

EXAMINATION REPORT OF
HERITAGE MUTUAL INSURANCE ASSOCIATION
PRESTON, IOWA
AS OF DECEMBER 31, 2017

Preston, Iowa
October 12, 2018

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, 2017

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

INTRODUCTION

Heritage Mutual Insurance Association, hereinafter referred to as the "Association", was last examined as of December 31, 2014. The examination reported herein was conducted by the Iowa Insurance Division.

SCOPE OF EXAMINATION

This examination covers the intervening period from January 1, 2015 to December 31, 2017. The examination was conducted in accordance with procedures established by the Iowa Insurance Division. 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, 2017.

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 of the Association 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.

Directors serving at December 31, 2017 were:

<u>Name</u>	<u>Principal Occupation</u>	<u>Term Expires</u>
Gary Shroeder Bryant, Iowa	Farmer	2018
Loran Jacobsen Goose Lake, Iowa	Farmer	2018
Norm Nielsen Princeton, Iowa	Agent	2018
Thomas Ridout Calmar, Iowa	College Finance Director	2019
Charles Jargo Clinton, Iowa	Farmer	2019
Merlin Kuennen Elkader, Iowa	Retired Veterinarian	2020
Kim Klocke Arlington, Iowa	Farmer	2020
Daniel Nolting Preston, Iowa	Farmer	2020
John Cuvelier Lawler, Iowa	Agent	2020

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 \$400 for each meeting attended and reimbursement of travel expense.

Salaries and remuneration of directors are 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.

Individuals serving on the Executive Committee at December 31, 2017 were as follows:

Charles Jargo, Director and Chairman
William Lampe, President/Treasurer
John Cuvelier, Director and Vice Chairman
Joan Vagts, Vice President/Secretary

Individuals serving on the Investment Committee at December 31, 2017 were as follows:

Thomas Ridout, Director
Gary Schroeder, Director
Norm Nielsen, Director

Individuals serving on the Building & Facilities Committee at December 31, 2017 were as follows:

John Cuvelier, Director
Daniel Nolting, Director

Individuals serving on the Agent Committee at December 31, 2017 were as follows:

Loran Jacobsen, Director
Kim Klocke, Director

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, 2017 were:

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

Salaries and remuneration of officers are shown on Exhibit A following this report.

CONFLICT OF INTEREST

Conflict of interest statements were signed annually by all officers, directors and key employees in 2015 and 2017. In 2016, no conflict of interest statements were executed by directors, including directors that also served as officers.

CORPORATE RECORDS

The Articles of Incorporation and Bylaws were not amended or substituted during the period covered by this examination.

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, 2014 was reviewed and accepted at the February 9, 2016 Board meeting.

AFFILIATED AGENCY

The Association owns the Preston office building and occupies 100 percent of its space.

In 2001, Preston Mutual Insurance Association formed a dormant agency named Preston Mutual Insurance Agency, Inc. In 2014, the Association changed the name from Preston Mutual Insurance Agency, Inc. to Heritage Mutual Holdings, Inc., which owns

100 percent of German Mutual Insurance Agency, Inc. Heritage Mutual Holdings, Inc. is owned 100 percent by the Association with a value of \$1 in 2017.

The Association also leases the West Union office building and shares a portion of the space with German Mutual Insurance Agency, Inc. This agency produced approximately one percent of the Association's business during 2017. The agency received \$7,377 in commissions from the Association during 2017.

There were no conflict of interest statements signed by the agency officers or Board of Directors during the exam period.

In lieu of rent or specific expenses, German Mutual Insurance Agency pays 100 percent of all net income (after expenses) to the Association. The Association received the following amounts: \$6,125 (2015); \$6,567 (2016); and \$6,881 (2017).

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
- Commercial umbrella
- Officers' and directors' liability
- Professional liability
- Business and personal property liability
- Building and contents
- General liability
- Business automobile liability
- Insurance agents errors and omissions 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 from a cafeteria plan with premiums partially paid by the Association. The Association will contribute \$500 a year to this plan for each employee that does not make any personal contributions, or will match up to \$1,000 of the employee's contribution to this cafeteria plan.

Retirement benefit contributions were made to a Simple IRA Program based on three percent of the full-time eligible employee's salary. Contributions of \$13,905 (2015), \$12,665 (2016), and \$15,179 (2017) were paid by the Association.

Profit share amounts of \$10,000, \$42,111, and \$44,433 for the years 2015, 2016, and 2017, respectively, were paid by the Association to full and part-time eligible employees.

REINSURANCE

The Association has reinsurance contracts in force as of December 31, 2017 with an authorized insurer which provide the following:

Per Risk Excess of Loss

First \$300,000 of ultimate net loss per risk is retained by the Association. First layer reinsurer will pay 100 percent of net loss in excess of retention. The maximum recovery for first layer is \$1,000,000. Second layer has a recovery of \$4,000,000 in excess of \$1,000,000 for each risk. Third layer has a maximum recovery of \$15,000,000 in excess of \$5,000,000. The Association is required to provide a timely notification to reinsurer of any risks exceeding \$10,000,000.

