

# CERTIFICATION

May 30, 2013

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

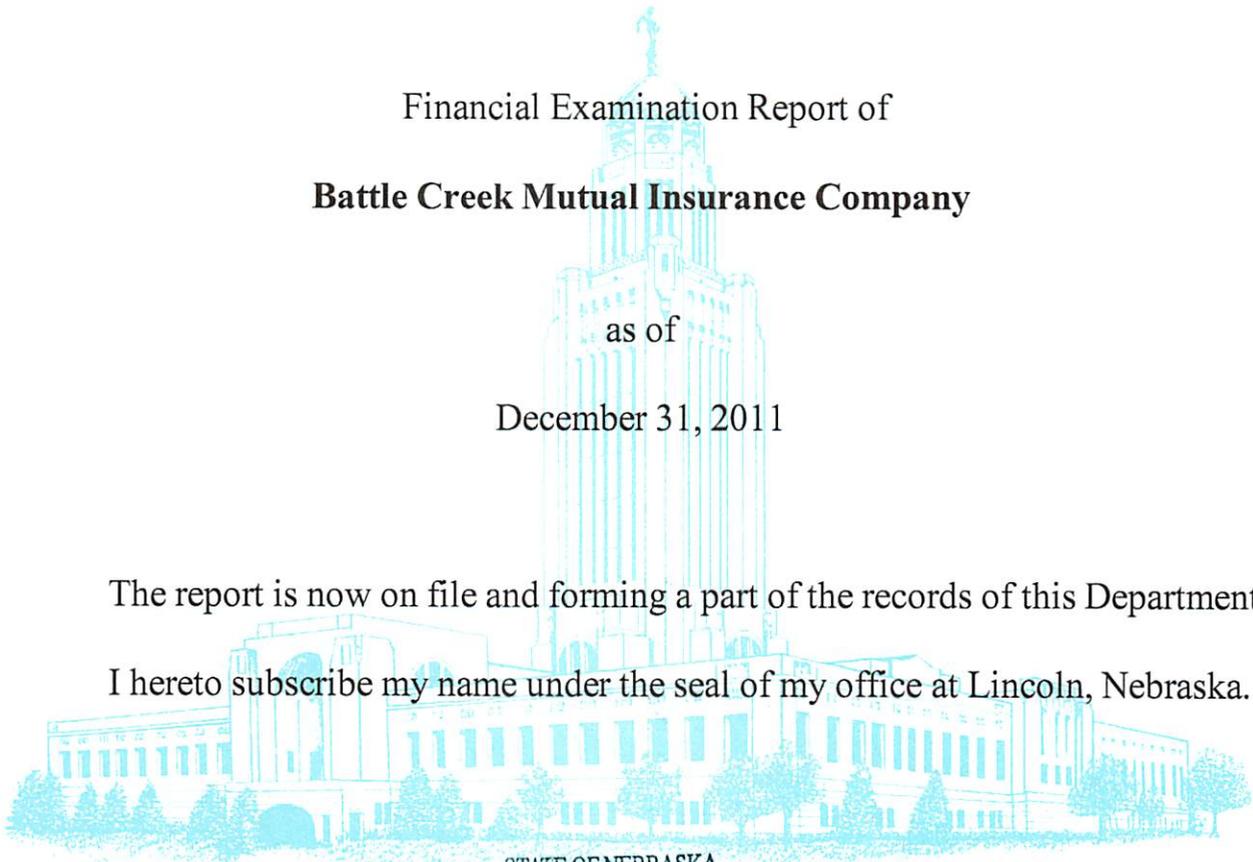
Financial Examination Report of  
**Battle Creek Mutual Insurance Company**

as of

December 31, 2011

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.



STATE OF NEBRASKA  
DEPARTMENT OF INSURANCE

MAY 30 2013

FILED



*Bruce R. Range*  
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DIRECTOR OF INSURANCE

**STATE OF NEBRASKA**

**Department of Insurance**

**EXAMINATION REPORT**

**OF**

**BATTLE CREEK MUTUAL INSURANCE COMPANY**

**as of**

**December 31, 2011**



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Battle Creek, Nebraska  
April 3, 2013

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:

**Battle Creek Mutual Insurance Company**  
**603 S. Preece Street**  
**Battle Creek, NE 68715**

(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, 2007 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2011, and includes such subsequent events and transactions as were considered pertinent to this report. The State of Nebraska participated in this examination and assisted in the preparation of this report.

