STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF EXAMINATION

OF

WALSH COUNTY MUTUAL INSURANCE COMPANY
MINTO, NORTH DAKOTA

AS OF
DECEMBER 31, 2019

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Walsh County Mutual Insurance Company

Minto, North Dakota

as of December 31, 2019, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

NORTH DAKOTA COMMISSIONER OF INSURANCE STATE OF SEAL

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this 26th day of May, 2021.

Jon Godfread
Commissioner of Insurance

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Minto, North Dakota
April 14, 2021

Honorable Jon Godfread
Commissioner of Insurance
North Dakota Insurance Department
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Commissioner:

Pursuant to your instructions and statutory requirements, an examination was made of the books, records, and financial condition of

Walsh County Mutual Insurance Company

Statutory Home Office
429 2nd Street
Minto, North Dakota, 58261

Walsh County Mutual Insurance Company hereinafter referred to as the ("Company"), was last examined as of December 31, 2014, by representatives of the North Dakota Insurance Department, hereinafter referred to as the ("Department").

SCOPE OF STATUTORY EXAMINATION

This examination was a financial condition examination conducted in accordance with North Dakota Century Code (N.D.C.C.) § 26.1-03-19.3 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review its corporate affairs and insurance operations. This statutory examination covers the period from January 1, 2015, to December 31, 2019, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

STATUS OF PRIOR EXAM FINDINGS

This examination included a review to determine the current status of the 13 exception conditions commented upon in the preceding Report on Examination which covered the period from January 1, 2010, to December 31, 2014. The Department determined that the Company had satisfactorily addressed all of these items, except the following:

Recommendation	Response
It is again recommended that the Directors and officers disclose all relevant conflicts and that the Board review any conflicts and document its determination as to how these conflicts are to be addressed in the Board minutes.	The Company partially complied. The Directors and staff signed conflict of interest disclosures, but the Manager's material conflict of adjusting claims for which he is also the agent of record was unmitigated. The accepted disclosure states, "If there is a problem in the future, we will handle it at that time." This approach is ineffective as no mitigation was put into place to identify or prevent problems. Multiple issues were noted with these Manager/Agent adjusted claims. **It is again recommended that the Directors and officers disclose all relevant conflicts and that the Board review any conflicts and document its determination as to how these conflicts are to be addressed in the Board minutes.**
It is recommended that the Company and Schanilec Insurance Agency enter into a formal written agreement which includes a list of services that the Company and Agency share, the method used to allocate the cost of those services, and the dates the cost of those services will be paid.	The Company partially complied by entering into a formal agreement, but the contract was not arm's-length and did not address shared expense allocations as required by SSAP 70. Also, the Manager breached this contract by not fulfilling his obligations under this agreement. **It is again recommended that the Company and Schanilec Insurance Agency enter into a formal written agreement which includes a list of services that the Company and Agency share, the method used to allocate the cost of those services, and the dates the cost of those services will be paid.**
It is recommended that the Company implement a procedure to ensure all of its producing agents and agencies are appropriately licensed and appointed.	The Company did not Comply. No procedure was implemented to ensure producing agents and agencies were appointed, and one producing agency was not appointed. **It is again recommended that the Company implement a procedure to ensure all of its producing agents and agencies are appropriately licensed and appointed.**

Findings and recommendations related to the above areas are addressed under various captions below for the current period under examination.

SUBSEQUENT EVENTS

Subsequent to the examination period, the Company amended its Bylaws to remove language relating to policy assessments, to comply with revised North Dakota Century Code ("N.D.C.C.").

Also subsequent to the examination period, on January 27, 2020 the Department approved the Company's December 23, 2019 request to expand its authorized territory to include Pierce county. On January 7, 2021, the Department approved the Company's December 29, 2020 request to expand its territory into Dickey, McIntosh, and Logan counties.

HISTORY

The Company was incorporated and commenced business June 27, 1885, as the "Walsh County Farmers Mutual Hail and Fire Insurance Company," with its home office and principal place of business at Minto, North Dakota.

