

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION
OF
SOUTHWEST MUTUAL INSURANCE COMPANY
NEW SALEM, NORTH DAKOTA**

**AS OF
DECEMBER 31, 2016**

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


Southwest Mutual Insurance Company

New Salem, North Dakota

as of December 31, 2016, with the original on file in this Department and that the same is a correct
transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal at my
office in the City of Bismarck, this 31st day of
May, 2018.





Jon Godfread
Insurance Commissioner

TABLE OF CONTENTS

| | |
|--|----|
| SCOPE OF STATUTORY EXAMINATION | 1 |
| STATUS OF PRIOR EXAM FINDINGS..... | 1 |
| SUMMARY OF SIGNIFICANT FINDINGS | 2 |
| SUBSEQUENT EVENTS | 2 |
| HISTORY..... | 2 |
| General..... | 2 |
| MANAGEMENT AND CONTROL | 3 |
| Membership..... | 3 |
| Directors..... | 3 |
| Officers..... | 3 |
| Committees | 4 |
| CORPORATE RECORDS | 4 |
| Members | 5 |
| Directors..... | 5 |
| CONFLICT OF INTEREST | 5 |
| EMPLOYEES WELFARE AND PENSION PLANS..... | 5 |
| FIDELITY BOND AND OTHER INSURANCE | 5 |
| TERRITORY AND PLAN OF OPERATION..... | 6 |
| SIGNIFICANT OPERATING RESULTS | 6 |
| Growth..... | 6 |
| Operating Ratios..... | 7 |
| MARKET CONDUCT ACTIVITY | 7 |
| Treatment of Policyholders | 7 |
| Claim Complaints | 7 |
| OPERATING AGREEMENTS | 7 |
| Investment Advisor Services..... | 7 |
| Loss Adjusting Services Agreement | 9 |
| OPERATIONS REVIEW | 10 |
| REINSURANCE..... | 10 |
| Grinnell Mutual Reinsurance Company..... | 10 |
| ACCOUNTS AND RECORDS | 11 |
| FINANCIAL STATEMENTS | 11 |
| COMMENTS ON FINANCIAL STATEMENTS | 14 |

| | |
|--|----|
| Assets..... | 14 |
| · <i>Certificates of Deposit</i> | 14 |
| Liabilities..... | 14 |
| <i>Unpaid Salaries</i> | 14 |
| <i>Commissions Due and Payable to Agents</i> | 14 |
| Surplus to Policyholders | 15 |
| CONCLUSION..... | 16 |
| COMMENTS AND RECOMMENDATIONS..... | 17 |

April 6, 2018
New Salem, North Dakota

Honorable Jon Godfread
Commissioner of Insurance
North Dakota Insurance Department
600 East Boulevard Avenue, Department 401
Bismarck, ND 58505-0320

Dear Commissioner:

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

Southwest Mutual Insurance Company

New Salem, North Dakota

Southwest Mutual Insurance Company (hereinafter referred to as "the Company") was last examined as of December 31, 2011, by representatives of the North Dakota Insurance 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 the 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, 2012 through December 31, 2016, 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

Our examination included a review to determine the current status of the 12 exception conditions commented upon in our preceding Report on Examination which covered the period from January 1, 2007, to December 31, 2011. We determined that the Company had satisfactorily addressed all of these items, except the following:

Recommendation

It is again recommended that the Company review the job functions of the Manager and Secretary-Treasurer and develop procedures

Response

The Company did not comply. No material changes in the segregation of duties were noted. **It is again recommended that the Board of Directors review the job functions**

to reduce the fraud risk associated with having the same person performing both functions.

of the Manager and Secretary-Treasurer and develop procedures to reduce the fraud risk associated with having the same person performing both functions.

It is again recommended that all Company officers and directors disclose any conflict of interests on the conflict of interest statement forms and that any conflicts noted be addressed by the Board of Directors.

The Company did not comply. The signed statements were not retained for two of the years under review. Examiners also identified undisclosed conflicts. **It is again recommended that the Company collect and retain board reviewed conflict of interest disclosures from its officers and directors.**

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

SUMMARY OF SIGNIFICANT FINDINGS

There were no material adverse findings or material changes in the financial statements.

