

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

**REPORT OF EXAMINATION**

**OF**

**MCLEAN MCHENRY MUTUAL  
INSURANCE COMPANY**

**TURTLE LAKE, NORTH DAKOTA**

**AS OF  
DECEMBER 31, 2014**

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

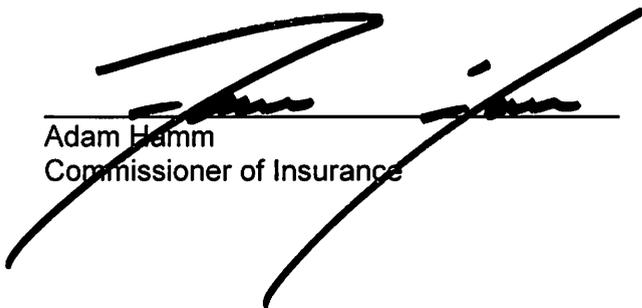
**McLean McHenry Mutual Insurance Company**

**Turtle Lake, North Dakota**

as of December 31, 2014, 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 1<sup>st</sup> day of October, 2015.

  
\_\_\_\_\_  
Adam Hamm  
Commissioner of Insurance

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Turtle Lake, North Dakota  
July 24, 2015

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 in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination was made of the books, records, and financial condition of

**McLean McHenry Mutual Insurance Company  
Turtle Lake, North Dakota**

as of December 31, 2014.

McLean McHenry Mutual Insurance Company, hereinafter referred to as the "Company," was last examined as of December 31, 2009, by representatives of the State of North Dakota.

## **SCOPE OF STATUTORY EXAMINATION**

This examination was a financial condition examination conducted in accordance with N.D.C.C. § 26.1-03-19.3 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the period from January 1, 2010, to December 31, 2014, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

## **STATUS OF PRIOR EXAM FINDINGS**

Our examination included a review to determine the current status of the 11 exception conditions commented upon in our preceding Report on Examination which covered the period from January 1, 2005, to December 31, 2009. We determined that the Company had satisfactorily addressed all of these items.

## **SUBSEQUENT EVENTS**

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

## **HISTORY**

The Company was incorporated under the laws of the State of North Dakota on December 17, 1904, and commenced business January 1, 1905, as the McLean County Farmers Mutual Fire, Lightning, and Cyclone Insurance Company, with its principal place of business at Washburn, North Dakota. During June 1910, its office was moved to Underwood, and in 1937 to Turtle Lake. During 1927, the Company's name was changed to McLean County Farmers Mutual Insurance Company, and the term of its existence was made perpetual.

In 1990, the Company merged with Viking Farmers Mutual Insurance Company, retaining the name McLean County Farmers Mutual Insurance Company.

Effective August 31, 1998, the Company and Farmers Mutual Insurance Company of McHenry County joined operations under an Articles of Consolidation to form a new company named McLean McHenry Mutual Insurance Company.

The Company was organized pursuant to the provisions of N.D.C.C. ch. 26.1-13 to insure against all of the risks and to possess all of the powers and to be subject to all of the liabilities and duties of a county mutual insurance company as now provided in N.D.C.C. ch. 26.1-13, as the same may be from time to time amended in the future.

## **MANAGEMENT AND CONTROL**

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges of membership. No person who does not reside within such territorial limits shall become a director of the Company.

### **Directors**

The Articles of Incorporation provide that the corporate powers of the Company shall be vested in a Board of Directors composed of nine members elected by a majority vote at the annual meeting of the membership. Directors are elected for a term of three years or until their successors are elected and duly qualified. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 2014, were as follows:

<b>Name and Residence</b>	<b>Term Expires</b>	<b>Occupation</b>
Richard Britton Turtle Lake, ND	2015	Farmer
Stephen Christensen Mercer, ND	2017	Farmer
Bruce Klabunde Garrison, ND	2016	Farmer
David Holje Maddock, ND	2015	Farmer
Kerry Bacon Granville, ND	2016	Farmer
Vernon Edinger Turtle Lake, ND	2017	Farmer
Nick Wagner Mercer, ND	2017	Sales
Harry Bergstad Voltaire, ND	2015	Farmer
Doris Wall Mercer, ND	2016	Farmer

