

CERTIFICATION

September 15, 2015

I, Bruce R. Ramage, Director of Insurance of the State of Nebraska, do hereby certify that the attached is a full and correct copy of the

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE

SEP 15 2015

Financial Examination Report of

FILED

POLK AND BUTLER MUTUAL INSURANCE COMPANY

as of

December 31, 2014

The report is now on file and forming a part of the records of this Department.

I hereto subscribe my name under the seal of my office at Lincoln, Nebraska.



Bruce R. Ramage
DIRECTOR OF INSURANCE

CERTIFICATE OF ADOPTION

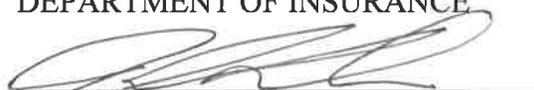
Take notice that the proposed report of the financial examination of

POLK AND BUTLER MUTUAL INSURANCE SOCIETY

dated as of December 31, 2014, verified under oath by the examiner-in-charge on August 25, 2015, and received by the company on September 4, 2015, has been adopted without modification as the final report pursuant to Neb. Rev. Stat. § 44-5906(3)(a).

Dated this 15 day of September, 2015.

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE



Justin C. Schrader
Chief Financial Examiner

STATE OF NEBRASKA

Department of Insurance

EXAMINATION REPORT

OF

Polk and Butler Mutual Insurance Company

as of

December 31, 2014



Osceola, Nebraska
July 8, 2015

Honorable Bruce R. Range
Director of Insurance
Nebraska Department of Insurance
941 "O" Street, Suite 400
Lincoln, Nebraska 68508

Dear Sir:

Pursuant to your instruction and authorizations, and in accordance with statutory requirements, an examination has been conducted of the financial condition and business affairs of:

POLK AND BUTLER MUTUAL INSURANCE COMPANY
431 Hawkeye Street, Box 262
Osceola, Nebraska 68651

(hereinafter also referred to as the "Company") and the report of such examination is respectfully presented herein.

INTRODUCTION

The Company was last examined as of December 31, 2009 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2014, and includes such subsequent events and transactions as were considered pertinent to this report.

SCOPE OF EXAMINATION

This examination was conducted pursuant to and in accordance with the provisions of Section §44-5904(1) of the Nebraska Insurance Statutes.

A general review was made of the Company's operations and the manner in which its business has been conducted in order to determine compliance with statutory and charter provisions. The Company's history was traced and has been set out in this report under the

caption "Description of Company". All items pertaining to management and control were reviewed. The Articles of Incorporation and By-Laws were reviewed, including appropriate filings of any changes or amendments thereto. The minutes of the meetings of the members and Board of Directors, held during the examination period, were read and noted. Attendance at meetings and election of Directors and Officers were also noted.

The fidelity bond and other insurance coverages protecting the Company's property and interests were reviewed. The Certificate of Authority to conduct the business of insurance in the State of Nebraska was inspected and a survey was made of the Company's general plan of operation.

The Company's reinsurance facilities were ascertained and noted, and have been commented upon in this report under the caption "Reinsurance". Accounting records and procedures were tested to the extent deemed necessary through the substantive examination process.

All accounts and activities of the Company were considered in accordance with the provisions of Section §44-5904(1) of the Nebraska Insurance Statutes. The assets were verified and evaluated and the liabilities were determined in order to present the statement of the Company's financial condition as of December 31, 2014.

Any failure of items to add to the totals shown in schedules and exhibits appearing throughout this report is due to rounding.

DESCRIPTION OF COMPANY

HISTORY

The Company, formerly the "Polk and Butler Counties Farmers Insurance Company", was incorporated under the laws of the State of Nebraska on February 23, 1892, as an assessment fire

and lightning insurance company for the purpose of insuring the property of its members located in Polk and Butler Counties in Nebraska against loss or damage by fire and lightning.