SUBSEQUENT EVENTS

The meeting minutes and general ledger were reviewed through January 2018. On April 20, 2017, Lisa Strom succeeded Brenda Doll as the Secretary-Manager of the Company.

HISTORY

General

The Company was incorporated on April 16, 1900, as "The Morton County Mutual Fire and Lightning Insurance Company" and commenced business on July 21, 1900. At a later date, the Company's operating rights were extended to include the County of Oliver and the name was amended to "The Morton and Oliver Counties Mutual Fire and Lightning Insurance Company."

Effective January 1, 1997, the Company merged with Adams Farm Mutual Insurance Company located in Hettinger, North Dakota. The two companies formed a new company called Southwest Mutual Insurance Company located at New Salem, North Dakota.

The Company's term of existence is perpetual as provided by N.D.C.C. § 26.1-13-03.

MANAGEMENT AND CONTROL

Membership

The Company is controlled by the membership. Any person owning property within the Company's authorized territorial limits may become a member of the Company and be entitled to all the rights and privileges accorded each member. No person who does not reside within such territorial limits shall become a director of the Company.

The date and place of the annual meeting of the members is set by the Board of Directors. The annual meeting is followed with a reorganizational meeting to address the appointment of Directors. Notice of the annual meeting is mailed to all policyholders at least 10 days in advance of the meeting.

Directors

The Bylaws provide that the general management of the Company's affairs, business, and property is vested in a Board of Directors consisting of seven members to be elected by the membership at an annual meeting, a majority of whom shall constitute a quorum to do business. Directors shall be elected by members of the Company at the annual meeting for a period of three years or until their successors are elected and qualified; one-third of said directorate shall be elected at each annual meeting. No person who does not reside within such territorial limits shall become a director of the Company. Directors serving as of December 31, 2016, were as follows:

| <u>Name and Residence</u> | <u>Term Expires</u> | <u>Occupation</u> |
|----------------------------------|---------------------|----------------------|
| Ronald Gunsch Zap, ND | 2017 | Farmer |
| Darrel Suchy Mandan, ND | 2018 | Farmer |
| Robert Gaebe New Salem, ND | 2018 | Retired |
| Marcus Erhardt New Salem, ND | 2019 | Retired Farmer/Agent |
| Randy John New Salem, ND | 2017 | Dairy Farmer |
| Delores Reiner New Salem, ND | 2018 | Retired |
| Gordonna Toepke New Salem, ND | 2019 | Retired |

Officers

The Bylaws provide that the directors shall elect from their number a President, Vice-President, Second Vice President, and Secretary/Treasurer of which the Secretary/Treasurer position may

be held by one person. All Officers shall hold their office for one year and until successors are elected and qualified. Officers serving as of December 31, 2016 were as follows:

| <u>Officer</u> | <u>Title</u> |
|----------------|-----------------------|
| Ronald Gunsch | President |
| Darrel Suchy | First Vice President |
| Randy John | Second Vice President |
| Brenda Doll | Secretary-Treasurer |

The Manager, Brenda Doll, oversees the day-to-day operations as Manager of the Company and serves on the Board of Directors as the Secretary/Treasurer. These two positions are inherently conflicting in nature as the Secretary-Treasurer oversees the work of the Manager. **It is again recommended that the Board of Directors review the job functions of the Manager and Secretary-Treasurer and develop procedures to reduce the fraud risk associated with having the same person performing both functions.**

Committees

At December 31, 2016, the Company had one standing committee, the Risk Review Committee. Risk Review Committee

In 2013, the Board implemented a Risk Review Committee to conduct detailed underwriting reviews of policies due for renewal. The table below shows the frequency of the Committee’s meetings during the period under review:

| | 2013 | 2014 | 2015 | 2016 |
|--------------------------|------|------|------|------|
| Review Committee Meeting | 8 | 10 | 9 | 9 |

Those members serving on this Committee as of December 31, 2016 were as follows:

| | |
|-----------------|----------------|
| Darrel Suchy | Marcus Erhardt |
| Gordanna Toepke | Lisa Strom |

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.

There were no amendments to the Bylaws or Articles of Incorporation during the period under review.

