

EXAMINATION REPORT OF
HERITAGE MUTUAL INSURANCE ASSOCIATION
PRESTON, IOWA
AS OF DECEMBER 31, 2020

Preston, Iowa
October 12, 2021

HONORABLE DOUG OMMEN
Commissioner of Insurance
State of Iowa
Des Moines, Iowa

Commissioner Ommen:

In accordance with your instructions and pursuant to Iowa statutory provisions, an examination has been made of the

HERITAGE MUTUAL INSURANCE ASSOCIATION
PRESTON, IOWA
AS OF DECEMBER 31, 2020

at its Home Office, 162 West Gillette Street, Preston, Iowa. The report, containing applicable comments and financial data, is presented herein.

INTRODUCTION

The Heritage Mutual Insurance Association, hereinafter referred to as the "Association", was last examined as of December 31, 2017. The examination reported herein was conducted by the Iowa Insurance Division.

SCOPE OF EXAMINATION

This examination covers the intervening period from December 31, 2017 to December 31, 2020. The examination was conducted in accordance with procedures recommended by the Iowa Insurance Division and generally accepted insurance examination standards. The Association's assets were verified and evaluated and the liabilities determined to reflect herein a statement of its financial condition as of December 31, 2020.

HISTORY

The Association was incorporated in 1874 for the purpose of insuring the property of its members against hazards and risks as permitted by Chapter 518, Code of Iowa. The corporate existence was made perpetual in 1955. In February 2010, the Association converted to an Association operating under the provisions of Chapter 518A of the Code of Iowa.

Effective January 1, 2014, Preston Mutual Insurance Association and German Mutual Insurance Association of West Union, Iowa, merged and became Heritage Mutual Insurance Association.

MANAGEMENT AND CONTROL

MEMBERSHIP

The membership consists of those persons or organizations having insurance written by the Association which is in full force and effect.

The annual meeting of the members shall be held at Preston, Iowa on the second Tuesday of February at 1:00 p.m. Special meetings of the members may be called by the Chairman as provided in the Articles of Incorporation. Due notice of the time and place of such special meeting shall be given the membership as specified in the Bylaws. Each member present at any meeting shall be entitled to one vote on each question voted to be decided. Voting by proxy is not permitted. One member more than the number of Directors present constitutes a quorum for any membership meeting.

BOARD OF DIRECTORS

The corporate powers of the Association are vested in a Board of not less than five nor more than fifteen directors, each elected by a majority vote at the annual meeting of the members for terms of three years. Any vacancy on the Board may be filled for the unexpired term by a majority vote of the remaining directors. Up to two independent agents as directors are allowed.

Directors serving at December 31, 2020 were:

<u>Name</u>	<u>Title</u>	<u>Location</u>	<u>Terms</u>
Joan Vagts	Board and Officer	West Union, Iowa	2022
Charles Jargo	Chairman	Clinton, Iowa	2022
John Cuvelier	Vice Chairman	Lawler, Iowa	2023
Dan Nolting	Board	Preston, Iowa	2023
Kim Klocke	Board	Arlington, Iowa	2023
Gary Schroeder	Board	Bryant, Iowa	2021
Norm Nielsen	Board	Princeton, Iowa	2021
Loran Jacobsen	Board	Goose Lake, Iowa	2021
Merlin Kuennen	Board	Elkader, Iowa	2023

The annual meeting of the Board shall be held immediately after the annual meeting of the members, and thereafter on the call of the Secretary. A majority present constitutes a quorum for the transaction of business.

Directors receive a fee of \$500 for each meeting attended and reimbursement of travel expense. Chairman is paid \$500 per month in lieu of meeting fees.

Remuneration of directors is shown on Exhibit A following this report.

