

EXAMINATION REPORT OF
MERCHANTS BONDING COMPANY (MUTUAL)
WEST DES MOINES, IOWA
AS OF DECEMBER 31, 2022

Des Moines, Iowa
May 23, 2024

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

Commissioner,

In accordance with your authorization and pursuant to Iowa statutory provisions, an examination has been made of the records, business affairs, and financial condition of

MERCHANTS BONDING COMPANY (MUTUAL)

WEST DES MOINES, IOWA

AS OF DECEMBER 31, 2022

with its headquarters at 6700 Westown Parkway, West Des Moines, Iowa.

INTRODUCTION

Merchants Bonding Company (Mutual), hereinafter referred to as the “Company” or “MBC”, was last examined as of December 31, 2017, by the Iowa Insurance Division. The Company’s controlled affiliate, Merchants National Bonding, Inc. (“MNB”), was examined concurrently with this examination with a separate report prepared for each entity.

SCOPE OF EXAMINATION

This is the regular comprehensive financial examination of the Company covering the intervening period from January 1, 2018, to the close of business on December 31, 2022, including any material transactions and events occurring and noted subsequent to the examination period.

The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Division plan and perform the examination to evaluate the financial condition, identify current and prospective risks of the Company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer’s surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management’s compliance with Statutory Accounting Principles.

The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company’s financial statements.

The examination report includes significant findings of fact and general information about the insurer and its financial condition.

HISTORY

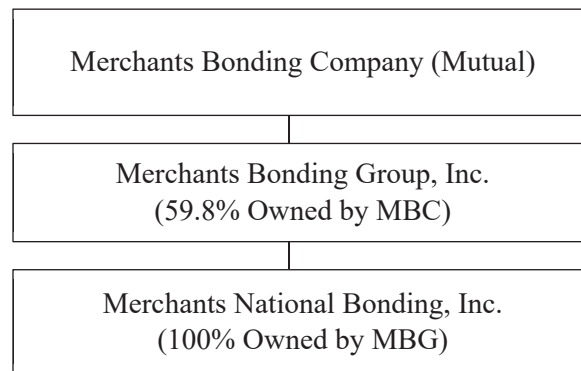
The Company was incorporated in 1933 under the name Merchants Mutual Bonding Company. It commenced business in 1934 writing fidelity and surety bonds and insuring against the loss or damage resulting from burglary or robbery, as then permitted by Iowa statutes. The Articles of Incorporation were amended in 1972 authorizing the Company to write multiple lines of business in accordance with Chapter 515, Section 515.48, Code of Iowa.

The corporate name was officially changed to Merchants Bonding Company (Mutual) on April 18, 1981.

The corporate existence of the Company was renewed for perpetual existence beginning March 30, 1991.

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System as defined by Chapter 521A, Code of Iowa, with all companies having a similar Board of Directors. An organizational chart identifying the Insurance Holding Company System, as of December 31, 2022, follows:



On January 1, 2012, Nations Bonding Company, a Texas domestic insurance company, re-domiciled to Iowa and concurrently changed the corporate name to Merchants National Bonding, Inc. (“MNB”). Merchants National Bonding, Inc. merged with Northern Casualty Company (Mutual), an Iowa domestic insurance company, on July 1, 2012, with MNB being the surviving entity. MNB also issued voting shares to former policyholders of Northern Casualty Company (Mutual).

Additionally, a new non-insurance holding company was formed, Merchants Bonding Group, Inc. The Company and former Northern Casualty Company (Mutual) (“NCC”) policyholders exchanged one-hundred (100%) percent of their common stock shares of MNB for Merchants Bonding Group, Inc. common stock. The Company utilizes the look-through approach in valuing its investment in Merchants Bonding Group, Inc. at \$18,163,146. Capital and ownership of Merchants Bonding Group, Inc. is as follows:

Ex-policyholders of NCC, preferred stock 32,161 shares at \$25	\$ 804,025
Ex-policyholders of NCC, common stock 89,801 shares (21.94%)	6,528,537
Merchants Bonding Company, common stock 250,000 shares (59.82%)	18,175,013
Equity Participation Plan, common stock 78,087 shares (18.69%)	<u>5,676,929</u>
Total equity of Merchants Bonding Group, Inc. at December 31, 2022	\$31,184,505

Equity Participation Plan: The Company established a program which will allow participation in the equity of the group through acquisition of ownership of restricted stock in Merchants Bonding Group, Inc. by certain key associates of the Company and its affiliates. The Compensation Committee of the Board of Directors shall make recommendations to the Boards as to which eligible associates may become recipients as well as the amount and time of awards under the plan, and final decisions as to such matters shall be made solely by the Boards. The aggregate number of shares of restricted stock that are outstanding under this plan, at any time, is limited to twenty percent (20%) of the total issued and outstanding common shares of Merchants Bonding Group, Inc.