At a special meeting of the policyholders held on February 28, 1963, the Articles of Incorporation were amended to change the Company's name to Polk and Butler Mutual Insurance Company with the principle place of business Osceola, Nebraska and the territory of the Company shall be limited to Polk County, Nebraska and the counties contiguous thereto.

The Articles of Incorporation provide that, "the purposes of the Company shall be to insure the property of its members against the risks and hazards permitted by Section 44-201(1) and (8) of the Revised Statutes of 1943 of the State of Nebraska and all acts amendatory thereto; to issue policies of insurance of the general character provided for mutual and assessment companies by Chapter 44 of the Revised Statutes of 1943, State of Nebraska; and to perform all other acts and to have and exercise all such rights and privileges as are necessary to carry out the general purposes of said company." The Articles of Incorporation also provide that the Company shall have perpetual existence.

MANAGEMENT AND CONTROL

Members

Article IV of the Articles of Incorporation state that, "the membership of the Company shall be limited to those persons, corporations, associations or partnerships having insurance in full force and effect." Membership is obtained by an application being approved by the Secretary or his authorized representative and shall cease when such insurance is canceled or terminates from any other cause. Each member is entitled to one vote at any annual or special meeting. The Articles state that, "annual membership meeting shall be held at Shelby, Nebraska on the second Thursday in February of each year commencing as 10 o'clock a.m. Special

membership meetings may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the members of the Company.”

Board of Directors

Article VI of the Articles state that, “the corporate powers of the Company shall be vested in a Board of nine Directors each elected by a majority vote of the annual meeting for terms of three years or until their successors are duly elected and qualified.” The Articles further state that, “no person shall hold the office of Director unless he is a policyholder”. A majority of the Board shall constitute a quorum for the transaction of business at any meeting of the Board of Directors.

The following persons were serving as Directors at December 31, 2014:

<u>Name</u>	<u>Residence</u>	<u>Term Expires</u>
Scot Bauer	Surprise, Nebraska	2015
Larry Heins	David City, Nebraska	2015
Darin Sterup	Osceola, Nebraska	2015
Walden Jones	Osceola, Nebraska	2016
John Messing	Shelby, Nebraska	2016
Dannie Steager	Surprise, Nebraska	2016
Mike Crook	Rising City, Nebraska	2017
Lee Fozzard	Rising City, Nebraska	2017
Curtis Ingalls	Shelby, Nebraska	2017

Directors receive \$50.00 per diem plus mileage at the rate set by the Federal government, for each meeting attended.

Officers

The Articles of Incorporation state that, “at the annual meeting of the Directors which shall be held immediately following the annual meeting of the members, they shall elect for a term of one year a President, Vice-President, Treasurer, and Secretary who when so designated by the Board may also serve as Treasurer and such additional Officers as they deem necessary.”

The President receives a \$200 annual stipend as compensation for the extra duties required of his position. The Board of Directors approved a salary increase for the Secretary/Treasurer on February 13, 2014 to \$18,000 per year.

The following is a listing of Officers elected and serving the Company at December 31, 2014:

<u>Name</u>	<u>Office</u>
Lee Fozzard	President
Dannie Steager	Vice President
Darin Sterup	Secretary and Treasurer

FIDELITY BOND AND OTHER INSURANCE

A fidelity bond covering the Secretary-Treasurer in the amount of \$25,000 protects the Company. The Company is protected by a combined Commercial General Liability and Commercial Property Policy that includes coverage of \$84,200 on its office building, \$7,900 on personal property, and \$4,500 on the sign attached to the building. The Commercial Property coverage is subject to a \$1,000 deductible. The Company is also protected by an Insurance Company Combined Professional Liability and Directors & Officers Liability Policy, which provides coverage in the amount of \$1,000,000 subject to a \$10,000 deductible. The Company also maintains an Agents Professional Liability policy for its two agents in the amount of \$1,000,000. This coverage includes a \$2,500 deductible.