Members

During the period under examination the annual meetings of the membership were held on the following dates:

| 2012 | 2013 | 2014 | 2015 | 2016 |
|----------|-----------|----------|----------|-----------|
| 6/5/2012 | 6/11/2013 | 6/5/2014 | 4/9/2015 | 4/12/2016 |

Directors

During the period under examination, the Board of Directors held 10 meetings in 2013 and 11 meetings in 2012, 2014, 2015 and 2016.

All investment transactions are retrospectively approved by the Board of Directors during these regular monthly meetings.

CONFLICT OF INTEREST

The Company's key employees, officers, and directors all sign conflict of interest statements annually. During the exam period, two years of disclosures were not retained and in no year under review were any conflicts disclosed by any director or employee. The exam found that the Company's biggest agent is a director, which could pose a conflict of interest when agent compensation is discussed in Board meetings. **It is again recommended that the Company collect and retain board reviewed conflict of interest disclosures from its officers and directors.**

EMPLOYEES WELFARE AND PENSION PLANS

The Company offers a Savings Incentive Match Plan for Employees Individual Retirement Account which is open to all full-time employees upon completion of one full year of employment. The Company matches up to three percent of the employee's gross salary each pay period. The Company spent \$2,271.36 on this matching program in 2016.

FIDELITY BOND AND OTHER INSURANCE

The Company has a fidelity bond in force which provides \$500,000 coverage for losses associated with employee dishonesty. The Company also has \$10,000 in coverage for employee dishonesty and forgery and alteration under its business owners policy. The coverage meets the minimum amount of fidelity insurance suggested in the NAIC's *Financial Examiners Handbook*.

The Company also has in force a Directors and Officers Liability Insurance Policy providing a \$2,000,000 limit 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.

TERRITORY AND PLAN OF OPERATION

At December 31, 2016, the Company was authorized to transact business in the following counties:

| | | | | |
|-----------|---------------|----------|-----------|----------|
| Adams | Billings | Burleigh | Bowman | Dunn |
| Hettinger | Golden Valley | Grant | Kidder | McKenzie |
| McLean | Mercer | Morton | Mountrail | Oliver |
| Sioux | Slope | Stark | Williams | |

At December 31, 2016, the Company had 58 independent agents producing business through 15 agencies. The Company also had four captive agents who produced business only for the Company and its affiliates.

SIGNIFICANT OPERATING RESULTS

Growth

The following exhibit reflects the growth of the Company for the 10-year period ended December 31, 2016. Data from 2007 through 2011 is compiled from the prior statutory examination. Data with respect to the years 2011 through 2016 is as compiled from home office copies of the filed Annual Statements. The operational results are presented on a modified cash basis.

| Year | Admitted Assets | Total Liabilities | Surplus as Regards Policyholders | Net Premiums Written | Underwriting Deductions | Investment And Other Income | Net Income (Loss) |
|------|--------------------|----------------------|--|----------------------------|----------------------------|-----------------------------------|-------------------------|
| 2007 | \$2,798,359 | \$ 744,162 | \$ 2,054,197 | \$1,127,200 | \$ 791,533 | \$ 206,511 | \$ 542,178 |
| 2008 | 2,709,650 | 1,086,769 | 1,622,1881 | 1,115,105 | 1,057,251 | 113,182 | 171,035 |
| 2009 | 2,664,032 | 752,784 | 1,911,248 | 1,024,126 | 1,325,062 | 112,152 | (188,784) |
| 2010 | 2,408,548 | 571,217 | 1,837,331 | 1,042,396 | 1,472,818 | 116,181 | (314,342) |
| 2011 | 2,522,715 | 868,962 | 1,653,753 | 1,007,085 | 1,062,595 | 3,164 | (52,346) |
| 2012 | 2,792,714 | 826,632 | 1,966,082 | 1,062,018 | 967,624 | 103,219 | 197,613 |
| 2013 | 2,744,176 | 871,781 | 1,872,395 | 1,079,708 | 1,353,495 | 135,220 | (138,567) |
| 2014 | 2,791,202 | 977,732 | 1,813,470 | 1,173,102 | 1,286,392 | 118,073 | 4,783 |
| 2015 | 2,822,189 | 882,017 | 1,940,172 | 1,159,416 | 1,152,679 | 158,750 | 165,487 |
| 2016 | 2,602,018 | 881,610 | 1,720,408 | 1,268,181 | 1,643,400 | 87,796 | (287,423) |

