REPORT OF
FINANCIAL EXAMINATION

FARMERS MUTUAL INSURANCE COMPANY OF HARRISON COUNTY, MISSOURI

AS OF
DECEMBER 31, 2005

FILED
SEP 1 9 2006
DIRECTOR OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION

STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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August 1, 2006
Bethany, Missouri

Honorable W. Dale Finke, 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 HARRISON COUNTY, MISSOURI

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 22205 East US Highway 136, Bethany, Missouri, telephone number (660) 425-3525. This examination began on June 14, 2006, and was concluded on June 15, 2006, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

The prior full-scope examination of the Company was made as of December 31, 2000, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 2001, through December 31, 2005, 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, 2000, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

Corporate Records

Comment: It was recommended that the Company complete their policies and procedures manual in written form. These policies and procedures should be maintained in an up-to-date manual and made available to Company management and personnel.

Company Response: The Company completed a written procedures manual during the examination period.

Current Findings: The Company currently maintains a written procedures manual that adequately addresses the operations and business of the Company.

Accounts and Records

Comment: Several differences to the financial statements were found during the examination which were considered to be immaterial on an individual basis but may be material on an aggregate basis. Company management should address each difference and resolve the underlying problems as communicated to the Company.

Company Response: The Company has addressed the accounting discrepancies and obtained a CPA review for the 2005 financial statements.

Current Findings: The current examination noted several differences regarding annual statement asset and liability balances (See the "Notes to Financial Statements" section of this report).

HISTORY

General

The Company was incorporated on February 26, 1895, as Farmers Mutual Fire Insurance Company of Harrison County, Missouri. On February 26, 1972, the Company amended its Articles of Incorporation, changing its name to Farmers Mutual Insurance Company of Harrison County, Missouri.

The Company has a Certificate of Authority dated July 1, 1991, and is covered by Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company's Certificate of Authority is renewed annually.

Management

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is held on the fourth Monday in January, 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 not 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 seven members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every month, and directors are compensated $150 per each meeting attended.

Members serving on the Board of Directors as of December 31, 2005, were as follows:

Name and Address	Occupation	Term
Vern R. Young 21802 East 310th Street Ridgeway, Missouri	Retired Farmer	2004-2007
Roger D. Gibson 19378 West 225th Avenue Ridgeway, Missouri	Farmer/County Commissioner	2005-2008

Barbara Smith 205 2nd Street Ridgeway, Missouri	Retired Education Administrator	2003-2006
Lewis Jones 34548 East State Highway CC Gilman City, Missouri	Farmer	2005-2008
Melbourne Rex Stevens 302 North Market Street New Hampton, Missouri	Delivery Truck Driver	2004-2007
Johnnie Kinnison 30493 East US Highway 136 Ridgeway, Missouri	State Employee	2003-2006
Judy Ledgerwood 31857 East 1347th Place Blythedale, Missouri	Farmer	2004-2007

The Board of Directors appoints for a term of one year, a President, a Vice-President, and a Secretary, who may also serve as Treasurer when designated by the Board.

The officers of the Company serving at December 31, 2005, were as follows:

Vern R. Young	President
Roger D. Gibson	Vice-President
Linda R. Barnett	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 and the Bylaws of the Company. On November 19, 2001, the Company amended the Articles of Incorporation and Bylaws to change the required number of directors from nine to seven.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. 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 $25,000. 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 liability coverage for its directors and officers with an aggregate limit of $2,000,000 and a $500 deductible in aggregate for each claim.

The Company's employee/agents are covered under the aforementioned directors and officers liability policy regarding errors and omissions. The Company requires its independent agents to obtain their own errors and omissions coverage.

The Company also carries property insurance coverage on its home office and equipment, as well as business liability insurance.

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has four full-time employees. The Company provides health, life and long-term disability insurance benefits to the employees and contributes 5% of each employee's gross salary into individual retirement accounts. The employees receive three weeks of vacation and two weeks of sick leave per year. The Company appears to have made adequate provisions in the financial statements for these employee benefits.