COMMITTEES

The Board of Directors shall be empowered to constitute and appoint such committees as they deem to be in the best interests of the Association. Board members, unless otherwise designated, serving in the following Committees at December 31, 2020 were:

Executive Committee

Charles Jargo, Chairman
William Lampe, President
John Cuvelier, Vice Chairman
Joan Vagts, Vice President

Building & Facilities

John Cuvelier, Vice Chairman
Daniel Nolting
Norm Nielsen

Investment Committee

Gary Schroeder
Merlin Kuennen

Agent Committteee

Loran Jacobsen
Kim Klocke
Charles Jargo

OFFICERS

At its annual meeting, the Board of Directors elects for a term of one year a President, Vice President, Chairman, Vice Chairman, Treasurer, Secretary, and may elect such other officers, including Vice Presidents, as it may deem advisable.

Officers serving at December 31, 2020 were:

<u>Name</u>	<u>Office</u>
William Lampe	President/Treasurer
Joan Vagts	Vice President/Secretary
Charles Jargo	Chairman
John Cuvelier	Vice Chairman

Remuneration of officers is shown on Exhibit A following this report.

CONFLICT OF INTEREST

Conflict of interest statements were signed annually by all officers and directors during the examination period.

CORPORATE RECORDS

The Articles of Incorporation were not amended or substituted during the period covered by this examination. In 2019, Bylaws were amended to add the word "independent" to clarify the category of agents allowed on the board.

The recorded minutes of the membership and Board of Directors meetings were read and noted. The minutes of the Board of Directors reflected that the Examination Report as of December 31, 2017 was reviewed and accepted at the February 12, 2019 Board meeting.

AFFILIATED AGENCY

The Association owns the Preston home office and occupies 100 percent of its space. Heritage Mutual Holdings, Inc., which owns 100 percent of German Mutual Insurance Agency, Inc., is owned 100 percent by the Association.

The Association leases an office building in West Union, with a rental payment of \$9,600 in 2020, and shares a portion of the space with German Mutual Insurance Agency, Inc. This agency produced less than one percent of the Association's business and received \$7,251 in commissions from the Association in 2020.

German Mutual Insurance Agency, Inc. paid 90 percent of all commissions to the Association for rent and other expenses. The remaining 10 percent was paid to officer, Joan Vagts, for agency management services. Total commissions paid annually to the Agency during the examination period were \$7,890, \$8,319 and \$7,471.

FIDELITY BONDS AND OTHER INSURANCE

The Association is protected by a blanket bond in the amount of \$500,000 for any one loss occurrence. The bond is written for an annual period and the indemnity is noncumulative.

Policies for other coverages are as follows:

- Workers compensation and employers liability
- Umbrella liability
- Officers and directors liability
- Professional liability
- Commercial property and personal property liability
- Building and contents
- General liability
- Auto property and liability

Adequate insurance is placed with authorized insurers except professional liability and officers and directors liability which is written by a surplus lines insurer permitted to write in Iowa.

EMPLOYEES' WELFARE

Full-time eligible employees are provided life and disability insurance with premiums fully paid by the Association. Full-time eligible employees are provided health, dental, and vision insurance with 80% of premiums paid by the Association. The Association will contribute \$500 a year to a cafeteria plan for each non-contributing employee or will match up to \$1,000 of the employee's contribution to this cafeteria plan.

The Association has a Simplified Employee Pension (SEP) Plan with an Association contribution of three percent of the eligible employee's salary. Annual contributions during the examination period were: \$15,917, \$17,738 and \$17,624. An employee incentive plan are bonuses paid to eligible employees. Association annual payments regarding the plan during the examination period were: \$50,598, \$37,288 and \$55,193.

A Non-Qualified Deferred Compensation plan, maintained for two officers, remains an asset of the Association until the officer has fulfilled his or her requirements under the agreement. The Association annually contributed \$14,000 during the examination period.

