

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

REPORT OF EXAMINATION

OF

**NORTH DAKOTA INSURANCE RESERVE FUND
BISMARCK, NORTH DAKOTA**

**AS OF
DECEMBER 31, 2013**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

North Dakota Insurance Reserve Fund

Bismarck, North Dakota

as of December 31, 2013, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto

set my hand and affixed my official seal at my office in the City of Bismarck, this 14th day of January, 2015.





Adam Hamm
Commissioner

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Bismarck, North Dakota
August 1, 2014

Honorable Adam Hamm
Commissioner
North Dakota Insurance Department
600 East Boulevard Avenue, Dept. 401
Bismarck, ND 58505-0320

Dear Commissioner:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records and financial condition of

**North Dakota Insurance Reserve Fund
Bismarck, North Dakota**

SCOPE OF EXAMINATION

This examination was a risk focused financial condition examination conducted in accordance with N.D.C.C. § 26.1-23.1-04(2) and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Fund's financial condition, its compliance with statutes, and to review its corporate affairs and insurance operations. This statutory examination covers the three-year period from January 1, 2011, to and including December 31, 2013, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

Our examination was conducted in accordance with examination policies and standards established by the North Dakota Insurance Department and procedures recommended by the NAIC. In accordance with the NAIC *Financial Condition Examiners Handbook*, we planned and performed the examination to evaluate the financial condition and identify prospective risks of the Fund by obtaining information about the Fund including corporate governance, identifying and assessing inherent risks within the Fund, and evaluating system controls and procedures used to mitigate those risks. Our examination also included assessment of the accounting principles used and significant estimates made by management as well as evaluation of the overall financial statement presentation, management's compliance with Statutory Accounting Principles, and when applicable, to domestic state regulations.

Work papers provided by the Fund's independent auditor, Eide Bailly, LLC, were reviewed and where deemed appropriate, certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers for this examination.

SUMMARY OF SIGNIFICANT FINDINGS

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

SUBSEQUENT EVENTS

There were no significant subsequent events noted through the date of this report.

HISTORY

General

The North Dakota Insurance Reserve Fund, hereinafter referred to as the "Fund", is a nonprofit government self-insurer pool engaged in the underwriting and insuring of property and casualty risks. The Fund commenced business on January 1, 1986, as the North Dakota Insurance Reserve Fund under a "Pooling Agreement", executed by political subdivisions of the State of North Dakota pursuant to the provisions of N.D.C.C. § 32-12.1-07.

The provisions of the Pooling Agreement were superseded by the Bylaws of the Fund, which were adopted by its Board of Directors on November 24, 1986, and ratified by the general membership of the Fund at its annual meeting on April 20, 1987. Accordingly, the provisions of the Pooling Agreement are no longer operative. On May 4, 1990, the Fund became an authorized government self-insurer pool in which all political subdivisions in the State of North Dakota are eligible to participate in accordance with N.D.C.C. ch. 26.1-23.1.

The purpose of the Fund is to establish a means for self-insurance of its members against various types of property and casualty risks to which they are exposed in the ordinary course of their operations. Members include cities, counties, townships, school districts, fire districts, park districts, ambulance associations, soil conservation districts and water districts within the State of North Dakota.

MANAGEMENT

Board of Directors

The Fund's Bylaws provide that the Board of Directors shall consist of nine members. Two of the Board members shall be elected from the class of participants consisting of cities, two of the Board members shall be elected from the class of participants consisting of counties, one of the Board members shall be elected from the class of participants consisting of elementary and secondary schools, and two of the Board members shall be elected from the class of participants consisting of all other participants. In addition, the North Dakota League of Cities and the North Dakota Association of Counties may each, in writing, appoint one permanent voting member to the Board of Directors.

The Board members shall be elected by vote of the North Dakota participants in the Fund and only elected officers or employees of North Dakota participants are eligible for the Fund's Board

membership. The Board of Directors is elected at the annual meeting of the Fund which is held on a date during the months of April or May as determined by the Board of Directors.