TERRITORY AND PLAN OF OPERATION

The Company is authorized to transact business in the State of Nebraska. The Company transacts the business of insurance in Polk, Butler, York, Merrick, and Platte Counties in Nebraska. The Company insures farms and farm property, town residence property, churches, schools, mobile trailer homes and non-commercial buildings.

The Company currently has two licensed agents producing business for the Company and two persons who adjust claims that may occur.

Policies are written for a term of three years with premiums being collected each year during the term of the policy. No membership fees are charged to the members.

The Company, as a convenience for its policyholders and agents, made available general liability coverage written by Acceptance Casualty Insurance Company through the Nebraska Farmers Agency Company. The Company handles the premium accounting on such business. Commissions received by the Company are transferred and disbursed to the agents responsible for the production of such business. The Company retains any expense or handling fees.

REINSURANCE

During each year covered by this examination, the Company had in effect a reinsurance agreement with the Nebraska Farmers Mutual Reinsurance Association (NFMRA), Wahoo, Nebraska. The term of each reinsurance agreement was for a period of one year. The latest agreement was executed as of January 1, 2015.

At the time of the execution of the reinsurance agreement in effect on December 31, 2014, the Company, as a member Association, represented that it had the sum of \$54,235,295 of fire insurance in-force and \$54,235,295 of wind insurance in-force covered by this agreement.

The coverage under this agreement is as follows:

Aggregate - NFMRA is liable for 100% of the amount, if any, by which the Company's aggregate ultimate net losses incurred during the term of this contract exceed the 2014 Retention (\$2,700 per million). The Company's preliminary aggregate retention for 2014 is \$146,435.

Excess Per Risk - Prior to the Company incurring ultimate net losses exceeding their aggregate retention mentioned above, NFMRA will be liable for 100% of the excess greater than \$40,000 on a single risk up to and equal to \$460,000 (\$1,160,000 as respects to risks of a single farm outbuilding or contents therein). If the Company's net losses do not exceed the aggregate retention for the year, the amount recovered is to be refunded to NFMRA prior to March 1 of the following year.

Mobile Home Risk- The Company shall retain the first \$1,000 of each risk, each loss, as respects to mobile home risks located in trailer courts. Also, limit of coverage shall be \$48,000 for losses in any one trailer court. Two or more trailers in one location shall constitute a trailer court.

Limit Per Risk- Single risks in excess of \$1,200,000 as respects to farm outbuildings and machinery pertaining to farm owners policies or \$500,000 for all other covered property and/or policies, any one risk shall be pro-rata reinsured by each member company.

The contract reviewed contained a standard insolvency clause, but did not contain an arbitration clause, an offset clause, or an errors and omissions clause. The contract also did not contain the entire agreement clause as required per SSAP No. 62R, paragraph 8c of the NAIC Accounting Practices and Procedures Manual.

BODY OF REPORT

FINANCIAL STATEMENTS

The following statement of assets and liabilities, together with the accompanying statement of income and disbursements, reflects the financial condition of the Company at December 31, 2014, as determined through this examination.

STATEMENT OF INCOME AND DISBURSEMENTS

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Balance, beginning of year	\$417,338	\$459,790	\$422,618	\$510,683	\$634,202
<u>Income</u>					
Gross receipts from assessments	\$269,690	\$269,268	\$290,135	\$346,099	\$343,352
Return on cancellations	<u>4,314</u>	<u>1,745</u>	<u>1,046</u>	<u>11,903</u>	<u>(5,264)</u>
Net amount received from members	\$265,376	\$267,523	\$289,089	\$334,196	\$338,088
Interest on investment	4,320	9,678	7,052	2,835	3,626
Rent					1,200
Liability premiums	<u>24,091</u>	<u>21,887</u>	<u>20,847</u>	<u>25,562</u>	<u>26,154</u>
Total income	<u>\$293,787</u>	<u>\$299,088</u>	<u>\$316,988</u>	<u>\$362,593</u>	<u>\$369,068</u>