REINSURANCE

The Association has property reinsurance contracts in force as of December 31, 2020 with an authorized insurer which provide the following:

Per Risk Excess of Loss

First layer includes the reinsurer paying 100 percent of each risk in excess of retention of \$250,000 up to a maximum recovery of \$1,000,000. A second layer has a recovery of \$4,000,000 in excess of \$1,000,000 for each risk. A third layer has a maximum recovery of \$15,000,000 in excess of \$5,000,000 for each risk. The Association is required to provide a timely notification to reinsurer of any risks exceeding \$10,000,000. Any risk in excess of \$20,000,000 is excluded from coverage.

Catastrophe Excess of Loss

First \$1,600,000 of ultimate net loss per loss occurrence, which is defined as the sum of all individual losses directly occasioned by any one event that occurs in any period of 96 consecutive hours, is retained by the Association. One-hundred percent of ultimate net loss in excess of retention is covered by the reinsurer.

Aggregate Excess of Loss

First \$6,250,000 of ultimate net losses in aggregate, net of all other reinsurance recoveries, is retained by the Association. One-hundred percent of ultimate net loss in excess of retention, which is unlimited, is covered by the reinsurer. Applies to new and renewal and in-force policies of the Association effective and becoming effective at and after the effective date of the contract until expiration of the contract.

Facultative

While facultative reinsurance was available, no risks were identified which would warrant a facultative agreement.

Reinsurance - General

Reinsurance attachments appear to be in compliance with Iowa statutes.

MARKET CONDUCT

TERRITORY AND PLAN OF OPERATION

The Association is authorized to transact business in the State of Iowa as a state mutual insurance association under the provisions of Chapter 518A, Code of Iowa. Business is authorized to be written in the following twenty-nine counties: Allamakee, Benton, Black Hawk, Bremer, Buchanan, Butler, Cedar, Cerro Gordo, Chickasaw, Clayton, Clinton, Delaware, Dubuque, Fayette, Floyd, Franklin, Grundy, Hardin, Howard, Jackson, Johnson, Jones, Linn, Mitchell, Muscatine, Scott, Tama, Winneshiek and Worth. It was noted from a review of numerous applications of policies in force, that risks appeared to be located within the authorized territory.

PRODUCER LICENSING

Business is written by 155 licensed and approved agents.

ADVERTISING

The Association's advertising was reviewed and found to be in compliance with statutory requirements.

RATING AND STATISTICAL REPORTING

The Association is neither a member of nor a subscriber to any rating bureau or statistical reporting agency.

POLICY FORMS AND UNDERWRITING PRACTICES

The Association has policies in force on farm, homeowner, rental, mobile homes and service line property classes in insurance covering fire, wind, and allied lines.

Policy and endorsement forms have been filed and approved. The policies and endorsements utilized by the Association are approved by the Board of Directors prior to usage.

Policies are renewed for a one-year period with premiums payable monthly, quarterly, semi-annually and annually. The Association underwrites farm policies every three years and every five years on all other policies. Of ten policies examined, nine applications were not signed by policyholders and eight were not signed by agents.

TREATMENT OF POLICYHOLDERS

CLAIMS

From a review of numerous claim files, it appeared that the Association made prompt and equitable settlements which were in keeping with the terms of the contracts.

Adjustment of claims performed by the Association's employees. The Association also contracted to have NCP Group and Grinnell Mutual conduct claims adjusting. Each were paid \$172,775 and \$38,750 in 2020, respectively.

COMPLAINT REGISTER

The Association had no complaints during the examination period.

CREDIT SCORES

Credit scoring is used for rating purposes. All credit scoring procedures required by the Iowa Code should be documented by the Association.