### **Officers**

Officers are elected at the annual meeting of the Board of Directors by a majority vote for a period of one year. Officers serving at December 31, 2014, were as follows:

<b><u>Name</u></b>	<b><u>Office</u></b>
Richard E Britton	President
Stephen Christensen	Vice President
Linda Huelsman	Secretary-Treasurer

The Company's Manager, Linda Huelsman, oversees the day-to-day operations of the Company. She also serves on the Board of Directors as the Secretary-Treasurer. These two positions are inherently conflicting in nature as the Secretary-Treasurer oversees the work of the Manager.

**It is recommended that the Company review the job functions of the Manager and Secretary-Treasurer and develop procedures to reduce the fraud risk associated with having the same person performing both functions.**

# CORPORATE RECORDS

## **Articles of Incorporation and Bylaws**

No amendments were made to the Articles or Bylaws during the period under examination.

## **Board of Directors, Members and Committee Minutes**

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

The Company's Board of Directors did not formally resolve to approve the Company's investment guidelines as required by N.D. Admin. Code § 45-03-12-05(3). There was no evidence in the minutes noting retrospective approval of individual investment transactions made by the Company's broker as required by N.D. Admin. Code § 45-03-12-05(4). There also was no record of the Company obtaining approval of each investment transaction by the Secretary/Manager or President as required by the Company's investment guidelines.

**It is recommended that the Company document the review and approval of investment transactions made by its broker within its Board minutes at least quarterly per N.D. Admin. Code § 45-03-12-05(03) and that the Board approve the Company's investment guidelines at least annually by a formal resolution per N.D. Admin. Code § 45-03-12-05(4).**

## **Members**

The Bylaws provide that the annual meeting of the Company shall be held between March 1 and June 30 of each year. During the period under examination the annual meetings of the policyholders were held on the following dates: June 14, 2010; June 13, 2011; June 11, 2012; June 10, 2013; June 16, 2014.

## **Directors**

During the period under examination, the Board of Directors held 10 meetings in 2010, 8 meetings in 2011, 11 meetings in 2012, 10 meetings in 2013, and 8 meetings in 2014.

## **Conflict of Interest**

The Company has a conflict of interest policy for directors, officers, and key employees and conflict of interest statements are completed annually. Not all conflicts were disclosed each year. Evidence of the review and approval of disclosed conflicts by the Board of Directors was not noted during the exam period.

**It is recommended that the Company's Board of Directors annually review and approve the conflict of interest statements and all disclosures.**

## FIDELITY BOND AND OTHER INSURANCE

At December 31, 2014, the Company was a named insured on a fidelity bond insuring against loss sustained by the Company as a result of dishonest or fraudulent acts committed by an employee. The bond provides for a \$50,000 single loss limit of liability for loss caused by each employee. The coverage meets the minimum amount of fidelity insurance recommended in the NAIC's *Financial Examiners Handbook*.

The Company is also covered by a directors and officers liability insurance policy providing a \$2,000,000 limit of liability each policy year. Each claim is subject to a \$10,000 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

The Company's home office in Turtle Lake is protected by a commercial lines policy that provides property coverage of \$135,200. The policy also provides liability coverage of \$1,000,000 per occurrence and a \$2,000,000 aggregate limit.

## TERRITORY AND PLAN OF OPERATION

At December 31, 2014, the Company had 58 licensed agents at 16 agencies and was authorized to transact business in the following 22 counties:

Benson	Bottineau	Burke	Burleigh
Eddy	Emmons	Kidder	McHenry
McLean	Mercer	Morton	Mountrail
Oliver	Pierce	Ramsey	Rolette
Sheridan	Sioux	Towner	Ward
Wells	Williams		

During the exam period, the Company wrote four commercial properties that were within the platted limits of an incorporated city. In accordance with N.D.C.C. § 26.1-13-15 commercial risks can only be written on properties located outside the platted limits of an incorporated city.

