Credit Card Policy.

2. Financial Reporting Errors (Page 15)

Material misstatements in CFM's Missouri Mutual annual statement were identified for the year-ended December 31, 2022. Our review determined the stock value of an investment in a subsidiary was overstated by \$10,558,862. This resulted in examination changes to decrease surplus by this amount. See the Financial Statement Changes Resulting from Financial Examination section of this report for additional details.

3. Allocation of Expenses between CFM and Cornerstone (Page 9)

Expenses are not being allocated appropriately between CFM and Cornerstone. For instance, the majority of Innovated Holdings, Inc. (Innovated) employees' salaries and benefits are allocated to CFM, with a relatively small percentage allocated to Cornerstone. The Cost Allocation Agreement stipulates how expenses are to be allocated between Cornerstone and CFM and states that "[a]ll costs covered under this Agreement will be allocated in accordance with SSAP No. 70, 'Allocation of Expenses.'" The agreement requires a study of employee activities (i.e., time spent), which is then to be used to allocate employee salaries and benefits and other expenses between the companies. The Company has implemented a process to allocate salary and benefits, but the resulting allocations were not fair and reasonable. In addition, there were instances of direct expenses not being recorded to the company incurring the expense. Since CFM does not wholly own Cornerstone, the minority ownership interest of the subsidiary was not attributed its share of these unallocated expenses. As such, expenses that should have passed on to the minority shareholders through the impact on the value of Innovated stock are inappropriately borne by the policyholders of CFM.

By not following the Cost Allocation Agreement, CFM's expenses are being overstated and the allocation of expenses is not fair and reasonable as required by Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted). Failure to allocate expenses to CFM and Cornerstone in conformity with customary insurance accounting practices consistently applied is not in compliance with Section 382.190(3), RSMo. By not following the terms of the agreement as previously approved by the Director, the Company is not in compliance with Section 382.195.1, RSMo (Prohibited transactions, exceptions).

4. Payments to Full Circle Entities (Page 4)

CFM officers signed checks made payable to Full Circle entities on behalf of Lewis County and Meramec Valley for services provided related to mergers. These services would have been completed before the Full Circle entities were organized. The Full Circle entities reported no expenses for these transactions and charged the same amount for services even though significant differences existed between companies. Payments from Lewis County and Meramec Valley to the Full Circle entities immediately before these companies merged into CFM essentially constituted unapproved capital contributions to the Full Circle entities. (The payments received by the Full Circle entities were subsequently returned to CFM at the request of the Department.)

5. Capital Planning and Sufficiency of Surplus (Page 18)

The Company did not complete an adequate cost-benefit analysis before investing in assets not readily available to pay policyholder obligations. For example, over \$9 million was invested during the examination period for a new policy administration system and over \$4 million was paid for home office improvements, without a written contract to control costs. As reported by the Company, assets not readily available to pay policyholder claims have grown substantially from \$1,036,768 as of December 31, 2016, to \$21,529,314 as of December 31, 2022.

CFM's surplus grew by 17% during the examination period while the gross inforce more than doubled. Continued growth without increase to capitalization levels will significantly increase the cost to obtain reinsurance coverage at a level required under Missouri Regulation 20 CSR 200-12.030 (Extended Missouri and Missouri Mutual Companies' Financial Reinsurance Requirements).

COMPANY HISTORY

General

The Company was originally organized in 1869 and was incorporated in 1930 as Freedom Farmers Insurance Company. On March 30, 1938, the Company changed its name to Concordia Farmers Mutual Insurance Company. On May 17, 2010, the Company changed its name to CFM Insurance, Inc. On July 1, 2010, Central Mutual Insurance Company merged into the Company, with CFM Insurance, Inc. being the surviving entity.

During the examination period of January 1, 2017, through December 31, 2022, the Company merged with four other Missouri Mutual insurance companies, created a holding company subsidiary, and purchased a stock property and casualty insurance company through its subsidiary, as described in the Mergers, Acquisitions, and Major Corporate Events section of the examination report.

The Company has a Certificate of Authority dated June 7, 2010, and is covered by Sections 380.201 through 380.611, RSMo (Extended Missouri Mutual Insurance Companies).

Mergers, Acquisitions, and Major Corporate Events

On October 17, 2018, a Form A was filed by CFM seeking Department approval to acquire the common stock of Cornerstone. Subsequently, CFM created a holding company subsidiary Innovated, which was organized on February 7, 2019. The acquisition of Cornerstone was approved by the Department with a closing date of March 1, 2019.

CFM merged with several other Missouri Mutual insurance companies during the exam period as follows:

- On January 1, 2017, Farmers Mutual Insurance Company of Grundy County merged into the Company, with CFM being the surviving entity.
- On July 1, 2019, Farmers Mutual Insurance Company of Benton County merged into the Company, with CFM being the surviving entity.
- On December 31, 2022, Meramec Valley Mutual Insurance Company (Meramec Valley) merged into Company, with CFM being the surviving entity.
- On December 31, 2022, Lewis County Mutual Insurance Company (Lewis County) merged into the Company, with CFM being the surviving entity.

Before the Meramec Valley merger, on December 19, 2022, the President and Chief Executive Officer of CFM and Executive Vice President and Chief Underwriting Officer of CFM signed checks from Meramec Valley's bank account to Full Circle Analytics, LLC, Full Circle Marketing, LLC, and Full Circle Advisors, LLC (collectively, "Full Circle entities") on behalf of Meramec Valley.

The checks were as follows:

- \$82,500 to Full Circle Analytics, LLC;
- \$82,500 to Full Circle Marketing, LLC; and
- \$85,000 to Full Circle Advisors, LLC.

Similarly, on December 21, 2022, before the merger with Lewis County, the President and Chief Executive Officer of CFM and the Executive Vice President and Chief Underwriting Officer of CFM signed checks from Lewis County's bank account on behalf of Lewis County for the same amounts and to the same Full Circle entities as noted above. At the time the checks were written, the President and Chief Executive Officer of CFM was also appointed the President of Lewis County. In addition, the President and Chief Executive Officer of CFM was also appointed Co-President of Meramec Valley, even though this office was not provided for in Meramec Valley's Articles of Incorporation. Notably, the Full Circle entities are indirect subsidiaries of CFM as shown in the Organizational Chart section of the examination report. They are controlled by CFM through Innovated, which is the sole member of each Full Circle entity. The President and Chief Executive Officer of CFM and the Executive Vice President and Chief Underwriting Officer of CFM hold the same officer positions in Innovated as they do in CFM. The Department learned of these transactions on March 14, 2023, during the review of annual statement filings for these companies.

Our review found issues with the transactions with the Full Circle entities as follows:

- Section 347.030(4), RSMo, prohibits a limited liability company from transacting business until the articles of organization are filed with the Secretary of State. The Full Circle entities' Articles of Organization were filed with the Missouri Secretary of State on November 30, 2022. Most, if not all, of the services listed on the invoices to Meramec Valley and Lewis County would have been provided before the Full Circle entities' Articles of Organization were filed with the Secretary of State Office. For example, the Full Circle Marketing, LLC invoice description of services was for "[p]olicyholder notification, mailings, newspapers, and social media" services. Special meetings of the members of Lewis County and Meramec Valley were held on September 26, 2022 and October 14, 2022, respectively, to consider the proposed merger plans. Policyholder notification services would have been provided before the dates of the special meeting, and therefore also prior to Full Circle Marketing, LLC's filing of Articles of Organization with the Missouri Secretary of State.
- The Full Circle entities' financial statements as of December 31, 2022, reported revenue in the amount of the transactions described above and no expenses. If the Full Circle entities provided services to Meramec Valley and Lewis County, the Full Circle entities should have incurred and recorded expenses. Additionally, the fees charged by the Full Circle entities were the same for Meramec Valley and Lewis County despite significant differences between the two companies. For example, Meramec Valley had 2,449 policyholders and Lewis County had 592 policyholders; however, the fees charged by Full Circle Marketing, LLC were the same for both companies.