GROWTH OF ASSOCIATION

The following historical data was taken from office copies of filed annual statements for the year indicated:

<u>Year</u>	<u>Admitted Assets</u>	<u>Policyholder Surplus</u>	<u>Premiums Earned</u>	<u>Losses Incurred</u>	<u>Investment Income Earned</u>
2018	\$21,233,088	\$15,597,792	\$6,891,839	\$3,331,134	\$305,051
2019	23,891,778	18,062,882	7,245,926	3,177,737	406,481
2020	25,280,805	19,385,089	7,712,071	4,656,794	356,729

UNDERWRITING EXPERIENCE

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>Total</u>
Premiums earned	<u>\$6,896,629</u>	<u>\$7,245,926</u>	<u>\$7,712,387</u>	<u>\$21,854,942</u>
<u>Incurred deductions</u>				
Losses	\$3,324,726	\$3,177,737	\$4,365,768	\$10,868,232
Loss adjustment expenses	205,074	184,583	212,548	602,205
Commissions	1,311,035	1,377,241	1,371,311	4,059,587
Salaries	500,230	541,740	595,313	1,637,283
Taxes, licenses and fees	136,203	136,072	133,027	405,302
Other underwriting expenses	<u>385,504</u>	<u>401,581</u>	<u>404,208</u>	<u>1,191,293</u>
Total deductions	<u>\$5,862,772</u>	<u>\$5,818,954</u>	<u>\$7,082,175</u>	<u>\$18,763,902</u>
Net underwriting gain (loss)	<u>\$1,033,857</u>	<u>\$1,426,972</u>	<u>\$ 630,212</u>	<u>\$ 3,091,040</u>

Expressed in ratios of expenses incurred to premiums earned:

<u>Incurred deductions</u>				
Losses	48.2%	43.9%	56.6%	49.7%
Loss adjustment expenses	3.0	2.5	2.8	2.8
Commissions	19.0	19.0	17.8	18.6
Salaries	7.2	7.5	7.7	7.4
Taxes, licenses and fees	2.0	1.9	1.7	1.9
Other underwriting expenses	<u>5.6</u>	<u>5.5</u>	<u>5.2</u>	<u>5.5</u>
Total deductions	<u>85.0%</u>	<u>80.3%</u>	<u>91.8%</u>	<u>85.9%</u>
Net underwriting gain (loss)	<u>15.0%</u>	<u>19.7%</u>	<u>8.2%</u>	<u>14.1%</u>

ACCOUNTS AND RECORDS

Office copies of the filed annual statements for the years under review were found to be in agreement with or reconciled to the general ledger balances of assets, liabilities, income and disbursements.

Selected cash receipts recorded during the period were checked and traced to the Association's depository. Checks paid during selected months were compared to the disbursement records and were scrutinized as to payees, amounts, and authorized signatures. Cash receipts and disbursements for selected months were proven by comparison and reconciliation to the monthly bank statements.

The Association was in compliance with the Commissioner's Bulletin 97-6 at December 31, 2020 relative to security custodial requirements.

The Association should escheat certain outstanding checks to the State Treasurer.

In accordance with Section 518A.37, Code of Iowa, surplus must be maintained at a level of not less than one hundred thousand dollars or one-tenth of one percent of the gross risk in force, whichever is greater. At December 31, 2020, the gross risk in force for the Association was \$2,684,000,000. The Association's statutory minimum surplus level as of December 31, 2020 was \$2,684,000. It is noted the Association's surplus level to minimum surplus level ratio was 7.2/1. The reported surplus/statutory minimum ratio average for the chapter 518A licensed industry at December 31, 2020 was 8.4/1.

F I N A N C I A L S T A T E M E N T S
A N D C O M M E N T S T H E R E O N

NOTE: Except as otherwise stated, the financial statements immediately following reflect only the transactions for the period ending December 31, 2020 and the assets and liabilities as of this date. Schedules may not add or tie precisely due to rounding.