The minutes show that the annual meetings of the Board were held as required by the Fund's Bylaws. In addition to the annual meetings, the Board held quarterly meetings in each year during the examination period.

Directors serving the Fund at December 31, 2013, were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
Tom Larson, Chairperson Park River, North Dakota	City Administrator/Auditor
Randy Bina Bismarck, North Dakota	Executive Director Bismarck Parks & Recreation District
Mark Johnson Bismarck, North Dakota	Executive Director North Dakota Association of Counties
Shawn Kessel Dickinson, North Dakota	City Administrator
Rod Landblom Dickinson, North Dakota	Executive Director Roosevelt-Custer Regional Council
Cindy Schwehr Rogers, North Dakota	Barnes County Commissioner
Connie Sprynczynatyk Bismarck, North Dakota	Executive Director North Dakota League of Cities (retired)
Bruce Strinden Mandan, North Dakota	Morton County Commissioner
Burdell Johnson Tuttle, North Dakota	Kidder County School Board Member

Officers

According to the Fund's Bylaws, the officers of the Board of Directors shall consist of a Chairperson, a Chairperson-elect, a Secretary and a Treasurer, each of whom shall be elected by the Board of Directors. The titles of President and Vice President are not used.

The terms of office of the Chairperson, Chairperson-elect, Secretary and Treasurer are one year commencing at the close of an annual meeting and ending at the close of the next succeeding annual meeting. Officers serving at December 31, 2013, were as follows:

<u>Name</u>	<u>Office</u>
Tom Larson	Chairperson
Bruce Strinden	Chairperson-elect
Steve Spilde	Secretary
Bob Tonolli	Treasurer

Committees

The Fund's Bylaws provide that the Board of Directors shall be entitled to establish any number of committees that, in the exercise of its discretion, shall be deemed helpful and appropriate. In addition to these ad hoc committees, the Board shall establish two standing committees, which includes an Executive Committee and a Finance Committee.

The Executive Committee shall consist of the current Chairperson and Chairperson-elect of the Board and at least three additional Board members to be appointed (including subsequent vacancies) by the current Chairperson of the Board.

The Finance Committee shall consist of the Chairperson-elect of the Board and at least four additional Board members, to be appointed (including subsequent vacancies) by the current Chairperson of the Board.

The Executive Committee met a total of four times during the exam period, and the Finance Committee met quarterly each year during the exam period.

The committees and their respective members at December 31, 2013, were as follows:

<u>Executive Committee</u>	<u>Finance Committee</u>
Tom Larson, Chairperson	Bruce Strinden, Chairperson
Randy Bina	Burdell Johnson
Shawn Kessel	Mark Johnson
Connie Sprynczynatyk	Cindy Schwehr
Bruce Strinden	Rod Landblom

In addition to the aforementioned committees, the Fund has a Nominating Committee, which meets on an as-needed basis and met a total of five times during the exam period. Members serving at December 31, 2013, were as follows:

Randy Bina, Chairperson
Mark Johnson
Connie Sprynczynatyk

Audit Committee

The Fund is not required to have an Audit Committee. During the period under examination, the Fund's independent auditor, Eide Bailly, LLC, conducted annual audits of the Fund's books and records. During the examination period, Eide Bailly did present their annual audit findings to the entire Board of Directors at the May regular scheduled meeting as well as the Fund's annual meeting.

CORPORATE RECORDS

Articles of Incorporation and Bylaws

The Fund made no changes to its Articles or Bylaws during the period under examination.

However, the address of the registered office and the registered agent listed in the Fund's Articles of Incorporation is not current. In addition, the Fund's Articles of Incorporation require that the number of Board of Directors shall be 10, while the Fund's Bylaws require that the Board of Directors shall be comprised of 9 members.

It is recommended that the Fund amend its Articles of Incorporation to reflect the Fund's current registered office, registered agent, and the required number of Board of Directors, and file its amended Articles of Incorporation with the North Dakota Insurance Department and the Secretary of State.

Board of Directors, Members, and Committee Minutes

The minutes of the Board of Directors, members, and committee meetings for the period under examination were read.