Without services provided by the Full Circle entities as a basis to support these transactions, the payments from Lewis County and Meramec Valley immediately before these companies merged into CFM essentially constituted capital contributions to the Full Circle entities. The \$500,000 in payments received by the Full Circle entities from Meramec Valley and Lewis County were subsequently returned to CFM at the request of the Department.

Dividends and Capital Contributions

By December 31, 2022, CFM had contributed software valued at \$9,287,102 to Innovated. In consideration of this contribution of assets, Innovated issued an additional 4,597 shares of Class A common stock to CFM.

There were no dividends paid to policyholders during the examination period.

MANAGEMENT AND CONTROL

Board of Directors

In accordance with the Articles of Incorporation (Articles), the annual meeting of the Company's members is held on the third Tuesday in March at the home office of the Company, or at such other place as may be designed by the Board of Directors. Special meetings of the members shall be called at any time by a majority vote of the Board of Directors or upon petition of five percent of the membership or 500 members, whichever is lesser. Eight members shall constitute a quorum at any membership meeting. Proxy voting is permitted.

The management of the Company is vested in a Board of Directors that are elected by the policyholders. The Company's Articles specify that there shall be a minimum of five and a maximum of twelve members of the Board. All directors must be policyholders of the Company by statute. The Board of Directors meets approximately five to six times per year. The Board of Directors reported in CFM's Missouri Mutual Annual Statement for the year-ended December 31, 2022, was as follows:

<u>Name and Address</u>	<u>Principal Occupation and Business Affiliation</u>
Dale L. Dieckhoff Concordia, Missouri	Retired Information Technology Director University of Central Missouri
James E. Joyner Warrensburg, Missouri	Business Owner / Insurance Producer Insurance Associates of Johnson County
Marla J. Zirkle Oak Grove, Missouri	Controller Steel City Media
Jacob R. Black Columbia, Missouri	President and Chief Executive Officer CFM Insurance, Inc.
George H. Zimmerschied Independence, Missouri	Sales Manager Kinze Manufacturing
Todd M. Hartley Marshall, Missouri	President and Owner Hartley Furniture Galleries, Inc.
Phillip D. Woods Warrensburg, Missouri	Retired Business Owner North Side Feed Supply
Eric C. Hoffman Trenton, Missouri	Owner / Operator Hoffman Farms, Inc.
Garrett L. Holzum Columbia, Missouri	Associate Director of Production Veterans United

At the March 15, 2022, Board of Director meeting following the annual meeting of the members, Roger E. Needham was appointed by the Board to fill the remaining unexpired term of a vacant director position, effective October 1, 2022. CFM's Missouri Mutual Annual Statement for the year-ended December 31, 2022, filed with the Department did not report Mr. Needham as a Director of the Company.

Senior Officers

The officers elected and serving, as of December 31, 2022, were as follows:

<u>Name</u>	<u>Office</u>
Jacob R. Black	President
Robert R. Gass	Vice President
Elizabeth B. Wilkens	Vice President
David S. Forrest	Secretary
Dennis W. Lowry	Treasurer

Principal Committees

The Company's Bylaws specify the Board may authorize and designate one or more executive committees with each committee consisting of two or more directors. As of December 31, 2022, the Board has established the following committees:

Audit / Investment

Garrett L. Holzum, Chair
Todd M. Hartley
Phillip D. Woods
Roger E. Needham

Executive / Corporate Governance

Marla J. Zirkle, Chair
George H. Zimmerschied
Jacob R. Black

Human Resource / Compensation

Eric C. Hoffman, Chair
Dale L. Dieckhoff
James E. Joyner

Board Succession

Marla J. Zirkle, Chair
Jacob R. Black
Dale L. Dieckhoff
George H. Zimmerschied

Enterprise Risk Management

James E. Joyner, Chair
Eric C. Hoffman
Garrett L. Holzum

Product, Rate and Reinsurance

Dale L. Dieckhoff, Chair
Garrett L. Holzum
James E. Joyner
Roger E. Needham

Mergers and Affiliations

Roger E. Needham, Chair
George H. Zimmerschied
Todd M. Hartley

Conflict of Interest

The Company has written conflict of interest procedures for the disclosure of material potential conflicts of interest or affiliations by its directors and officers. The Company's directors and officers sign conflict of interest statements on an annual basis.

Review of conflict of interest disclosures and related party transactions noted an officer of the Company failed to disclose a material potential conflict regarding a transaction between CFM and a family member of the employee. The Company paid the employee's family member \$150 per hour as an independent project management consultant for the implementation of a new policy administration system. From May 2020 through December 31, 2022, the Company paid the employee's family member a total of \$95,560. The Company's Outside Employment and Conflicts of Interest policy includes placement of business with a company owned or controlled by an employee or family member as one of the circumstances that should be avoided. The Company's Code of Business Conduct and Ethics states "[a]ny actual, apparent, or potential conflicts of interest must be fully disclosed." The Company indicated that this arrangement was presented to and approved by the Board, and the relationship will be disclosed in future conflict of interest statements.

Corporate Records

The Company's Articles and By-Laws were reviewed. No revisions were made to the Articles during the examination period. At the May 18, 2021, Board of Director meeting, the Board approved an amendment to CFM's By-Laws with an effective date of March 16, 2022. The Bylaws were amended to remove the requirement that directors be a resident in the territory the Company operates, to allow the board of directors to hold meetings over digital media, and to change the title and job description for several officer positions.

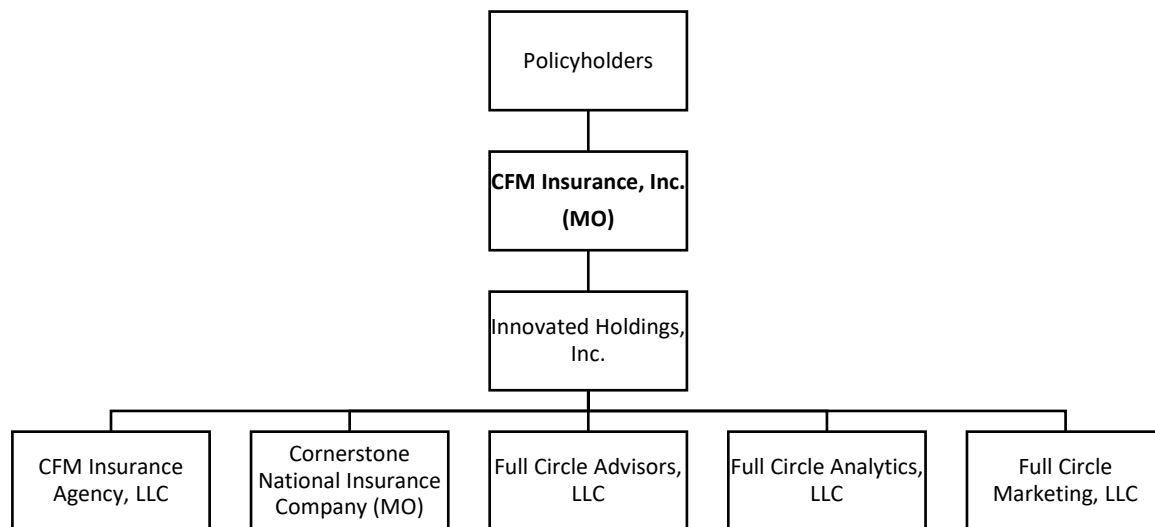
The minutes of the membership, board of directors and committees were reviewed for the period under examination. The Audit / Investment Committee annually reviewed the independent auditor's report on the financial statements of CFM. The Committee's meeting minutes described a "clean audit" or "relatively clean" for the audit of CFM's financial statement as of December 31, 2020, 2021, and 2022. However, the independent auditor's report had a qualified opinion on U.S. Generally Accepted Accounting Principles for each of those years. The basis for the qualified opinion was surplus note accounting treatment which caused material misstatement of the financial statements.