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
<u>Disbursements</u>					
Gross losses paid	\$ 45,157	\$369,304	\$ 64,222	\$ 82,135	\$247,114
Less discount and salvage	1,750	24,500			7,000
Less reinsurance recovered	<u>6,049</u>	<u>228,861</u>	<u>55,208</u>	<u>76,214</u>	<u>85,815</u>
Net losses paid	\$ 37,358	\$115,943	\$ 9,014	\$ 5,921	\$154,299
Adjusting expense	\$ 1,309	\$ 6,453	\$ 1,493	\$ 691	\$ 3,955
Commissions paid to agents	18,165	18,727	20,770	22,425	44,461
Expense of agents	244	1,983	1,165	2,642	3,273
Salaries of Directors and Officers	2,446	53,667	54,049	46,423	24,401
Salaries of office employees	55,588	5,060	5,720		
Repair on real estate				1,842	980
Taxes on real estate	393	399	397		362
Insurance Department licenses and fees	6,657	5,793	5,522	5,545	8,946
All other taxes	14,190	13,227	13,214	10,383	9,327
Advertising, printing, and stationery	1,299	1,359	1,000	1,281	761
Telephone and postage	1,385	1,293	1,383	2,481	2,519
Reinsurance premiums paid	70,700	75,153	82,290	97,976	140,982
Office expense	518	515	294	3,113	743
Maintenance, supplies, and utilities	2,677	2,983	2,535	3,416	3,405
Other insurance	4,159	4,287	4,292	5,318	6,078
Liability insurance	22,479	20,336	18,531	21,720	21,739
Professional fees	1,675	2,025	1,900	2,247	2,168
Annual meeting	243	162	106	252	237
Office equipment				2,282	257
Prior interest adjustment				3,000	
Employee benefits	4,800	4,800	4,800		
Donations	5,050	50			
Travel, meetings	<u> </u>	<u>2,045</u>	<u>448</u>	<u>116</u>	<u>1019</u>
Total expenses	\$213,977	\$220,317	\$219,909	\$233,153	\$275,613
Total disbursements	<u>\$251,335</u>	<u>\$336,260</u>	<u>\$228,923</u>	<u>\$239,074</u>	<u>\$429,912</u>
Balance, end of year	<u>\$459,790</u>	<u>\$422,618</u>	<u>\$510,683</u>	<u>\$634,202</u>	<u>\$573,358</u>

STATEMENT OF ASSETS AND LIABILITIES
December 31, 2014

ASSETS

Ledger Assets

Certificates of deposit	\$435,689	
Other cash deposited in banks	131,074	
NFMRA surplus note	<u>6,595</u>	
Total ledger assets		<u>\$573,358</u>

Non-Ledger Assets

Interest due or accrued on investments	586	
Reinsurance receivable	8,506	
Furniture	<u>\$ 5,375</u>	
Total non-ledger assets		<u>\$ 14,467</u>
Gross assets		<u>\$587,825</u>

Assets Not Admitted

Furniture	\$ 5,375	
NFMRA surplus note	<u>6,595</u>	
Total assets not admitted		<u>\$ 11,970</u>
Total admitted assets		<u>\$575,855</u>

LIABILITIES AND SURPLUS

Unearned premiums		\$145,377
Premium tax payable		1,715
Accounts payable		539
Payroll tax payable		969
Employee retirement benefits liability		<u>9,600</u>
Total liabilities		\$158,200
Surplus as regards members		<u>417,655</u>
Total liabilities and surplus		<u>\$575,855</u>

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The recommendations appearing in the previous report of examination are reflected below together with the remedial actions taken by the Company to comply therewith:

Unearned Premiums Liability – It is recommended that the Company calculate unearned premiums and state that calculation on page 5, line 31 of future annual statements.

Action: The Company has complied with this recommendation.

Fidelity Bond - It is recommended that the Company reviews the adequacy of its fidelity bond.

Action: The Company has complied with this recommendation.

Total Liabilities – It is recommended that the Company does not include the policyholders surplus in future annual statements.

Action: The Company has complied with this recommendation.

