**REPORT OF**
**FINANCIAL EXAMINATION**

# UNION TOWN MUTUAL INSURANCE COMPANY

**AS OF**
**DECEMBER 31, 2003**

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

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March 31, 2004
Union, 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

**UNION TOWN 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 7 North Washington Avenue, Union, Missouri, telephone number (636) 583-2292. This examination began on March 29, 2004, and was concluded on March 31, 2004, and is respectfully submitted.

## SCOPE OF EXAMINATION

**Period Covered**

The prior full-scope examination of the Company was made as of December 31, 1999, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 2000, 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, 1999, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

**Comments-Previous Examination Report**

**Comment:** The Board should take action to address the items remaining from the previous examination report. In particular, the Board should implement measures to ensure a quorum is present for annual meetings, take action to ensure compliance with its Articles of Incorporation and Bylaws, adopt written policies and procedures, and obtain written agent's agreements.

**Company Response:** The Directors are researching ways to involve more members at annual meetings. In addition, the Articles of Incorporation and Bylaws are being reviewed to ensure compliance of current practices. An Executive Committee has been established to recommend agreements, policies and other needed procedures. An agent's agreement has been approved by the Board.

**Current Findings:** The Company appears to currently comply with quorum and other requirements of its Articles of Incorporation and Bylaws and has executed written agent's agreements. However, the Company does not have written policies and procedures (See the "Corporate Records" section of this report).

**Corporate Records**

**Comment**: The Articles of Incorporation and Bylaws contained numerous outdated references. The Board should revise the Articles of Incorporation and Bylaws, obtain approval from the membership at a proper meeting of the members and ensure that changes are filed with the appropriate State officials.

**Company Response:** The Board is currently reviewing the Bylaws and Articles of Incorporation for revision.

**Current Findings:** The Company has restated its Articles of Incorporation and Bylaws to address the previously noted deficiencies.

**Fidelity Bond and Other Insurance**

**Comment**: The Board needs to ensure that the fidelity bond provides coverage for the appropriate individuals. Also, the process for obtaining errors and omissions coverage for the Company's own employee should be evaluated by the Board. Obtaining the coverage directly by the Company may be more cost effective and provide for better control by the Company.

**Company Response:** The fidelity bond is being updated to cover the current Secretary, Treasurer and employee. The Board has approved errors and omissions coverage for its employees. An application has been received and is being completed for submission.

**Current Findings:** The Company's fidelity bond provides coverage for the appropriate individuals. The Company currently purchases errors and omissions coverage for its employee.

**Territory and Plan of Operations**

**Comment**: The Board is directed to write policies only within the Company's designated territory. Policies written for members residing within the territory are acceptable; however, a policy written for someone completely out of Franklin and surrounding counties is a violation of Section 380.021(2) RSMo. and the Company must cease this practice.

**Company Response:** The Board will see that no policies are written outside of the Company's designated territory. Corrective action is being taken on those policies that do not comply.

**Current Findings:** During the examination period, the Company received a Certificate of Authority that allows the Company to write policies throughout the state of Missouri. The Company currently complies with this Certificate of Authority.

**Policy Forms and Underwriting Practices**

**Comment**: The Board is directed to issue policies which contain the notice of annual meeting as required by Section 380.041 (3) RSMo.

**Company Response:** Currently, all policies issued include the annual meeting information.

**Current Findings:** The policies issued by the Company contain notice of the annual membership meeting.

**Accounts and Records**

**Comment**: The Board should take action to ensure that its members' interests are protected and should control policyholders' records. In addition, any agent's agreement would be enhanced if ownership of these policies was clearly defined in the agreement.

**Company Response:** The Company has control of all current policyholder records. Records of prior policies are being reviewed to ensure all data is in the control of the Company. The agent's agreement approved by the Board specifically states that business written is the property of the Company.

**Current Findings:** The Company currently controls policyholder records and agents are allowed access only to policy that they produce. In addition, the agent's agreements stipulate that ownership of policies rests with the Company.

**Subsequent Events**

**Comment**: The Board is directed to comply with Section 380.041(1) RSMo. and not allow anyone to serve on the Board of Directors unless that person is a policyholder of this Company.

**Company Response:** The Company is currently in compliance with 380.041(1) RSMo.

**Current Findings:** As of the examination date, all directors were policyholders of the Company.

**Comment**: The Board should obtain a complete and signed promissory note for the funds provided to Walter Sohl & Associates. This should include the principal of the loan, interest rate, and repayment schedule. Also, approval for loans should be shown in the Board meeting minutes.

**Company Response:** The loan has been repaid in full by Walter Sohl.

**Current Findings:** The note was paid in full during the examination.

## HISTORY

### General

The Company was originally organized on February 7, 1914, and incorporated on February 11, 1922, as Union Town Fire Mutual Insurance Company. On December 29, 1979, the Company changed its name to Union Town Mutual Insurance Company. 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 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. Ten 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 seven members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every month, and the directors are compensated $50 per meeting attended.