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 coverages. The Company's policies are sold by four licensed employee/agents and two licensed independent agents. The employee/agents receive a salary, and the independent agents receive a 15% commission.

Policy Forms and Underwriting Practices

The Company uses AAIS policy forms. The policies are written on a continuous period. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured. Inspections are performed by the Company employee/agents and independent inspectors. Adjusting services are performed by independent adjusters.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	Admitted Assets	Liabilities	Gross Assessment	Gross Losses	Investment Income	Underwriting Income	Net Income
2005	$394,584	$154,410	$544,537	$ 519,127	$(1,954)	$ (11,081)	$ (11,948)
2004	798,782	494,906	812,239	2,384,087	8,845	(257,099)	(239,550)
2003	579,605	261,776	799,342	216,388	13,626	(34,068)	(20,148)
2002	627,485	296,452	695,781	398,919	16,525	(62,821)	(43,579)
2001	697,930	295,760	662,613	470,583	21,704	(151,162)	(115,865)

At year-end 2005, 931 policies were in force.

As can be seen in the above analysis, the Company has reported net losses in all of the last five years. Due to the current size of the Company, the reinsurance and administrative costs are such that further reductions in surplus levels are likely. The Company also has very few liquid assets and has borrowed money against its home office building to meet its day to day expenses. The Company's policyholder surplus at December 31, 2005 per examination equaled $240,174, or $90,174 in excess of the minimum surplus requirements of Section 380.271 RSMo. (Financial Reinsurance Requirements). The Company's financial position is such that one large storm would reduce the policyholder surplus level to below the statutory minimum and would be detrimental to the interests of the policyholders. The Company should take immediate steps to secure the interests of the policyholders, such as securing a merger partner or making drastic reductions in operating expenses through measures such as decreased staffing, sale of the home office, or more efficient utilization of the home office facilities. If these steps cannot be achieved in the immediate future, further regulatory action will be necessary. The Company is further directed to provide financial statements to the Missouri Department of Insurance on a monthly basis, until otherwise notified.

REINSURANCE

General

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

	2001	2002	2003	2004	2005
Direct	$662,613	$695,781	$799,342	$812,239	$544,537
Assumed	0	0	0	0	0
Ceded	(166,333)	(112,441)	(178,512)	(289,918)	(219,508)
Net	$496,280	$583,340	$620,830	$522,321	$325,029

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 agreement for both property and casualty risks. The per risk excess of loss section of the agreement pertains to property risks and consists of two layers. Under the first layer, the Company retains \$30,000 per risk and the reinsurer's limit is \$100,000. The second layer retention is \$130,000 and the reinsurer's limits are \$50,000 for commercial and confinement risks and \$250,000 for all other risks. The reinsurer's combined per occurrence limit for both layers is \$700,000. Risks ceded under the agreement are limited to \$180,000 for commercial and confinement risks and \$380,000 for all other risks. The 2005 premium rate, as a percentage of written premiums, equaled 14% for layer one and 2% for layer two.

The catastrophe excess of loss section of the agreement pertains to property risks and consists of two layers. Under the first layer, the Company's retention is \$185,000 per occurrence, and the reinsurer's limit is 95% of \$1,000,000 per occurrence. Under the second layer, the Company's retention is \$1,185,000, and the reinsurer's limit is 100% of \$2,000,000. The reinsurer's annual limits are 95% of \$2,000,000 for the first layer and 100% of \$4,000,000 for the second layer. The 2005 premium rate was \$.1548 and \$.1250 per \$1,000 total insurance in force for layers one and two, respectively.