The minutes of the various meetings indicate that full Board meetings were well attended and were held in compliance with the Bylaws, Articles of Incorporation, and statutory requirements. The deliberations of the Board were adequately documented and supported the Fund's transactions and events.

Investments made during the period covered by the examination were approved by the Finance Committee and the full Board of Directors.

Conflict of Interest

The Fund does not have an established procedure for annually disclosing potential conflicts of interest to its Board of Directors of any material interest or affiliation on the part of its directors, officers, or key employees which is in, or likely to, conflict with the official duties of such person.

It is recommended that the Fund require the directors, officers, and key management employees to sign conflict of interest statements each year. If conflicts are identified, it is recommended that the Fund's Board of Directors develop a process to address identified conflicts.

FIDELITY BOND AND OTHER INSURANCE

The Fund is protected against loss from fraudulent or dishonest acts of its employees by a fidelity bond providing coverage in the amount of \$500,000. The amount of the coverage meets the minimum amount recommended in the NAIC's *Financial Examiners Handbook*.

The Fund has other types of coverage including Directors and Officers Liability, Automobile, and Commercial Excess Liability which were considered adequate.

PENSION AND INSURANCE PLANS

Profit-Sharing Plan

The Fund has a qualified profit-sharing plan, which covers all employees who meet eligibility requirements. The Fund's contribution to the plan is at the sole discretion of the Fund. The contributions become 100 percent vested once disbursed to the plan. The Fund's contributions for 2013 and 2012 were \$153,000 and \$136,000, respectively.

Deferred Compensation Plan

The Fund has an elective employees' deferred compensation plan for all employees. The plan allows employees to contribute up to the maximum allowable by law per year. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. Beginning January 1, 2009, the Fund began matching contributions up to two and a half percent of gross wages for all participating employees. The Fund's contributions for 2013 and 2012 were \$36,000 and \$40,000, respectively.

TERRITORY AND PLAN OF OPERATION

At December 31, 2013, the Fund was licensed and qualified to write property and casualty insurance for North Dakota state agencies and political subdivisions. The Fund writes general liability, auto lines, and inland marine coverages. The Fund is not authorized to write property coverages offered by the State Fire and Tornado Fund under the provisions of N.D.C.C. § 26.1-22 as they existed on December 31, 1988.

The Fund's products are distributed through over 300 independent agents located throughout the state and are issued on a nonassessable basis. At December 31, 2013, the Fund had a total membership of 2,555. Members include cities, counties, townships, school districts, fire districts, park districts, ambulance associations, soil conservation districts and water districts within the State of North Dakota.

Agency Plan

The Fund distributes its products through a network of over 300 independent agents to its 2,555 members. The Fund does not require written contracts with its agents or agencies. Current

membership represents well over 90 percent of eligible members. The Fund operates on the same basis and serves the same constituents as the North Dakota State Fire and Tornado Fund, which provides property coverages to the same state entities and political subdivisions. However, the Fire and Tornado Fund services these same entities without the use of agents and, therefore, does not pay commissions. All of the Fire and Tornado Fund's business is bound directly through employees of the Fire and Tornado Fund. During 2013, the Insurance Reserve Fund paid a total of \$1,431,009 in commission to its agents.

It is recommended that the Fund review the business needed to write new and renewal business through an independent agency force rather than directly through the Fund.

GROWTH OF THE COMPANY

The table below shows the Fund's written premium activity compared to its surplus over the examination period:

	Premiums Written		
	2013	2012	2011
Direct	\$11,465,000	\$11,042,000	\$10,735,000
Ceded	33,000	33,000	30,000
Net Premiums	\$11,432,000	\$11,009,000	\$10,705,000
Surplus	\$19,565,000	\$18,163,000	\$17,850,000
Premium-to-Surplus Ratio	58%	61%	60%
Total Members	2,555	2,557	2,550

The Fund's net premium written has grown by seven percent over the exam period while its premium to surplus ratio has remained conservative. Membership has held steady at greater than 90 percent of all eligible state political subdivisions.