**It is recommended that the Company non-renew the commercial policies written on risks inside the platted limits of incorporated cities at the end of each policy's current term and that the Company no longer write commercial properties inside the platted limits of an incorporated city in accordance with N.D.C.C. § 26.1-13-15.**

## SIGNIFICANT OPERATING RESULTS

### Growth

The following exhibit reflects the growth of the Company over the 10-year period ending December 31, 2014. Data with respect to the years 2005-2008 and 2010-2013 is compiled from home office copies of the filed Annual Statements. Data for the years 2009 and 2014 reflects the results of the statutory examination. The operational results are presented on a cash basis.

<b>Year</b>	<b>Admitted Assets</b>	<b>Total Liabilities</b>	<b>Surplus as Regards Policyholders</b>	<b>Net Premiums Written</b>	<b>Underwriting Deductions</b>	<b>Investment And Other Income</b>	<b>Net Income (Loss)</b>
2005	1,413,762	473,590	940,172	600,527	402,477	55,103	253,153
2006	1,304,518	460,335	844,182	650,022	780,473	78,050	(52,401)
2007	1,534,154	531,822	1,022,332	704,223	539,026	78,047	243,243
2008	1,573,953	591,134	982,818	715,158	725,605	81,127	70,681
2009	1,862,573	531,250	1,331,323	725,130	633,130	81,054	173,084
2010	2,180,756	622,935	1,557,821	705,176	649,098	85,553	141,631
2011	1,988,611	580,876	1,407,736	754,311	843,997	76,843	(12,843)
2012	2,153,998	696,049	1,457,948	849,189	752,618	61,788	158,359
2013	2,517,678	708,270	1,809,408	866,602	592,389	65,473	339,686
2014	2,604,065	760,291	1,843,774	858,848	856,655	72,879	75,072

### **Operating Ratios**

The underwriting ratios presented below are on a cash basis and encompass the five-year period ending December 31, 2014:

	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Premiums</b>	100%	100%	100%	100%	100%
<b>Deductions:</b>					
Losses and Loss Adjustment	51.9	27.5	49.9	70.1	51.2
Underwriting Expenses	47.8	40.9	38.7	41.8	40.9
<b>Total Deductions</b>	99.7	68.4	88.6	111.9	92.1
<b>Net Underwriting Gain (Loss)</b>	0.3	31.6	11.4	(11.9)	7.9

## **MARKET CONDUCT ACTIVITY**

### **Treatment of Policyholders**

**Claims** Based on a limited review of claim files, the Company pays claims fairly within policy provisions upon receipt of satisfactory proof of loss or damage.

**Advertising** The Company's advertising consists primarily of newspaper, directory advertising, and miscellaneous ads (i.e., county fair). The advertising material was reviewed and no violations of N.D.C.C. § 26.1-04-03(2) were noted.

## OPERATING AGREEMENTS

### Grinnell Adjusting Service

On April 23, 2010, the Company entered into a contract with Grinnell Advisory Company, a subsidiary of Grinnell Mutual Reinsurance Company, to perform claims adjusting and risk review services.

For services provided in 2014, Grinnell Advisory Company was paid \$25,000. The fee charged is a flat rate for up to 100 claims. Any additional claims would be billed at \$400 per claim. There was no fee for risk reviews delineated within the contract.

**It is recommended that the Company allocate the fixed fee paid to Grinnell Advisory Company between underwriting expenses and claims adjustment expenses based on the number of claims adjusted and risk reviews performed by Grinnell Advisory Company.**

## OPERATIONS REVIEW

Representatives of Grinnell Mutual Reinsurance Company (Grinnell) performed an operations review of the Company in August 2012 covering the following areas:

- General Operations
- Underwriting and Loss Control
- Claims

This review performed by Grinnell contained six suggestions, none of which were considered significant for this examination.

