

**REPORT OF
FINANCIAL EXAMINATION**

**FARMERS MUTUAL INSURANCE
COMPANY OF ADAIR COUNTY**

**AS OF
DECEMBER 31, 2003**

**STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI**

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April 2, 2004
Kirksville, Missouri

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Sir:

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

FARMERS MUTUAL INSURANCE COMPANY OF ADAIR COUNTY

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 1312 North Baltimore, Kirksville, Missouri, telephone number (660) 665-6205. This examination began on April 1, 2004, and was concluded on April 2, 2004, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

The prior full-scope examination of the Company was made as of December 31, 1998, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 1999, through December 31, 2003, and was conducted by examiners from the Missouri Department of Insurance.

This examination also included material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri prevailed.

Comments-Previous Examination Report

The comments, recommendations, and notes of the previous examination report dated December 31, 1998, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

Management and Control

Comment: The Company should amend its Articles of Incorporation to establish the number of members required to constitute a quorum at membership meetings. In accordance with Section 380.381 (2) RSMo, the quorum should consist of not fewer than eight members.

Company Response: The Company amended the Articles of Incorporation at the February 2002 membership meeting.

Current Findings: The Company membership approved an amendment to the Articles of Incorporation on February 12, 2002, which established that eight members constitute a quorum at membership meetings. The amendment was properly filed with the Missouri Department of Insurance and accepted by the Missouri Secretary of State on October 16, 2000.

Policy Form and Underwriting Practices

Comment: The Company should file, or have filed on its behalf, the homeowner policy forms the Company uses, with the Missouri Department of Insurance.

Company Response: The Company made the appropriate filings.

Current Findings: The Company's homeowner policy forms were filed with the Missouri Department of Insurance on July 30, 1999.

HISTORY

General

The Company was originally organized on May 8, 1894, and incorporated on October 7, 1939, as Farmers Mutual Insurance Company of Adair County. The Company operates under Sections 380.201 through 380.611 RSMo (Extended Missouri Mutual Companies).

Management

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is held on the second Saturday in February, at the home office of the Company or at such other place as may be designated by the Board of Directors. Special meetings of the members may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the members. Eight members shall constitute a quorum at any membership meeting. Proxy voting is permitted.

The management of the Company is vested in the Board of Directors, who are elected from the general membership. The Board of Directors consists of nine members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets at least annually, and the directors are compensated \$20 per meeting attended.

Members serving on the Board of Directors as of December 31, 2003, were as follows:

<u>Name and Address</u>	<u>Occupation</u>	<u>Term</u>
Donna Broadwell 705 Swanson Avenue Novinger, Missouri	Teacher	2003-2006
William Swisher 20948 State Highway FF Green Castle, Missouri	Retired	2003-2006
Larry L. Smith 13829 State Highway 6 Novinger, Missouri	Retired/Farmer	2004-2007
Duane Turner 25882 Igloo LaPlata, Missouri	Retired	2002-2005
Garry Ledford 2211 South Haliburton	Contractor	2004-2007

Kirksville, Missouri

Arthur Hutchison 12076 Willow Creek Way Greentop, Missouri	Retired	2002-2005
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Jim Forquer 1208 South Boundary Kirksville, Missouri	Adjuster	2003-2006
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Bill Wayman 1806 South Cottage Grove Kirksville, Missouri	Agent/Realtor	2004-2007
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Jeff Brawner 30403 Benton Way Kirksville, Missouri	Agent/Farmer	2002-2005
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The Board of Directors elects for a term of one year a President, Vice-President, and Secretary, who may also serve as Treasurer when so designated by the Board.

The officers of the Company serving at December 31, 2003, were as follows:

Bill Wayman	President
Duane Turner	Vice-President
Ann Walker	Secretary/Treasurer

Conflict of Interest

The Company has written conflict of interest procedures for the disclosure of material conflicts of interest or affiliations by its directors and officers. The Company has its directors and officers sign conflict of interest statements on an annual basis, and no material potential conflicts were disclosed.

Corporate Records

A review was made of the Articles of Incorporation (Articles) and the Bylaws of the Company. Both the Articles and Bylaws were amended during the examination period.