Holding Company, Subsidiaries, and Affiliates

CFM is a member of an Insurance Holding Company System, as defined by Section 382.010 RSMo (Definitions). CFM is the ultimate controlling entity within the holding company system. CFM is owned by its policyholders. Cornerstone is the only other insurance company within the holding company system. Other entities include a subsidiary holding company, a captive insurance agency, and three limited liability companies established to provide services to other insurance companies outside of the insurance holding company system.

Organizational Chart

The following organizational chart depicts the holding company group as of December 31, 2022. All subsidiaries are wholly owned with the exception of Innovated, which is owned by CFM (93.3%) and Forrester Mutual (6.7%). Forrester Mutual is not considered an affiliate under Chapter 382.010, RSMo.



Intercompany Transactions

The following agreements represent significant contracts executed with affiliated entities that were in effect as of December 31, 2022. A brief description of these agreements are as follows:

Tax Allocation Agreement: CFM, Cornerstone, and Innovated are parties to a Tax Allocation Agreement effective February 1, 2019. The terms of the agreement state that the tax liability apportioned to each member of the group is based on the relative federal income tax liability of each company that would have incurred on a separate company basis. Estimated payments or refunds are to be made quarterly, with a final settlement to be made within 30 days of filing the combined return or receipt of refund.

Cost Allocation Agreement: CFM, Cornerstone, and Innovated are parties to a Cost Allocation Agreement effective April 1, 2019. Per the terms of the agreement, Innovated will provide various management and administrative support services to Cornerstone and CFM, including claims processing, underwriting, marketing/advertising, accounting/tax, and numerous others. On the effective date of the agreement, all employees of Cornerstone and CFM became employees of Innovated. The monthly fee paid by Cornerstone and CFM is equal to the direct costs incurred by Innovated for the provision of such services.

Exhibit B of the Cost Allocation Agreement between the parties states that the allocable portion of the salary and benefits of Innovated employees will be determined by a study of employee activities by company (i.e. time spent) and will be adjusted annually as necessary.

The Company's process to allocate salary and benefits between companies is to have employee directors and managers determine allocation percentages during the annual budget and planning process. However, this process of allocation did not yield the most accurate results in accordance with SSAP 70 and was not fair and reasonable in accordance with Section 382.190 RSMo, as noted in the following examples:

- During 2022, the Chief Executive Officer and the Vice President of Sales and Marketing had 100 percent of salary and benefits allocated to CFM. These same employees were officers of Cornerstone but had zero percent of salary and benefits allocated to Cornerstone.
- Also in 2022, the Chief Financial Officer had 95 percent of his salary and benefits allocated to CFM, and the remaining employees with accounting duties had 100 percent of salary and benefits allocated to CFM. While CFM is the larger company by asset and premium volume, the majority of financial reporting responsibilities in the holding company system are attributable to Cornerstone.
- A report from Cornerstone's claims system shows one employee was the assigned claims adjuster on 280 paid claims in 2022; however, 100 percent of the salary and benefits for this individual was capitalized to a software project and reported as an asset by CFM.
- Three employees in 2021 and two employees in 2022 had 100 percent of their salary and benefits capitalized to a software project and reported as an asset by Innovated. The job titles of these employees included Underwriting Manager, Executive Personal Assistant, and Claims Adjuster, suggesting various other duties unrelated to computer or software systems.

The capitalizing of loss adjusting expense as a future benefit illustrates how the Company's process in place does not result in fair and reasonable allocation based on statutory accounting principles. Furthermore, SSAP 70, paragraph 9, states "...personnel costs associated with the

adjusting and paying of claims, must be borne solely by the reporting entity and are not to be apportioned to other entities within a group.”

The Company did not follow the Cost Allocation Agreement in the allocation of other expenses in Exhibit B. The majority of expenses in these categories were recorded directly to a specific company instead of being allocated based on percentage of payroll. The Company’s process for allocating credit card expenses was to provide employees with credit cards issued under each company name as necessary and appropriate. Purchases on credit cards issued to CFM and Cornerstone were recorded directly to the respective company’s accounting records. Purchases on credit cards issued under Innovated were allocated between companies based on review of individual transactions. This process does not meet the requirement in the Cost Allocation Agreement to allocate expenses in specified categories based on percentage of total payroll.

In addition to not following the Cost Allocation Agreement, the process to allocate expenses in specified categories did not result in fair and reasonable allocation. Purchases on CFM and Cornerstone credit cards in 2022 combined for a total of \$2,022,928 in charges, with 98 percent of expenses recorded to CFM and 2 percent recorded to Cornerstone. Review of two months of purchases on Innovated credit cards noted 96 percent of expenses were recorded to CFM and 4 percent were recorded to Cornerstone.

Travel and entertainment, education and training, and board fees and expenses are listed as categories to be allocated between companies. In 2022, CFM had credit card transactions recorded directly to general ledger accounts of travel/meeting registration totaling \$503,967 and board fees totaling \$121,002. These expenses were not allocated based on percentage of total payroll. For example, a Director and Company officer retreat with Board and Board Committee meetings was held for each company within the Holding Company System. Cornerstone’s Board of Directors and Board Committees held four separate meetings during this retreat, but Cornerstone was not allocated any of the costs associated with the retreat.

It was noted that expenses were not always reported by the company incurring the expense. For example, review of the 2022 credit card statements for the credit card issued to the National Sales Director identified travel related transactions in the states of Arkansas, Illinois, Kansas, Oklahoma, and Tennessee, all states where Cornerstone wrote business in 2022. However, these expenses were recorded as being incurred by CFM, which is authorized to do business only in the state of Missouri.

Another example of not allocating direct expenses to the company incurring the expense is a transaction at a hotel in Little Rock, Arkansas for hotel, meeting room and catering expenses. The Company’s explanation for the purpose of transaction is to host Arkansas agents and train them on the new quoting system. Again, this expense was recorded as being incurred by CFM, which is authorized to do business only in the state of Missouri. The agency listing provided for CFM did not include any agents with an Arkansas business address.

Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted), require that material transactions by registered insurers with their affiliates have terms that are fair and reasonable, and that charges or fees for services be reasonable. Per SSAP No. 25, paragraph 20, expenses that result from cost allocations shall be allocated subject to a fair and reasonable standard. Paragraph 20 further states, “Regulatory scrutiny of related party transactions where amounts charged for services that do not meet the fair and reasonableness standard established, may result in (a) amounts charged being recharacterized as dividend or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory

action.” The processes used by the companies to allocate employee salary and benefit expenses and thus also other total expenses, as required in Exhibit B of the Cost Allocation Agreement, did not meet the fair and reasonable standard required by Section 382.190(1) and (2) and SSAP No. 25. In addition, as required in Exhibit B of the Cost Allocation Agreement, direct costs paid by Innovated were not passed through to the appropriate entity.

Based on the above-described issues, the allocation of expenses resulted in CFM’s expenses being overstated. The allocation of expenses to CFM was not fair and reasonable under Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted), and the failure to allocate expenses to Cornerstone in conformity with customary insurance accounting practices consistently applied is not in compliance with Section 382.190(3). Additionally, the allocation of expenses to CFM outside of the allocation method prescribed in the Cost Allocation Agreement constitutes a cost sharing arrangement that the Director did not approve as required by Section 382.195.1, RSMo (Prohibited transactions, exceptions).

EMPLOYEE BENEFITS

The Company provides group health, life, dental, vision, workers compensation, and long-term care insurance, as well as paid time off to its full-time employees. Full-time employees are also eligible to participate in a 401(k) retirement, to which the Company contributes a percentage of each employee’s salary. In addition, the Company offers a profit sharing program for eligible employees.