At the annual meeting of the membership held June 21, 1968, the Articles of Incorporation and Bylaws were amended changing the name of the Company to read the "Walsh County Mutual Insurance Company," with its territory to include all of Walsh, Grand Forks, Nelson, Ramsey, Cavalier, and Pembina Counties.

The Company is organized pursuant to the provisions of N.D.C.C. § 26.1-13 to insure against all of the risks and to possess all of the powers and to be subject to all of the liabilities and duties of a county mutual insurance company as now provided in N.D.C.C. § 26.1-13 and as the same may be from time to time amended in the future.

The Company has perpetual existence as provided under N.D.C.C. § 26.1-13-03.

MANAGEMENT AND CONTROL

Membership

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges of membership. A person must reside within the Company's territorial limits to be a director of the Company.

Board of Directors

According to the Bylaws the management of the Company's affairs, business, and property is to be vested in a Board of Directors composed of five members elected for staggered terms of three years each at the annual meeting of the membership. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 2019, were as follows:

Name and Residence	Term Expires	Occupation
Cory Kouba Lankin, ND	2022	Farmer
Ben Suda Grafton, ND	2021	Farmer
Louis A Kadlec Pisek, ND	2020	Farmer
John Miller Fordville, ND	2022	Farmer
Don Barclay Grafton, ND	2020	Farmer

Officers

Officers are elected at the organizational meeting of the Board of Directors by a majority vote for a period of one year or until their successors are elected and qualified. Officers serving at December 31, 2019, were as follows:

Name	Officer
Cory Kouba	President
John Miller	Vice President
Brad Schanilec	Manager, Secretary-Treasurer

Finance Committee

Previously referred to as the Investment Committee, this committee is unchartered and did not formally meet separate from the full Board during the exam period. The following individual were appointed by the Board of Directors to serve on the Finance Committee at December 31, 2019:

Name

Cory Kouba
Don Barclay
Brad Schanilec

The Company has an investment account where its broker has discretionary trading authority within the bounds of an investment guidelines statement. Per N.D. Admin Code § 45-03-12-05(3):

> Investments shall be acquired and held under the supervision and direction of the board of directors and the board shall evidence by formal resolution, at least annually that it has determined whether all investments have been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the board or a committee of the board charged with the responsibility to direct its investments.

During the examination period, no formal resolutions meeting the requirements of N.D. Admin Code § 45-03-12-05(3) were noted.

It is recommended that the Board evidence by formal resolution, at least annually, that it has determined whether all investments have been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the Board or a committee of the Board charged with the responsibility to direct its investments, per N.D. Admin Code § 45-03-12-05(3).

Per N.D. Admin Code § 45-03-12-05(4):

> On no less than a quarterly basis, the board of directors or committee of the board of directors shall:
> a) Receive and review a summary report on the insurer's investment portfolio, its investment activities, and investment practices engaged in under delegated authority, in order to determine whether the investment activity is consistent with its written plan.

The Board minutes and specimen meeting records reviewed during the examination indicate the Board is provided investment balance information only, which is inadequate to confirm compliance with approved investment guidelines as required under N.D. Admin Code § 45-03-12-05(4).

It is recommended that the Board of Directors receive and review the investment custodian's statements in order to meet investment activity disclosure requirements of N.D. Admin Code § 45-03-12-05(4).

Manager

During the examination period, the Board engaged the Manager as an independent contractor. The Department has expressed concern with this independent contractor arrangement, as opposed to the standard employer-employee relationship, in the past two examinations. Per IRS Publication 15-A the Manager does not appear to be an independent contractor as the Board ultimately has the authority to dictate the processes, procedures, and outcomes of the Manager position, it just chooses not to actively exercise this authority.

It is recommended that the Company classify the Manager as an employee.

It was noted during the prior examination that the Manager's compensation basis was calculated on a percentage of the net in force premium, rather than by a metric that encouraged effective underwriting, such as surplus growth or net profit. During examination fieldwork, subsequent to the exam period, the Board approved a new contract with the Manager that fixed annual compensation at 4 percent of surplus, paid monthly, subject to a $10,000 monthly cap.

