

**REPORT OF
FINANCIAL EXAMINATION**

**MISSOURI STATE MUTUAL INSURANCE
COMPANY**

**AS OF
DECEMBER 31, 2005**

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

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August 7, 2006
Billings, 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

MISSOURI STATE MUTUAL INSURANCE COMPANY

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 118 S.W. Highway 60, Billings, Missouri, telephone number (417) 744-2717. This examination began on June 7, 2006, and was concluded on June 8, 2006, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

Missouri State Mutual Insurance Company has not previously been examined by the Missouri Department of Insurance. The current full-scope examination covers the period from January 1, 2003, 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

Missouri State Mutual Insurance Company has not previously been examined by the Missouri Department of Insurance

HISTORY

General

The Company was formed on July 25, 2003, as a result of the merger of Farmers Mutual Insurance Company of Rockport, Missouri and Vernon County Mutual Insurance Company. The surviving company, Vernon County Mutual Insurance Company, was renamed Missouri State Mutual Insurance Company on the date of the merger and the home office was relocated to Billings, Missouri. On January 1, 2005, the Company and the Mutual Fire Insurance Company of St. Charles merged operations, with Missouri State Mutual Insurance Company remaining as the surviving entity.

The Company has a Certificate of Authority dated October 7, 2004, 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 second Thursday 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. Ten members shall constitute a quorum at any membership meeting. Proxy voting is allowed provided that voting is done by a member and that the proxy is filed with the Secretary not less than ten days prior to any meeting at which it is to be voted. A proxy shall be valid for one year or until revoked.

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 approximately every quarter, and directors are compensated \$100 per each meeting attended.

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

| <u>Name and Address</u> | <u>Occupation</u> | <u>Term</u> |
|--|---|-------------|
| Charles Smith 641 Cave Springs Road Galena, Missouri | Company Secretary and Business Manager | 2003-2006 |
| Harold Hodges P.O. Box 220 Sparta, Missouri | Insurance Agent | 2003-2006 |
| Ron Welch 11330 West Farm Road 174 Republic, Missouri | Realtor | 2004-2007 |
| Wayne Eutsler 30874 State Highway 13 Galena, Missouri | Retired | 2005-2008 |
| Andy Reavis P.O. Box 321 Marionville, Missouri | Self-Employed | 2004-2007 |
| Robert Edwards 30874 State Highway 413 Galena, Missouri | Insurance Agent | 2003-2006 |
| Connie Kennemer 15211 East Farm Road 132 Springfield, Missouri | Retired | 2005-2008 |
| Andrew Bowles 9728 Lawrence Miller, Missouri | Insurance Agent | 2004-2007 |
| Gary Fowler Route 2 Sheldon, Missouri | Farmer | 2005-2008 |

The Board of Directors appoints for a term of one year, a President, a Vice-President, a Secretary and a Treasurer. The Secretary and Treasurer are not required to be members of the Board of Directors.

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

| | |
|-----------------|----------------|
| Harold Hodges | President |
| Wayne Eutsler | Vice-President |
| Charles Smith | Secretary |
| Russell Dunning | 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 July 25, 2003, the Company amended and restated its Articles of Incorporation and Bylaws. Significant changes to the both documents included updating the Company name, allowing proxy voting and authorizing the Board of Directors to amend the Bylaws. The Articles of Incorporation were also amended to change the required number of directors and the date of the annual membership meeting.

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 \$50,000. 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 liability coverage for its directors and officers with an aggregate limit of

\$2,000,000 and a \$1,000 deductible in aggregate for each claim.

The Company utilizes only independent agents, which are responsible for obtaining errors and omissions insurance.

The Company also carries property insurance coverage on an office building owned by the Company and on its equipment, as well as business liability and workers compensation insurance.

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has one full-time employee. The employee receives two weeks of paid vacation per year and sick leave as approved by management.

The Company is also a party to a shared operations contract with Billings Mutual Insurance Company (Billings Mutual). Under the terms of the contract, Billings Mutual provides management services, claims adjusting, investment management, computer services and office supplies to the Company. The contract provides for compensation to Billings Mutual equal to three percent of the Company's direct written premiums.

The agreement was in force during 2004 and 2005; however, Billings Mutual waived the payment of fees for services rendered during these years.

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, liability, crop and other insurance in all counties in the State of

Missouri. The Company writes fire, wind and liability coverages. The Company's policies are sold by approximately 20 licensed agencies. The agencies receive commissions of 12% for liability, 8% for inland marine and 15% for all other policies.