The North Dakota Insurance Department also conducted an examination of Nodak Mutual Insurance Company, who has ultimate control of the Company, as of December 31, 2011.

## **SCOPE OF EXAMINATION**

This examination was conducted pursuant to and in accordance with both the NAIC Financial Condition Examiners Handbook (Handbook) and Section §44-5904(1) of the Nebraska Insurance Statutes. The Handbook requires that examiners plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including, but not limited to: corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement Instructions, when applicable to domestic state regulations.

The examination was completed under coordination of the holding company group approach with the North Dakota Insurance Department as the coordinating state. The companies examined under this approach benefit to a large degree from common management, systems and processes, and internal control and risk management functions that are administered at the consolidated or business unit level.

The coordinated examination applies procedures sufficient to the comprise a full scope financial examination of each of the companies in accordance with the examination procedures and standards promulgated by the NAIC and by the respective state insurance departments where the companies are domiciled. The objective is to enable each domestic state to report on their respective companies' financial condition and to summarize key results of examination procedures.

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, including provisions for disclosure of conflicts of interest to the Board of Directors and the departmental organization of the Company. 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 policyholders, Board of Directors and committees, held during the examination period, were read and noted. Attendance at meetings, proxy information, election of Directors and Officers, approval of investment transactions and authorizations of salaries were also noted.

The fidelity bond and other insurance coverage's protecting the Company's property and interests were reviewed, as were plans for employee welfare and pension. Certificates of Authority to conduct the business of insurance in Nebraska was inspected and a survey was made of the Company's general plan of operation.

Data reflecting the Company's growth during the period under review, as developed from the Company's filed annual statements, is reflected in the financial section of this report under the caption "Body of Report".

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 risk-focused examination process. The Company's method of claims handling and procedures pertaining to the adjustment and payment of incurred losses were also noted.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This included a review of work papers prepared by Meriwether, Wilson and Company, PLLC, Nodak Mutual Insurance Company's (Nodak) external auditors, during their audit of the Nodak's accounts for the years ended December 31, 2010 and 2011. Portions of the auditor's workpapers have been incorporated into the workpapers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination.

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 was formed and commenced business as an unincorporated mutual insurer in 1892 under the name of Battle Creek Mutual Insurance Company. Incorporation of the Company as a mutual assessment association under the laws of the State of Nebraska was initiated on December 26, 1896, with the adoption of its original Articles of Incorporation. These original Articles were amended on January 19, 1937, thereby authorizing the Company to insure property in accordance with the laws of Nebraska relating to assessment associations. A Certificate of Renewal of the Articles of Incorporation, dated December 26, 1946, perpetually renewed the term of its corporate existence until dissolved in the manner provided by law. The Articles of Incorporation were amended effective January 25, 1966, thereby allowing the Company to act as a domestic assessment association under the laws of the State of Nebraska and to make all kinds of insurance permitted by such

companies.

The Articles of Incorporation and By-Laws were restated as of April 1, 2011 due to the new affiliation with Nodak Mutual Insurance Company (Nodak), a North Dakota domiciliary insurer. The Company cedes 100% of all business to Nodak. The affiliation between the two companies was reviewed and accepted by the Nebraska Department of Insurance.

Presently, the Company is a limited assessment multiple line casualty company which is licensed to do business in the State of Nebraska only. The Company is authorized to write the kinds of insurance prescribed by Section 44-201, Subsections 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 16, 18 and 20 of the Nebraska Insurance Code.

## **MANAGEMENT AND CONTROL**

### **Holding Company**

The Company is a member of an insurance holding company system as defined by Nebraska Statute. Nodak Mutual Insurance Company (Nodak) ultimately controls the Company through a 2/3 majority of the Board of Directors. An organizational listing as reported in the 2011 Annual Statement is represented by the following:

Nodak Mutual Insurance Company  
Nodak Agency, Inc.  
American West Insurance Company  
Battle Creek Mutual Insurance Company (Board controlled by Nodak)

### **Policyholders**

The business of the Company is conducted on the mutual plan. The Articles of Incorporation provides for the annual meetings of the members to be held as prescribed in the By-Laws. The By-Laws currently specify that the annual meeting will be held on the

fourth Wednesday in April of each year at the home office of the Company.