Operating Ratios

The underwriting ratios presented below are on a cash basis and encompass the five-year period ending December 31, 2016:

| | 2016 | 2015 | 2014 | 2013 | 2012 |
|-------------------------------------|--------|------|-------|--------|------|
| Premiums | 100% | 100% | 100% | 100% | 100% |
| Deductions: | | | | | |
| Losses and Loss Adjustment | 76.2 | 48.8 | 60.7 | 74.2 | 42.1 |
| Underwriting Expenses | 53.4 | 50.6 | 48.9 | 51.2 | 49.0 |
| Total Deductions | 129.6 | 99.4 | 109.7 | 125.4 | 91.1 |
| Net Underwriting Gain (Loss) | (29.6) | 0.6 | (9.7) | (25.4) | 8.9 |

MARKET CONDUCT ACTIVITY

Treatment of Policyholders

Claims Based on a limited review of claim files, the Company pays claims fairly within policy provisions upon receipt of satisfactory proof of loss or damage.

Advertising The Company's advertising consists primarily of newspaper, radio, and miscellaneous ads (i.e., county fair). The advertising material was reviewed and did not appear to be deceptive.

Claim Complaints

N.D.C.C § 26.1-04-03(10) requires that the Company adopt and implement reasonable standards for the prompt handling of written communications, primarily expressing grievances received by the Company from insureds or claimants. The Company had a complaints log during the period under review, but the two formal complaints observed were not logged.

It is recommended that the Company establish and maintain an internal complaints log that meets the requirements of N.D.C.C. § 26.1-04-03(10) for any complaints or grievances that are reported to the Company.

OPERATING AGREEMENTS

Investment Advisor Services

The Company has a custodial agreement with broker-dealer, Edward D. Jones & Co., L.P (Edward Jones) under which Edward Jones provides safekeeping of the Company's invested assets.

The agreement was reviewed for compliance with N.D. Admin. Code § 45-03-23-02. The following provisions were not included in the agreement:

The agreement must be in writing and must be authorized by the resolution of the board of directors of the insurance company or of an authorized committee of the board. The terms of the agreement must comply with the following:

a. Securities certificates held by the custodian must be held separate from the securities of the custodian and of all of its other customers.

b. Securities held indirectly by the custodian and securities in a clearing corporation must be separately identified on the custodian's official records as being owned by the insurance company. The records must identify which securities are held by the custodian or by its agent and which securities are in a clearing corporation. If the securities are in a clearing corporation, the records must also identify where the securities are and, if in a clearing corporation, the name of the clearing corporation and, if through an agent, the name of the agent.

c. All custodied securities that are registered must be registered in the name of the company or in the name of a nominee of the company or in the name of the custodian or its nominee or, if in a clearing corporation, in the name of the clearing corporation or its nominee.

d. Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company, except that custodied securities used to meet the deposit requirements set forth in North Dakota Century Code section 26.1-05-23 must, to the extent required by that section, be under the control of the insurance commissioner and must not be withdrawn by the insurance company without the commissioner's approval.

f. During the course of the custodian's regular business hours, any officer or employee of the insurance company, any independent accountant selected by the insurance company, and any representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records relating to custodied securities, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurance company.

g. The custodian and its agents shall be required to send to the insurance company:

(1) All reports which they receive from a clearing corporation on their respective systems of internal accounting control; and

(2) Any reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request.

h. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting

schedules, the custodian agrees to maintain records sufficient to determine and verify such information.

i. The custodian shall provide, upon written request from an appropriate officer of the insurance company, the appropriate affidavits, substantially in the form described in the appendices to this chapter, with respect to custodied securities.

k. In the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

l. The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

m. In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurance company, the custodian shall promptly replace the securities or their value thereof and the value of any loss of rights or privileges resulting from the loss of securities.