TERRITORY AND PLAN OF OPERATION

The Company is licensed by the Department as an Extended Missouri Mutual Insurance Company operating under Sections 380.201 through Section 380.611, RSMo (Extended Missouri Mutual Insurance Companies). The Company is authorized to write fire, windstorm, liability, and other insurance in all counties in the state of Missouri. The Company’s policies are sold by licensed independent agencies and agents, who receive a 15% commission. Agents are eligible for a contingent commission if certain profitability criteria are met.

GROWTH OF COMPANY AND LOSS EXPERIENCE

The Company experienced an increase in premiums written during the examination period through a combination of organic growth in writing new policies and from mergers with other Missouri Mutual insurance companies. At year-end 2022, the Company reported 32,693 policies in force compared to 20,961 policies in force at year-end 2016. The table below summarizes the Company’s premium writings and writing ratios for the period under examination:

(\$000s omitted)

Year	Net Premiums Written (NPW)	Change in Net Premiums	Ratio of Underwriting Expenses to NPW	Capital and Surplus	Ratio of Net Premiums to Surplus
2017	\$ 20,177	\$ 3,246	43%	\$ 20,743	97%
2018	25,632	5,455	46%	22,846	112%
2019	29,398	3,766	46%	26,509	111%
2020	30,605	1,207	46%	25,932	118%
2021	34,760	4,155	44%	21,489	162%
2022	38,766	4,006	49%	31,107	125%

The Company experienced an increase in the loss ratio for the most recent years under examination contributing to underwriting losses for three consecutive years in 2020 through 2022. The table below summarizes the Company's incurred losses and loss ratios for the period under examination:

(\$000s omitted)

Year	Net Premiums Earned	Net Losses and Loss Adjustment Expenses	Loss Ratio
2017	\$ 18,574	\$ 8,087	44%
2018	23,947	12,062	50%
2019	27,983	13,695	49%
2020	29,280	19,386	66%
2021	32,600	19,855	61%
2022	36,072	20,809	58%

REINSURANCE

General

The Company's premium activity on a direct written, assumed, and ceded basis for the period under examination is detailed below:

(\$000s omitted)

Premium Type	2017	2018	2019	2020	2021	2022
Direct Premiums Written	\$ 24,083	\$ 28,613	\$ 35,543	\$ 35,660	\$ 41,037	\$ 47,150
Reinsurance Assumed:						
Non-Affiliates	0	0	38	0	0	0
Reinsurance Ceded:						
Non-Affiliates	3,906	2,981	3,182	5,055	6,277	8,384
Net Premiums Written	\$ 20,177	\$ 25,632	\$ 29,398	\$ 30,605	\$ 34,760	\$ 38,766

Assumed Reinsurance

CFM assumed \$38,000 in premiums in 2019. The Company did not assume business for any other year of the examination period.

Ceded Reinsurance

CFM utilizes reinsurance broker BMS Intermediaries, Inc. for the placement of most reinsurance coverage. Grinnell Mutual Reinsurance Company (Grinnell) is the primary reinsurer utilized and has an "A" (Excellent) rating by AM Best. CFM has multi-line excess of loss, property catastrophe excess of loss, and property aggregate stop loss reinsurance agreements with Grinnell. CFM also has quota share reinsurance agreements with Grinnell for earthquake coverage, auto, and umbrella (casualty only). The Company also has an equipment & service line agreement with Factory Mutual Insurance Company and a property flood agreement with Munich Reinsurance America, Inc.

Under coverage A of the multi-line excess of loss agreement (property), CFM retains \$300,000 each loss, each risk with a limit of \$19.7 million. Under coverage B of the agreement (casualty), CFM retains \$300,000 of each occurrence with a limit of \$700,000. Coverage C of the agreement involves one or more classes of property and casualty business subject to contract and provides for \$300,000 in coverage per occurrence in excess of Company retention of \$300,000.

Under the property catastrophe agreement, CFM retains \$2.5 million per occurrence, and Grinnell's limit is \$47.5 million per occurrence. Under the aggregate stop loss agreement, Grinnell is liable for 100% of losses that exceed 67.5% of net earned premium.

Under the umbrella quota share agreement with Grinnell, the Company cedes 95% quota share participation on umbrella liability business of the first \$1 million of net liability each occurrence, each policy. CFM cedes 100% of the net liability of \$5 million excess of the first \$1 million.

CFM has agreements with Grinnell for 100% quota share on earthquake coverage and 15% quota share on automobile coverage. CFM has an agreement with Munich Reinsurance America, Inc. for 100% quota share on inland flood coverage and an agreement with Factory Mutual Insurance Company for 100% quota share on equipment breakdown coverage.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance contract.

ACCOUNTS AND RECORDS

Independent Auditor

The certified public accounting (CPA) firm, Cain Ellsworth & Company, LLP in Sheldon, Iowa, performed an audit of the Company's financial statement prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for years 2022, 2021, and 2020 in the examination period. Hauk, Kruse & Associates, LLC in St. Louis, Missouri performed the audit for years 2019 and 2018. Marberry & Eagle, LLC in Columbia, Missouri performed the audit for year 2017.

Information Systems

In conjunction with this examination, Alicia Galm, CFE, Information Systems Financial Examiner, and Kimberly Dobbs, CFE, AES, CISA, Information Systems Financial Examiner-in-Charge, with the Department, conducted a review of the Company's information systems.

Key Activity Review - Expenses

Our examination included a review of expenses as a key activity during the examination period.

Management Expenses

Our review identified numerous management expenses determined to be noncompliant with the Company's Business Travel Expense Policy to limit expenses to reasonable amounts. In addition, the Company did not maintain adequate records to support all expenses.

Our review of expenses included a test of 50 credit card transactions from over 4,000 transactions totaling over \$2.2 million in charges identified on the 2022 credit card statements.

Our review identified transactions for charter flight services totaling \$332,363 in 2022. Chartered flights averaged a cost of over \$18,000 per one-way flight segment and typically consisted of 1 to 3 Company employees on each flight. The flights were from Columbia, Missouri to metropolitan locations such as Denver, Colorado, Houston, Texas, and Little Rock, Arkansas. The cost for each one-way chartered flight far exceeded the cost of individual commercial flights tickets purchased by CFM during this time frame, which rarely exceeded \$1,000 per ticket for a domestic flight and never exceeded \$2,400 for a domestic flight. The expenses were incurred despite the

Business Travel Expense Policy requirement that expenses be limited to reasonable amounts. The Company was able to provide some passenger manifests after requesting information from the charter company.

In addition to the flight costs noted above, our review also noted that the Company spent at least \$262,190 on other expenses for out of state travel. These expenses are also subject to the Company's Business Travel Expense Policy and should be reviewed for compliance with the policy's requirement that expenses be limited to reasonable amounts.

Multiple trips from the sampled transactions had minimal documentation retained to demonstrate a business purpose to the Company as exemplified by the following:

- Documentation retained for travel to Phoenix, Arizona, consisted of a text message to an individual the Company warranted to be a representative of their reinsurance broker and dinner reservations for eight at a local restaurant. The text message did not describe any scheduled meetings.
- Documentation retained for travel to Denver, Colorado consisted of an internal calendar showing one meeting with a reinsurance broker and another company. The trip included five nights of hotel paid for by the Company at a cost of \$13,444 and total trip cost of \$82,915. The Company President and a Board Director were the only two Company personnel on the trip. They were accompanied by individuals who were not employed by and did not provide any services for the Company.

Company-provided explanations for travel were deemed insufficient to demonstrate a business purpose or the reasonableness of the expense. The following are just two examples from our examination review and the company explanations provided:

- Company explanation for travel to Phoenix, Arizona: *“Round trip travel for expanding reinsurance options for 2023. Summit meeting in Phoenix AZ with brokers from BMS and multiple reinsurers and other clients. Reviewed structures that could possibly be alternatives bringing more interest from the open market.”*

Examination Review: The use of charter flights, at a cost of \$71,359, increased the total cost of this trip. Our review identified Company costs incurred by the President and two employees on the trip totaling \$83,842, which included two chartered flights from Scottsdale, Arizona to Columbia, Missouri. The Company stated one of the chartered flights was canceled by the vendor. Our review of the credit card statements for 2022 did not identify any refunds from the vendor. Commercial air travel would have significantly reduced cost of this trip.