CORPORATE RECORDS

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

Amendments to Articles of Incorporation and Bylaws

No Articles or Bylaws amendments were noted during the examination period.

Members

During the period under examination the annual meetings of the membership were held on the following dates: March 25, 2015; March 23, 2016; March 20, 2017; March 28, 2018; and March 20, 2019.

Directors

During the period under examination the Board of Directors held four meetings and one reorganizational meeting in each of the years 2015, 2016, 2017, 2018, and 2019. The Finance Committee did not meet during the examination period.

Conflict of Interest

In response to conflict of interest disclosure related findings from the prior two examinations, the Directors and staff signed conflict of interest disclosures during the exam period, but the Manager's material conflict of adjusting claims for which he is also the agent of record was unmitigated. The Board accepted disclosure states, "If there is a problem in the future, we will handle it at that time." This approach is flawed as no mitigation was put into place to identify or prevent problems from arising.

It is again recommended that the Directors and officers disclose all relevant conflicts and that the Board review any conflicts and document its determination as to how these conflicts are to be addressed in the Board minutes.

During claim file testing, multiple issues were noted with these Manager/Agent adjusted claims; 2of the 85 sampled claims had material documentation deficiencies. One claim invoice was $100 less than the total paid on the claim. After the Company was notified of this discrepancy, a second invoice screenshot was provided with $100 additional labor costs handwritten outside the margin of the original invoice. A second claim, for which the Manager was also the Agent and Adjuster, the file included only a small black and white photo of the damaged property with no supporting narrative or explanation of the loss, no invoices, and no estimates.

It is recommended that the Manager discontinue adjusting claims on policies for which he is the agent of record and adjust and settle all other claims pursuant to the Board approved claims manual documentation standards.

On another claim, it was noted that the insured, a Director of the Company, requested permission from his agent (the Manager), to euthanize a covered livestock that was at risk of drowning. The Manager approved the euthanization and paid out the $1,500 claim with no further loss documentation or investigation. Damage or loss caused by euthanasia or any other intentional act is not an insurable loss.

It is recommended that the Company settle claims in compliance with approved policy provisions and limits.

At December 31, 2019, the Company did not have a related party claims disclosure and approval process or policy where the claims of Officers, Directors, or key employees (independent contractors) are disclosed and approved within the Board meetings. It is a best practice for any claim of these "related parties" to be discussed and approved within the quarterly Board meeting minutes to avoid potential impropriety in the settlement process.

It is recommended that the Board approve and submit to the Department a policy detailing how related party claims are discussed and approved by the Board.

In 2019, the Company's Federal Income Tax return did not include a 1099 for its janitorial contractor, Kassia Schanilec who received $888.94 during the year.

It is recommended that the Company comply with Federal IRS laws related to independent contractors, including but not limited to the filing of 1099's for contractors receiving over $600 per year.

In 3 of the 85 sampled claims, the adjuster made note that Russell Schanilec, the Manager's son, was involved in making decisions regarding the claims settlement process on behalf of the Company. Russell is the Company's designated successor for the Manager position, but at the time of these claims, he was an appointed agent with no other formal employment or independently contracted relationship with the Company. This is of concern as the Company's professional liability insurance (or any other applicable coverages) would not apply to Russell.

It was also noted that Russell incurred airfare, hotel, and dining expenses on behalf of the Company during in state and out of state travel without Board approval.

It is recommended that the Board approve a formal employment arrangement or contract for training Russell Schanilec (subject to IRS Form SS-8 determination) and address his duties and authorities in regard to the Company.

AFFILIATED COMPANIES

The Manager owns and operates an unlicensed, unregistered insurance agency doing business as "Schanilec Insurance Agency" (SIA). The Agency is operated within the Walsh County Mutual office.