### **Surplus Note**

On December 30, 2010, the Company issued a surplus note to the now affiliated Nodak in the amount of \$3,000,000 to be paid in full about or on December 30, 2040. The interest rate is set at 1.0% per annum and calculated on a 360-day year of twelve 30-day months. Scheduled interest payments commence July 1, 2011 with semi-annual payments to be made every January 1<sup>st</sup> and July 1<sup>st</sup>. All payments of interest or principal may be made only from the Company's available surplus when the amount of surplus over all liabilities is double that of the amount of principal and interest being paid and only with the prior approval of the Nebraska Department of Insurance pursuant to Section 44-221 of the Nebraska Revised Statutes.

### **Board of Directors**

The Company's By-Laws state that, "the Board of Directors shall consist of not less than five (5) nor more than ten (10) members. Directors shall be elected for a three-year (3-year) term, and as nearly as may be, one-third (1/3) shall be elected annually." The remaining two-thirds (2/3) will be appointed by the affiliate, Nodak, during the term of the Surplus Note or the 100% Quota Share Agreement.

The following persons were serving as Directors at December 31, 2011:

<b><u>Name and Residence</u></b>	<b><u>Principal Occupation</u></b>
Eric Asmundstad Devils Lake, ND	Self-Employed Farmer
Duaine Espesgard Grand Forks, ND	Retired Bank Chief Executive Officer
Brian Doom Fargo, ND	Chief Financial Officer, Nodak Mutual Insurance Company
Michael Alexander Fargo, ND	Executive Vice President and Chief Executive Officer, Nodak Mutual Insurance Company

Bruce Zimmerman  
Battle Creek, NE

Regional Vice President, Nodak Mutual Insurance  
Company

Victoria Ashker  
Battle Creek, NE

Retired Secretary and Treasurer, Zimmerman  
Insurance Agency

### **Officers**

The Company's By-Laws state that, "the Company shall have a Chairman, a President, a Secretary, a Treasurer and such other Officers, if any, as the Board of Directors from time to time may elect. The Board of Directors may elect officers at any time. Each Officer shall hold office until his or her successor has been elected, unless a different term is specified in the resolution electing the Officer, or until his or her earlier death, resignation or removal."

Compensation of Officers shall be fixed by the Board of Directors.

The following is a listing of Officers elected and serving the Company at December 31, 2011:

<b><u>Name</u></b>	<b><u>Office</u></b>
Eric Aasmundstad	Chairman of the Board
Michael Alexander	President and Chief Executive Officer
Brian Doom	Secretary and Treasurer
Rebecca Ridder	Assistant Treasurer

### **TRANSACTIONS WITH AFFILIATES**

#### **Affiliation Agreement**

This agreement, effective April 1, 2011, between the Company and Nodak Mutual Insurance Company (Nodak) covers all aspects of the affiliation including the 100% Quota Share Reinsurance Agreement, Amended Shared Operations Agreement, Surplus Note, Amended and Substituted Articles of Incorporation, and By-Laws of the Company.

### **Employee Leasing Agreement**

This agreement was entered into between the Company and Zimmerman Insurance Agency (ZIA) on January 1, 2011. The Company has no employees, with all the work to be conducted by the employees of ZIA. The Company shall pay all indirect costs incurred by ZIA which includes salaries or wages, payroll taxes and fringe benefits. All direct costs will be paid by the Company. This agreement was terminated on April 30, 2012 with most of the employees of ZIA being terminated and a few of those hired back as Nodak employees. Those employees will continue to conduct the daily business of the Company.

### **Lease Agreement**

This agreement was entered into between the Company and ZIA on January 1, 2011. This agreement remained in place after the affiliation with Nodak took place on April 4, 2011. This agreement automatically renews on an annual basis unless terminated sooner. There are two (2) parts to the agreement 1) it allows the Company to use the equipment owned by ZIA and 2) it allows ZIA to maintain space within the building.

### **TERRITORY AND PLAN OF OPERATION**

As evidenced by current or continuous Certificates of Authority, the Company is licensed to transact business in the State of Nebraska. The Company is subject to the Producer-Controlled Property and Casualty Insurer Act. This act applies whenever, in any calendar year, the aggregate amount of gross written premium placed by a controlling producer is equal to or greater than five percent of the admitted assets of the Company as reported in the annual statement of the prior year.

Business was produced by Zimmerman Insurance Agency, Inc. during 2011 in the amount of \$405,613, which is in excess of 5% of the Company's 2010 admitted assets.