STATEMENT OF ASSETS AND LIABILITIES

ASSETS

	<u>Assets</u>	<u>Not Admitted</u>	<u>Net Admitted</u>
Bonds	\$11,522,708	\$	\$11,522,708
Preferred stocks	278,000		278,000
Common stocks	7,713,142		7,713,142
Real estate properties occupied	26,573		26,573
Cash:			
Cash holdings	1,519,992		1,519,992
Short-term investments	2,676,524		2,676,524
Investment income due and accrued	102,762		102,762
Uncollected premiums	186,768		186,768
Deferred premiums	1,107,170		1,107,170
Amounts recoverable from reinsurers	147,443		147,443
Current federal income tax recoverable	155,000	155,000	
Electronic data processing equipment	3,892		3,892
Furniture and equipment	13,006	13,006	
Aggregate write-ins for assets:			
Transportation equipment	78,951	78,951	
Payroll tax credit receivable	3,000	3,000	
Total Assets	<u>\$25,534,931</u>	<u>\$249,957</u>	<u>\$25,284,974</u>

LIABILITIES AND SURPLUS

Losses		\$	100,708
Loss adjusting expenses			38,745
Commissions payable and contingent commissions			353,965
Other expenses			98,162
Taxes, licenses and fees			3,498
Unearned premiums			4,538,329
Advance premiums			182,358
Ceded reinsurance premiums payable			146,678
Funds held by company under reinsurance treaties			59,628
Amounts withheld for account of others			17,923
Aggregate write-ins for liabilities:			
Retirement			84,841
Suspense			5,597
Total liabilities			<u>\$ 5,630,432</u>
Surplus as regards policyholders			<u>19,654,542</u>
Total Liabilities and Surplus			<u>\$25,284,974</u>

UNDERWRITING AND INVESTMENT EXHIBIT

ONE-YEAR PERIOD ENDED DECEMBER 31, 2020

STATEMENT OF INCOME

<u>Underwriting Income</u>	
Premiums earned	\$ 7,712,387
 <u>Deductions</u>	
Losses incurred	\$4,365,768
Loss expenses incurred	212,548
Other underwriting expenses incurred	<u>2,529,601</u>
Total underwriting deductions	<u>7,107,917</u>
 Net underwriting gain (loss)	 \$ 604,470
 <u>Investment Income</u>	
Net investment income earned	\$ 360,581
Net realized capital gain (loss)	43,466
 <u>Other Income</u>	
Net premiums written for others	\$ 46,658
Miscellaneous income	50
Aggregate write-ins: Loss on sale of assets	<u>(796)</u>
 Net income before federal income taxes	 \$ 1,054,429
 Federal income taxes incurred	 <u>142,365</u>
 Net income	 <u>\$ 912,064</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2019	<u>\$18,062,882</u>
 <u>Gains and (Losses) in Surplus</u>	
Net income	\$ 912,064
Net unrealized capital gains	805,078
Change in non-admitted assets	<u>(125,482)</u>
 Change in surplus as regards policyholders	 <u>\$ 1,591,660</u>
 Surplus as regards policyholders, December 31, 2020	 <u>\$19,654,542</u>

UNDERWRITING AND INVESTMENT EXHIBIT

THREE-YEAR PERIOD ENDED DECEMBER 31, 2020

STATEMENT OF INCOME

Underwriting Income

Premiums earned		\$21,854,942
 <u>Deductions</u>		
Losses incurred	\$10,868,232	
Loss expenses incurred	602,205	
Other underwriting expenses incurred	<u>7,319,207</u>	
Total underwriting deductions		<u>18,789,644</u>
 Net underwriting gain (loss)		 \$ 3,065,398

Investment Income

Net investment income earned		\$ 1,072,113
Net realized capital gain (loss)		356,926

Other Income

Agents' or premium balances charged off		\$ (6,967)
Net premiums written for others		127,280
Miscellaneous income		4,012
Aggregate write-ins: Loss on sale of assets		<u>(796)</u>

Net income before federal income taxes \$ 4,617,866

Federal income taxes 756,330

Net income \$ 3,861,536

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2017 \$14,896,515

Gains and (Losses) in Surplus

Net income		\$ 3,861,536
Net unrealized capital gains		1,058,658
Change in non-admitted assets		<u>(162,167)</u>