In response to a prior examination finding, the Board of Directors formally entered into an arrangement with the independently contracted Manager where the Manager's agency "Schanilec Insurance Agency" agreed to act as "Grounds-keeper and care-taker of the premises of Walsh County Mutual Insurance Co." in exchange for property rent and incidental expenses. Despite the favorable terms of this agreement, the Manager did not follow this arrangement. The examination identified the following 2019 "Office Maintenance & Repairs" expenses which qualify as groundskeeper/caretaker expenses:

• Narloch Trucking LLP (Snow Removal)	$ 575
• Office Cleaning Services	1,115
• Window Washing	40
• Outside Flowers	303
• Lawn Work at Office	25
Total	$ 2,058

This "in-kind" arrangement does not address the expense segregation and allocation deficiencies referenced within the prior finding which is reiterated verbatim within the current recommendation.

Also, due to inadequate expense documentation, (e.g., automobile mileage logs, the names of meeting attendees and the nature of the discussions that took place, and meeting agenda/itinerary for out of state travel events, etc.) the examination could not verify whether expenses reported on the Company's books were those of the Company or of the Manager's commingled agency including significant expenses in the following categories:

- Gas
- Agent meetings
- Restaurant and bar expense
- Out of state airfare, dining, and lodging

Per SSAP 25, transactions involving services between related parties need to be arm's length and "In general, amounts charged for services are based either on current market rates or on allocations of costs."

Per SSAP 70, allocation of expenses should be based on a method that yields the most accurate results.

It is again recommended that the Company and "Schanilec Insurance Agency" enter into a formal written agreement which includes a list of services that the Company and Agency share, the method used to allocate the cost of those services, and the dates the cost of those services will be paid.

It is further recommended that the Manager follow SSAPs 25 and 70 and clearly bifurcate his Agency business operations and expenses from those of the Company as commingling these operations without proper classification poses a serious conflict of interest for the Company.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2019, the Company was had $100,000 of coverage for employee dishonesty risks. The coverage meets the minimum amount of fidelity insurance suggested by the NAIC's *Financial Examiners Handbook.*

The Company also had in force a directors and officers liability insurance policy providing a limit of liability of $1,000,000, subject to a $10,000 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

A commercial lines policy provides property coverage for the replacement cost of the office building in Minto. The policy also provides commercial liability and cyber breach coverage.

TERRITORY AND PLAN OF OPERATION

At December 31, 2019, the Company was authorized to transact business in the following counties:

Barnes	Benson	Cass	Cavalier
Eddy	Foster	Grand Forks	Griggs
Kidder	LaMoure	Nelson	Pembina
Ramsey	Ransom	Richland	Sargent
Sheridan	Steele	Stutsman	Towner
Traill	Walsh	Wells	

During the period under review, the Company accepted 20 policies in Dickey county and 6 policies in McIntosh county, both of which were outside the Company's authorized territory until the Department approved the territory expansion on January 7, 2021. The Company also wrote one policy in Burke county which was and remains outside of the authorized territory. These 27 policies represent over $35 million of risk in force and over $100,000 in annual premiums.

The Company also reported to the Department that it added Pierce county to its territory "effective December 23, 2019". The date of the Company's request for expansion was December 23, 2019, but the Department did not approve that expansion request until January 27, 2020.

Per N.D.C.C. § 26.1-13-02:

> The territory of operation is subject to the review and approval of the commissioner. An existing county mutual insurance company that desires to expand its territory of operation shall submit to the commissioner for review and approval.

Per N.D.C.C § 26.1-13-15(1):

> A county mutual insurance company may not insure property beyond the company's authorized territory of operation except as provided in subsection 2 of section 26.1-13-12 and except that this territorial limitation does not apply to reinsurance contracts.

It is recommended that the Company not accept business that is outside of its authorized territory, per N.D.C.C. §§ 26.1-13-02 and 26.1-13-15(1).