o. In the event that the custodian gains entry in a clearing corporation through an agent, there shall be an agreement between the custodian and the agent under which the agent shall be subject to the same liability for loss of custodied securities as the custodian; provided, however, that if the agent shall be subject to regulation under the laws of a jurisdiction which is different from the jurisdiction the laws of which regulate the custodian, the insurance commissioner of the state of domicile of the insurance company may accept a standard of liability applicable to the agent which is different from the standard of liability applicable to the custodian.

p. The custodian shall provide written notification to the insurer's domiciliary commissioner if the custodial agreement with the insurer has been terminated or if one hundred percent of the account assets in any one custody account have been withdrawn. This notification shall be remitted to the insurance commissioner within three business days of the receipt by the custodian of the insurer's written notice of termination or within three business days of the withdrawal of one hundred percent of the account assets.

It is recommended that the company enter into a custodial agreement that meets the requirements of N.D. Admin Code § 45-03-23-02.

Loss Adjusting Services Agreement

During the examination period, the Company contracted with FarMutual Adjusting Program (Mutual Claim Services), a subsidiary of Grinnell Mutual Reinsurance Company, to perform claims adjusting services. The 2016 terms of this agreement include adjustment services for a limit of 200 claims at a fixed fee of \$45,320 for the calendar year. This fee is due in installments of \$3,777 on the first of each month. Additional claims over the 200 claims will be adjusted at a rate of \$400 per claim.

OPERATIONS REVIEW

In June 2012, representatives of Grinnell Mutual Reinsurance Company (Grinnell) performed an operations review of the Company covering the following areas:

- General Operations
- Underwriting and Loss Control
- Claims

This was the fourth review performed by Grinnell and it contained seven recommendations and three comments. Of the recommendations and comments made by Grinnell none were considered material to this examination.

The Operations Review was subsequent of the exam period but the review was completed before field work was started for the examination.

REINSURANCE

The following is a summary of the Company's most significant reinsurance contracts in force at December 31, 2016:

Grinnell Mutual Reinsurance Company

Nonaffiliated Ceding Contract:

| | |
|------------|--|
| Type: | Excess of Loss |
| Reinsurer: | Grinnell Mutual Reinsurance Company |
| Scope: | All policy forms and endorsements issued by the Company |
| | (A) Property Per Risk Excess of Loss – Covers up to \$20 million in losses from fire and windstorm risks written by the Company in excess of a \$175,000 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 \$450,000 retention. |
| | (C) Property Aggregate Excess of Loss - Provides coverage for 100 percent of the Company's aggregate net losses in excess of a defined annual retention limit. The retention limit for 2016 was \$900,000. |
| Premium: | (A) Property Per Risk Excess of Loss - The 2016 annual premium was \$88,800 or \$7,400 per month. |

- (B) Property Catastrophe Excess of Loss – The 2016 annual premium was \$143,760 or \$11,980 per month.
- (C) Aggregate Excess - The 2016 annual premium was \$44,820 or \$3,735 per month.

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, 2016, was extracted from the general ledger and traced to the appropriate schedules of the Company's 2016 Annual Statement. Revenues and expenses were test checked to the extent deemed necessary.

FINANCIAL STATEMENTS

The following pages present a Statement of Assets, Liabilities, and Surplus as of December 31, 2016, and an Statement of Income for 2016.

These financial statements are based on the statutory financial statements filed by the Company with the North Dakota Insurance Department and present the financial condition of the Company for the period ending December 31, 2016. 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.

Southwest Mutual Insurance Company
Statement of Assets, Liabilities, and Surplus
December 31, 2016

ASSETS:

LEDGER ASSETS:

| | | |
|------------------------------------|------------|--------------------|
| Bonds | \$ 245,247 | |
| Stocks | 765,983 | |
| Real Estate | 100,345 | |
| Cash on Hand and Checking Accounts | 142,533 | |
| Cash on Deposit | 1,087,862 | |
| Furniture, Fixtures, and Equipment | 26,411 | |
| | | |
| TOTAL LEDGER ASSETS | | \$2,368,381 |