LOSS EXPERIENCE

The table below shows the Fund's loss reserves and losses incurred over the exam period:

	2013	2012	2011
Total Loss and LAE reserves	\$8,553,000	\$7,912,000	\$7,791,000
Losses incurred	\$4,934,000	\$4,666,000	\$5,022,000
LAE Incurred	1,235,000	1,400,000	1,536,000
Total Incurred	\$6,169,000	\$6,066,000	\$6,558,000
Loss ratio	53.9%	55.1%	61.2%

The Fund's loss reserves have increased by 10 percent and its losses incurred have decreased by 6 percent over the exam period. Loss reserves have developed redundant over the exam period.

REINSURANCE

The Fund currently does not have any excess of loss or aggregate reinsurance in place. The Fund is required by N.D.C.C. § 26.1-23.1-01(2) to limit its exposure on any single risk or hazard to 10 percent of the amount of its admitted assets unless the Fund obtains excess insurance or reinsurance with insurance companies approved for such business by the Insurance Commissioner.

At December 31, 2013, this requirement limits the Fund's acceptance of risks or hazards to no more than \$3,841,800 without reinsurance of any amounts in excess of that limit.

A review of the Fund's exposures showed the Fund obtained facultative coverage for one risk with a coverage limit of \$30 million and a retention of \$5 million. While the reinsurance was placed with an approved reinsurer, the retention was in excess of the maximum allowed. Additionally, there were also an additional 21 policies which had exposure limits in excess of the statutory limit.

It is recommended that the Fund obtain appropriate reinsurance for single risks or hazards that exceed 10 percent of its admitted assets as required by N.D.C.C. § 26.1-23.1-01(2).

ACCOUNTS AND RECORDS

The Fund's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and a trial balance as of December 31, 2013, was extracted from the general ledger and traced to the appropriate schedules of the Fund's 2013 Audited Financial Statement. The Fund's ledgers are maintained electronically. Revenues and expenses were test checked to the extent deemed necessary.

The Fund is audited annually by Eide Bailly, LLC, an outside firm of independent certified public accountants. Eide Bailly's work papers were made available to the Examiners and were used to the extent deemed appropriate for this examination.

The Fund prepares its financial statements on a GAAP basis with supplementary statutory based supporting schedules. Our review focused on the statutory based financial data.

FINANCIAL STATEMENTS

The financial statements of the Fund are presented on the following pages in the sequence listed below:

Statement of Assets, Liabilities, Surplus and Other Funds, December 31, 2013
Statement of Income, Year Ended December 31, 2013
Reconciliation of Capital and Surplus, January 1, 2011 through December 31, 2013

North Dakota Insurance Reserve Fund
Statement of Assets
December 31, 2013
In Thousands

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$31,982		\$31,982
Stocks:			
Common Stocks	4,248		4,248
Real Estate:			
Properties Occupied by the Company	759		759
Cash	704		704
Investment income due and accrued	204		204
Agents' Balances or Uncollected Premiums:			
Premiums and Agents' Balances in Course of Collection	355		355
Electronic data processing equipment and software	166		166
Totals	<u>\$38,418</u>	<u>\$0</u>	<u>\$38,418</u>

**North Dakota Insurance Reserve Fund
Liabilities, Surplus, and Other Funds
December 31, 2013
In Thousands**

Losses and loss adjustment expenses	\$8,553
Incurred but not reported losses	4,351
Unearned premiums	4,121
Accounts payable	96
Accrued expenses	147
Conferment payable	<u>1,585</u>
Total Liabilities	\$18,853
Unassigned Funds (Surplus)	<u>19,565</u>
Total Liabilities, Capital and Surplus	<u><u>\$38,418</u></u>

North Dakota Insurance Reserve Fund
Statement of Income
December 31, 2013
In Thousands

Underwriting Income

Premiums earned		\$11,432
Deductions:		
Losses incurred	\$4,934	
Loss expenses incurred	1,235	
Other underwriting expenses incurred	4,269	
Total underwriting deductions		10,438
Net underwriting gain (loss)		\$ 994