The aggregate excess of loss section of the agreement pertains to property risks. The reinsurer is liable for 95% of losses in excess of 75% of the Company's net written premium. The reinsurer's annual limit is \$2,000,000. The 2005 reinsurance rate was 3.0% of 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's current reinsurance program does not meet the minimum requirements of 20 CSR 200-12.030 (Financial Reinsurance Requirements). Section 1(A) of the regulation deems a reinsurance program as sufficient if the per risk retention is equal to or less than 10% of policyholder surplus. The Company's December 31, 2005 policyholder surplus per examination equaled \$240,174, which would indicate that a reinsurance program containing a per risk retention of approximately \$24,000 or less is required for compliance with the regulation. The Company is directed to obtain sufficient reinsurance coverage in order to comply with 20 CSR 200-12.030 (Financial Reinsurance Requirements).

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. Richard D. Glenn, CPA, prepares monthly financial statements for the Company. The CPA firm of Van de Ven, LLC performed a review of the 2005 financial statements and prepared the annual statement.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2005, 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, 2005

Bonds	$ 34,930
Real Estate	270,276
Cash on Deposit	6,112
Reinsurance Recoverable on Paid Losses	19,031
Asset Write-Ins (Note 1)	64,235
Total Assets	$ 394,584

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2005

Losses Unpaid	$ 41,911
Borrowed Money (Note 2)	90,000
Liability Write-ins (Note 3)	22,499
Total Liabilities	$ 154,410
Guaranty Fund	$ 150,000
Other Surplus	90,174
Total Surplus	$ 240,174
Total Liabilities and Surplus	$ 394,584

STATEMENT OF INCOME
December 31, 2005

Net Premium	$ 325,029
Other Insurance Income	24,955
Net Losses Incurred	(84,762)
Other Underwriting Expenses	(276,303)
Net Underwriting Income (Loss)	$ (11,081)
Investment Income	$ (1,954)
Other Income	1,087
Gross Income (Loss)	$ (11,948)
Federal Income Tax	0
Net Income (Loss)	$ (11,948)

CAPITAL AND SURPLUS ACCOUNT
December 31, 2005

Policyholders' Surplus, December 31, 2004	$ 390,359
Net Income (Loss)	(11,948)
Prior Period Adjustments – Reinsurance and Securities	18,985
Prior Period Adjustments – Non-admitted Assets	(6,703)
Examination Change – Asset Write-Ins (Note 1)	(132,614)
Examination Change – Liability Write-Ins (Note 2)	(17,905)
Policyholders' Surplus, December 31, 2005	$ 240,174

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Asset Write-Ins

The Company reported an asset of $86,483 which pertained to the amount paid to two agents for their books of business upon their resignations in 2004. Per examination, the policies are currently serviced by the Company's employee/agents and the books of business will not be resold. As such, the balance does not constitute a valid asset and was non-admitted. In addition, the Company reported an asset of $46,131 for assessments due in 2006 that were billed in 2005 but not received as of December 31, 2005. The Company did not report an offsetting unearned assessment liability for these receivables, which would be entirely unearned as of December 31, 2005. Therefore, the receivable was not admitted for examination purposes. The examination changes resulted a net decrease in the asset write-ins balance and policyholder surplus balance of $132,614.

Note 2 – Borrowed Money

The $90,000 consists of an unsecured note payable issued to a local bank. In 2006, the Company subsequently issued an additional $50,000 unsecured note payable to an individual. Also in 2006, the Company obtained a $100,000 loan with a twenty year term and an additional $100,000 line of credit, both secured by the Company's home office building, through a local bank. Section 380.461 RSMo (Company may borrow to pay losses – assessments to pay loan) provides for the companies to borrow money; however, the statue requires that assessments be levied in an amount needed to repay the loan within a year of incurring the losses or expense paid from the loan, unless otherwise permitted by the Director of the Missouri Department of Insurance. Based on the terms of the aforementioned outstanding debt, the Company does not appear to be in compliance with the statute. The Company is directed to receive prior approval from the Director of the Missouri Department for any future issuance of debt.

Note 3 – Liability Write-Ins

The Company failed to accrue for various unpaid liabilities at December 31, 2005, including director fees of $13,436, salaries of $2,969 and an appraisal fee of $1,500. An examination change was made for the neglected accruals, resulting in an increase in the liability write-ins balance and a corresponding decrease in the policyholder surplus balance of $17,905.