Property Catastrophe Excess of Loss

First \$1,200,000 of ultimate net loss per catastrophe, which is any period of 96 consecutive hours arising out of and directly occasioned by the same event, 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 \$5,900,000 of ultimate net loss in aggregate, net of all other insurance recoveries is retained by the Association. One-hundred percent of ultimate net loss in excess of retention is covered by the reinsurer. Reinsurance recovery is unlimited. Applies to new, 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 counties: Allamakee, Benton, Blackhawk, 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.

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.

POLICY FORMS AND UNDERWRITING PRACTICES

The Association has policies in force on farm personal property, and homeowners classes in insurance covering fire, and allied lines.

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.

TREATMENT OF POLICYHOLDERS

Claims

Adjustment of claims is handled primarily by the Association's salaried Home Office personnel. Outside adjusters are retained to assist if needed. Numerous claim files were reviewed to determine adequacy of loss reserves and the treatment of policyholders. From the claims reviewed, it appeared that the Association made prompt and equitable settlements which were in keeping with the terms of the contracts.

Complaint Register

A review was made of all written complaints received by the Association during the period under examination. The Association had one complaint during the examination period that was dealt with in a fair and timely manner.

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>Surplus to Policyholders</u>	<u>Premiums Earned</u>	<u>Losses Incurred</u>	<u>Investment Income Earned</u>
2015	16,894,554	12,417,333	5,525,935	2,859,658	321,654
2016	18,735,043	14,043,848	5,937,743	1,987,259	355,714
2017	20,009,945	15,086,941	6,218,736	3,941,193	314,331

UNDERWRITING EXPERIENCE

Underwriting experience as reflected by the Association's annual statements for the three-year period ended December 31, 2017 was as follows:

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Total</u>
Premiums earned	<u>\$5,535,466</u>	<u>\$5,937,743</u>	<u>\$6,213,946</u>	<u>\$17,687,155</u>
Deductions				
Losses incurred	2,961,647	1,987,259	3,947,601	8,896,507
Loss adjustment expenses	135,679	163,336	347,464	646,479
Commissions	1,076,379	1,181,601	1,199,659	3,457,639
Salaries	617,742	564,834	599,522	1,782,098
Taxes, licenses and fees	76,207	79,988	85,923	242,118
Other underwriting expenses	260,932	294,186	281,113	836,231
Total underwriting deductions	<u>\$5,128,586</u>	<u>\$4,271,204</u>	<u>\$6,461,282</u>	<u>\$15,861,072</u>
Underwriting gain (loss)	<u>\$ 406,880</u>	<u>\$1,666,539</u>	<u>\$ (247,336)</u>	<u>\$ 1,826,083</u>

Expressed in ratios of expenses incurred to premiums earned, the percentages would be:

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Total</u>
Deductions				
Losses incurred	53.5%	33.5%	63.5%	50.3%
Loss adjustment expenses	2.5	2.8	5.6	3.7
Commissions	19.4	19.9	19.3	19.5
Salaries	11.2	9.5	9.6	10.1
Taxes, licenses and fees	1.4	1.3	1.4	1.4
Other underwriting expenses	4.6	4.9	4.6	4.7
Total underwriting deductions	<u>92.6%</u>	<u>71.9%</u>	<u>104.0%</u>	<u>89.7%</u>
Underwriting gain (loss)	<u>7.4%</u>	<u>28.1%</u>	<u>(4.0%)</u>	<u>10.3%</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, 2017 relative to security custodial requirements.

Investments do not appear to be properly reported in the Association's filed annual statement. The Association holds equities in an investment account and the annual statement, Schedule D Part 2, Section 2, does not detail each individual holding.

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, 2017, the gross risk in force for the Association was \$2,872,584,851. The Association's statutory minimum surplus level as of December 31, 2017 was \$2,872,585. It is noted the Association's surplus level to minimum surplus level ratio was 5.2/1. The reported surplus/statutory minimum ratio average for the chapter 518A licensed industry at December 31, 2017 was 8.2/1.

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, 2017 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>Ledger</u>	<u>Not Admitted</u>	<u>Admitted</u>
Bonds	\$10,995,650	\$ 23,225	\$10,972,425
Preferred stocks	25,210		25,210
Common stocks	4,902,153		4,902,153
Real estate	38,347		38,347
Cash and short-term investments	2,733,613		2,733,613
Investment income due and accrued	105,902		105,902
Premiums and considerations:			
Uncollected premiums	22,373	2,862	19,511
Deferred premiums	1,099,252	2,491	1,096,761
Amounts recoverable from reinsurers	68,657		68,657
Current federal income tax recoverable	33,640	33,640	
EDP equipment	8,936		8,936
Equipment and furniture	21,218	21,218	
Transportation equipment	42,784	42,784	
	\$20,097,735	\$126,220	\$19,971,515
Total			