MANAGEMENT AND CONTROL

MEMBERSHIP

Every individual, firm, partnership, corporation, or association obtaining insurance or a bond as principal directly from the Company shall be a member during the period that such insurance or bond is in force and effect. A member may have more than one policy or bond and shall be entitled to vote at annual or special meetings, but no member shall be entitled to more than one vote.

The Articles of Incorporation provide for the annual meeting of the membership to be held at the Home Office and shall be convened between the hours of 10:00 a.m. and 2:00 p.m. on the last Saturday of April of each calendar year. Special meetings may be called by three-fifths of the members of the Board of Directors or by a majority of members holding policies or bonds in the Company when such meeting is called.

The number of members of the Company constituting a quorum for the transaction of business at an annual or special meeting shall be equal to the sum of one (1) plus the number of Directors currently sitting on the Board of Directors, but a lesser number may adjourn the meeting from time to time until a quorum is present.

BOARD OF DIRECTORS

The Articles of Incorporation provide that the affairs and business of the Company shall be managed by a Board of Directors consisting of at least five (5) but not more than nine (9) Directors. The Board of Directors shall be divided into five classes. The election of Directors shall occur at each annual meeting. The minimum number of Directors of the class whose terms expire at such meeting shall be, and any Director positions which are vacant within any class may be, elected in such number, within the limit specified by the Articles, as shall be determined at such meeting.

The Articles also provide that regular meetings of the Board of Directors shall be held quarterly, upon written notice, or as prescribed in the Bylaws. One such meeting shall immediately follow the annual meeting of policyholders and shall be designated as the Annual Board meeting. Special meetings of the Board of Directors may be called by the President or by any three (3) members of the Board of Directors upon written call.

The members of the Board of Directors, as reflected on the December 31, 2022, are as follows:

<u>Name and Address</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
Janet Taylor Des Moines, Iowa	Retired	2024
William W. Warner Jr. Urbandale, Iowa	Senior Vice President Operations & Corporate Secretary Merchants Bonding Company (Mutual)	2024
Brenda J. Cushing West Des Moines, Iowa	Retired Insurance Executive/Insurance Consultant BC Consulting, LLC	2025

<u>Name and Address</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
Melissa A. Warner Phoenix, Arizona	Salesperson HomeSmart	2025
Donald K. Kemp Bonita Springs, Florida	Retired KPMG	2026
William N. Taylor Denver, Colorado	Senior Director of Sales VMware, Inc.	2026
Jeffrey W. Taylor Cary, North Carolina	WW Channel Marketing Leader Lenovo	2027
Lawrence B. Taylor West Des Moines, Iowa	Chairman of the Board and President Merchants Bonding Company (Mutual)	2028

Two of the Company's eight directors are independent. The remaining six directors are all related family members.

Directors receive \$13,000 per quarterly meeting, whether attended or not (with no compensation for special meetings). The Company shares the cost of directors' incurred travel expenses with Merchants National Bonding, Inc.

EXECUTIVE COMMITTEE

The Bylaws require that the Board of Directors shall annually appoint an Executive Committee consisting of the President and at least two other directors or officers. The Executive Committee shall review strategic and operational issues pertaining to the Company, shall otherwise assist the Board of Directors in the management of the affairs of the Company, and shall discharge other duties as are delegated to it by resolution of the Board of Directors. Members serving on this committee are also the named officers.

OTHER COMMITTEES

The Board of Directors may also establish other committees from time to time to discharge such duties as the Board of Directors shall establish. The following are the other Committees of the Board of Directors:

- Audit Committee
- Compensation and Board Member Nominating Committee
- Joint Investment Committee

The Audit Committee shall consist of at least three members of the Board. The Compensation and Board Member Nominating Committee shall consist of at least three members and a majority of members shall not be officers or employees. The Joint Investment Committee shall consist of at least four members from among the officers and directors.

OFFICERS

The Bylaws prescribe that the Board of Directors shall elect a President, a Secretary, a Treasurer, and such officers as may be necessary for the conduct of business of the Company. Any two or more offices may be held by the same person.