NONLEDGER ASSETS:

| | | |
|---|----------|----------------|
| Interest Due and Accrued on Bonds | \$ 2,943 | |
| Interest Due and Accrued on Certificates of Deposit and Passbook Savings | 3,215 | |
| Assessments or Premiums in Course of Collection | 141,831 | |
| Market Value of Stocks Over Book Value | 88,240 | |
| Reinsurance Recoverable on Paid Losses | 4,318 | |
| Federal Income Tax Recoverable | 19,860 | |
| | | |
| TOTAL NONLEDGER ASSETS | | 260,407 |

DEDUCT: ASSETS NOT ADMITTED

| | | |
|----------------------------------|-----------|-----------------|
| Furniture, Fixtures, Automobiles | \$ 26,411 | |
| Premiums over 90 Days Past Due | 359 | |
| | | |
| TOTAL NONADMITTED ASSETS | | (26,770) |

TOTAL NET ADMITTED ASSETS

\$2,602,018

LIABILITIES:

| | | |
|---|---------|------------------|
| Unpaid Losses | \$ 0 | |
| Incurred But Not Reported Claims (IBNR) | 6,000 | |
| Unpaid Loss Adjustment Expense | 4,500 | |
| Advanced Premiums | 23,883 | |
| Unearned Premium Reserve | 792,656 | |
| Commissions Due and Payable to Agents | 0 | |
| Unpaid Taxes | 11,819 | |
| Unpaid Salaries | 5,780 | |
| Unpaid General Expenses | 3,802 | |
| Reinsurance Premiums Due and Payable | 24,645 | |
| Premiums Written for Others | 7,371 | |
| Amounts Withheld for Others | 1,154 | |
| | | |
| TOTAL LIABILITIES | | \$881,610 |

SURPLUS TO POLICYHOLDERS

\$1,720,408

TOTAL LIABILITIES AND SURPLUS

\$2,602,018

**Southwest Mutual Insurance Company
Statement of Income
For the Year 2016**

INCOME:

| | | |
|--------------------------------|-------------|--------------------|
| Gross Premium Income | \$1,597,910 | |
| Less: Return Premiums | 32,606 | |
| Premiums for Reinsurance Ceded | 297,123 | |
| NET PREMIUM INCOME | | \$1,268,181 |

| | | | |
|---|--|---------|--------------------|
| Interest on Bonds | | 16,804 | |
| Dividends on Stocks | | 33,901 | |
| Gross Rent from Company's Property | | 6,000 | |
| Interest on Cash on Deposit (Banks and Savings & Loan Deposits) | | 18,683 | |
| Profit on sale or Maturity of Ledger Assets | | (6,006) | |
| Commissions and Service Fees Received | | 14,577 | |
| Miscellaneous Income | | 3,837 | |
| TOTAL INCOME RECEIPTS | | | \$1,355,977 |

DISBURSEMENTS:

| | | |
|---|-----------|--|
| Gross Losses Paid and Incurred in 2016 | 1,189,684 | |
| Gross losses paid current year but occurred in previous years | 18,855 | |
| Deduct: Subrogation received | 4,000 | |
| Deduct: Reinsurance recovered | 285,578 | |

| | | |
|------------------------|--|----------------|
| NET LOSSES PAID | | 918,961 |
|------------------------|--|----------------|

| | |
|---|---------|
| Claim Adjustment Expenses | 46,764 |
| Commissions Paid to Agents | 272,946 |
| Directors Fees and Expenses | 20,545 |
| Salaries to Employees | 165,493 |
| Printing, Stationery and Office Supplies | 10,117 |
| Rent and Rent Items | 6,000 |
| Real Estate Expenses (other than taxes) | 8,287 |
| Taxes on Real Estate | 1,052 |
| State and Local Insurance Taxes | 25,138 |
| Insurance Dept. Licenses & Fees | 970 |
| Payroll Taxes | 19,243 |
| Federal Income Taxes | 24,719 |
| Legal Fees and Auditing | 2,808 |
| Travel and Travel Items | 10,778 |
| Advertising | 5,548 |
| Dues and Donations | 7,884 |
| Equipment purchased (or depreciation on same) | 14,556 |
| Insurance and Bonds | 6,755 |
| Postage, Telephone, Internet and Bank charges | 11,357 |
| Employee Relations and Welfare | 17,242 |
| Data Processing Expenses | 16,987 |
| Risk Reviews and Other Underwriting Expenses | 9,513 |
| Investment Fees | 10,283 |
| Miscellaneous Expense | 9,454 |

| | | |
|------------------------------|--|------------------|
| TOTAL FUNDS DISBURSED | | 1,643,400 |
|------------------------------|--|------------------|

| | | |
|-------------------|--|--------------------|
| NET INCOME | | (\$287,423) |
|-------------------|--|--------------------|