EXAMINATION CHANGES

Total Policyholder's Surplus Per Company, December 31, 2005			$ 390,693
	Increase in Surplus	Decrease in Surplus	
Asset Write-Ins	$ 0	$ (132,614)	
Liability Write-Ins	$ 0	$ (17,904)	
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Total Change	$ 0	$ (150,519)	(150,519)
Total Policyholder's Surplus Per Examination, December 31, 2005			$ 240,174

GENERAL COMMENTS AND RECOMMENDATIONS

Growth and Loss Experience of the Company (Page 6)

The Company's financial position is such that one large storm would reduce the policyholder surplus level to below the statutory minimum and would be detrimental to the interests of the policyholders. The Company should take immediate steps to secure the interests of the policyholders, such as securing a merger partner or making drastic reductions in operating expenses through measures such as decreased staffing, sale of the home office, or more efficient utilization of the home office facilities. If these steps cannot be achieved in the immediate future, further regulatory action will be necessary. The Company is further directed to provide financial statements to the Missouri Department of Insurance on a monthly basis, until otherwise notified.

Reinsurance (Page 8)

The Company is directed to obtain sufficient reinsurance coverage in order to comply with 20 CSR 200-12.030 (Financial Reinsurance Requirements).

Notes to Financial Statements – Borrowed Money (Page 12)

The Company has issued debt instruments which do not appear to comply with Section 380.461 RSMo (Company may borrow to pay losses – assessments to pay loan). The Company is directed to receive prior approval from the Director of the Missouri Department for any future issuance of debt.

SUBSEQUENT EVENTS

On May 1, 2006, the Company issued a ten year unsecured promissory note to an individual. Under the provisions of the note, the Company received $50,000 at an interest rate of 7.5% per annum. The provisions require only interest payments for the first five years, with interest and principal payments required for the remainder of the life of the note. Subsequent to the examination fieldwork date, the Company obtained a $100,000 loan with a twenty year term at an interest rate of 8.25% per annum and an additional $100,000 line of credit, both secured by the Company's home office building, through a local bank.

ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Farmers Mutual Insurance Company of Harrison County, Missouri 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 1st day of August, 2006.

My commission expires:

March 4, 2008

Kathryn Randolph
Notary Public

KATHRYN RANDOLPH
MY COMMISSION EXPIRES
March 4, 2008
NOTARY SEAL
Cole County
NOTARY PUBLIC, STATE OF MISSOURI

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

FARMERS MUTUAL INSURANCE COMPANY
OF HARRISON COUNTY, MISSOURI
22205 East U.S. Highway 136
Bethany, Missouri 64424
660-425-3525

September 8, 2006

Missouri Department of Insurance
Attn: Mr. Kirk Schmidt
Harry S. Truman State Office Building, Room 530
301 West High – P.O. Box 690
Jefferson City, Missouri 65102-0690

Re: Farmers Mutual Insurance of Harrison County, Missouri\
Examination Report dated August 21, 2006

Dear Mr. Schmidt:

The Company is in receipt of the Examination Report dated August 21, 2006 covering the period ending December 31, 2005.

With one exception concerning health, life and long term disability benefits to employees, the report is accurate and was approved by a vote of the Board of Directors on August 21, 2006.

For clarification purposes, only two of the four employees receive health, life and long term disability benefits. Those benefits are offered to the Secretary/Treasurer and Assistant Secretary/Treasurer. The other employees are paid $10.00 - $10.50/hour.

Board members are also in agreement with the Department's merger recommendations. In fact, the Board met with Mike Godby and Melvin Needham to discuss merger options on August 21, 2006 when the report was first disseminated by the Department. To date, the Board has contacted eight (8) other companies regarding the possibility of merging and started the process of requesting and sharing financial information.

We have been advised that the merger process could take awhile. In this connection, we would be happy to provide the department with regular status reports. Please call regarding your suggestions on keeping the Department informed.

Very truly yours,

Linda R. Barnett

Linda R. Barnett
Secretary-Treasurer

LRB