The officers duly elected and serving as of December 31, 2022, were as follows:

<u>Name</u>	<u>Title</u>
Lawrence B. Taylor	Chairman of the Board and President
Donald R. Blum*	Chief Financial Officer & Treasurer
Stacey L. Cale	Vice President, Human Resources
Jason L. Dettbarn	Senior Vice President, Contract Underwriting
Steven J. Dorenkamp	Senior Vice President, Specialty Solutions Underwriting
Jason T. Farley	Vice President, Claims
David S. Hewett	Chief Underwriting Officer
James A. Holter	Senior Vice President, Commercial Underwriting
Bradley N. Rasmussen	Chief Information Officer
William W. Warner Jr.**	Senior Vice President, Operations & Corporate Secretary
Therese M. Wielage	Chief Marketing and Communications Officer

*Effective April 2023, Donald R. Blum retired and was replaced by Elisabeth A. Sandersfeld.

**Effective April 2023, William W. Warner Jr. transitioned roles with the title of Senior Vice President & Corporate Secretary.

The compensation for the above officers is shown in Exhibit A to be found immediately following the signature page of this report.

CONFLICT OF INTEREST

The Company has an established procedure for the annual disclosure to its Board of Directors of any material interest or affiliation on the part of its officers, directors or key employees which is in conflict with, or is likely to be in conflict with, the official duties of such persons. A review of these statements indicated there were no conflicts found that would appear to interfere with that person's official duties.

CORPORATE RECORDS

The minutes of the meetings of the policyholders, Board of Directors, and Audit Committee were read and noted. They were complete and properly attested.

The minutes of the Board of Directors meeting held August 24, 2019, acknowledged the review and receipt of the Iowa Insurance Division Financial Examination Reports for the period from January 1, 2013, through December 31, 2017.

The Articles of Incorporation were not amended or restated during the examination period.

The Bylaws were not amended or restated during the examination period.

FIDELITY BONDS AND OTHER INSURANCE

The Company, along with its affiliates, is protected by a financial institution bond which covers the fidelity of each officer and employee up to \$5,000,000 for any one occurrence.

The other interests of the Company appear to be adequately protected through coverages afforded by policies in force.

EMPLOYEE WELFARE

A program of insurance and retirement benefits is available to all eligible full-time associates. The Company offers the following programs:

- Group health/medical and dental insurance
- Group vision and vision savings eye care program
- Group life and voluntary life insurance
- Group long-term disability
- Flexible benefit spending account plan
- Defined contribution pension 401(k) plan

The Company also sponsors a nonqualified deferred compensation plan covering certain management employees and independent and independent contractors. Contributions consist of elective deferrals covered individuals and discretionary employer contributions. The Company has a recorded liability for plan obligations of \$12,007,410 at December 31, 2022.

INTERCOMPANY AGREEMENTS

The Company has a Management Services Agreement with its subsidiary, MNB. Services listed include management services, administrative services, personnel, facilities, and possess and maintain all books and records. MNB agrees to pay the Company in accordance with the intercompany reinsurance and pooling agreement.

REINSURANCE

The reinsurance contracts of the Company were reviewed, and no contract provisions were found to be outside the custom of the industry. All contracts had acceptable insolvency clauses and transfer of risk. The Company has no reinsurance contracts with unauthorized reinsurers.

INTER-COMPANY POOLING

The Company and MNB are parties to an intercompany pooling arrangement whereby the companies will pool, on a 90% and 10% basis respectively, the net retained underwriting operations excluding intercompany balances, real estate expenses, Federal or State income taxes, investment expenses, director's fees and similar expenses of a corporate nature. The agreement was amended, updating the pooling arrangement to 88% and 12% respectively, effective January 1, 2014.

CEDED

Excess of Loss

Effective January 1, 2018, the Company and MNB entered into a Surety Excess of Loss Reinsurance Contract in which the reinsurer agrees to indemnify the Company the net excess liability that may accrue to the Company under all bonds in force at the inception of the contract, or written or renewed by or on behalf of the Company during the term of the contract, and Employer's Comprehensive Notary Public Errors and Omissions Policies written on or after January 1, 2013, subject to terms and conditions within the contract.

The contract includes three layers of coverage. The first layer provides \$7,000,000 in coverage in excess of \$1,000,000 in losses. The second layer provides \$12,000,000 in coverage over \$8,000,000 in losses. The third layer provides \$20,000,000 in coverage in excess of \$30,000,000 in losses. The coverage applies on a per principal basis. The coverage applies to both contract and commercial principals.

