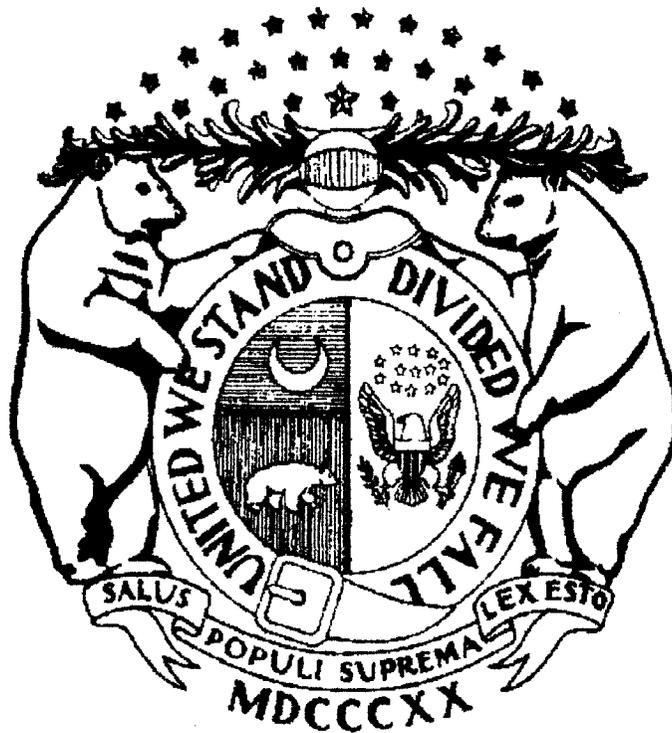


**REPORT OF THE
FINANCIAL EXAMINATION OF
FARMERS MUTUAL FIRE & LIGHTNING
INSURANCE COMPANY**

**AS OF
DECEMBER 31, 2006**



STATE OF MISSOURI

**DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS
AND PROFESSIONAL REGISTRATION**

JEFFERSON CITY, MISSOURI

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July 12, 2007
Mound City, Missouri

Honorable Douglas M. Ommen, Director
Missouri Department of Insurance, Financial
Institutions and Professional Registration
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 FIRE & LIGHTNING INSURANCE COMPANY

hereinafter referred to as such, or as the "Company". The Company's administrative office is located at 505 State Street (P.O. Box 206), Mound City, Missouri 64470, telephone number (660) 442-5445. This examination began on July 11, 2007, and was concluded on July 12, 2007, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

The prior full-scope examination of the Company was made as of December 31, 2001, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 2002, through December 31, 2006, and was conducted by examiners from the Missouri Department of Insurance, Financial Institutions and Professional Registration (DIFP).

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 DIFP 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, 2001, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

Conflict of Interest

Comment: The Company was directed to ensure all directors and officers sign conflict of interest statements on an annual basis and that all conflicts of interest are disclosed.

Company Response: The Company requires directors and officers to complete conflict of interest forms on an annual basis.

Current Findings: The directors and officers completed conflict of interest statements on an annual basis during the exam period with no potential material conflicts disclosed or noted.

Territory and Plan of Operations

Comment: The Company was directed to revise its agent contracts to reflect the current reinsurance ceding commissions actually being received by the agents.

Company Response: Agent contracts were revised to reflect current reinsurance ceding commissions received by the agents.

Current Findings: The current agent contracts accurately disclose the commissions paid on all lines of business.

Accounts and Records

Comment: The Company was directed to maintain its records and prepare its annual statement on an accrual basis on accounting.

Company Response: The Company maintains its records and prepares the annual statement on an accrual basis of accounting.

Current Findings: The Company's records are currently maintained on an accrual basis of accounting. Annual statements filed during the examination period were also prepared utilizing an accrual basis of accounting.

HISTORY

General

The Company was originally established in 1891 and was incorporated on September 8, 1896, as Farmers Mutual Fire and Lightning Insurance Company of Holt County, Missouri. In 1979, the Company changed its name to Farmers Mutual Fire and Lightning Insurance Company.

The Company has a Certificate of Authority dated August 28, 2001, and is covered by Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Insurance 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 first Tuesday after the first Monday in March at the home office of the Company or at such place designated by the Board of Directors. Special meetings may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the members. Ten 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 quarter, and directors are compensated \$100 per each meeting attended.

Members serving on the Board of Directors as of December 31, 2006, were as follows:

| <u>Name and Address</u> | <u>Occupation</u> | <u>Term</u> |
|--|-------------------|-------------|
| Claude Corbin 13123 Highway N Mound City, Missouri | Farmer | 2006-2009 |
| Thomas Hare 36737 Holt 340 Road Oregon, Missouri | Retired | 2004-2007 |
| Phillip Morris 30355 Highway 59 Oregon, Missouri | Farmer | 2005-2008 |

| | | |
|---|---------|-----------|
| Lloyd Norman 15668 Omaha Road Maitland, Missouri | Retired | 2005-2008 |
| Kirby Rosier 22325 Holt 140 Mound City, Missouri | Farmer | 2004-2007 |
| Wayne Voltmer 21998 Driftwood Drive Craig, Missouri | Farmer | 2006-2009 |
| Hugh Wallace 24579 Holt 120 Mound City, Missouri | Farmer | 2004-2007 |

The Board of Directors appoints for a term of one year, the officers of the Company. The officers of the Company serving at December 31, 2006, were as follows:

| | |
|----------------|---------------------|
| Lloyd Norman | President |
| Phillip Morris | Vice-President |
| Dean Johnson | 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 potential conflicts of interest were disclosed.