On February 12, 2000, the Articles were amended to set the quorum requirements for membership meetings at eight members and to allow for proxy voting. On February 9, 2002, the Articles and Bylaws were amended, changing all references from "assessment" to "premium," to facilitate the Company's

conversion from an assessable to a non-assessable mutual.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. In addition, the Company's policies for investments and underwriting were reviewed. The minutes and records of the Company appear to properly reflect corporate transactions and events.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond providing a limit of liability of \$50,000. The fidelity bond coverage of the Company meets the minimum amount suggested in the guidelines promulgated by the NAIC, which is between \$25,000 and \$50,000 in coverage.

The Company carries directors' and officers' liability coverage with per claim and aggregate limits of \$750,000 and a \$500 deductible for each director and officer each loss and a \$2,500 deductible in aggregate as it pertains to directors and officers liability.

The Company purchases errors and omissions insurance for its four exclusive agents with limits of \$750,000 and a \$1,000 deductible. The Company utilizes an independent agent who purchases errors and omissions coverage at their own expense, with a limit of \$500,000 and a deductible of \$5,000.

The Company has a business owner's coverage on its buildings and contents. The policy provides coverage of \$135,200 on the building and \$30,000 on office contents. The policy also provides for commercial liability coverage with a per occurrence limit of \$300,000 and a general aggregate limit of \$600,000, with medical expense limits of \$5,000 per person.

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has two full-time employees. The Company provides health and long-term disability insurance coverage, as well as paid vacation and sick leave for the employees. The Company also makes an

annual contribution to each employee's individual retirement account. It appears the Company has made adequate provisions in its financial statements for the employee benefit obligations.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is licensed by the Missouri Department of Insurance as an Extended Missouri Mutual Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company is authorized to write fire, wind and liability insurance in all counties in the State of Missouri. The Company writes fire, wind and liability coverage.

The Company's policies are sold by four exclusive agents and one independent agent, who receive a 20% commission.

Policy Forms and Underwriting Practices

The Company uses AAIS policy forms provided by the Missouri Association of Mutual Insurance Companies. The policies are continuous. Property inspections are performed by the agents. An independent adjuster performs adjustment services for the Company. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	Admitted Assets	Liabilities	Gross Assessment	Gross Losses	Investment Income	Underwriting Income	Net Income
2003	\$1,225,600	\$24,805	\$526,737	\$137,826	\$29,959	\$84,033	\$109,868
2002	1,102,910	11,983	454,346	157,557	30,624	32,045	59,579
2001	1,061,415	30,067	424,903	127,431	44,445	39,186	77,756
2000	978,020	24,428	411,889	125,133	48,351	(29,485)	12,603
1999	948,028	7,039	420,567	56,805	39,908	43,634	78,284

At year-end 2003, 1,192 policies were in force.

REINSURANCE

General

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

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Direct	\$420,567	\$411,889	\$424,903	\$454,346	\$526,737
Assumed	0	0	0	0	0
Ceded	<u>(249,676)</u>	<u>(269,722)</u>	<u>(160,110)</u>	<u>(200,659)</u>	<u>(108,806)</u>
Net	\$170,891	\$142,167	\$264,793	\$253,687	\$417,931

Assumed

The Company does not reinsure other companies.

Ceded

The Company has all of its reinsurance through Cameron Country Mutual Insurance Company (the reinsurer) under a single reinsurance contract for fire, wind and liability risks. The per-risk excess of loss section of the contract pertains to fire and wind risks and consists of two layers. The Company retains \$25,000 per risk under the first layer and \$125,000 per risk under the second layer. The reinsurer's limits are \$100,000 per risk under the first layer. Under the second layer, the reinsurer's limits are \$50,000 for commercial and confinement risks and \$250,000 for all other risks. The per-occurrence limit regarding both layers is \$700,000. The reinsurance rate is 8.0% and 2.0% of net written premium for layers one and two, respectively.

The catastrophe excess of loss section of the contract pertains to fire and wind risks and consists of two layers. The Company retains \$131,000 per occurrence under the first layer and \$1,131,000 per occurrence under the second layer. The per-occurrence limit is \$950,000 under the first layer and \$1,000,000 under the second layer. The annual limit is \$1,900,000 under the first layer and \$2,000,000 under the second layer. Annual premium for the catastrophe coverage is \$.0688 per \$1,000 in force for

layer one and \$.0413 per \$1,000 in force for layer two.

