

EXAMINATION REPORT OF  
MERCHANTS NATIONAL BONDING, INC.  
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 NATIONAL BONDING, INC.

WEST DES MOINES, IOWA

AS OF DECEMBER 31, 2022

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

#### INTRODUCTION

Merchants National Bonding, Inc., hereinafter referred to as the “Company” or “MNB”, was last examined as of December 31, 2017, by the Iowa Insurance Division. The Company’s ultimate parent, Merchants Bonding Company (Mutual) (“MBC”), 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

Nations Bonding Company (“NBC”) was organized on April 15, 2003, and was licensed by the Texas Department of Insurance on April 16, 2003. Effective January 1, 2012, NBC 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).

Northern Casualty Company (Mutual), an Iowa domestic insurance company, was incorporated in 1932 under the name Northern Mutual Bonding Company. It commenced business on September 20, 1932, 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 on February 20, 1947, changing the name of the Company to Northern Casualty Company (Mutual). This company was affiliated with the ultimate parent, Merchants Bonding Company (Mutual), via interlocking directors.

## CAPITAL STOCK AND DIVIDENDS

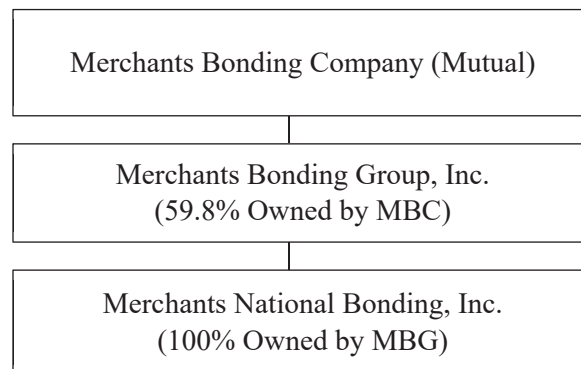
The aggregate number of shares authorized to be 2,000,000 shares of common stock authorized and 300,000 of the shares issued and outstanding with a par value of \$10. Each share shall have equal rights with each other share in respect of dividends, voting and in liquidation. The Company has common capital stock of \$3,000,000 and gross paid in and contributions of \$6,088,655; all of which are held by Merchants Bonding Group, Inc. (“MBG”).

The Company paid stockholder dividends during the examination period as follows:

2018	\$ 76,382
2019	76,382
2020	76,382
2021	76,382
2022	201,382

## 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:



A new non-insurance holding company, Merchants Bonding Group, Inc., was formed. Merchants Bonding Company (Mutual) and former Northern Casualty Company (NCC) policyholders exchanged one-hundred (100%) of their common stock shares of MNB for Merchants Bonding Group, Inc. common stock. MBC 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: MBC 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

### SHAREHOLDERS

Each outstanding share, regardless of class, shall be entitled to one vote on each matter submitted to a vote at a meeting of shareholders, except to the extent that the voting rights of shares of any class or classes are limited or denied by the articles of incorporation. At any meeting of the shareholders every shareholder having the right to vote shall be entitled to vote in person, or by proxy appointed by an instrument in writing subscribed by such shareholder, or by his duly authorized attorney-in-fact.

The Bylaws provide for the annual meeting of shareholders to 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 of the shareholders, for any purpose or purposes, unless otherwise prescribed by statute, or the articles of incorporation, or by the Bylaws, may be called by the Chairman of the Board of Directors or the President, the Board of Directors, or the holders of not less than one-fourth of all the shares entitled to vote at the meeting.

### BOARD OF DIRECTORS

The Articles of Incorporation provide that the affairs and property of the corporation shall be managed by not fewer than seven (7) directors. The exact number of directors shall be designated by the shareholders from year to year but shall never be decreased to less than seven (7) in number. The directors currently in office shall serve until their successors shall be elected and qualified.

The Bylaws 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 the shareholders and shall be designated as the Annual Board meeting.