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

| Name and Address | Occupation | Term |
|---|---|---|
| Maurice Schulte<br>203 McKinley<br>Union, Missouri | Hardware Store Employee | 2001-2004 |
| Victor Parmentier<br>P.O. Box 436 | Real Estate Broker | 2002-2005 |

| | | |
|---|---|---|
| Union, Missouri | | |
| Mike Bocklage<br>24 Roesner<br>Union, Missouri | Retired | 2001-2004 |
| Donald Schroeder, Jr.<br>1100 West Park<br>Union, Missouri | Postal Employee | 2002-2005 |
| James Cooper<br>P.O. Box 819<br>Union, Missouri | Developer | 2003-2003 |
| Michael Schroeder<br>275 Brown<br>Union, Missouri | Self-Employed- Automotive | 2001-2004 |
| Bud Weiskopf<br>P.O. Box 389<br>Union, Missouri | Realtor | 2002-2005 |

The Board of Directors elects for a term of one year a President, Vice-President, Secretary and Treasurer.

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

| | |
|---|---|
| Maurice Schulte | President |
| Victor Parmentier | Vice-President |
| Donald Schroeder, Jr. | Secretary |
| Michael Bocklage | 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 January 10, 2001, the Articles were restated to correct outdated references and allow for the Company to convert to an Extended Missouri Mutual. The amendment added liability, crop and other insurance to the lines of business the Company could write. On October 10, 2001, the Articles were amended to delete crop and other insurance lines. On June 27, 2001, the Articles were amended to update the registered office of the Company.

On January 10, 2001, the Bylaws were amended. In addition to updating the language of the document, the amendment changed all references of “assessment” to “premium” in order to facilitate the Company’s conversion from an assessable to a non-assessable mutual company.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. The minutes of the Company appear to properly reflect corporate transactions and events. The Company does not have a written manual that outlines the policies and procedures of the Company. It is recommended the Company adopt a written policies and procedures manual which outlines, at a minimum, the investment, conflict of interest, signature of checks and employee expense policies; agent underwriting and claims payment policies; inspection process and job descriptions of the Company.

## FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond providing a limit of liability of $15,000. The fidelity bond coverage of the Company does not meet the minimum amount suggested in the guidelines promulgated by the NAIC, which is between $25,000 and $50,000 in coverage. It is recommended the Company obtain a fidelity bond with a coverage limit of at least $25,000, the minimum suggested for a company its size in the guidelines promulgated by the NAIC.

The Company carries directors' and officers' liability coverage with per claim and aggregate limits of $1,000,000 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 employee-agent with a limit of $100,000 and a $1,000 deductible. The Company utilizes two independent agents which are required to purchase errors and omissions coverage at their own expense.

The Company does not own its home office building and does not own sufficient property to warrant insurance coverage.

The insurance coverage appears adequate.

## EMPLOYEE BENEFITS

The Company has one full-time and one part-time employee. The full-time employee receives one week of vacation per year. No other benefits are provided to the employees. 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 and wind and offers liability coverage through a cooperative agreement with Cameron Country Mutual Insurance Company.

The Company's policies are sold by one employee-agent and two independent agents. The employee-agent receives a 12% commission and the independent agents receive a 15% 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 on new risks are performed by the agents.

An independent adjuster performs inspections on renewal risks and adjustments. 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 | $215,727 | $57,830 | $197,738 | $339,568 | $5,597 | $(35,710) | $(16,795) |
| 2002 | 234,220 | 81,751 | 155,892 | 28,812 | 9,164 | (23,967) | (9,387) |
| 2001 | 206,654 | 44,788 | 95,141 | 23,101 | 11,172 | (22,699) | (7,666) |
| 2000 | 201,635 | 32,102 | 68,070 | 14,412 | 10,731 | (4,749) | 8,649 |

At year-end 2003, 431 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:

| | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|
| Direct | $66,130 | $93,367 | $153,353 | $193,934 |
| Assumed | 0 | 0 | 0 | 0 |
| Ceded | (22,718) | (33,926) | (59,221) | (121,838) |
| Net | $43,412 | $59,441 | $94,132 | $72,096 |

**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 both fire and wind risks. The per risk excess of loss section of the contract is for fire risks and contains two layers. The Company retains $10,000 per risk under the first layer and $110,000 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 19.0% and 2.0% of net written premium for layers one and two, respectively.

The catastrophe excess of loss coverage section is also for fire risks. The Company retains $30,000 per occurrence and the reinsurer is liable for 95% of losses in excess of the Company retention. The per occurrence limit is $950,000 and the annual limit is $1,900,000. Annual premium for the catastrophe coverage is $.055 per $1,000 in force.

The contract also provides for aggregate excess of loss coverage for fire 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 $500,000. The reinsurance rate is 2.0% of net written premium.

The Company cedes 100% of wind risks and 78% of wind premiums under the property quota share section of the contract. The reinsurer limits are $160,000 for commercial and confinement risks and $360,000 for all other risks.

The Company has a cooperative agreement with Cameron Country Mutual Insurance Company for lines of business other than fire and wind. The Company receives a 20% ceding commission for farm and homeowner's liability and earthquake policies and a 12% ceding commission for general liability and inland marine policies.