The aggregate excess of loss coverage section of the contract pertains to fire and wind risks. The reinsurer is liable for 95% of losses in excess of 75% of the Company's net written premium, with a maximum limit of \$2,000,000. The reinsurance rate is 2.0% of net written premium.

The contract has a liability quota share section for liability risks. The Company cedes 100% of the liability risks and premium to the reinsurer and receives a 22% ceding commission.

The Company has a cooperative agreement with Cameron Country Mutual Insurance Company for general liability lines of business. The Company receives a 12% commission for premiums written under the agreement.

The Company participates in a contingent profit commission agreement as a part of the reinsurance contracts. The commission is based on the number of years the Company has been party to the reinsurance contract and the five-year loss ratio of the Company. The contingent profit commission range is from 0% to 8% of written premium ceded under the contract.

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

ACCOUNTS AND RECORDS

The accounting records are maintained by the Company on an accrual basis. The Company's accountant, Schott and Van de Ven, CPA, performs an annual review of the Company's financial statements, and prepares the Company's Annual Statement and federal income tax return.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2003, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow 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 differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for each individual annual statement item.

ANALYSIS OF ASSETS
December 31, 2003

Bonds	362,021
Real Estate	107,909
Cash on Deposit	750,596
Computer Equipment	404
Federal Income Tax Recoverable	155
Interest Due and Accrued	3,140
Prepaid Insurance	1,375

Total Assets	\$1,225,600
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LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2003

Losses Unpaid	\$15,299
Ceded Reinsurance Payable	6,790
Unearned Premium (Note 1)	176,243
Accounts Payable	2,716

Total Liabilities	\$ 201,048

Guaranty Fund	\$ 150,000
Other Surplus	874,552

Total Surplus	\$ 1,024,552

Total Liabilities and Surplus	\$ 1,225,600
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STATEMENT OF INCOME
December 31, 2003

Net Premium	\$ 417,931
Reinsurance Commission	15,288
Net Losses Incurred	(125,438)
Other Underwriting Expenses	(223,748)

Net Underwriting Income (Loss)	\$ 84,033

Investment Income	\$ 29,959
Other Income	1

Gross Income	\$ 113,993
Federal Income Tax	4,125

Net Income (Loss)	\$ 109,868
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CAPITAL AND SURPLUS ACCOUNT
December 31, 2003

Policyholders' Surplus, December 31, 2002	\$ 1,090,927
Net Income (Loss)	109,868
Examination Adjustment for Unearned Premium Reserve	(176,243)

Policyholders' Surplus, December 31, 2003	\$ 1,024,552
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NOTES TO THE FINANCIAL STATEMENTS

Unearned Premium (Note 1) \$(176,243)

The Company failed to report an unearned premium reserve, as required due to its status as a non-assessable mutual company. The result of the examination adjustment was an increase to the unearned premium reserve of \$176,243 and a corresponding decrease to policyholder surplus.

EXAMINATION CHANGES

Total Policyholder Surplus Per Company, December 31, 2003		\$1,200,795
	Increase in Surplus	Decrease in Surplus
Unearned Premium	\$ 0	\$176,243
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Total Change	<u>\$ 0</u>	<u>\$176,243</u> <u>(176,243)</u>
Total Policyholder Surplus Per Examination, December 31, 2003		<u>\$1,024,552</u>

GENERAL COMMENTS AND RECOMMENDATIONS

Notes to the Financial Statements (Page 12)

Since the Company converted to a non-assessable mutual during the examination period, the Company is required to report the portion of premiums unearned at year-end as a liability on the Annual Statement. The Company failed to report an unearned premium reserve on the 2003 Annual Statement. It is recommended the Company report an unearned premium reserve on future Annual Statements.

SUBSEQUENT EVENTS

None.

ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Farmers Mutual Insurance Company of Adair County during the course of this examination is hereby acknowledged and appreciated.

VERIFICATION

State of Missouri)
) ss
County of Cole)

I, Shannon W. Schmoeger 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 the facts appearing upon the books, records or other documents of the company, 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.

Shannon W. Schmoeger, CFE
Financial Examiner
Missouri Department of Insurance

Sworn to and subscribed before me this _____ day of _____, 2004.

My commission expires:

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.

Frederick G. Heese, CFE, CPA
Audit Manager – Kansas City
Missouri Department of Insurance