LIABILITIES AND SURPLUS

Losses		\$ 252,810
Loss adjustment expenses		36,711
Commissions payable		363,922
Other expenses		31,519
Taxes, licenses and fees		7,973
Unearned premiums		4,010,891
Advance premium		152,225
Ceded reinsurance premiums payable		160,441
Funds held by company under reinsurance treaties		47,906
Amounts withheld or retained by company for account of others		157
Accrued vacation		1,268
Suspense		9,177
		\$ 5,075,000
Total liabilities		
Surplus as regards policyholders		14,896,515
Total liabilities and surplus		\$19,971,515

UNDERWRITING AND INVESTMENT EXHIBIT

ONE-YEAR PERIOD ENDED DECEMBER 31, 2017

STATEMENT OF INCOME

<u>Underwriting Income</u>		
Premiums earned		\$ 6,213,946
<u>Deductions</u>		
Losses incurred	\$3,947,601	
Loss expenses incurred	347,464	
Other underwriting expenses	2,166,217	
Total underwriting deductions		<u>6,461,282</u>
Net underwriting gain (loss)		\$ (247,336)
<u>Investment Income</u>		
Net investment income earned	314,331	
Net realized capital gain (loss)	18,850	
Net investment income		\$ 333,181
<u>Other Income</u>		
Miscellaneous income	449	
Net premiums collected for others	59,583	
Total other income		<u>\$ 60,032</u>
Net income before Federal income tax		\$ 145,877
Federal income tax incurred		<u>22,500</u>
Net income (loss)		<u>\$ 123,377</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2016		<u>\$ 14,043,848</u>
<u>Gains and (Losses) in Surplus</u>		
Net income (loss)		\$ 123,377
Change in net unrealized gains or (losses)		727,303
Change in not-admitted assets		<u>1,987</u>
Change in surplus as regards policyholders for the year		<u>\$ 852,667</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 14,896,515</u>

UNDERWRITING AND INVESTMENT EXHIBIT
FOUR-YEAR PERIOD ENDED DECEMBER 31, 2017
STATEMENT OF INCOME

<u>Underwriting Income</u>		
Premiums earned		\$ 17,687,155
<u>Deductions</u>		
Losses incurred	\$ 8,896,507	
Loss expenses incurred	646,479	
Other underwriting expenses	6,318,086	
Total underwriting deductions	<u>15,861,072</u>	
Net underwriting gain (loss)		\$ 1,826,083
<u>Investment Income</u>		
Net investment income earned	991,354	
Net realized gains (loss)	398,406	
Total investment income	<u>1,389,760</u>	
<u>Other Income</u>		
Miscellaneous income	54,839	
Premiums collected for other companies (net)	159,795	
Total other income	<u>214,634</u>	
Net income before Federal income tax		\$ 3,430,477
Federal income tax incurred		<u>611,881</u>
Net income (loss)		<u>\$ 2,818,596</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2014	<u>\$ 11,460,040</u>
<u>Gains and (Losses) in Surplus</u>	
Net income (loss)	\$ 2,818,596
Change in net unrealized gains or (losses)	615,340
Change in not-admitted assets	<u>2,539</u>
Change in surplus as regards policyholders for the period	<u>\$ 3,436,475</u>
Surplus as regards policyholders, December 31, 2017	<u>\$ 14,896,515</u>

SURPLUS AS REGARDS POLICYHOLDERS

The changes which resulted in the net decrease 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>			
Uncollected premiums	\$ 21,810	\$ 19,511	\$ (2,299)
Deferred premiums	1,099,252	1,096,761	(2,491)
Current federal income tax recoverable	33,640		(33,640)
<u>Liabilities</u>			
Losses	246,402	252,810	(6,408)
Commissions payable	215,459	363,922	(148,463)
Other expenses	28,695	31,519	(2,824)
Amounts withheld or retained for account of others	7,124	157	6,967
Accrue vacation		1,268	<u>(1,268)</u>
Net change to surplus			\$ (190,426)
Surplus per Association			<u>\$15,086,941</u>
Surplus per examination			<u>\$14,896,515</u>

During the period under review, surplus funds increased \$3,436,475 from the amount of \$11,460,040 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:

Uncollected premiums \$ 19,511

This asset was decreased by \$2,299 to reflect the actual amount of premiums received in 2017.

Deferred premiums \$ 1,096,761

This asset was decreased by \$2,491 to reflect the actual amount of premiums received in 2017.

Current federal income tax recoverable \$ 0

This asset was decreased by \$33,640 to reflect the income tax refund not received but instead credited to 2018 tax.

Losses \$ 252,810

This liability was increased by \$6,408 to reflect actual loss development.

Commissions payable \$ 363,922

This liability was increased by \$148,463 to reflect the actual commissions paid on premiums receivable and capture deferred commissions payable.

Other expenses \$ 31,519

This liability was increased by \$2,824 to reflect actual expenses paid in 2018 for 2017.

Amounts withheld or retained by company for account of others \$ 157

This liability was decreased by \$6,967 to reflect the actual amount of retirement funds paid in 2018 for 2017.

Accrued vacation \$ 1,268

This liability was established to reflect unused vacation pay carried over into 2018.

CONCLUSION

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

Respectfully submitted,

_____/s/ Abby Kramer_____
ABBY KRAMER
Cain Ellsworth & Company, LLP
Representing the State of Iowa