COMMENTS ON FINANCIAL STATEMENTS

Financial statement balances at December 31, 2016, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Assets

Certificates of Deposit

Cash on Deposit as determined by this examination was \$1,087,861, or \$2,793 less than what was reported by the Company. The Company reported four of its negotiable certificates of deposit (CDs) at amounts higher than face value. As the Company reported its negotiable CDs on Schedule N, it has no ability to distinguish between book value, cost, and market value.

Liabilities

Unpaid Salaries

The Company's liability for unpaid salaries, which includes accrued paid-time-off, was determined by this examination to be \$5,780, or \$2,564 more than what was reported by the Company. The Company changed its policy regarding paid-time-off carry-over late in 2016, but did not include this liability on its 2016 annual statement.

Commissions Due and Payable to Agents

The liability for Commissions Due and Payable to Agents, as determined by this examination, was overstated by \$1,236. This figure represents 15 percent of the Company's current outstanding billed premiums. As the Company already reports its premium receivables net of commissions, no additional liability for Commissions Due and Payable to Agents is needed.

Surplus to Policyholders

Surplus to policyholders was determined by this examination to be \$1,720,408 or \$4,121 less than the amount reported by the Company. Adjustments to surplus are shown in the following schedule:

| <u>Description</u> | <u>Company</u> | <u>Examination</u> | <u>Increase (Decrease) to Surplus</u> |
|---|----------------|--------------------|---|
| <u>Ledger Assets:</u> | | | |
| Cash on deposit | 1,090,654 | 1,087,862 | (2,793) |
| <u>Liabilities:</u> | | | |
| Unpaid Salaries | 3,216 | 5,780 | (2,564) |
| Commissions Due and Payable to Agents | 1,236 | 0 | 1,236 |
| | | | <u>\$ (4,121)</u> |
| Net Decrease | | | <u>\$ (4,121)</u> |
| Surplus to Policyholders as reported by Company | \$1,724,529 | | |
| Increase(Decrease) to Surplus from above | <u>(4,121)</u> | | |
| Surplus to Policyholders per Examination | \$1,720,408 | | |

CONCLUSION

The financial condition of Southwest Mutual Insurance Company, New Salem, North Dakota, as determined by this examination is summarized as follows:

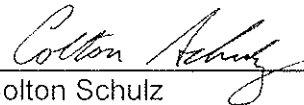
| | | |
|-------------------------------|------------------|--------------------|
| TOTAL ADMITTED ASSETS | | <u>\$2,602,018</u> |
| Liabilities | \$ 881,610 | |
| Surplus to Policyholders | <u>1,720,408</u> | |
| TOTAL LIABILITIES AND SURPLUS | | <u>\$2,602,018</u> |

Since the last examination conducted as of December 31, 2011, the Company's admitted assets have increased \$79,303, its total liabilities have increased \$12,648, and its surplus as regards policyholders has increased \$66,655.

In addition to the undersigned, North Dakota Insurance Department Examiner Andrea Rebsom and Chief Examiner Ed Moody, CFE, CPA participated in this examination.

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

Respectfully submitted,



Colton Schulz
Supervising Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is again recommended that the Board of Directors review the job functions of the Manager and Secretary-Treasurer and develop procedures to reduce the fraud risk associated with having the same person performing both functions.

It is again recommended that the Company collect and retain board reviewed conflict of interest disclosures from its officers and directors.

It is recommended that the Company establish and maintain an internal complaints log that meets the requirements of N.D.C.C. § 26.1-04-03(10) for any complaints or grievances that are reported to the Company.

It is recommended that the company enter into a custodial agreement that meets the requirements of N.D. Admin Code § 45-03-23-02.