Policy Forms and Underwriting Practices

The Company uses AAIS, Grinnell, and Company 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. Inspection and adjusting services are provided by Billings Mutual under the provisions of the aforementioned shared operations contract.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

| | <u>Admitted Assets</u> | <u>Liabilities</u> | <u>Gross Assessment</u> | <u>Gross Losses</u> | <u>Investment Income</u> | <u>Underwriting Income</u> | <u>Net Income</u> |
|------|----------------------------|--------------------|-----------------------------|-------------------------|------------------------------|--------------------------------|-------------------|
| 2005 | \$2,963,265 | \$60,765 | \$531,552 | \$119,717 | \$65,988 | \$59,152 | \$120,827 |
| 2004 | 505,932 | 35,983 | 566,730 | 700,920 | 10,818 | (65,385) | (38,628) |
| 2003 | 596,505 | 87,928 | 503,826 | 250,576 | 5,175 | (23,394) | (16,005) |

At year-end 2005, 1,298 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>2003</u> | <u>2004</u> | <u>2005</u> |
|---------|------------------|------------------|------------------|
| Direct | \$503,826 | \$566,730 | \$531,552 |
| Assumed | 0 | 0 | 0 |
| Ceded | <u>(195,040)</u> | <u>(146,702)</u> | <u>(158,262)</u> |
| Net | <u>\$308,786</u> | <u>\$420,028</u> | <u>\$373,290</u> |

Assumed

The Company does not reinsure other companies.

Ceded

The Company has all of its reinsurance through Grinnell Mutual Reinsurance Company (the reinsurer) under an individual occurrence of loss excess with aggregate excess reinsurance agreement. The first occurrence of loss excess section of the agreement covers wind and fire risks. The Company retains \$50,000 per occurrence and the reinsurer's limit is \$25,000 per occurrence. First occurrence of loss rates are calculated based on net recoveries paid by the reinsurer, with minimum rate of .1372 and a maximum rate of 1.0980 per \$1,000 of adjusted gross risk in force. The individual excess of loss section of the agreement covers wind and fire risks. The Company retains \$75,000 for each loss occurrence and the reinsurer's limits are \$500,000 for dwellings, commercial and public property and livestock, poultry and horse operations and \$750,000 for farm outbuildings. Risks in excess of these limits may be ceded to the reinsurer on a facultative basis per the agreement provisions. Rates and acceptability of risks ceded under the facultative provisions are determined by the reinsurer on an individual basis. The annual premium rate paid to the reinsurer for individual occurrence of loss coverage in 2005 was \$.3998 for fire and \$.0665 for wind per \$1,000 of adjusted gross fire risks in force.

The aggregate excess section of the agreement covers fire and wind risks. The Company's annual aggregate net retention, or attachment point, is based upon the Company's ten-year average fire loss ratio plus a load, which is mutually agreed upon. The reinsurer is liable for 100% of losses in excess of this retention. The attachment point for 2005 was \$205,691, and the annual premium paid was \$.8463 per \$1,000 of adjusted gross fire risks in force.

The agreement also provides for liability risk coverage. The Company cedes 100% of the risk and premium to the reinsurer and receives a 20% 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. The Company's independent CPAs, Marberry, Miller & Bales, P.C., conduct an annual audit and prepare the Company's annual statement and tax filings.

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 | \$ 110,859 |
| Stocks | 1,500 |
| Real Estate | 6,187 |
| Cash on Deposit | 2,840,489 |
| Premium Receivable | 406 |
| Computer Equipment | 3,824 |
| | ----- |
| Total Assets | <u><u>\$ 2,963,265</u></u> |

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2005

| | |
|-------------------------------|----------------------------|
| Losses Unpaid | \$ 29,200 |
| Ceded Reinsurance Payable | 13,800 |
| Federal Income Tax Payable | 13,574 |
| Liability Write-Ins | 4,191 |
| | ----- |
| Total Liabilities | \$ 60,765 |
| | ----- |
| Guaranty Fund | \$ 150,000 |
| Other Surplus | 2,752,500 |
| | ----- |
| Total Surplus | 2,902,500 |
| | ----- |
| Total Liabilities and Surplus | <u><u>\$ 2,963,265</u></u> |

STATEMENT OF INCOME
December 31, 2005

| | |
|--------------------------------|------------|
| Net Premium | \$ 373,290 |
| Other Insurance Income | 4,695 |
| Net Losses Incurred | (133,975) |
| Other Underwriting Expenses | (184,858) |
| | ----- |
| Net Underwriting Income (Loss) | \$ 59,152 |
| | ----- |
| Investment Income | \$ 65,988 |
| Other Income | 8,737 |
| | ----- |
| Gross Income (Loss) | \$ 133,877 |
| Federal Income Tax | (13,050) |
| | ----- |
| Net Income (Loss) | \$ 120,827 |
| | ===== |

CAPITAL AND SURPLUS ACCOUNT
December 31, 2005

| | |
|--|--------------|
| Policyholders' Surplus, December 31, 2004 | \$ 469,949 |
| Net Income (Loss) | 120,827 |
| Merger of Mutual Fire Insurance Company of St. Charles | 2,311,724 |
| | ----- |
| Policyholders' Surplus, December 31, 2005 | \$ 2,902,500 |
| | ===== |

NOTES TO THE FINANCIAL STATEMENTS

There were no notes to the financial statements.

EXAMINATION CHANGES

There were no examination changes.

GENERAL COMMENTS AND RECOMMENDATIONS

There were no general comments or recommendations.

SUBSEQUENT EVENTS

None.