Corporate Records

A review was made of the Articles of Incorporation and the Bylaws of the Company. Neither the Articles of Incorporation nor the Bylaws of the Company were amended during the examination period.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. In addition, the Company's written policies and procedures were reviewed. The minutes and records of the Company appear to properly reflect the 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 \$100,000. The fidelity bond coverage of the Company meets the minimum amount suggested in the guidelines promulgated by the NAIC, which is between \$50,000 and \$75,000 in coverage.

The Company carries directors and officers liability coverage with an aggregate limit of \$500,000 and a \$5,000 deductible in aggregate for each claim.

The Company purchases errors and omission coverage for each of its three agents.

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

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has three part-time employees. The Company offers its employees a benefit package

which includes life and health insurance and one week of paid vacation per year. The Company appears to have made adequate provisions for the benefits in the financial statements.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is licensed by the DIFP as an Extended Missouri Mutual Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Insurance 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 3 licensed agencies, who receive a 20% commission. The agents are also eligible for a bonus commission of up to 5% if certain loss ratio requirements are met. The agent agreements do not contain some recommended language to protect the interests of the Company. It is recommended the Company amend its agent agreements to set time limits for the delivery of fully completed applications and forms to the home office and to add provisions which address the responsibility for obtaining errors and omissions insurance.

Policy Forms and Underwriting Practices

The Company uses AAIS policy forms. The policies are written on a continuous period, with properties inspected at least every three years. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured. Inspections and adjusting services are performed by the agents. Independent adjusters are also utilized by the Company.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

| | <u>Admitted Assets</u> | <u>Liabilities</u> | <u>Gross Assessments</u> | <u>Gross Losses</u> | <u>Investment Income</u> | <u>Underwriting Income</u> | <u>Net Income</u> |
|------|----------------------------|--------------------|------------------------------|-------------------------|------------------------------|--------------------------------|-------------------|
| 2006 | \$2,336,476 | \$ 8,375 | \$439,534 | \$226,749 | \$94,801 | \$(109,467) | \$(12,666) |
| 2005 | 2,350,084 | 9,317 | 404,835 | 61,489 | 77,399 | 466 | 79,865 |
| 2004 | 2,276,905 | 9,862 | 407,074 | 140,840 | 70,800 | 23,989 | 83,039 |
| 2003 | 2,201,040 | 112,658 | 380,798 | 47,687 | 65,805 | (33,296) | 32,509 |
| 2002 | 2,153,545 | 97,672 | 372,092 | 98,542 | 84,988 | (42,829) | 42,205 |

At year-end 2006, 757 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>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> |
|---------|------------------|------------------|------------------|------------------|------------------|
| Direct | \$372,092 | \$380,794 | \$407,074 | \$404,835 | \$439,534 |
| Assumed | 0 | 0 | 0 | 0 | 0 |
| Ceded | <u>(160,897)</u> | <u>(198,037)</u> | <u>(22,438)</u> | <u>(97,134)</u> | <u>(96,822)</u> |
| Net | <u>\$211,195</u> | <u>\$182,761</u> | <u>\$384,636</u> | <u>\$307,701</u> | <u>\$342,712</u> |

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 \$40,000 per risk and the reinsurer's limit is \$100,000. The second layer

retention is \$140,000 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. The 2006 premium rate, as a percentage of written premiums, equaled 6% for layer one coverage and 2% for layer two coverage.

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 \$108,000 per occurrence, and the reinsurer's limit is 95% of \$1,000,000 per occurrence. Under the second layer, the Company's retention is \$1,108,000, 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 2006 premium rate was \$.1858 and \$.1500 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, with an annual limit of \$2,000,000. The 2006 reinsurance rate was 3% 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 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. Helen Taylor, CPA, prepares the Company's annual statement and tax filings.