The treaties provide for a warranty, with respect to any principal, that the treaty shall not cover any bonds issued for any principal where the Company's maximum bonded work program exceeds \$100,000,000, and no single bond shall exceed \$50,000,000, unless submitted to the reinsurer for special acceptance.

Large Principal Quota Share

Prior to the Surety Excess of Loss Reinsurance Contract, MBC and MNB entered into a facultative reinsurance agreement, effective August 1, 2011, where the reinsurer may accept a quota share percentage on the bonds for certain principals which are named in each Certificate of Reinsurance. As of December 31, 2022, the Company had Certificates of Reinsurance for five principals.

COMMITMENTS AND CONTINGENT LIABILITIES

The Company has other post-employment benefits payable to an eligible individual. The Company has recorded a liability in the amount of \$831,035 on December 31, 2022, for the discounted present value of the remaining payments due.

STATUTORY DEPOSIT

The book/adjusted carrying value of special deposits held in trust, which are not held for the protection of all policyholders of the Company, total \$2,431,506 and are as follows:

Arkansas	\$394,562	New Mexico	\$231,547
Georgia	35,000	North Carolina	277,890
Massachusetts	185,259	Oregon	287,152
New Hampshire	625,508	Virginia	394,562

The book/adjusted carrying value of special deposits held in trust for the protection of all policyholders is \$3,083,410 as of December 31, 2022.

TERRITORY AND PLAN OF OPERATION

The Company is authorized to write multi-lines in all 50 states and the District of Columbia. Approximately ninety-four (94%) of premium is written in contract surety (construction-bid, performance, payment, maintenance, and subdivision) and six percent (6%) is commercial fidelity coverage (licenses and permit, notary, probate and public official, fidelity, collateral, and funds administration). The business plan is to write new contract surety accounts with the Company's affiliate, Merchants National Bonding, Inc., while commercial surety is written at Merchants Bonding Company (Mutual), except New Hampshire where Merchants National Bonding, Inc. is not licensed.

GROWTH OF COMPANY

The growth of the Company is reflected by the following data taken from the filed annual statements for the years indicated.

Year	Admitted Assets	Surplus to Policyholders	Net Premium Earned	Net Losses Incurred	Investment Income Earned
2022	\$ 381,789,579	\$ 241,908,057	\$ 150,777,634	\$ 11,286,696	\$ 6,261,059
2021	348,302,398	228,198,593	125,437,910	8,724,503	4,511,530
2020	300,475,081	196,104,130	114,133,937	4,719,810	4,938,091
2019	265,319,464	162,690,830	106,908,482	7,518,716	4,819,231
2018	226,033,865	134,741,525	93,634,664	3,323,067	3,837,378

ACCOUNTS AND RECORDS

Trial balances of the Company's general ledgers were taken for each year under examination and were found to be in agreement with the office copies of the filed annual statements for those years. Cash receipts and disbursements were tested to the extent deemed necessary.

During the course of the examination, no material aggregate surplus difference was identified from the amount reflected in the financial statements, as presented in the annual statement at December 31, 2022.

SUBSEQUENT EVENTS

No subsequent events were noted during the examination.

FINANCIAL STATEMENTS
AND COMMENTS THEREON

Note: The following financial statements are based on the statutory financial statements filed by the Company with the Iowa Insurance Division and present the financial condition of the Company for the period ending December 31, 2022.

STATEMENT OF ASSETS AND LIABILITIES

ASSETS

	<u>Assets</u>	<u>Non-Admitted</u>	<u>Admitted</u>
Bonds	\$ 226,994,807	\$	\$ 226,994,807
Common stocks	66,516,754		66,516,754
Real estate properties occupied by the company	11,457,262		11,457,262
Real estate properties held for the production of income	193,629	193,629	
Cash, cash equivalents and short-term investments	22,288,237		22,288,237
Other invested assets	1,880,669		1,880,669
Investment income due and accrued	1,284,484		1,284,484
Uncollected premiums and agents' balances in the course of collection	21,203,433	3,835,066	17,368,367
Amounts receivable from reinsurers	6,404,833		6,404,833
Net deferred tax asset	1,907,316		1,907,316
Electronic data processing equipment and software	126,471		126,471
Furniture and equipment	233,772	233,772	
Receivables from parent, subsidiaries and affiliates	14,398,285		14,398,285
Cash value of life insurance	11,162,094		11,162,094
Equity participation plan – non vested portion	30,014	30,014	
Prepaid expenses	377,558	377,558	
	\$ 386,459,618	\$	\$ 381,789,579
Total Assets	\$ 386,459,618	\$	\$ 381,789,579