## REINSURANCE

The reinsurance treaty in force at December 31, 2014, is summarized below.

Nonaffiliated Ceding Contract:

Type:	Excess	
Reinsurer:	Grinnell Mutual Reinsurance Company	
Scope:	All policy forms and endorsements issued by the Company:	
(A)	Individual Occurrence of Loss Excess - covers all risks written by the Company in excess of \$100,000 retention subject to the following limits:	
	Dwellings	\$1,000,000
	Farm Outbuildings	1,000,000
	Livestock/Poultry/Horse Operations	1,000,000
	Commercial and Public Property	1,000,000
	Farm Machinery and Equipment Storage	2,000,000

- (B) Aggregate Excess - provides coverage for 100 percent of the Company's aggregate net losses in excess of a defined retention limit. The retention limit for 2014 was \$595,713.
- Premium: (A) Individual Occurrence of Loss Excess - The 2014 annual premium and monthly premium was \$0.0370 per \$1,000 adjusted gross fire risks in force.
- (B) Aggregate Excess - The 2014 annual premium was \$0.0428 per \$1,000 of adjusted gross fire risks in force.
- Commissions: Sliding scale contingent commission that ranges from zero percent to five percent based on the five year loss ratio.
- Termination Date: The agreement may be terminated only as of the last day of any calendar year by either party upon 90 days' notice in writing.

The contract contained the insolvency clause required by N.D.C.C. § 26.1-02-21 and all of the clauses required by the NAIC's *Accounting Practices and Procedures Manual*.

## **ACCOUNTS AND RECORDS**

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and a trial balance as of December 31, 2014, was extracted from the general ledger and traced to the appropriate schedules of the Company's 2014 Annual Statement. Revenues and expenses were tested to the extent deemed necessary.

The Company's trial balance did not list all accounts and transactions necessary to tie it to the Annual Statement. Several of the trial balance accounts were not updated with the current year's figures, and errors corrected in the preparation of the Annual Statement were not reflected in the trial balance totals.

**It is recommended that the Company properly post recordable transactions to the general ledger and that any accruals needed to comply with the Annual Statement reporting requirements be posted to the worksheet that documents the reconciliation of the general ledger trial balance to the Annual Statement.**

### **Custodial Agreements**

During the exam period, the Company entered into a custodial agreement with broker-dealer Edward D. Jones & Co., L.P. (Edward Jones), under which Edward Jones provides safekeeping of the Company's invested assets. This agreement was executed as a result of a prior examination finding that stated the Company did not have a compliant custodial agreement.

The Company's custodial agreement with Edward Jones was granted an exemption by the Department for N.D. Admin. Code § 45-03-23-02(2)(p) effective September 4, 2012. In July 2014, this agreement was replaced by Edward Jones with a new agreement which does not

contain the nonexempted language required by N.D. Admin. Code § 45-03-23-02(2). Therefore, the exemption granted for the original agreement is no longer applicable. The revised agreement does not contain the following language as specified in N.D. Admin. Code § 45-03-23-02(2):

2. The agreement must be in writing and must be authorized by the resolution of the board of directors of the insurance company or of an authorized committee of the board. The terms of the agreement must comply with the following:
  - a. Securities certificates held by the custodian must be held separate from the securities of the custodian and of all of its other customers.
  - b. Securities held indirectly by the custodian and securities in a clearing corporation must be separately identified on the custodian's official records as being owned by the insurance company. The records must identify which securities are held by the custodian or by its agent and which securities are in a clearing corporation. If the securities are in a clearing corporation, the records must also identify where the securities are and, if in a clearing corporation, the name of the clearing corporation and, if through an agent, the name of the agent.
  - c. All custodied securities that are registered must be registered in the name of the company or in the name of a nominee of the company or in the name of the custodian or its nominee or, if in a clearing corporation, in the name of the clearing corporation or its nominee.
  - d. Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company, except that custodied securities used to meet the deposit requirements set forth in North Dakota Century Code section 26.1-05-23 must, to the extent required by that section, be under the control of the insurance commissioner and must not be withdrawn by the insurance company without the commissioner's approval.
  - f. During the course of the custodian's regular business hours, any officer or employee of the insurance company, any independent accountant selected by the insurance company, and any representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records relating to

custodied securities, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurance company.