During 2019, the Company paid commissions to "Grinnell Specialty Insurance". Grinnell Specialty Agency, Inc. is not appointed to produce business for the Company. Per N.D.C.C. § 26.1-26-06:

> An insurance producer who sells, solicits, or negotiates an application for insurance of any kind is, in any controversy between the insured or the insured's beneficiary and the insurer, regarded as representing the insurer and not the insured or the insured's beneficiary. An insurance producer may not act as an agent of an insurer unless the insurance producer becomes an appointed insurance producer of that insurer. This section does not affect the apparent authority of an agent.

It is again recommended that the Company implement a procedure to ensure all of its producing agents and agencies are appropriately licensed and appointed.

MARKET CONDUCT ACTIVITY

Advertising

The majority of the Company's advertising expenses relate to the use of its logo in a sports arena and on give-away items.

Claims

At December 31, 2019, the Company had a complaints log that was compliant with N.D.C.C. § 26.1-01-03(10). Complaints logged during the examination period were reviewed and found to be adequately remediated.

During claims testing, it was noted that the Manager approved paying twice the policy limit for tree removal. No other policy limit deviations were noted during testing.

It is recommended that the Company settle claims in compliance with approved policy provisions and limits.

Rates and Forms

The Company incorrectly applied two deductibles on a claim for one continuous claim event that caused damage on two sides of a combine.

On a related party claim, the Company inappropriately waived the deductible. The Company reasoned that because the insured provided the labor related to the claim, waiving the deductible was justified, but this is not acceptable under the approved policy language.

It is recommended that the Company apply deductibles in compliance with approved policy language.

For one of the claims sampled, the Manager instructed the adjuster to not apply holdback depreciation. This policy is a standard Home-Guard Select Dwelling (HO3) policy which requires payment of the actual cash value of the loss until repairs have been completed.

It is recommended that the Company apply holdback depreciation in compliance with approved rates and forms.

OPERATING AGREEMENTS

Grinnell Adjusting Service

On January 1, 2016, the Company entered into a contract with FarMutual Insurance Services, LLC, a subsidiary of Grinnell Mutual Reinsurance Company "Grinnell", to perform claims adjusting services. This entity has changed names over the years and at December 31, 2019, was referred to as Claims Mutual Services.

For adjusting services provided in 2019, Grinnell was paid $53,734.96. The fee charged was a flat rate for up to 200 claims. If needed, additional adjustments are billed at $450 per claim.

Dakota Adjusting

Effective August 8, 2008, the Company contracted with Dakota Adjusting for claims adjusting and risk review services on an extended basis. The Company renewed this agreement with Dakota Adjusting on August 4, 2014 and again on August 4, 2017.

The Contract states that the Board of Directors approves the compensation rate paid to the adjustor annually. In 2019, Dakota Adjusting received $60,750 from the Company for services provided under the contract.

During 2019, Grinnell served as the primary adjuster and Dakota Adjusting primarily conducted risk reviews; however, the full amount of Dakota Adjusting's 2019 contract was reported as claims adjustment expense. As loss adjustment expenses are included in the Company's loss ratio, it is important to differentiate between risk reviewing, which is an underwriting expense, and loss adjustment expense. The Company reported that Dakota Adjusting adjusted 24 claims and completed approximately 200 risk reviews so the contract should have been allocated proportionately between "loss adjusting expense" and "risk review & other underwriting expenses."

It is recommended that the Company correctly allocate Dakota Adjusting's contract fee between Risk Review & Other Underwriting and Claim Adjustment Expenses, based on actual time or number of policies/claims reviewed.

REINSURANCE

The following is a summary of the Company's significant reinsurance contracts in force at December 31, 2019:

Nonaffiliated Ceding Contract:

Type:	Excess of Loss	
Reinsurer:	Grinnell Mutual Reinsurance Company	
Scope:	All policy forms and endorsements issued by the Company:	
	(A)	Individual Occurrence of Loss Excess – Covers up to $20 million in losses from fire and windstorm risks written by the Company in excess of a $250,000 retention.
	(B)	Property Catastrophe Excess of Loss – Covers 100 percent of the Company's net losses incurred from windstorm, hail, or tornado loss occurrences within a period of 96 consecutive hours, in excess of a $700,000 retention.
	(C)	Aggregate Excess - provides coverage for 100 percent of the Company's aggregate net losses in excess of a defined retention limit. The retention limit for 2019 was $1,750,000.
Premium:	(A)	Property Per Risk Excess of Loss – The 2019 annual premium was $28,764.
	(B)	Property Catastrophe Excess of Loss – The 2019 annual premium was $101,904.
	(C)	Aggregate Excess - The 2019 annual premium was $493,176.
Termination Date:	The agreement may be terminated by either party with a written 90 day notice.	