- Company explanation for travel to Houston, Texas: *“Meeting with strategy consultant on corporate structuring, partnerships, marketing, regulatory issues, government affairs and legal. CEO of [the consulting company] is based out of Houston where meetings took place.”*

Examination Review: Our review identified costs for the trip totaling \$32,782 including charter flight expense of \$26,915. Commercial air travel would have significantly reduced cost of this trip. No invoice or evidence of consulting fees being paid to the consulting company were provided. In addition, the Company was unable to provide passenger manifests for the charter flights.

These travel expenses were not compliant with the Business Expense Travel Policy requirement to keep expenses to reasonable amounts and any additional expenses arising from non-business portion of travel to be the responsibility of the employee.

Underwriting Costs

CFM underwriting costs are higher than other Missouri Mutual companies in several expense categories. In 2022, CFM spent \$1,176,617 on advertising while the other 74 Missouri Mutuals combined spent a total of \$700,185 on advertising. Stated another way, CFM's 2022 advertising expense, as a percentage of direct premium, was 2.4%, or 8 times greater than the 0.3% ratio reported collectively by the other 74 Missouri Mutuals. CFM's strategy to use event marketing at tradeshows/fairs, concerts, and sporting events appears to contribute to higher advertising costs. For example, CFM held a promotional event at the Southeastern Conference college football game between University of Missouri and the University of Tennessee in Knoxville, Tennessee. Our review of costs associated with this event identified direct costs for the event totaling \$67,090. This single promotional event in Knoxville, Tennessee cost approximately \$11,000 more than any other Missouri Mutual spent for the entire year on advertising. The Company stated the event hosted multiple CFM agents and policyholders. Passenger information for the charter flight to Knoxville, Tennessee, only included CFM employees and others who were not employed by CFM and who provided no services for CFM. CFM is only authorized to do business in the state of Missouri.

Allocation of Expenses

Our review of expenses determined the Company is not following the Cost Allocation Agreement in the allocating of expenses between companies as described in the Intercompany Transaction section of the examination report. Additionally, since CFM does not wholly own Cornerstone, the minority ownership interest of the subsidiary was not attributed its share of these unallocated expenses. As such, expenses that should have passed on to the minority shareholders through the impact on the value of Innovated stock are inappropriately borne by the policyholders of CFM.

Company Credit Card Policy

The Company failed to follow the Company Credit Card Policy of requiring a supporting receipt for all purchases shown on the Company credit card statement and in the issuance of Company credit cards to employees. Our review of 50 credit card transactions found 6 transactions did not have a purchase receipt. The policy also allows the amount of purchase to be deducted from employee's paycheck if a supporting receipt is not turned in.

Company Vehicle Policy

CFM's asset listing reported 21 vehicles with a total cost of \$872,851 (average cost of \$41,564 per vehicle). The Company had approximately 50 employees at year-end 2022, thus providing over 40 percent of employees with a vehicle available for use. CFM utilizes independent agents to write Company business and utilizes both independent adjusters and employee adjusters, reducing the amount of regular employee travel. Fuel purchases were made on Company credit cards at out-of-state locations. CFM is not authorized to write business outside of the state of Missouri.

Key Activity Review - Investments

Our examination included a review of investments as a key activity. Our review identified issues with the reporting of the stock value of subsidiary Innovated and the reporting of real estate and controls related to real estate transactions.

Stock Value - Innovated

Our review of the stock value of Innovated identified issues with the accounting treatment of surplus note, goodwill, and computer software assets. Our review has determined the reported value for Innovated was overstated by \$10,558,862.

CFM reported a stock value of Innovated contrary to condition three of the Department's Amended Stipulation to the Approval Order of the acquisition of Cornerstone by CFM. Condition three specifies the accounting treatment for the value of stock of Innovated to be reported within the Section 380.482, RSMo financial statements of CFM. Condition three states "CFM will be allowed to include the GAAP value of the stock of Innovated Holdings...." Innovated has an annual audit of financial statements prepared on a GAAP basis. The independent auditor's report on the financial statements as of December 31, 2022, had a qualified opinion due to a departure from GAAP for the valuation of a surplus note as equity instead of debt to conform with GAAP. Correction for the departure from GAAP would reduce Innovated reported policyholders' surplus by \$6,071,156 as of December 31, 2022.

Innovated reported software-in-progress asset totaling \$9,287,102 as of December 31, 2022, which was included in CFM statutory financial statements as an asset through the stock value of Innovated. Non-operating computer software is considered a non-admitted asset through Statement of Statutory Accounting Principles No. 16 – Revised Electronic Data Processing Equipment and Software (SSAP No. 16R). As noted in the Dividend and Capital Contribution section of the examination report, CFM contributed the software to subsidiary Innovated on December 31, 2022. The result of the transaction was to transfer a non-admitted asset under statutory accounting from CFM to its subsidiary Innovated where it could be valued in accordance with US GAAP.

Accounting Standards Codification (ASC) 350-40, Intangibles-Goodwill and Other – Internal Use Software, is the guidance issued by the Financial Accounting Standards Board (FASB) for capitalized software on a GAAP basis. ASC 350-40-30-1 allows for software development costs to be capitalized, which includes internal or external costs to develop or obtain software. Internal costs for payroll and benefits can only include those employees "directly associated with and who devote time to the internal-use computer software project, to the extent of time spent directly on the project."

Innovated did not properly track costs by vendor, type of costs, project, or modules within projects. Only a listing of general ledger entries with limited information was maintained. Innovated also did not track completion dates for projects or modules within multi-phase projects. Sufficient tracking of costs and completion dates is needed to ensure compliance with ASC 350-40. The Company's failure to properly track costs and completion dates required estimations in our examination to determine a more accurate balance for the capitalized software asset.

Innovated included several costs in the capitalized software asset for the period from July 2020 through December 2022 that should have been expensed as follows:

- Subscription Fees – Innovated included \$1,255,539 in fees from service agreements that provide for software support, maintenance, security, and other services. These services are not considered software development and should have been expensed.
- Payroll and Benefits – Innovated included \$585,141 of payroll and benefits costs for employees in areas of management, underwriting, claims, and human resources. 100 percent of payroll and benefits were capitalized as a part of the software asset for three employees in 2021 and for two employees in 2022. There were no records provided to document the actual time spent and activities performed by these employees. Thus,

there was no evidence that employees with no IT backgrounds could be directly associated with software development for an entire one- or two-year period. The capitalization of payroll and benefit costs was not supported, and therefore the costs should have been expensed. ASC 350-40-25 specifies internal training costs are to be expensed as incurred during all stages of development.

- Data Migration – ASC 350-40-25-5 allows data migration costs to be capitalized only if the costs are for the development of software to facilitate the data migration. Innovated's agreements with vendors providing data migration services and the invoices from these vendors that we sampled and reviewed did not indicate that such services included software development. Payments of \$702,084 for services to migrate data from legacy systems to the new system should have been expensed.
- Other Costs – Innovated capitalized costs of \$571,030 paid to vendors for other IT services that were not for software development and should have been expensed. These services included an agreement for logged incidents and service requests, expenses for the preliminary project stage of a mobile application, and expenses for a project manager. None of these IT services qualify as software development per ASC 350-40.

In addition, ASC 350-40 requires amortization of capitalized software to begin once each module or component within a project is completed and ready for use. Several components of Innovated's capitalized software had been completed for Cornerstone at various dates during 2022. However, Innovated did not record any amortization of the applicable capitalized costs for the completed software used by Cornerstone in 2022. Our examination determined that an estimated \$867,841 of capitalized software costs should have been amortized as of December 31, 2022.