Investment Income

Net investment income earned	\$843	
Net realized capital gains (losses)	368	
Net investment gain (loss)		\$1,211

Other Income

Total other income		0
Net income		\$2,205

North Dakota Insurance Reserve Fund
Reconciliation of Capital and Surplus Accounts
January 1, 2011, Through December 31, 2013
In Thousands

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Capital and Surplus, December 31, previous year	\$18,163	\$17,850	\$18,844
Net income	2,205	2,262	1,412
Net unrealized capital gains or (losses)	784	148	(404)
Change in non-admitted assets	(2)	17	(18)
Conferment declared	(1,585)	(2,114)	(1,984)
Net change in Capital and Surplus for the year	1,402	313	(994)
Capital and Surplus, December 31, current year	<u>\$19,565</u>	<u>\$18,163</u>	<u>\$17,850</u>

COMMENTS ON FINANCIAL STATEMENTS

Financial statement balances at December 31, 2013, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Assets

Bonds

The Fund reported \$31,982,000 of bonds in its statutory financial statements. The Fund valued and reported bonds at original cost rather than amortized cost as required by SSAP No. 26.

Underwriting Deductions

Losses Incurred

The Fund reported \$4,934,000 of losses incurred in its statutory financial statements. This amount did not include salvage and subrogation of \$279,512 received during 2013, as required by SSAP No. 55.

Loss Expense Incurred

The Fund reported \$1,235,000 of loss expense incurred in its statutory financial statements. This amount did not include \$712,750 of Claims Department expenses incurred during 2013, as required by SSAP No. 70.

Other Underwriting Expenses Incurred

The Fund reported \$4,269,000 of other underwriting expense incurred in its statutory financial statements. This amount included \$279,512 of salvage and subrogation received in 2013, which should have been included as a reduction of losses incurred per SSAP No. 55. In addition, the Fund included \$712,750 of Claims Department expenses incurred during 2013, which should have been included as loss expenses per SSAP No. 70.

The adjustments to correct the identified errors above are shown below:

	<u>Per Company</u>	<u>Per Exam</u>	<u>Difference</u>
Losses incurred	\$ 4,934,000	\$ 4,654,488	\$ (279,512)
Loss expenses incurred	1,235,000	1,947,750	712,750
Other underwriting expenses incurred	4,269,000	3,835,761	(433,238)
Total underwriting deductions	<u>\$10,438,000</u>	<u>\$10,438,000</u>	<u>\$ 0</u>

No adjustments were considered necessary to the statutory financial statements as the amounts were immaterial.

CONCLUSION

The financial condition of the Fund, as of December 31, 2013, as determined by this examination, is summarized as follows:

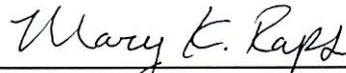
Admitted Assets		<u>\$38,418,000</u>
Total Liabilities	\$18,853,000	
Total Capital and Surplus	<u>19,565,000</u>	
Liabilities, Surplus, and Other Funds		<u>\$38,418,000</u>

Since December 31, 2010, the Fund's admitted assets have increased \$1,428,000, its total liabilities have increased \$707,000, and its capital and surplus has increased \$720,000.

The courteous cooperation extended by the officers and employees of the Fund during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Mike Andring, FCAS, MAAA, of the North Dakota Insurance Department, participated in this examination.

Respectfully submitted,



Mary Raps, AFE
Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is recommended that the Fund amend its Articles of Incorporation to reflect the Fund's current registered office, registered agent, and the required number of Board of Directors, and file its amended Articles of Incorporation with the North Dakota Insurance Department and the Secretary of State.

It is recommended that the Fund require the directors, officers, and key management employees to sign conflict of interest statements each year. If conflicts are identified, it is recommended that the Fund's Board of Directors develop a process to address identified conflicts.

It is recommended that the Fund review the business needed to write new and renewal business through an independent agency force rather than directly through the Fund.

It is recommended that the Fund obtain appropriate reinsurance for single risks or hazards that exceed 10 percent of its admitted assets as required by N.D.C.C. § 26.1-23.1-01(2).