The contract contained all of the clauses required by the NAIC's *Accounting Practices and Procedures Manual.*

ACCOUNTS AND RECORDS

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and a trial balance as of December 31, 2019, was obtained and traced to the appropriate schedules of the Company's 2019 Annual Statement. Revenues and expenses were tested to the extent deemed necessary.

Custodial Agreements

The Company's securities are held under an agreement executed with UBS Financial Services, Inc. This agreement was reviewed and found to be in compliance with N.D. Admin Code § 45-03-23-02.

At December 31, 2019, the Company held five separate Exchange Traded Funds (ETFs) issued by Vanguard Group, Inc. with market values totaling $501,948.67. As all of these funds were issued by a single entity, Vanguard Group, Inc., the Company's statutory 3 percent concentration limit was $181,855.64. Per N.D.C.C. § 26.1-05-19(20)(a):

> Investments in preferred guaranteed, and common stocks issued or guaranteed by a single person may not exceed three percent of the insurance company's admitted assets.

It is recommended that the Company implement procedures for monitoring asset concentrations to maintain compliance with N.D.C.C. § 26.1-05-19(20)(a).

FINANCIAL STATEMENTS

The following pages present a Statement of Assets, Liabilities, and Surplus as of December 31, 2019, and a Statement of Income for 2019.

These financial statements are based on the statutory financial statements filed by the Company with the Department and present the financial condition of the Company for the period ending December 31, 2019. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

Walsh County Mutual Insurance Company
Statement of Assets, Liabilities, and Surplus
December 31, 2019

ASSETS			
LEDGER ASSETS:			
Bonds	$ 186,880		
Stocks	1,980,096		
Real Estate	556,127		
Cash on Hand and Checking Account	170,246		
Cash on Deposit	2,557,196		
Premiums in Course of Collection	191,124		
Furniture, Fixtures & Automobiles	21,976		
TOTAL LEDGER ASSETS		$5,663,645	
NONLEDGER ASSETS:			
Interest Due and Accrued on Bonds	$ 1,430		
Interest Due and Accrued on Cash on Deposit	10,611		
Market Value of Stocks over Book Value	398,342		
Reinsurance Recoverable on Paid Loss	29,735		
TOTAL NONLEDGER ASSETS		440,118	
DEDUCT: ASSETS NOT ADMITTED			
Furniture, Fixtures & Automobiles	$ 21,976		
TOTAL NONADMITTED ASSETS		21,976	
TOTAL NET ADMITTED ASSETS			$6,081,787
LIABILITIES			
Unpaid Losses	$ 112,889		
Incurred But Not Reported Claims (IBNR) Estimate	30,000		
Advance Premiums	28,974		
Unearned Premium Reserve	1,519,584		
Commissions Due and Payable to Agents	(1,049)		
Unpaid Taxes	24,053		
Unpaid General Expenses	7,528		
Reinsurance Premiums Due and Payable	51,987		
Premiums Written for Others	20,960		
Suspense	(355.02)		
TOTAL LIABILITIES		$1,794,571	
SURPLUS TO POLICYHOLDERS		4,287,216	
TOTAL LIABILITIES AND SURPLUS			$6,081,787