Elected directors at December 31, 2022 were as follows:

<u>Name and Address</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
William W. Warner, Jr. Urbandale, Iowa	Senior Vice President Operations & Corporate Secretary Merchants Bonding Company (Mutual)	2023
Janet Taylor Des Moines, Iowa	Retired Merchants Bonding Company (Mutual)	2024
Melissa A. Warner Phoenix, Arizona	Salesperson HomeSmart	2025

<u>Name and Address</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
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

The Board consisted of six directors at December 31, 2022, as Lloyd B. Taylor was removed as a Director, following his passing on November 29, 2022.

Each of the Board members is a member of the Board of Directors of Merchants Bonding Company (Mutual). All directors are related family members.

Directors receive \$2,000 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 Bonding Company (Mutual).

#### 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 proper conduct of business of the Company. Any two (2) 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
Steven J. Dorenkamp	Senior Vice President, Specialty Solutions Underwriting
Jason T. Farley	Vice President, Claims
James A. Holter	Senior Vice President, Commercial Underwriting
William W. Warner Jr.	Senior Vice President, Operations & Secretary

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

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 Shareholders and Board of Directors, 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 Report 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

Personal services are provided via a Management Services Agreement between the Company and MBC. A program of insurance and retirement benefits is available to all eligible full-time associates. A nonqualified deferred compensation plan also covers certain management employees and independent contractors. Contributions consist of elective deferrals by covered individuals and discretionary employer contributions.

#### INTERCOMPANY AGREEMENTS

##### Management Services Agreement

The Company has a Management Services Agreement with its ultimate parent, MBC. Services provided by MBC include management services, administrative services, personnel, facilities, and possessing and maintaining all books and records. The Company agrees to pay MBC in accordance with the reinsurance and pooling agreement.

##### Federal Income Tax Consolidation Agreement

The Company has a Federal Tax Consolidation Agreement with its parent, Merchants Bonding Group, Inc. The Company and Merchants Bonding Group, Inc. agree to file consolidated fiscal income tax returns in accordance with the Federal Income Tax Consolidation 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

Merchants Bonding Company (Mutual) and the Company are parties to an intercompany pooling arrangement whereby the companies will pool, on a ninety percent (90%) and ten percent (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, MBC and the Company 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 the Company 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.

### 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 \$1,770,598 and are as follows:

Arkansas	\$185,259	New Mexico	\$255,015
Delaware	15,000	North Carolina	231,574
Georgia	25,000	Oregon	287,153
Massachusetts	107,379	Virginia	250,000
Nevada	228,960	Wyoming	185,259

The book/adjusted carrying value of special deposits held in trust for the protection of all policyholders is \$2,649,030 as of December 31, 2022.

### TERRITORY AND PLAN OF OPERATION

The Company is authorized to write multi-lines in 50 jurisdictions, excluding New Hampshire, and wrote premiums in 48 states. Approximately ninety-nine percent (99%) of premium is written in contract surety (construction-bid, performance, payment, maintenance, and subdivision) and less than one percent (1%) is commercial fidelity coverage (licenses and permit, notary, probate and public official, fidelity). The business plan is to write new contract surety accounts with the Company, while commercial surety business is written at Merchants Bonding Company (Mutual), except for New Hampshire where the Company 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.

<u>Year</u>	<u>Admitted Assets</u>	<u>Surplus to Policyholders</u>	<u>Net Premium Earned</u>	<u>Net Losses Incurred</u>	<u>Investment Income Earned</u>
2022	\$ 70,501,411	\$ 31,164,668	\$ 20,560,586	\$ 1,539,095	\$ 1,111,616
2021	64,302,484	30,270,042	17,105,170	1,189,705	853,282
2020	55,916,261	25,552,896	15,563,720	643,611	844,484
2019	49,421,216	20,947,046	14,578,429	1,025,279	811,304
2018	39,519,528	17,221,423	12,768,363	453,146	603,771