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 a modified cash basis. The Company compiles 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, 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**

| | |
|---|---|
| Cash on Deposit | 202,864 |
| Reinsurance Recoverable | 11,914 |
| Computer Equipment | 667 |
| Asset Write-Ins | 283 |
| | --------------- |
| Total Assets | $215,728 |
| | ========== |

**LIABILITIES, SURPLUS AND OTHER FUNDS**
**December 31, 2003**

| | |
|---|---|
| Ceded Reinsurance Payable | $21,782 |
| Unearned Premium (Note 1) | 69,079 |
| | --------------- |
| Total Liabilities | $ 90,861 |
| | --------------- |
| Guaranty Fund (Note 2) | $ 150,000 |
| Other Surplus (Note 3) | (25,133) |
| | -------------- |
| Total Surplus | $ 124,867 |
| | -------------- |
| Total Liabilities and Surplus | $ 215,728 |
| | ========== |

## STATEMENT OF INCOME
## December 31, 2003

| | |
|---|---|
| Net Premium | $ 62,779 |
| Reinsurance Commission | 1,362 |
| Net Losses Incurred | (10,862) |
| Other Underwriting Expenses | (88,990) |
| | ------------- |
| Net Underwriting Income (Loss) | $ (35,710) |
| | ------------- |
| Investment Income | $ 5,597 |
| Other Income | 13,318 |
| | ------------- |
| Gross Income | $ (16,796) |
| Federal Income Tax | 0 |
| | ------------- |
| Net Income (Loss) | $ (16,796) |
| | ======== |

## CAPITAL AND SURPLUS ACCOUNT
## December 31, 2003

| | |
|---|---|
| Policyholders' Surplus, December 31, 2002 | $ 152,480 |
| Net Income (Loss) | (16,796) |
| Examination Adjustments (Note 4) | (10,817) |
| | ------------- |
| Policyholders' Surplus, December 31, 2003 | $ 124,867 |
| | ======== |

## NOTES TO THE FINANCIAL STATEMENTS

Unearned Premium (Note 1) $69,079

The Company failed to report an unearned premium reserve, as required due to its status as a non-assessable mutual company. The result was an examination adjustment, increasing the unearned premium liability by $69,079.

Guaranty Fund (Note 2) $150,000

The Company failed to report a guaranty fund as required by Section 380.271 RSMo. (Guaranty fund required). The result was an examination adjustment, increasing the guaranty fund account by $150,000.

Other Surplus (Note 3) $(25,133)

As a result of examination adjustments to the financial statements, including unearned premium (Note 1) and guaranty fund (Note 2) balances, the Company is not in compliance with Section 380.271 (Guaranty fund required). The Company's surplus balance of $124,867 as of December 31, 2003, is deficient by $25,133 of the minimum surplus requirement of $150,000, as stated in the statute. The Company is directed to take immediate steps to bring its surplus in compliance and to formulate a plan showing how this minimum requirement will be maintained in the future.

Examination Adjustments (Note 4) $10,817

Due to various errors made in the 2003 Annual Statement, including unearned premium amounts (Note 1), an examination adjustment of $10,817 was required to properly reconcile the Company's December 31, 2002 surplus account to the balance as of December 31, 2003.

## EXAMINATION CHANGES

| | | | |
|---|---|---|---|
| Total Policyholder's Surplus Per Company, December 31, 2003 | | | $193,946 |
| | Increase in Surplus | Decrease in Surplus | |
| Unearned Premium | $ 0 | $69,079 | |
| | ------------ | ------------ | |
| Total Change | $ 0 | $69,079 | (69,079) |
| Total Policyholder's Surplus Per Examination, December 31, 2003 | | | $124,867 |

## GENERAL COMMENTS AND RECOMMENDATIONS

Corporate Records (Page 7)

It is recommended the Company adopt a written policies and procedures manual which outlines, at a minimum, the investment, conflict of interest, signature of checks and employee expense policies; agent underwriting and claims payment policies; inspection process and job descriptions of the Company.

Fidelity Bond and Other Insurance (Page 7)

It is recommended the Company obtain a fidelity bond with a coverage limit of at least $25,000, the minimum suggested for a company its size in the guidelines promulgated by the NAIC.

Notes to the Financial Statements (Page 14)

**Based on the company's recent and recurring operating losses, the Company is directed to take immediate steps to bring its surplus to a comfortable margin above the $150,000 minimum and to formulate a plan showing how this minimum will be maintained in the future. If the company cannot achieve both of these in an acceptable form to the Department by May 31 it should commence non-renewing all policies on their next anniversary date.**

## SUBSEQUENT EVENTS

None.

## ACKNOWLEDGMENT

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

## VERIFICATION

State of Missouri )<br>
) ss<br>
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.

______________________________<br>
Shannon W. Schmoeger, CFE<br>
Financial Examiner<br>
Missouri Department of Insurance

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

My commission expires:

_____________________ __________________________________<br>
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.

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