Our review determined a total correction for departure from GAAP of \$3,981,635 to reduce the reported value of Innovated's software-in-progress.

Innovated reported goodwill of \$1,228,762 in the financial statements as of December 31, 2022, related to the acquisition of Cornerstone. Our review of the goodwill account determined the account to be capitalized acquisition expenses including legal, advisory, consulting, and lobbying fees. FASB ASC paragraph 805-10-25-23, Business Combinations – Overall – Recognition, states “[t]he acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with other applicable GAAP.”

Review of the Company's workpapers for this account noted the following analysis regarding accounting treatment for this transaction:

“Treat Innovated as a Modified Cash Company- since under generally accepted accounting principles (GAAP) beginning in 2009- costs associated with the acquisition (due diligence, accountants', attorneys, and investment bankers, etc.) are not considered part of the fair value exchanged between the buyer and seller and are therefore expensed as incurred. The Modified Cash Basis of accounting is an other comprehensive basis of accounting, and treats certain items differently than would be treated under the strict adherence of GAAP in preparing Innovated Holdings financial statements. The Modified Cash basis of accounting uses elements of both the cash basis and accrual basis of accounting. Deviations from GAAP will be identified and disclosed in the footnotes to the financial statements - so as not to mislead the intended readers/users of such financial statements.”

CFM's statutory financial statements are not allowed to be reported on a basis other than as prescribed by the Department and by the NAIC Accounting Practices and Procedures Manual. CFM did not provide notice to the Department that it intended to follow accounting practices other than those prescribed. This is the Department's first financial examination of CFM since the acquisition of Cornerstone and formation of Innovated and other subsidiaries.

Real Estate – Book Value

CFM acquired real estate and made home office improvements totaling \$4,285,920 during the examination period. This amount does not include real estate acquired through mergers with other Missouri Mutual companies. Major acquisitions and improvements during the examination period included an east building addition to CFM's home office in Concordia, Missouri, and leasehold improvements reported as an asset by subsidiary Innovated. Our testing of the Company's real estate additions during the examination period found the following issues:

- CFM or its subsidiary did not enter into a written contract for construction or improvements with contractors during the examination period. Without a contract, it is unclear how the Company determined the markup, overhead, and profit charged by the contractor were reasonable or appropriate.
- Invoices provided by the contractor did not always provide a detailed list or description of the services or goods provided. Without a contract or invoice detail, it is unclear how the Company determined the invoice amount was reasonable and accurate.
- Leasehold improvements made to the Columbia office building when CFM acquired Cornerstone in 2019 were capitalized directly by CFM and reported as real estate by CFM.

Key Activity Review – Capital and Surplus

Our examination included a review of capital and surplus as a key activity.

Our review determined the Company did not sufficiently plan the impact on available capital before making major capital investments. During the examination period, CFM invested \$9,287,102 in a new policy administration system without conducting a formal cost-benefit analysis of such project on current and future capital levels. In addition, CFM completed major home office renovations during the examination period without a written contract to establish total cost. Review of the Board of Director meeting minutes noted the minutes describe the status of the project but do not document the overall cost of the construction project.

The Company has increased the amount of illiquid assets that are not readily available to pay policyholder claims. As of December 31, 2022, the Company reported illiquid assets totaling \$21,529,314, which primarily consist of real estate and investment in subsidiary, compared to total illiquid assets of \$1,036,768 as of December 31, 2016.

Our examination resulted in an adjusted surplus of \$20,547,740 as of December 31, 2022. CFM's surplus increased by \$2,948,833 or 17% during the examination period, while the gross inforce amount more than doubled. Continued growth without increase to capitalization levels will significantly increase the cost to obtain reinsurance coverage at a level required under Missouri Regulation 20 CSR 200-12.030 (Extended Missouri and Missouri Mutual Companies' Financial Reinsurance Requirements).

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 CFM Insurance, Inc. for the period ending December 31, 2022. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the financial statements and should be considered an integral part of the financial statements. The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Comments on Financial Statement Items.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual key activity.

ASSETS

As of December 31, 2022

	Assets
Bonds – Book Value	\$ 29,073,854
Stocks (Note 1) (Note 2) (Note 3)	17,422,550
Mutual Funds	4,056,009
Real Estate – Book Value	4,687,283
Cash on Deposit	6,010,436
Other Investments	406,253
Computer Equipment (Hardware Only)	63,251
Interest Due and Accrued	128,835
Prepaid Insurance	39,314
Prepaid – Other	18,160
Accounts Receivable	43,347
TOTAL ASSETS	\$ 61,949,290

LIABILITIES, SURPLUS AND OTHER FUNDS

As of December 31, 2022

Gross Losses Unpaid less Reinsurance Recoverable	\$ 6,140,528
Ceded Reinsurance Premium Payable	907,003
Unearned Premiums	20,537,463
Accounts Payable to Agents	1,475,186
Accounts Payable (Other)	491,721
Accounts Payable	992,931
Premium Tax Liability	133,072
Suspense	164,784
TOTAL LIABILITIES	\$ 30,842,688
Guaranty Fund	1,600,000
Other Surplus	29,506,602
TOTAL POLICYHOLDER SURPLUS	\$ 31,106,602
TOTAL LIABILITIES AND SURPLUS	\$ 61,949,290

UNDERWRITING AND INVESTMENT EXHIBIT

For the Year Ended December 31, 2022

Net Earned Assessment / Premium Income	\$ 36,071,582
Other Insurance Income	2,566,496
Net Losses & Loss Adjustment Expense	(20,809,366)
Underwriting Expenses	(18,893,129)
Net Underwriting Gain (Loss)	\$ (1,064,417)
Investment Income	163,549
Investment Expense	12,247
Net Investment Income	\$ 151,212
Other Income	4,000
Gross Profit or Loss	\$ (909,205)
Federal Income Tax	0
NET INCOME (LOSS)	\$ (909,205)

RECONCILIATION OF CAPITAL AND SURPLUS

Changes from January 1, 2017 to December 31, 2022

(\$000s omitted)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
Capital and Surplus, Beginning of Year	\$ 17,609	\$ 20,743	\$ 22,846	\$ 26,509	\$ 25,932	\$ 21,513
Net Income (Loss)	2,989	2,200	2,235	(436)	(98)	(909)
Change in Net Unrealized Capital Gains (Losses)	(22)	(90)		451	(210)	(864)
Other Comprehensive Income			238			
Change in Nonadmitted Assets	(265)	(7)	(652)	(592)	(3,974)	5,036
Merger Surplus and Acquisition Costs	432		1,843			6,331
Prior Year Adjustment					(161)	
Net Change in Capital and Surplus	3,134	2,103	3,664	(577)	(4,443)	9,594
Capital and Surplus, End of Year	\$ 20,743	\$ 22,846	\$ 26,509	\$ 25,932	\$ 21,489	\$ 31,107

SUMMARY OF RECOMMENDATIONS

Management Expenses

Page 13

CFM should file a plan with the Department that outlines measures to implement controls over management expenses and specifies actions that will be taken to reduce management expenses. The plan should include a description of the measures the Company is implementing to achieve better control over expenses and ensure the appropriateness and approval of expenses.

Financial Reporting Errors

Page 15

CFM should treat the surplus note and acquisition costs for purchase of Cornerstone in accordance with GAAP when reporting the value of subsidiary investments. CFM should work with its financial statement auditor to adjust the value of the software asset to comply with applicable GAAP pronouncements.

Allocation of Expenses Between CFM and Cornerstone

Page 9

The Company's processes should be revised to ensure that the percentage of salaries and benefits and other total expenses allocated between the companies, as well as the assignment of direct expenses, meet the fair and reasonable standard required by SSAP No. 25 (Affiliates and Other Related Parties), and to comply with SSAP No. 70 (Allocation of Expenses) and Sections 382.190 and 382.195, RSMo. The Company should file the revised processes and the allocation results with the Department, or file a new cost allocation agreement with other acceptable methodologies to allocate costs.