COMMENTARY ON CURRENT EXAMINATION FINDINGS

Certificates of Deposit **\$435,689**

As of December 31, 2014 the Company had five certificates of deposit with a value of \$435,689. Each certificate of deposit was verified by direct confirmation from the respective depositories.

Cash Deposited in Banks **\$131,074**

This asset consisted of a checking account and a savings account balances. These deposits were verified by obtaining a direct confirmation from the bank. The amount indicated thereon for the checking account was reconciled to the Company's records as of December 31, 2014, by giving consideration to outstanding checks.

NFMRA Surplus Note **\$ 6,595**

The surplus note issued by Nebraska Farmers Mutual Reinsurance Association (NFMRA) had a value of \$6,595 as of December 31, 2014. This item is deducted, as an asset not admitted

in both the Company’s 2014 Annual Statement and the financial statements of this report in accordance with Statement of Statutory Accounting Principles No. 41.

This surplus note is considered to be “borrowed funds to provide policyholder surplus” for the reinsurance association. The note bears an interest rate of 4% per annum. The principal and/or interest can be paid only when the amount of the surplus of the reinsurance association over all liabilities is double that of the amount of the principle and/or interest then being paid. The reinsurance association has the right to make such payment when it has received the approval from the Department of Insurance. The surplus note is not a liability of the reinsurance association and cannot be used as a claim against it.

Statement of Statutory Accounting Principles No. 41, Paragraph 10(b) states that, “holders of surplus notes shall value their investment in surplus notes as follows: by applying a ‘statement factor’ to the outstanding face amount of the capital or surplus notes. The ‘statement factor’ is equal to the total capital and surplus, including surplus notes, less the greater of 5% of admitted assets or \$6,000,000, divided by capital or surplus notes. If ‘statement factor’ is negative, the surplus note(s) shall be carried at zero.”

Calculation of the NFMRA surplus note is as follows:

\$7,206,699	Admitted assets (including surplus note)
<u>6,031,077</u>	Less liabilities
\$1,175,622	Total capital, surplus, and surplus note

\$7,206,699	
<u>5%</u>	of admitted assets
\$ 360,335	

Greater of \$360,335 or \$6,000,000

\$ 1,175,622	
<u>- 6,000,000</u>	
\$(4,824,378) / 1,175,622 = -4.10	statement factor

Interest Due or Accrued **\$ 586**

The non-ledger amount of \$586 reflects the interest accrued as of December 31, 2014.

Reinsurance Receivable **\$ 8,506**

The non-ledger amount of \$8,506 represents a receivable balance from the Company's reinsurer, NFMRA, for paid losses subject to reinsurance. This item was erroneously included as an asset not admitted which resulted in the Company's asset balance being understated by \$8,506. It is recommended that such amounts be shown as admitted assets in future financial statements.

Furniture **\$ 5,375**

The non-ledger amount of \$5,375 reflects the depreciated cost of the Company's office equipment. This item is deducted, as an asset not admitted in both the Company's 2014 Annual Statement and the financial statements of this report in accordance with accepted insurance accounting practices.

Unpaid Losses **\$ 0**

The Company historically has attempted to settle all claims prior to year-end. In 2014 there may have been a small number of outstanding claims that were not reported by the Company in the annual statement. However, the Company met their reinsurance retention for the year which transfers any outstanding liability to the Company's reinsurer. As such, the Company does not have any unpaid loss liability. In the future the Company should consider booking a liability with reductions for any applicable reinsurance coverage.

Unearned Premiums**\$145,377**

The Company reported unearned premiums of \$145,377 in its December 31, 2014 Annual Statement. Amounts reported are calculated by applying unearned factors of 43 percent to the premiums received for the year.

Premium Tax Liability**\$ 1,715**

The Company reported a premium tax liability of \$1,715 in its December 31, 2014 Annual Statement.

Accounts Payable**\$ 539**

The Company reported an accounts payable liability of \$539 in its December 31, 2014 Annual Statement. This amount consists of unpaid, but not overdue, utilities for the Company's office building.