Walsh County Mutual Insurance Company
Statement of Income
For the Year 2019

INCOME:			
Gross Premium Income	$3,158,975		
Less: Returned Premiums	119,958		
Premiums for Reinsurance Ceded	622,825		
NET PREMIUM INCOME		$2,416,192	
Interest on Bonds		3,394	
Dividends on Stocks		67,654	
Gross Rent from Company's Property		6,000	
Interest on Cash on Deposit		28,943	
Profit on sale or Maturity of Ledger Assets		19,078	
Commissions and service fees received		45,048	
Insurance proceeds in excess of repair		16,936	
TOTAL INCOME RECEIPTS			$2,603,245
DISBURSEMENTS:			
Gross Losses Paid and Incurred in 2018	$ 931,811		
Gross Losses Paid in 2018 but Incurred in Prior Years	258,738		
Deduct: Salvage & Subrogation	9850		
Reinsurance Recovered	2,907		
NET LOSSES PAID		$ 1,177,792	
Claim adjustment expenses		62,488	
Commissions paid to agents		477,319	
Directors' fees and expenses		3,592	
Salaries to employees		188,104	
Printing, stationery, and office supplies		4,306	
Rent and rent items		6,000	
Real estate expenses		41,585	
Taxes on real estate		4,604	
State and local insurance taxes		41,679	
Insurance department licenses and fees		483	
Payroll taxes		5,637	
Federal income tax		81,511	
Legal fees and auditing		17,055	
Travel and travel items		8,003	
Advertising		12,466	
Dues and donations		13,562	
Equipment		4,804	
Insurance and bonds		10,908	
Postage, telephone, and bank charges		15,142	
Employee relations and welfare		2,276	
Data processing expenses		33,736	
Risk reviews and other underwriting expenses		51,637	
Investment Brokerage Fees		25,245	
Miscellaneous expenses		11,587	
TOTAL FUNDS DISBURSED			2,301,521
NET GAIN (LOSS)			$ 301,724

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 2019, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Assets

Real Estate

At December 31, 2019, the Company reported a Real Estate balance of $565,930, including two non-depreciating items that do not meet the definition of an asset per SSAP 4:

• Special Assessment (1985)	$2,583.57
• Special Assessment (2011)	$7,219.02
Total	$9,802.59

The Special Assessments should never have been included on the Company's Real Estate schedule as these items are the City of Minto's assets, not the Company's. This resulted in an overstatement of net admitted assets and surplus of $9,802.59.

It is recommended that the Company remove the special assessment entries from its real estate asset schedule.

Reinsurance Recoverable on Paid Loss

At December 31, 2019, the Company reported $0 in Reinsurance Recoverable on Paid Losses. The examination identified a large claim that exceeded the Company's individual occurrence loss (IOL) reinsurance retention limit, for which the Company did not submit for reinsurance recovery, totaling $29,735. This resulted in an understatement of Reinsurance Recoverables on Paid Losses and Surplus of $29,735.

As this $29,735 reinsurance recoverable on paid loss meets the definition of an asset, per SSAP 4, the Company should have reported this balance on its 2019 Annual Statement.

It is recommended that the Company establish a procedure to identify and submit reinsurance recoverables on paid losses to its reinsurer in a timely manner.

Income

Risk Reviews and Other Underwriting Expense and Claim Adjustment Expense

At December 31, 2019, the Company reported $114,125 in Claim Adjustment Expenses and $0 in Risk Reviews and Other Underwriting Expense.

The examination noted that one of the two contracted claim adjusters primary conducted risk reviews, which is an underwriting expense, not a loss adjustment expense. With a 12 percent allocation to loss adjustment expenses and a 78 percent allocation of underwriting expenses, this error resulted in an overstatement of Claim Adjustment Expense of $51,637.50 and an understatement of Risk Reviews and Other Underwriting Expense of $51,637.50. Surplus was not impacted by this classification error.

It is recommended that the Company correctly allocate Dakota Adjusting's contract fee between Risk Review & Other Underwriting and Claim Adjustment Expenses, based on actual time or number of policies/claims reviewed.