- g. The custodian and its agents shall be required to send to the insurance company:

  - (1) All reports which they receive from a clearing corporation on their respective systems of internal accounting control; and
  - (2) Any reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request.
- h. The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's annual statement and supporting schedules and information required in any audit of the financial statements of the insurance company.
- i. The custodian shall provide, upon written request from an appropriate officer of the insurance company, the appropriate affidavits, substantially in the form described in the appendices to this chapter, with respect to custodied securities.
- j. A national bank, state bank, or trust company shall secure and maintain insurance protection in an adequate amount covering the bank's or trust company's duties and activities as custodian for the insurer's assets and shall state in the custody agreement that protection is in compliance with the requirements of the custodian's banking regulator. A broker-dealer shall secure and maintain insurance protection for each insurance company's custodied securities in excess of that provided by the securities investor protection corporation in an amount equal to or greater than the market value of each respective insurance company's custodied securities. The commissioner may determine whether the type of insurance is appropriate and the amount of coverage is adequate.
- k. The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities, except that the custodian shall not be so

obligated to the extent that the loss was caused by other than the negligence or dishonesty of the custodian.

- l. The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.
- m. In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurance company, the custodian shall promptly replace the securities or their value thereof and the value of any loss of rights or privileges resulting from the loss of securities.
- o. In the event that the custodian gains entry in a clearing corporation through an agent, there shall be an agreement between the custodian and the agent under which the agent shall be subject to the same liability for loss of custodied securities as the custodian; provided, however, that if the agent shall be subject to regulation under the laws of a jurisdiction which is different from the jurisdiction the laws of which regulate the custodian, the insurance commissioner of the state of domicile of the insurance company may accept a standard of liability applicable to the agent which is different from the standard of liability applicable to the custodian.
- p. The custodian shall provide written notification to the insurer's domiciliary commissioner if the custodial agreement with the insurer has been terminated or if one hundred percent of the account assets in any one custody account have been withdrawn. This notification shall be remitted to the insurance commissioner within three business days of the receipt by the custodian of the insurer's written notice of termination or within three business days of the withdrawal of one hundred percent of the account assets.

**It is recommended that the Company enter into a custodial agreement that meets the requirements of N.D. Admin. Code § 45-03-23-02 and that the agreement be approved by the Board of Directors.**

### **Claim Complaints**

N.D.C.C. § 26.1-04-03(10) requires that the Company adopt and implement reasonable standards for the prompt handling of written communications, primarily expressing grievances received by the Company from insureds or claimants. Currently, the Company does not have or maintain an internal complaints log that records all grievances received by the Company as required by N.D.C.C. § 26.1-04-03(10).

**It is recommended that the Company establish and maintain an internal complaints log that meets the requirements of N.D.C.C. § 26.1-04-03(10) for any complaints that are reported to the Company.**

## **FINANCIAL STATEMENTS**

The following statements reflect the financial condition of the Company as of December 31, 2014, as determined by this examination and its operating results for the year then ended.