Payment to Full Circle Entities

Page 4

CFM should ensure any merger related services to be provided by an affiliated entity are approved by the Board of Directors of the merging companies, and the details of the services and fees are clearly documented in each Board of Directors' meeting minutes. Charges for these services should be reflective of the level of services provided. Expenses related to the services provided should be recorded by the legal entity providing the services.

Conflict of Interest Disclosures

Page 7

The Company should follow its Code of Conduct and Ethics policy and ensure any actual, apparent, or potential conflicts of interest are disclosed on conflict of interest disclosure statement. The Company should follow its Outside Employment and Conflicts of Interest policy and avoid placement of business with a company owned or controlled by an employee or family member.

Company Credit Card Policy

Page 15

The Company should follow the Company Credit Card Policy by requiring a receipt for all purchases shown on the Company credit card statement.

Capital Planning and Sufficiency of Surplus

Page 18

CFM should conduct a formal, detailed cost-benefit analysis before making major capital investments that are not readily available to pay claims. In addition, CFM should file a plan with the Department that outlines measures to implement control over the growth in business written to surplus level.

SUBSEQUENT EVENTS

Several significant events and/or transactions occurred subsequent to the examination period, as follows:

- On April 30, 2023, Oakwood Mutual Insurance Company (Oakwood Mutual), an Indiana insurance corporation, purchased 495 shares of Class C common stock in Innovated. As a result of the transaction, Innovated was owned by CFM (90.2%), Forreton Mutual (6.5%), and Oakwood Mutual (3.3%). This transaction did not require regulatory approval.
- On June 26, 2023, Gasconade County Mutual Insurance Company merged into the Company, with CFM being the surviving entity.
- On August 9, 2023, CFM submitted a Form D filing requesting approval of a capital contribution of \$2,000,000 from CFM to Innovated to Cornerstone. The filing sought the Director's approval that the contribution be considered an admitted asset on Cornerstone's June 30, 2023, statutory financial statements as a receivable under SSAP 72, paragraph 8. The Department non-disapproved the contribution on August 10, 2023. On August 14, 2023, CFM made a \$2,000,000 cash contribution.

In consideration for CFM's \$2,000,000 capital contribution, Innovated issued 990 shares of Class A common stock to CFM effective June 30, 2023. As a result of the transaction, Innovated was owned by CFM (90.8%), Forreton Mutual (6.1%), and Oakwood Mutual (3.1%).

- According to unaudited financial statements provided by the Company, CFM reported a net loss of \$12,504,762 for the period January 1, 2023 to September 30, 2023.

ACKNOWLEDGMENT

In addition to the undersigned, Joshua Nash, CPA, CFE, Examiner-In-Charge, and Tim Tunks, CPA, CFE, and Rebecca Edwards, APIR, Examiners, for the Missouri Department of Commerce and Insurance, also participated in this examination.

VERIFICATION

State of Missouri)
) ss
County of Cole)

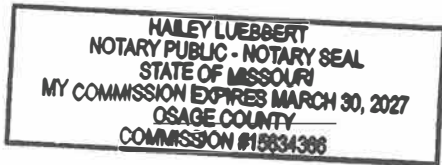
I, Brian D. Hammann, CPA, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records, or other documents of CFM Insurance, Inc., its agents or other persons examined, or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs, and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Brian D. Hammann

Brian D. Hammann, CPA, CFE
Examiner-In-Charge
Missouri Department of Commerce and Insurance

Sworn to and subscribed before me this 10th day of January, 2024.

My commission expires: March 30, 2027 *Hailey Lueggert*
Notary Public



SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the *Financial Condition Examiners Handbook* has been confirmed, except where practices, procedures, and applicable regulations of the Missouri Department of Commerce and Insurance and statutes of the state of Missouri prevailed.



Michael Shadowens
Assistant Chief Financial Examiner
Missouri Department of Commerce and
Insurance



February 8, 2024

Mr. Shannon W. Schmoeger, CFE, AR
Chief Financial Examiner
Missouri Department of Commerce & Insurance

Re: Response of CFM Insurance, Inc. to Examination Report as of 12-31-22

Dear Mr. Schmoeger:

This letter is to provide CFM Insurance, Inc.'s (CFM) response to the Examination Report as of 12-31-22 (Report). We ask that this response be included in the Report as a public document.

This was CFM's first examination since its acquisition of Cornerstone National Insurance Company (Cornerstone) and the creation of its insurance company holding system with Innovated Holdings, Inc. (Innovated) and Cornerstone in 2019. Since the acquisition in 2019, CFM has been consistent and transparent with Department and its independent auditors as to how these accounting treatments were shown in its financial statements.

1. Management Expenses (Pages 2, 13, 14, 15 and 23).

CFM deemed the expenses to be business related and reasonable. Per Section 380.231 RSMo, CFM only writes insurance in Missouri. However, it is occasionally necessary for CFM directors and employees to travel outside of Missouri. For example, CFM is a member of the National Association of Mutual Insurance Companies (NAMIC). NAMIC is the national trade association for mutual insurance companies. NAMIC holds meetings, educational seminars and conferences around the United States. CFM directors and employees travel outside of Missouri to attend NAMIC events. CFM employees also travel outside of Missouri to meet with reinsurers, CFM's reinsurance broker and vendors.

Section 380.231 RSMo does not prohibit CFM directors and employees from traveling outside of Missouri. Rather, this statute restricts CFM from writing insurance policies outside of Missouri.

Regarding expenses relating to chartered flights, there were reasons supporting the use of chartered flights especially during the COVID pandemic.

Per below, CFM's direct expense ratios during the years covered by the Report have not been unreasonably high:

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
CFM Direct Expense Ratio	35.6%	40.7%	41.6%	37.5%	34.4%	37.0%

2. Financial Reporting Errors (Pages 2, 15, 16, 17, and 22).

a. Valuation of Surplus Note (Pages 15, 16 and 22).

Cornerstone issued a Surplus Note in 2004. Since that time, Cornerstone has carried the Surplus Note as surplus on its financial statements in accordance with SSAP 41R. With the acquisition of Cornerstone in 2019, Innovated showed on its books the value of Cornerstone, which carried through the effect of the Surplus Note. When CFM thereafter included the value of its Innovated stock in its financial statements, the SSAP treatment of the Surplus Note flowed through to CFM.

CFM's independent auditor in conducting its audit of CFM's 2022 financial statement, qualified its opinion on the basis that the Surplus Note should have received no value as it flowed to, and was reported by, entities reporting on a GAAP basis. CFM submits that no intentional violation of accounting rules or Orders took place, these are complicated accounting issues, and we believed that the 2022 accounting for the Surplus Note would be consistent with the 2021 treatment of the Surplus Note. This accounting treatment for the surplus note has been shown in the financials of CFM since 2019.

At the time of the acquisition, CFM was not aware of the issue of GAAP treatment of the surplus note at the Innovated or CFM levels. CFM will reconcile the accounting treatment of the Surplus Note to conform to GAAP, but submits that an immediate reconciliation of the \$6,549,192 amount (as of 12-31-23) imposes an overly harsh impact on CFM's policyholder members. CFM is requesting authorization to delay the implementation of the accounting adjustment to January 1, 2025.

b. Accounting Treatment of Software (Pages 15, 16, 17 and 21). The examination report specified that certain items relating to the implementation of new policy administration software (the software project) should be expensed instead of being capitalized as a software asset. The software asset is held by Innovated on a GAAP basis and reflected in the value of CFM's stock in Innovated.

i. Payroll and Benefits (Page 16). Regarding the allocation and capitalization of \$585,141 in payroll and benefit costs to the software project, CFM determined that the allocation process would include employees that worked on the project as subject matter experts (SME's). These employees designated as SME's were employees of Innovated. Their expenses were allocated to the software project. This determination was documented in a memo provided to the Department. These employees did in fact work on the software project in setting up, developing and testing the underwriting and claims segments of the software project.