Currently, the Company's business is being produced by 593 licensed agents through 121

agencies. All agencies receive the same rate of commission for each line of business. The Company currently has five fieldsmen/adjusters under the supervision of its President and Claims Manager. These fieldsmen also assist and instruct agents in the production of business.

All applications are submitted to the Home Office for final underwriting and policy issue. Premium billings originate from the affiliate Nodak Mutual Insurance Company's Home Office.

## **REINSURANCE**

### **Ceded – Quota Share Agreement**

On April 1, 2011 the Company entered into a 100% Quota Share Agreement with its affiliate Nodak Mutual Insurance Company (Nodak). The agreement reinsures the Company 100% on policies written with the inception dates of April 1, 2011 and thereafter, including 100% of prior year loss reserve development, net of any applicable prior reinsurance.

The Company will be held harmless in the event of any cost to any actions, claims, proceedings, demands, costs, damages, judgments and expenses that the Company may become subject pertaining to any of the business ceded.

The Company agrees to pay Nodak gross premium written less premiums returned on cancellations on the business covered under this agreement. A ceding commission will be paid to the Company at a provisional rate of 33% on all premium ceded. If the Company's expense ratio, the Company's loss adjustment expense and other underwriting expenses divided by the premium ceded, is greater than 33%, additional commission will be allowed. The additional commission is calculated by subtracting 33% from the expense ratio. If the expense ratio is less than 33%, then there will be returned commission using the expense ratio less 33%. The expense ratio is calculated for any year subject to the agreement.

All settlements will be paid by the owing party within 10 days after the quarterly accounting period.

### **Multi-Cedent Agreements**

The Company is named on a Multiple Line Excess of Loss agreement with American Agriculture Insurance Company (AAIC), effective April 1, 2011. Coverage includes property and liability lines for fire, allied lines, multi-peril, inland marine and auto. Property coverage is \$1,200,000 excess of \$300,000. Liability coverage is in three layers: Layer 1 is \$2,500,000 excess of \$600,000, Layer 2 is \$4,500,000 excess of \$2,500,000, Layer 3 is \$5,000,000 excess of \$4,500,000. The agreement has a risk limit of \$1,500,000 and event limit of \$2,400,000.

The Company is named on an Occurrence Property and Auto Catastrophe agreement with AAIC, effective January 1, 2011. Property coverage includes fire, allied lines, farm-owner and homeowner multi-peril, commercial multi-peril, inland marine, earthquake and auto physical damage. Coverage for the 1<sup>st</sup> layer is \$10,000,000 and 2<sup>nd</sup> layer is \$11,300,000 with retention of \$2,500,000

The Company is named on an Over Other Protections agreement with AAIC, effective January 1, 2011. Property coverage includes fire, allied lines, farm-owner and homeowner multi-peril, commercial multi-peril, inland marine, earthquake and auto physical damage. Coverage is \$12,000,000 excess of \$23,800,000 (per occurrence) with a \$24,000,000 aggregate limit

The Company is named on an All Lines Aggregate agreement through an addendum with an effective date of January 1, 2011 with a termination date of January 1, 2014. Coverage is all lines of property and casualty business except those lines in A) Schedule P of the Annual Statement, parts N and O Reinsurance Assumed and B) All Schedule P parts of Company's 2009 Annual Statement for which the Company shows zero business. Coverage is \$17,500,000 in

aggregate, with an annual limit of 7.5% of net written premium, excess of 71.5% of net earned premium

The Company is included in eight reinsurance agreements not including the Nodak 100% Quota Share contract for 2012. These agreements are: Multiple Lines Excess of Loss, Occurrence Property and Auto Catastrophe, Occurrence Property Catastrophe-Terrorism, Over Other Protections, Cat Excess of Loss, Farm Pollution Liability, Insurance Agents Professional Liability and Multi-Peril Crop Insurance-Aggregate Excess of Loss.

### **General**

During the review of the Company's 2011 and 2012 reinsurance programs, it was noted that 100% of the Company's written business is ceded under the Quota Share agreement with Nodak. The Company is also named in other reinsurance contracts that Nodak has in place discussed above. These agreements are commonly referred to as multi-cedent agreements. The Company appears to be a non-direct party of these multi-cedent agreements. As a named party to the multi-cedent agreements, the Company does not maintain cost allocation agreements with Nodak. In order to comply with NAIC Accounting Practices and Procedures Manual SSAP No. 62R, paragraph 9, it is recommended that 1) the Company file a written allocation agreement for each multi-cedent agreement with the Director of the Nebraska Department of Insurance under the provisions of the Insurance Holding Company System Act, Neb. Rev. Stat. §44-2133 or 2) remove the Company's name off of each contract that it does not directly participate.