Payroll Tax Payable**\$ 969**

The Company reported a payroll tax liability for future amounts owed of \$969 in its December 31, 2014 Annual Statement.

Employee Retirement Benefits**\$ 9,600**

The Company has a post retirement compensation agreement with its former Secretary/Treasurer, Walter Crook. The agreement pays Mr. Crook \$800 a month for ten years. The Company currently expenses the payments through its salary expense and does not have an associated liability. It is recommended that the Company establish a liability in the amount of \$9,600 which represents one year of payments. This liability should continue to be recorded on future annual statements until such a time that the Company's obligations to Mr. Crook have been settled. It is also recommended that the Company include a note to the annual statement that

discloses the remaining balance payable to Mr. Crook. The remaining amount owed at December 31, 2014 was \$63,200.

The Company's Board of Directors has also approved a retirement compensation plan for its current Secretary/Treasurer, Darin Sterup. This agreement compensates Mr. Sterup \$500 each month with the balance vesting after five years. The Company currently does not carry a liability for this obligation. It is recommended that the Company include a note to the annual statement disclosing the accumulated balance of these non-vested funds prior to their vesting. Once vested, it is recommended that the Company establish a liability for the entire amount due to Mr. Sterup.

Policyholder's Surplus

\$417,655

Policyholder's surplus, as determined by this examination, amounted to \$417,655 at December 31, 2014.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following comments and recommendations have been made as a result of this examination:

Reinsurance Clause - It is recommended that the Company amend its reinsurance contract to include an arbitration clause, an offset clause, and an error and omissions clause. It is also recommended that the Company include an entire agreement clause to comply with SSAP No. 62R, paragraph 8c of the NAIC Accounting Practices and Procedures Manual.

Reinsurance Receivable – It is recommended that the Company account for reinsurance receivables in accordance with SSAP No. 62R.

Post Retirement Compensation (Walter Crook) – It is recommended that the Company establish a liability in the amount of \$9,600 which represents one year of payments due to Mr. Crook under his post retirement compensation agreement. This liability should continue to be recorded on future annual statements until such a time that the Company's obligations to Mr. Crook have been settled. It is also recommended that the Company include a note to the annual statement that discloses the remaining balance payable to Mr. Crook.

Post Retirement Compensation (Darin Sterup) – It is recommended that the Company include a note to the annual statement disclosing the accumulated balance of the contributions made to Mr. Sterup’s retirement during the five year vesting period. Once vested, it is recommended that the Company establish a liability for the entire amount due to Mr. Sterup.

ACKNOWLEDGEMENT

The courteous cooperation extended by the Officers and employees of the Company during this examination is hereby acknowledged.

In addition to the undersigned, Linda K. Scholl, CISA, CFE, Financial Examiner with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,

Kevin L. Stubbs, CFE
Examiner-in-Charge
Department of Insurance
State of Nebraska

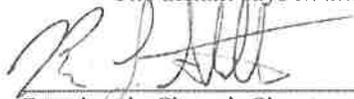
State of Nebraska,

County of Lancaster,

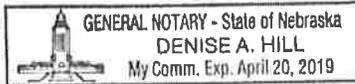
Kevin Stubbs, being duly sworn, states as follows:

1. I have authority to represent the Department of Insurance of the State of Nebraska in the examination of the **Polk and Butler Mutual Insurance Company**.
2. The Department of Insurance of the State of Nebraska is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of the **Polk and Butler Mutual Insurance Company** was performed in a manner consistent with the standards and procedures required by the Department of Insurance of the State of Nebraska.

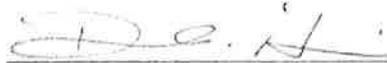
The affiant says nothing further.


 Examiner-in-Charge's Signature

Subscribed and sworn before me by Kevin Stubbs on this 25 day of August, 2015.



(SEAL)


 Notary Public

My commission expires 4-20-19 [date].