Change in surplus as regards policyholders \$ 4,758,027

Surplus as regards policyholders, December 31, 2020 \$19,654,542

CASH FLOW STATEMENT

Cash from Operations

Premiums collected net of reinsurance	\$ 8,061,662
Net investment income	472,765
Miscellaneous income	<u>(765)</u>
Total	<u>\$ 8,533,662</u>
Benefit and loss related payments	\$ 4,815,622
Commissions, expenses paid and aggregate write-ins	2,656,266
Federal income taxes paid (recovered) net	<u>347,365</u>
Total	<u>\$ 7,819,253</u>
Net cash from operations	<u>\$ 714,409</u>

Cash from Investments

Proceeds from investments sold, matured and repaid:	
Bonds	\$ 5,299,314
Stocks	<u>276,673</u>
Total investment proceeds	<u>\$ 5,575,987</u>
Cost of investments acquired (long-term) only:	
Bonds	\$ 5,429,999
Stocks	<u>1,193,064</u>
Total investments acquired	<u>\$ 6,623,063</u>
Net cash from investments	<u>\$ (1,047,076)</u>

Cash from Financing and Miscellaneous Sources

Other cash provided (applied)	<u>\$ 27,565</u>
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Reconciliation of Cash and Short-Term Investments

Net change in cash and short-term investments	<u>\$ (305,102)</u>
Cash and short-term investments:	
Beginning of year	<u>4,501,618</u>
End of year	<u>\$ 4,196,516</u>

SURPLUS AS REGARDS POLICYHOLDERS

The changes which resulted in the net increase are shown in the following statement of differences:

<u>Classification</u>	<u>Association Annual Statement</u>	<u>Examination Financial Statement</u>	<u>Surplus Increase (Decrease)</u>
<u>Assets</u>			
Bonds	\$11,767,708	\$11,522,708	\$ (245,000)
Cash	2,822,794	1,519,992	(1,302,802)
Short-term investments	1,124,870	2,676,524	1,551,654
Uncollected premiums	30,447	186,768	156,321
Deferred premiums	1,263,174	1,107,170	(156,004)
<u>Liabilities</u>			
Losses	391,734	100,708	291,026
Commissions payable	413,064	353,965	59,099
Aggregate write-in: Retirement		84,841	<u>(84,841)</u>
Net increase in surplus			<u>\$ 269,453</u>
Surplus per Association			<u>\$19,385,089</u>
Surplus per examination			<u>\$19,654,542</u>

During the period under review, surplus funds increased \$4,758,027 from the amount of \$14,896,515 as shown in the last previous examination report. An operating statement reflecting the increase is shown in the financial section.

COMMENTS

The major changes in the Association's financial statement were due to the following:

Bonds \$11,522,708

This asset was decreased by \$245,000 to reclassify a Certificate of Deposit maturing within a year of the examination date.

Cash \$ 1,519,992

This asset was decreased by \$1,302,802 due to reclassifying a money market fund of \$1,551,654 to short-term investments and to reclassify from bonds a Certificate of Deposit of \$248,538 maturing within a year of the examination date.

Short-term investments \$ 2,676,524

This asset was decreased by \$1,551,654 to reclassify a money market fund from Cash.

Uncollected premiums \$ 186,768

This asset was increased by \$156,321 to reclassify current premiums from Deferred premiums.

Deferred premiums \$ 1,107,170

This asset was decreased by \$156,004 due primarily to reclassifying current premiums to Uncollected premiums.

Losses \$ 100,708

This liability was decreased by \$291,026 to reflect actual loss development.

Commissions payable \$ 353,965

This liability was decreased by \$59,099 to reclassify employee bonuses to other expenses.

Aggregate write-ins: Retirement \$ 84,841

This liability was increased by \$84,841 to recognize the amount of deferred compensation due to officers.

CONCLUSION

The cooperation and assistance extended by the officers and personnel of the Association is hereby acknowledged.

Respectfully submitted,

/s/ Jerry P. Cihota
Jerry P. Cihota, CPA, CFE
Examiner Specialist
Iowa Insurance Division