**McLean McHenry Mutual Insurance Company**  
**Statement of Assets, Liabilities, and Surplus**  
**as of December 31, 2014**

**ASSETS**

**LEDGER ASSETS:**

Stocks	\$ 125,852
Real Estate	20,950
Checking Accounts	162,528
Cash on Deposit	2,172,908
Premiums in Course of Collection	75,224
Furniture and Fixtures	<u>5,596</u>

**TOTAL LEDGER ASSETS** **\$2,563,058**

**NONLEDGER ASSETS:**

Interest Due and Accrued on certificates of deposit and passbook savings	\$ 17,961
Market Value of Stocks over Book Value	<u>28,642</u>

**TOTAL NONLEDGER ASSETS** **\$ 46,603**

**DEDUCT ASSETS NOT ADMITTED:**

Furniture and Fixtures	<u>\$ (5,596)</u>
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**TOTAL NET ADMITTED ASSETS** **\$2,604,065**

**LIABILITIES**

Unpaid Losses	\$ 109,395
Unpaid Loss Adjustment Expense	2,083
Advance Premiums	19,819
Unearned Premium Reserve	541,770
Commission Due and Payable to Agents	30,325
Unpaid Taxes	7,692
Unpaid Salaries	3,500
Unpaid General Expenses	16,760
Reinsurance Premiums Due and Payable	17,093
Federal Income Tax Due	2,500
Liability and Equipment Breakdown Premiums Payable to Grinnell	<u>9,354</u>

**TOTAL LIABILITIES** **\$ 760,291**

**SURPLUS TO POLICYHOLDERS** **\$1,843,774**

**TOTAL LIABILITIES AND SURPLUS** **\$2,604,065**

**McLean McHenry Mutual Insurance Company**  
**Statement of Income and Disbursements**  
**as of December 31, 2014**

**INCOME:**

Gross Premium Income	\$1,076,523	
Less: Return Premiums	16,571	
Premiums for Reinsurance Ceded	201,104	
<b>NET PREMIUM INCOME</b>	<b>\$858,848</b>	
Dividends on Stocks	6,900	
Gross Rent from Company's Property	2,000	
Interest on Cash on Deposit	40,827	
Commissions and Fees Received on Equipment Breakdown & Liability Premiums	21,745	
Profit on Sale of Ledger Assets	815	
Other Income	593	
<b>TOTAL INCOME RECEIPTS</b>	<b>\$931,728</b>	

**DISBURSEMENTS:**

Gross Losses Paid and Incurred in 2014	\$372,465	
Gross Losses Paid in 2014 But Incurred in Prior Years	55,415	
Deduct: Salvage & Subrogation	6,850	
Reinsurance Recovered	0	
<b>NET LOSSES PAID</b>	<b>\$421,031</b>	
Claim Adjustment and Risk Review Expenses	25,000	
Commissions Paid to Agents	172,936	
Directors Fees and Expenses	11,750	
Salaries to Employees	85,013	
Printing, Stationary, and Office Supplies	7,977	
Rent and Rent Items	2,000	
Real Estate Expenses	6,903	
Taxes on Real Estate	296	
State and Local Insurance Taxes	18,295	
Insurance Department Licenses and Fees	877	
Payroll Taxes	8,136	
Federal Income Taxes	6,802	
Legal Fees and Auditing	1,725	
Travel and Travel Items	6,459	
Advertising	9,258	
Dues and Donations	6,114	
Equipment Purchased	5,823	
Insurance and Bonds	10,637	
Postage, Telephone, and Bank Charges	7,168	
Employee Relations and Welfare	17,950	
Data Processing Expenses	16,092	
Miscellaneous Expenses	8,423	
<b>TOTAL FUNDS DISBURSED</b>	<b>856,656</b>	
<b>Net Gain</b>		<b>\$75,072</b>

## COMMENTS ON THE FINANCIAL STATEMENTS

### Assets

#### Premiums in Course of Collection

Premiums in course of collection as determined by this examination consisted of the following items and amounts:

<u>Description</u>	<u>Company</u>	<u>Examination</u>
Assessments or premiums in course of collection	\$ 62,255	\$ 75,224
Total	\$ 62,255	\$ 75,224

The Company did not report its net deferred premiums correctly at December 31, 2014, per the Deferred Installment Policy Listing report. The net result of this error understated admitted assets and surplus by \$12,968.88.