It was also noted within the 2011 and 2012 reinsurance programs, that the Company was not timely signing the agreements and addendums. In order to comply with NAIC Accounting Practices and Procedures Manual SSAP No. 62R, paragraph 24, it is recommended that the

Company sign all agreements and addendums in a timely fashion in order to account for these agreements on a prospective reinsurance basis.

All contracts reviewed contained standard insolvency, arbitration, errors and omissions, and termination clauses where applicable. All contracts contained the clauses necessary to assure reinsurance credits could be taken. All multi-cedent contracts did not contain the necessary allocation agreements.

## **BODY OF REPORT**

### **GROWTH**

The following comparative data reflects the growth of the Company during the period covered by this examination:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Bonds	\$3,652,215	\$2,797,607	\$1,722,777	\$3,572,487
Admitted assets	6,681,893	4,745,601	6,751,685	4,579,800
Loss reserves	1,318,731	1,319,748	1,198,446	0
Unearned premium	1,810,808	1,769,075	1,797,486	0
Total liabilities	3,778,618	3,585,502	3,541,507	347,079
Capital and surplus	2,903,275	1,160,099	3,206,764	4,232,721
Premiums earned	4,163,571	3,908,849	3,842,518	1,609,200
Net investment income	315,883	49,752	(113,330)	(60,236)
Losses incurred	2,995,120	2,763,419	2,427,848	512,330
Net income	(1,260,509)	(1,510,881)	(1,263,280)	892,834

### **FINANCIAL STATEMENTS**

The following statement of admitted assets and liabilities, together with the accompanying summary of operations, reflects the financial condition of the Company at December 31, 2011 and its transactions during the year 2012 as determined through this examination. A reconciliation of the capital and surplus account for the period under review is also included.

**FINANCIAL STATEMENT**  
**December 31, 2011**

<b><u>Assets</u></b>	<b><u>Assets</u></b>	<b><u>Assets Not Admitted</u></b>	<b><u>Net Admitted Assets</u></b>
Bonds	\$3,572,487		\$3,572,487
Real Estate	150,541		150,541
Cash	<u>335,523</u>		<u>335,523</u>
Subtotal, cash and invested assets	\$4,058,550		4,058,550
Investment income due & accrued	25,839		25,839
Uncollected premiums & agent balances	2,968		2,968
Deferred premiums	454,915		454,915
Amounts recoverable from reinsurers	24,976		24,976
Net deferred tax asset	1,150,779	1,150,779	
EDP equipment and software	12,552		12,552
NSF's	<u>3,362</u>	<u>3,362</u>	
Totals	<u>\$5,733,941</u>	<u>\$1,154,141</u>	<u>\$4,579,800</u>

**Liabilities, Surplus, and Other Funds**

Commissions payable	\$ 81,659
Other expenses	24,323
Taxes, licenses, and fees	32,723
Remittances and items not allocated	49,519
Payable to parent, subsidiaries, and affiliates	<u>158,855</u>
Total liabilities	<u>\$ 347,079</u>
Surplus notes	\$3,000,000
Unassigned funds (surplus)	<u>1,232,721</u>
Total capital and surplus	<u>\$4,232,721</u>
Totals	<u>\$4,579,800</u>

## STATEMENT OF INCOME – 2011

### Underwriting Income

Premiums earned	\$1,609,200
Losses incurred	512,330
Loss adjustment expenses incurred	208,732
Other underwriting expenses incurred	<u>12,588</u>
Total underwriting deductions	<u>\$ 733,650</u>
Net underwriting gain	<u>\$ 875,550</u>

### Investment Income

Net investment income earned	\$ 160,287
Net realized capital losses	<u>(220,523)</u>
Net investment gain	<u>\$ (60,236)</u>

### Other Income

Net gain from agents' or premium balances charged off	\$ 425
Finance and service charges not included in premiums	57,371
Miscellaneous income	<u>19,724</u>
Total other income	<u>\$ 77,520</u>
Net income	<u>\$ 892,834</u>