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses			\$ 15,399,041
Reinsurance payable on paid losses and loss adjustment expenses			1,093,950
Loss adjustment expenses			13,449,874
Commissions payable, contingent commissions and other similar charges			3,080,103
Other expenses			6,409,928
Taxes, licenses and fees			921,072
Current federal and foreign income taxes			169,694
Unearned premiums			71,372,980
Dividends declared and unpaid: Policyholders			6,596,061
Ceded reinsurance premiums payable			8,088,564
Amounts withheld or retained by company for account of others			13,300,255
			\$ 139,881,522
Total Liabilities			\$ 139,881,522
Unassigned funds (surplus)			\$ 241,908,057
Total liabilities, capital and surplus			\$ 381,789,579

STATEMENT OF INCOME

Underwriting Income

Premiums earned		<u>\$ 150,777,634</u>
 <u>Deductions</u>		
Losses incurred	\$ 11,286,696	
Loss adjustment expenses incurred	5,021,625	
Other underwriting expenses incurred	<u>104,362,534</u>	
Total underwriting deductions		<u>\$ 120,670,855</u>
 Net underwriting gain		 \$ 30,106,779

Investment Income

Net investment income earned	\$ 6,261,059	
Net realized capital gains	<u>334,086</u>	
Net investment gain		\$ 6,595,145

Other Income

Net (loss) from agents' or premium balances charged off	\$ (100,401)	
Aggregate write-ins for miscellaneous income	<u>(2,427,081)</u>	
Total other income		<u>\$ (2,527,482)</u>
 Net income before dividends to policyholders		 \$ 34,174,442
Dividends to policyholders		<u>4,322,168</u>
Net income before federal income tax		\$ 29,852,274
Federal and foreign income taxes incurred		<u>7,439,899</u>
 Net income		 <u>\$ 22,412,375</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2021		<u>\$ 228,189,593</u>
 <u>Gains and (Losses) in Surplus</u>		
Net income		\$ 22,412,375
Change in net unrealized capital gains		(9,179,614)
Change in net deferred income tax		1,296,685
Change in non-admitted assets		(810,983)
 Change in surplus as regards policyholders for the year		 <u>\$ 13,718,463</u>
Surplus as regards policyholders, December 31, 2022		<u>\$ 241,908,056</u>

CASH FLOW STATEMENT

Cash from Operations

Premiums collected net of reinsurance	\$ 162,697,053	
Net investment income	6,842,285	
Miscellaneous income	<u>(2,527,482)</u>	
Total		\$ 167,011,856
Benefit and loss related payments	\$ 11,442,484	
Commissions, expenses paid and aggregate write-ins	106,885,861	
Dividends paid to policyholders	3,060,071	
Federal income taxes (paid) recovered	<u>6,100,000</u>	
Total		<u>\$ 127,488,416</u>
Net cash from operations		<u>\$ 39,523,440</u>

Cash from Investments

Proceeds from investments sold, matured or repaid:		
Bonds	\$ 56,889,424	
Stocks	4,079,508	
Other invested assets	<u>305,156</u>	
Total investment proceeds		\$ 61,274,088
Cost of investments acquired (long-term only):		
Bonds	\$ 81,834,941	
Stocks	5,980,128	
Real estate	36,100	
Other invested assets	<u>127,317</u>	
Total investments acquired		<u>\$ 87,978,486</u>
Net cash from investments		<u>\$ (26,704,398)</u>

Cash from Financing and Miscellaneous Sources

Other cash provided (applied)	<u>\$ (1,377,422)</u>	
Net cash from financing and miscellaneous sources		<u>\$ (1,377,422)</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Net change in cash, cash equivalents and short-term investments	\$ 11,441,620
Cash, cash equivalents and short-term investments:	
Beginning of year	<u>10,846,617</u>
End of period	<u>\$ 22,288,237</u>

CONCLUSION

The cooperation and assistance extended by the officers and employees of the Company during the course of this examination is hereby acknowledged.

In addition to the undersigned, examiners from the Iowa Insurance Division and Risk & Regulatory Consulting, LLC, actuaries, participated in the examination and the preparation of this report.

Respectfully submitted,

/s/ Bob Wong
Bob Wong, CFE
Examiner-in-Charge
Iowa Insurance Division
State of Iowa