**It is recommended that the Company report Deferred Premiums as shown in the “Deferred Installment Policy Listing” report.**

#### Cash on Deposit

At December 31, 2014, cash on deposit was determined to be in excess of the FDIC/NCUA deposit insurance limits of \$250,000 at three banking institutions. Per Bulletin 2010-2, North Dakota domestic insurers are allowed to report long-term certificates of deposit as cash as long as the aggregate amount of funds deposited with any single issuer does not exceed \$250,000.

**It is recommended that the Company keep deposits at any one banking institution within the deposit insurance limits.**

### Liabilities

#### Unpaid Losses

Unpaid Losses as determined by this examination consisted of the following items and amounts:

<u>Description</u>	<u>Company</u>	<u>Examination</u>
Case Reserves	\$ 94,553	\$ 104,008
Incurred But Not Reported (IBNR) Reserves	0	5,387
Total Unpaid Losses	\$ 94,553	\$ 109,395

The Company determines its unpaid claims liability at year end by reviewing and totaling all of its reported claims that have not yet been paid. The Company’s accounting system can generate a report that identifies all unsettled reported claims at year end. The Company should monitor claims development against this report to determine if initial case reserves were sufficient.

The Company also did not record a liability for incurred by not reported (IBNR) claims. IBNR claims are claims that occurred during a reporting period, but are not reported to the Company until after the financial statements are prepared for that reporting period. The Company's claims records showed there were eight IBNR claims during the five-year examination period. By dividing the total amount paid on these IBNR claims by five, the rolling five-year IBNR average can be established. This process was used to determine that the IBNR reserve should have been \$5,387 at year end.

**It is recommended that the Company use the APPS "Open Claims Report" as the starting point for establishing its unpaid loss figure. The Company should monitor claims development against the open claims report figures to determine if initial case reserves were sufficient. The Company should also combine a rolling five-year historical average of IBNR claims and add this to the unpaid claims figures at year end for reporting unpaid losses on the Annual Statement.**

Unearned Premium Reserve

Unearned Premiums as determined by this examination consisted of the following items and amounts:

<b>Description</b>	<b>Company</b>	<b>Examination</b>
Unearned Premium Reserve	\$555,288	\$ 541,770
Total	<u>\$ 555,288</u>	<u>\$ 541,770</u>

Members' premiums are not fully earned upon receipt by the Company. Unearned Premiums are the portion of the members' policies that have not yet been earned by the Company and are subject to refund if the member cancels their policy. Policy fees are fully earned upon receipt and should be excluded from the Unearned Premium Reserve calculation. Policy fees included in the Unearned Premiums Reserve at year end were \$13,518.

**It is recommended that the Company not include policy fees when determining its liability for unearned premiums.**

Expenses

Equipment Purchased and Data Processing Expenses

Equipment Purchased and Data Processing Expenses as determined by this examination consisted of the following items and amounts:

<b>Description</b>	<b>Company</b>	<b>Examination</b>
Equipment Purchased (or depreciation on same)	\$ 858	\$ 5,823
Data Processing Expenses	\$21,048	\$16,083
Total	<u>\$ 21,906</u>	<u>\$21,906</u>

The Company incorrectly expensed equipment that it purchased to the Data Processing Expenses account instead of to the Equipment Purchased account. Per the Annual Statement reporting instructions, the Data Processing Expenses account is only for software expenses and

technical support relating to computer software. The change was only a reclassification of expenses and did not affect the ending balances of Assets, Liabilities, or Surplus.