This approach was very conservative considering the number of Innovated employees who worked on the software project from 2020 through 2022. These employees included personnel from the underwriting, accounting, claims, IT and legal departments.

ASC 350-40-30-1 states that payroll and payroll related (employee benefits) costs shall be capitalized for employees who are directly associated with and who devote time to the

software project to the extent of the time spent directly on the project. Testing is included in the employee activities that can be capitalized. ASC 350-40-25-2 states that internal costs incurred to develop software during the application development stage shall be capitalized.

The process that CFM selected eliminated the need to track every employee (20) that touched the software project over the past 3 years yet provided a reasonable amount to allocate to the project. CFM's independent auditors agreed that this approach provided a reasonable allocation of salary and benefits to the project.

The Report disregards the payroll support provided and the input from CFM's independent auditors and requires CFM to remove \$585,141 from the software asset and expense this amount instead. By doing this, CFM is allocating \$0 of internal employee costs to this project. We ask that the Department reconsider the capitalization of payroll and benefit costs to the software project.

- ii. Data Migration (Page 17). Costs that are for the development of software to facilitate data migration can be capitalized per ASC 350-40-25-3. In other words, does the work contribute to creating software to facilitate data migration. If so, then it is capitalized. If the work involves the actual migration of data, then it is expensed.

In reviewing outside vendor invoices relating to migration costs, CFM with the assistance of these vendors identified services provided that were for the development of software to facilitate the data migration. This process determined which vendor costs were attributable to the development of software to facilitate the data migration.

ASC 350-40-25-5 states that if the costs involve the actual migration of data, then those costs are expensed. CFM did not capitalize any costs relating to the actual migration of data. Rather, those costs were expensed.

The Report disregards the input from CFM's data migration vendors and requires the CFM to remove \$702,084 from the software asset and expense this amount instead. We ask that the Department reconsider the capitalization of these data migration costs.

- iii. Other Costs (Page 17). At the request of the software vendor, CFM brought it an external project manager to assist with the development of the software project. It is typical on a software project of this size and scope to have a project manager. Per ASC 350-40, costs relating to an external project manager would appear to be capitalized. The Report did not cite any provisions under ASC 350-40 supporting that the costs relating to an external project manager should be expensed. We ask that the Department reconsider the capitalization of the \$95,560 in project manager costs.
- iv. Amortization of Capitalized Software (Page 17). ASC 350-40-35-6 states that for each module or component of a software project, amortization shall begin when the computer software is ready for its intended use.

At the start of the software project, CFM made the decision to begin amortizing the software asset when the project was completed, and it communicated this decision to its independent auditors. The software project will be complete in January 2025. The software

has been developed in stages with the stages building on one another. We would not describe the software as being in separate, standalone modules or components. CFM's auditors agreed with this determination and found it to be reasonable. We ask that the Department reconsider its position on this issue and allow CFM to begin amortizing the software asset on January 1, 2025.

3. Allocation of Expenses (Pages 2, 9, 10, 11, 15).

Regarding the allocation of expenses between CFM and Cornerstone, our department managers review employee activities during our annual budgeting process to determine the percentage allocation of payroll and benefits between CFM and Cornerstone.

The below comparison is as of December 31, 2022. Per the comparison, the percentage breakdown of the result of our allocation of payroll and benefits by company is similar to the percentage breakdown of total income (direct written premiums, other income and fees) of the companies.

This comparison indicates that the overall result of our cost allocation of payroll and benefits is producing a result that is in step with and reasonable in relation to total income by company.

	<u>Innovated Holdings</u>	<u>CFM</u>	<u>Cornerstone</u>
Salary and Benefits	0.6%	86.3%	13.1%
Total Income	0.1%	83.9%	16.0%

The report asserts at page 10 that there were instances of expenses being recorded directly to a specific company as opposed to being allocated based on percentage of payroll. We construe the Cost Allocation Agreement and Exhibit B of the Cost Allocation Agreement at paragraph E that if an expense is 100% attributable to one company, then that expense may be directly passed through to that company.

The Report at page 9 asserts that loss adjusting expenses were capitalized. As previously mentioned in page 2 of this letter, certain employees mainly from the underwriting and claims departments worked on the development of the software project as subject matter experts.

We post thousands of expense transactions each year. We have steps and a process in place to avoid errors in posting expense transactions. There will likely always be instances in which some expense transactions are incorrectly recorded to the wrong company.

The Allocation of Expenses paragraphs on page 2 and 15 of the Report, state that the minority shareholders of Innovated were not attributed their share of unallocated expenses. Innovated's stock is owned by three insurance companies - CFM, being the majority shareholder, and two other insurance companies that each own a small minority interest. Innovated did not provide any services under the Cost Allocation Agreement to the two companies that have minority ownership interests in Innovated. In fact, neither of the two minority shareholders are parties to the Cost Allocation Agreement. As a result, expenses were not allocated to these two companies. In addition, being a shareholder does not by itself result in the allocation of expenses to the

shareholder. However, Innovated's results, including change in surplus, are allocated to the two minority shareholders on a percentage of ownership basis.

4. Payments to Full Circle Entities (Pages 3 and 4).

The payments were for services provided by Innovated Holdings, Inc. to prepare the merging companies for merger with CFM. A flat fee structure was created which included three fee groups based on the size of the company. Regarding the billing of the services provided to the merger companies, it would have been more specific if Innovated had charged a fee for the services it provided until the Full Circle LLC's inception on November 30. Innovated as the sole member of the Full Circle LLC's decided to push all the fees down to its Full Circle subsidiaries. At the Department's request, Innovated reversed these transactions back to CFM.

5. Capital Planning and Sufficiency of Surplus (Pages 3 and 18).

The legacy policy administration software systems of CFM and Cornerstone were insufficient. Between CFM and Cornerstone there were three different policy administration systems in use.

We identified three software vendors that offered policy administration software that met our current and future needs. After a period of due diligence and comparing the systems we chose one of the systems. It was not the most expensive of the three systems. We carefully considered the cost of this software and how it would be expensed. We determined that the cost of new system was reasonable in relation to the advantages and costs savings of getting our companies on one, modern software platform.

6. Conflict of Interest (Pages 7 and 23).

Regarding disclosure of the family member, this person was hired in the second quarter of 2020 as an independent contractor and project manager to work on the implementation and development of the software project on an as needed basis. The software vendor requested that CFM have a project manager to assist with the development of the software project. The family member has 10 years of experience in the field of software project management. Her status as an independent contractor, the scope of work and the hourly rate, and her marital relationship with an officer of CFM were presented to the CFM Board of Directors and discussed at a board meeting held on May 21, 2020. This item was in the CFM Operations Report which was part of the board packet and agenda provided to the board of directors for the May 21, 2020, board meeting.

Her work on the project has been discussed in other CFM board meetings since the May 21, 2020, including most recently the 2023 project budget projections that were presented to the CFM board on March 21, 2023. The payments made to her for work on the software project through December 31, 2022, are as follows:

2020 - \$23,625

2021 - \$43,238

2022 - \$28,697

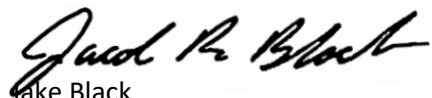
It is important to note that the family member and the officer work in different and separate departments of CFM. The decision to hire the family member was made at levels above the officer.

The officer was not involved in the hiring of or the management of the family member.

We did not construe the provisions of CFM's Code of Business Conduct and Ethics or the CFM Conflicts of Interest Statement as specifically triggering a need for additional disclosure under these circumstances, especially since the Board was specifically and fully aware of this relationship. In the future, the officer can add this matter to his Conflicts of Interest Statement.

Please let us know if you have questions or if we can provide additional information.

Sincerely,

A handwritten signature in black ink that reads "Jake Black". The signature is written in a cursive, flowing style.

Jake Black
President and CEO