Surplus to Policyholders

Surplus to Policyholders was determined by this examination to be $4,287,216 or $19,932 more than what was reported by the Company. Adjustments to surplus are shown in the following schedule:

Description	Company	Examination	Increase or (Decrease)
Ledger Assets			
Real Estate	$565,930	$556,127	$ (9,803)
Non-Ledger Assets			
Reinsurance Recoverable on Paid Loss	$ 0	$ 29,735	$ 29,735
Net Change			**$19,932**

Surplus to Policyholders per Company	$4,267,284
Exam Adjustments	19,932
Surplus to Policyholders per Examination	$4,287,216

CONCLUSION

The financial condition of Walsh County Mutual Insurance Company, Minto, North Dakota, as determined by this examination as of December 31, 2019, is summarized as follows:

TOTAL ADMITTED ASSETS		$6,081,787
Total Liabilities	$1,794,571	
Surplus to Policyholders	4,287,216	
TOTAL LIABILITIES AND SURPLUS		$6,081,787

Since the last examination conducted as of December 31, 2014, the Company's admitted assets have increased $1,495,165, its total liabilities have increased $217,123 and its surplus as regards policyholders has increased by $1,278,042.

The Examiners express their appreciation for the courteous cooperation extended them during the course of the examination.

Respectfully submitted,

Colton Schulz, CFE, CFE (Fraud)
Supervising Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is recommended that the Board evidence by formal resolution, at least annually, that it has determined whether all investments have been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the Board or a committee of the Board charged with the responsibility to direct its investments, per N.D. Admin Code § 45-03-12-05(3).

It is recommended that the Board of Directors receive and review the investment custodian's statements in order to meet investment activity disclosure requirements of N.D. Admin Code § 45-03-12-05(4).

It is recommended that the Company classify the Manager as an employee.

It is again recommended that the Directors and officers disclose all relevant conflicts and that the Board review any conflicts and document its determination as to how these conflicts are to be addressed in the Board minutes.

It is recommended that the Manager discontinue adjusting claims on policies for which he is the agent of record and adjust and settle all other claims pursuant to the Board approved claims manual documentation standards.

It is recommended that the Company settle claims in compliance with approved policy provisions and limits.

It is recommended that the Board approve and submit to the Department a policy detailing how related party claims are discussed and approved by the Board.

It is recommended that the Company comply with Federal IRS laws related to independent contractors, including but not limited to the filing of 1099's for contractors receiving over $600 per year.

It is recommended that the Board approve a formal employment arrangement or contract for training Russell Schanilec (subject to IRS Form SS-8 determination) and address his duties and authorities in regard to the Company.

It is again recommended that the Company and "Schanilec Insurance Agency" enter into a formal written agreement which includes a list of services that the Company and Agency share, the method used to allocate the cost of those services, and the dates the cost of those services will be paid.

It is further recommended that the Manager follow SSAPs 25 and 70 and clearly bifurcate his Agency business operations and expenses from those of the Company as commingling these operations without proper classification poses a serious conflict of interest for the Company.

It is recommended that the Company not accept business that is outside of its authorized territory, per N.D.C.C. §§ 26.1-13-02 and 26.1-13-15(1).

It is again recommended that the Company implement a procedure to ensure all of its producing agents and agencies are appropriately licensed and appointed.

It is recommended that the Company apply deductibles in compliance with approved policy language.

It is recommended that the Company apply holdback depreciation in compliance with approved rates and forms.

It is recommended that the Company correctly allocate Dakota Adjusting's contract fee between Risk Review & Other Underwriting and Claim Adjustment Expenses, based on actual time or number of policies/claims reviewed.

It is recommended that the Company implement procedures for monitoring asset concentrations to maintain compliance with N.D.C.C. § 26.1-05-19(20)(a).

It is recommended that the Company remove the special assessment entries from its real estate asset schedule.

It is recommended that the Company establish a procedure to identify and submit reinsurance recoverables on paid losses to its reinsurer in a timely manner.

It is recommended that the Company correctly allocate Dakota Adjusting's contract fee between Risk Review & Other Underwriting and Claim Adjustment Expenses, based on actual time or number of policies/claims reviewed.