**It is recommended that the Company file its Annual Statement according to all applicable Annual Statement Instructions and statutory accounting practices and procedures.**

Surplus to Policyholders

Surplus to policyholders was determined by this examination to be \$1,832,128 or \$11,645 more than the amount reported by the Company in its 2014 Annual Statement. Adjustments to surplus are shown in the following schedule:

Description	Company	Examination	Increase or (Decrease) to Surplus
<u>Assets:</u>			
Assessments or premiums in course of collection	\$ 62,255	\$75,224	\$ 12,969
<u>Liabilities:</u>			
Unearned Premium Reserve	555,288	541,770	13,518
Unpaid Losses	94,553	109,395	(14,842)
Net Increase			<u>\$ 11,645</u>
Surplus to Policyholders as reported by Company	\$1,832,128		
Increase (Decrease) to Surplus from above	<u>11,645</u>		
Surplus to Policyholders per Examination	\$1,843,774		

## CONCLUSION

The financial condition of McLean McHenry Mutual Insurance Company, Turtle Lake, North Dakota, as determined by this examination is summarized as follows:

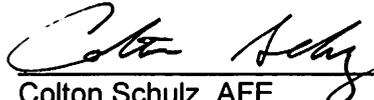
TOTAL ADMITTED ASSETS		<u>\$2,604,065</u>
Liabilities	\$ 760,291	
Surplus to Policyholders	<u>1,843,774</u>	
TOTAL LIABILITIES AND SURPLUS		<u>\$2,604,065</u>

During the five-year period under examination, admitted assets increased by \$741,492, liabilities increased by \$229,041, and surplus to policyholders increased by \$512,451.

The examiners express their appreciation for the courteous cooperation extended them during the course of this examination.

In addition to the undersigned, Chief Examiner Ed Moody, CFE, participated in this exam

Respectfully submitted,

  
Colton Schulz, AFE  
Examiner  
N.D. Insurance Department

## **COMMENTS AND RECOMMENDATIONS**

It is recommended that the Company review the job functions of the Manager and Secretary-Treasurer and develop procedures to reduce the fraud risk associated with having the same person performing both functions.

It is recommended that the Company document the review and approval of investment transactions made by its broker within its Board minutes at least quarterly per N.D. Admin. Code § 45-03-12-05(03) and that the Board approve the Company's investment guidelines at least annually by a formal resolution per N.D. Admin. Code § 45-03-12-05(4).

It is recommended that the Company's Board of Directors annually review and approve the conflict of interest statements and all disclosures.

It is recommended that the Company nonrenew the commercial policies written on risks inside the platted limits of incorporated cities at the end of each policy's current term and that the Company no longer write commercial properties inside the platted limits of an incorporated city in accordance with N.D.C.C. § 26.1-13-15.

It is recommended that the Company allocate the fixed fee paid to Grinnell Advisory Company between underwriting expenses and claims adjustment expenses based on the number of claims adjusted and risk reviews performed by Grinnell Advisory Company.

It is recommended that the Company properly post recordable transactions to the general ledger and that any accruals needed to comply with the Annual Statement reporting requirements be posted to the worksheet that documents the reconciliation of the general ledger trial balance to the Annual Statement.

It is recommended that the Company enter into a custodial agreement that meets the requirements of N.D. Admin. Code § 45-03-23-02 and that the agreement be approved by the Board of Directors.

It is recommended that the Company establish and maintain an internal complaints log that meets the requirements of N.D.C.C. § 26.1-04-03(10) for any complaints that are reported to the Company.

It is recommended that the Company report Deferred Premiums as shown in the "Deferred Installment Policy Listing" report.

It is recommended that the Company keep deposits at any one banking institution within the deposit insurance limits.

It is recommended that the Company use the APPS "Open Claims Report" as the starting point for establishing its unpaid loss figure. The Company should monitor claims development against the open claims report figures to determine if initial case reserves were sufficient. The Company should also combine a rolling five-year historical average of IBNR claims and add this to the unpaid claims figures at year end for reporting unpaid losses on the Annual Statement.

It is recommended that the Company not include policy fees when determining its liability for unearned premiums.

It is recommended that the Company file its Annual Statement according to all applicable Annual Statement Instructions and statutory accounting practices and procedures.