## CAPITAL AND SURPLUS ACCOUNT

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Capital and surplus, beginning	\$ 4,545,558	\$ 2,903,275	\$ 1,160,099	\$ 3,206,764
Net income	\$(1,260,509)	\$(1,510,881)	\$(1,263,280)	\$ 892,834
Change in net unrealized capital gains/(losses)	(585,719)	(164,879)	311,085	82,307
Change in net deferred income tax	689,622	547,158	256,386	(229,556)
Change in nonadmitted assets	(485,677)	(614,574)	(257,526)	280,372
Surplus notes			3,000,000	
Net change for the year	<u>\$(1,642,283)</u>	<u>\$(1,743,176)</u>	<u>\$ 2,046,665</u>	<u>\$ 1,025,957</u>
Capital and surplus, ending	<u>\$ 2,903,275</u>	<u>\$ 1,160,099</u>	<u>\$ 3,206,764</u>	<u>\$ 4,232,721</u>

## EXAMINATION CHANGES IN FINANCIAL STATEMENTS

Unassigned funds (surplus) in the amount of \$1,232,721, as reported in the Company's 2011 Annual Statement has been accepted for examination purposes. Examination findings, in the aggregate, were considered to have no material effect on the Company's financial condition.

## 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:

**Investments** – It is recommended that the Company record bond and stock transaction on the trade date.

**Action:** The Company has complied with this recommendation

**Advanced Premium** – It is recommended that the Company report advance premiums under the annual statement line captioned “Advance Premiums.”

**Action:** The Company no longer has advance premiums.

## **SUBSEQUENT EVENTS**

### **Farmers Mutual Home Insurance Company Acquisition**

The Company entered into an Assumption and Reinsurance Agreement on June 8, 2012 with Farmers Mutual Home Insurance Company (FMH), a Nebraska assessment insurance association. On July 1, 2012, the Company assumed all outstanding insurance policies and liabilities, together with substantially all of the assets of FMH in exchange for the Company's assumption of the outstanding insurance policies and liabilities.

FMH held a special policyholder meeting on June 20, 2012 in which the policyholders voted in the affirmative for the agreement with the Company and dissolution of the Articles of Incorporation. These Articles of Dissolution was dated December 26, 2012 and approved by the Nebraska Department of Insurance on December 28, 2012.

A FMH policyholder was able to reject the assumption of their policy by notifying the Company, if so chose. Any rejected assumption would still be 100% co-insured by the Company. On and after July 1, 2012, policyholders that accepted the assumption became members of the Company and were afforded all the rights of membership in the Company.

## **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

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

**Cost Allocation Agreement** – In order to comply with NAIC Accounting Practices and Procedures Manual SSAP No. 62R, paragraph 9, it is recommended that 1) the Company file a written allocation agreement for each multi-cedent agreement with the Director of the Nebraska Department of Insurance under the provisions of the Insurance Holding Company System Act, Neb. Rev. Stat. §44-2133 or 2) remove the Company's name off of each contract that it does not directly participate.

**Timeliness of Signing Reinsurance Agreements and Addendums** – In order to comply with NAIC Accounting Practices and Procedures Manual SSAP No. 62R, paragraph 24 it is recommended that if the Company is going to be named on reinsurance contracts that it does not directly participate in, then all contracts and addendums must be signed in a timely fashion to avoid different accounting and contract terms for deposit accounting and retroactive agreements.

## ACKNOWLEDGEMENT

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

In addition to the undersigned, Derek J. Petersen, CFE, MCM and Erin E. Garvin, Financial Examiner; and Gary Evans, AES, CISA, CFE, Information Systems Specialist; all with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,



Derek J. Petersen, CFE, MCM  
Examiner-in-Charge  
Department of Insurance  
State of Nebraska

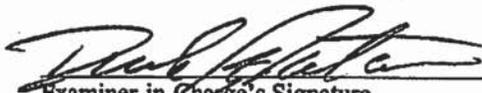
State of Nebraska,

County of Lancaster,

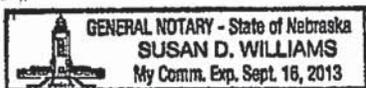
Derek J. Petersen, being duly sworn, states as follows:

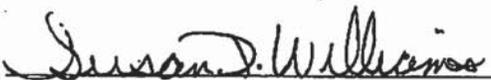
1. I have authority to represent the Department of Insurance of the State of Nebraska in the examination of Battle Creek Mutual Insurance Company.
2. The Department of Insurance of the State of Nebraska is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Battle Creek 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 Susan D. Williams on this 4<sup>th</sup> day of April, 2013.

(SEAL) 

  
Notary Public

My commission expires 9/16/2013 [date].