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	\$ 43,401,012	\$ -	\$ 43,401,012
Common stocks	8,611,972		8,611,972
Cash and short-term investments	8,718,689		8,718,689
Other invested assets	248,389		248,389
Investment income due and accrued	245,355		245,355
Uncollected premiums in course of collection	10,061,411	2,270,670	7,790,741
Amounts recoverable from reinsurers	1,093,950		1,093,950
Current federal and foreign income tax recoverable	4,106		4,106
Net deferred tax asset	387,197		387,197
	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 72,772,081</u>	<u>\$ 2,270,670</u>	<u>\$ 70,501,411</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	\$ 2,099,869
Reinsurance payable on paid losses and loss adjustment expenses	187,706
Loss adjustment expenses	1,834,074
Commissions payable, contingent and other	420,014
Other expenses	955,394
Taxes, licenses and fees	91,322
Unearned premiums	9,732,679
Dividends declared and unpaid: policyholders	899,463
Ceded reinsurance premiums payable	8,668,226
Amounts withheld or retained for account of others	49,711
Payable to parent, subsidiaries, and affiliates	14,398,285
	<hr/>
Total liabilities	<u>\$ 39,336,743</u>
Common capital stock	\$ 3,000,000
Gross paid in and contributed surplus	6,088,655
Unassigned funds (surplus)	22,076,013
	<hr/>
Surplus as regards policyholders	<u>\$ 31,164,668</u>
	<hr/>
Total liabilities and surplus	<u>\$ 70,501,411</u>

## STATEMENT OF INCOME

### Underwriting Income

Premiums earned		\$ 20,560,586
 <u>Deductions</u>		
Losses incurred	\$ 1,539,095	
Loss adjustment expenses incurred	684,525	
Other underwriting expenses incurred	<u>14,223,488</u>	
Total underwriting deductions		<u>\$ 16,447,108</u>
 Net underwriting gain		 \$ 4,113,478

### Investment Income

Net investment income earned	\$ 1,111,616	
Net realized capital gains	<u>31,576</u>	
Net investment gain		\$ 1,143,192

### Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (50,532)	
Aggregate write-ins for miscellaneous income	<u>8,149</u>	
Total other income		<u>\$ (42,383)</u>
 Net income before dividends to policyholders		 \$ 5,214,287
Dividends to policyholders		<u>589,386</u>
Net income before federal income tax		\$ 4,624,901
Federal and foreign income taxes incurred		<u>1,022,714</u>
 Net income		 <u>\$ 3,602,187</u>

## CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2021		<u>\$ 30,270,042</u>
 <u>Gains and (Losses) in Surplus</u>		
Net income		\$ 3,602,187
Change in net unrealized capital gains or (losses)		(1,846,315)
Change in net deferred income tax		280,914
Change in non-admitted assets		(940,777)
Dividends to stockholders		(201,383)
 Change in surplus as regards policyholders for the year		 <u>\$ 894,626</u>
Surplus as regards policyholders, December 31, 2022		<u>\$ 31,164,668</u>

## CASH FLOW STATEMENT

### Cash from Operations

Premiums collected net of reinsurance	\$ 21,341,788	
Net investment income	1,115,022	
Miscellaneous income	<u>(42,383)</u>	
Total		<u>\$ 22,414,427</u>
Benefit and loss related payments	\$ 572,399	
Commissions, expenses paid and aggregate write-ins	14,563,392	
Dividends paid to policyholders	417,282	
Federal and foreign income taxes paid (recovered)	<u>875,000</u>	
Total		<u>\$ 16,428,073</u>
Net cash from operations		<u>\$ 5,986,354</u>

### Cash from Investments

Proceeds from investments sold, matured or repaid:		
Bonds	\$ 13,467,663	
Stocks	1,004,054	
Other invested assets	40,304	
Net gains or (losses) on cash and short-term investments	<u>(2,122)</u>	
Total investment proceeds		<u>\$ 14,509,899</u>
Cost of investments acquired (long-term only):		
Bonds	\$ 16,546,771	
Stocks	1,061,959	
Other invested assets	<u>16,815</u>	
Total investments acquired		<u>\$ 17,625,545</u>
Net cash from investments		<u>\$ (3,115,646)</u>

### Cash from Financing and Miscellaneous Sources

Dividends to stockholders	\$ 201,383	
Other cash provided (applied)	<u>1,768,218</u>	
Net cash from financing and miscellaneous sources		<u>\$ 1,566,835</u>

## RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Net change in cash, cash equivalents and short-term investments	\$ 4,437,543
Cash, cash equivalents and short-term investments:	
Beginning of year	<u>4,281,146</u>
End of period	<u>\$ 8,718,689</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