The Company's 2006 operating expenses as a percentage of gross premiums equaled 57%, which was considerably higher than the Missouri Mutual average of 33%. The majority of operating expenses were concentrated in salaries and related payroll taxes, employee benefits and agent commissions, which represented 84% of all operating expenses reported for 2006. Agent commissions as a percentage of gross premiums equaled 24%, compared to the Missouri Mutual average of 14%. The Company is directed to review its expense structure and take the actions necessary to reduce its operating expense ratios to reasonable levels.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2006, 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, 2006

| | |
|------------------------|----------------------------|
| Bonds | \$ 581,640 |
| Stocks | 50,000 |
| Cash on Deposit | 1,701,877 |
| Assessments Receivable | 2,090 |
| Interest Due & Accrued | 869 |
| | ----- |
| Total Assets | <u><u>\$ 2,336,476</u></u> |

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2006

| | |
|-----------------------------------|----------------------------|
| Net Losses Unpaid | \$ 850 |
| Net Loss Adjusting Expense Unpaid | 25 |
| Ceded Reinsurance Premium Payable | 1,161 |
| Commissions Payable | 6,339 |
| | ----- |
| Total Liabilities | \$ 8,375 |
| | ----- |
| Guaranty Fund | \$ 150,000 |
| Other Surplus | 2,178,101 |
| | ----- |
| Total Surplus | 2,328,101 |
| | ----- |
| Total Liabilities and Surplus | <u><u>\$ 2,336,476</u></u> |

STATEMENT OF INCOME
For the Year Ending December 31, 2006

| | | |
|--|----|-----------|
| Net Premiums Earned | \$ | 342,712 |
| Other Insurance Income | | 2,043 |
| Net Losses & Loss Adjustment Expenses Incurred | | (201,388) |
| Other Underwriting Expenses Incurred | | (252,834) |
| | | ----- |
| Net Underwriting Income (Loss) | \$ | (109,467) |
| Investment Income | | 94,801 |
| Other Income | | 2,000 |
| | | ----- |
| Gross Profit (Loss) | \$ | (12,666) |
| Federal Income Tax | | (0) |
| | | ----- |
| Net Income (Loss) | \$ | (12,666) |
| | | ===== |

CAPITAL AND SURPLUS ACCOUNT
December 31, 2006

| | | |
|---|----|-----------|
| Policyholders' Surplus, December 31, 2005 | \$ | 2,340,767 |
| Net Income (Loss) | | (12,666) |
| | | ----- |
| Policyholders' Surplus, December 31, 2006 | \$ | 2,328,101 |
| | | ===== |

NOTES TO THE FINANCIAL STATEMENTS

There were no notes to the financial statements.

EXAMINATION CHANGES

There were no examination changes.

GENERAL COMMENTS AND RECOMMENDATIONS

Territory and Plan of Operation (Page 4)

It is recommended the Company amend its agent agreements to set time limits for the delivery of fully completed applications and forms to the home office and to add provisions which address the responsibility for obtaining errors and omissions insurance.

Accounts and Records (Page 5)

The Company is directed to review its expense structure and take the actions necessary to reduce its operating expense ratios to reasonable levels.

SUBSEQUENT EVENTS

None.

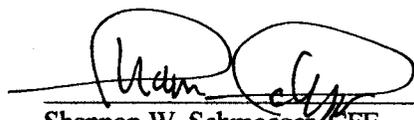
ACKNOWLEDGMENT

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

VERIFICATION

State of Missouri)
) ss
County of Cole)

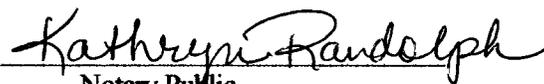
I, Shannon W. Schmoeger on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only the facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the 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.

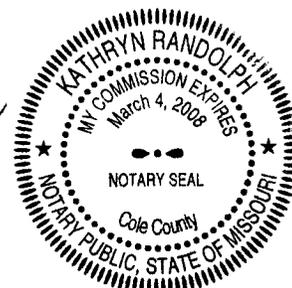

Shannon W. Schmoeger, CFE
Financial Examiner
Missouri DIFP

Sworn to and subscribed before me this 31st day of August, 2007.

My commission expires:

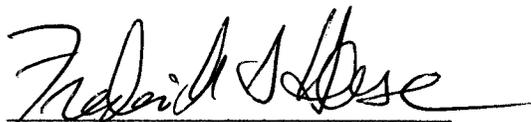
March 4, 2008


Kathryn Randolph
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 DIFP

November 19, 2007

Farmers Mutual Fire & Lightning Insurance Company
505 State Street
PO Box 206
Mound City, MO 64470

RECEIVED
NOV 21 2007
INSURANCE SOLVENCY
&
COMPANY REGULATION

Department of Insurance, Financial Institutions
And Professional Registration
Attn. Mr. Frederick G. Heese
301 W. High St., Room #530
PO Box 690
Jefferson City, MO 65102-0690

Dear Mr. Heese:

Please accept this letter as confirmation that Farmers Mutual Fire & Lightning Insurance Company has received a copy of our company's Examination Report for the period ending December 31, 2006. Our company took special notice of the General Comments and Recommendations contained on page 8 of the Examination Report. Furthermore, company leadership developed an action plan to amend its agent agreements and reduce our company's operating expense ratios.

Please include this letter as a public document in our company's Examination Report for the period ending December 31, 2006. Farmers Mutual Fire & Lightning Insurance Company looks forward to a constructive working relationship with the Department of Insurance, Financial Institutions and Professional Registration for many years to come.

Sincerely,



Dean Johnson
Secretary and Treasurer
Farmers Mutual Fire & Lightning Insurance Company