

Report of Examination of

**Central Mutual Insurance Company**  
Van Wert, Ohio

As of December 31, 2011

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Columbus, Ohio  
February 8, 2013

Honorable Mary Taylor  
Lt. Governor/Director  
State of Ohio  
Department of Insurance  
50 West Town Street  
3<sup>rd</sup> Floor – Suite 300  
Columbus, Ohio 43215

Dear Lt. Governor/Director:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

**Central Mutual Insurance Company**

an Ohio domiciled, mutual, property and casualty insurance company, hereinafter referred to as the “Company.”

**Scope of Examination**

The Department last examined the Company as of December 31, 2008. The Department’s current examination covers the period of January 1, 2009 through December 31, 2011.

The Department, as the coordinating state regulator of the insurance company subsidiaries of the Company, led the multi-state coordinated examination that included representatives from the state of Texas.

The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

For all years under examination, the Certified Public Accounting firm of Plante & Moran, PLLC provided an unqualified opinion on the Company’s financial statements based on Statutory Accounting Principles. The audited financial reports were reviewed during the examination.

## Management and Control

### Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

<b>Name</b>	<b>Principal Occupation</b>
Edward R. Buhl	Senior Vice President - Secretary, Central Mutual Insurance Company
Jeffrey L. Hanson	Chief Financial Officer, Central Mutual Insurance Company
Thomas B. Kearney	Chief Executive Officer, Flipdaddy's LLC
Ronald J. Kutella	Chairman, Craft Brewery and Hospitality Company
Rodger S. Lawson	Retired
Drew P. Maconachy	President, Maconachy Investigative Group
Edward J. Noonan	Chairman and Chief Executive Officer, Validus Holdings, Ltd.
F.W. Purmort, III	Chairman of the Board and President, Central Mutual Insurance Company
C. Allan Runser	Member and Attorney, Runser & Putman, LLC

## **Officers**

As of the examination date, the following principal executive officers were elected and serving in accordance with the Company's Bylaws:

<b>Name</b>	<b>Title</b>
F.W. Purmort, III	Chairman of the Board and President
Edward R. Buhl	Senior Vice President - Secretary
Thad R. Eikenbary	Vice President and Treasurer
James F. Glasser	Vice President
Michael P. Guth	Senior Vice President
Jeffrey L. Hanson	Chief Financial Officer
Cynthia M. Hurless	Vice President
Patrick J. Jackson	Vice President
Stephen K. Moore	Vice President
Timothy L Rauch	Vice President
Jana L. Ringwald	Vice President
Janet L. White	Vice President
John E. White	Vice President
Paul C. Woirol	Senior Vice President

## **Insurance Holding Company System**

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The Company is the ultimate controlling person in the holding company system. The Company owns 100% of the outstanding stock of All America Insurance Company ("All America"), an Ohio domiciled insurer. All America controls CMI Lloyds, a Texas domiciled insurer, through a trust agreement with 12 underwriters.

## **Territory and Plan of Operations**

The Company and All America participate in an intercompany reinsurance arrangement whereby all business acquired by the two companies is pooled, with losses and expenses prorated. The current participations are the Company, 84% and All America, 16%. CMI Lloyds has not written any business in a few years. It otherwise would cede 100% of its premiums into the pool under a reinsurance agreement and would retain no business for its own account.

The Company and All America underwrite both personal and commercial insurance coverages. Personal lines consist of private passenger auto and homeowners products and currently represent approximately 58% of total written premiums with the balance in commercial lines that consist of commercial multi-peril, workers' compensation, commercial auto liability and other commercial lines.

Business is distributed through approximately 400 independent agents in 18 states, predominantly in the South and Midwest. Regional offices are located in Alpharetta, Georgia; Waltham, Massachusetts; Van Wert, Ohio; and Irving, Texas.

During 2011, the largest states in terms of direct premium written were as follows: Texas, \$98.1 million (21.2%); Ohio, \$66.9 million (14.4%); North Carolina, \$59.9 million (12.9%); Georgia, \$49.8 million (10.7%); and Indiana, \$22.3 million (4.8%).

The table below illustrates the Company's 2011 direct and net premiums written, in thousands, by line of business:

<b>Line of Business</b>	<b>Direct</b>	<b>Assumed</b>	<b>Ceded</b>	<b>Net</b>	<b>Net %</b>
Homeowners multiple peril	\$125,036	\$ 259	\$ 34,537	\$ 90,758	24.2
Private passenger auto liability	94,387	0	16,474	77,913	20.7
Commercial multiple peril	80,176	17,954	30,314	67,816	18.0
Auto physical damage	73,356	2,528	12,860	63,024	16.8
Commercial auto liability	16,722	7,701	5,728	18,695	5.0
Other liability – occurrence	24,030	19	8,665	15,384	4.1
Workers' compensation	9,711	3,643	2,709	10,645	2.8
Products liability - occurrence	10,774	2,571	3,143	10,202	2.7
All other lines	<u>29,307</u>	<u>785</u>	<u>8,605</u>	<u>21,487</u>	<u>5.7</u>
<b>Total</b>	<b><u>\$463,499</u></b>	<b><u>\$35,460</u></b>	<b><u>\$ 123,035</u></b>	<b><u>\$375,924</u></b>	<b><u>100.0</u></b>

The Company reported the following operating percentages during the examination period:

	<b>2011</b>	<b>2010</b>	<b>2009</b>
Loss and loss adjustment expense ratio	79.4	86.5	74.8
Expense ratio	31.9	31.9	32.7
Policyholder dividends	<u>0.4</u>	<u>0.5</u>	<u>0.8</u>
Combined ratio	<u>111.7</u>	<u>118.9</u>	<u>108.3</u>

### **Reinsurance**

Joint reinsurance arrangements afford protection for the Company and its insurance affiliates. The largest net aggregate amount insured for any one umbrella risk, property risk, or casualty occurrence is \$1.5 million on a combined coverage basis. Excess of loss reinsurance affords recovery for \$10.5 million in excess of \$1.5 million per risk on property losses and umbrella claims, and \$10.5 million in excess of \$1.5 million on an occurrence basis for casualty claims. A casualty clash cover affords recovery for \$40 million in excess of \$12 million. In addition, property catastrophe reinsurance affords recovery in layers for 100% of \$165 million in excess of a \$15 million retention.

## Financial Statements

At December 31, 2011, differences exist between the annual statement prepared by the Company and the audited financial report – statutory basis, related to the adoption of SSAP No. 10R, *Income Taxes - A Temporary Replacement of SSAP No. 10*. In the audited financial report, the amount of additional admitted assets was presented as a change in accounting principle as a separate component on the statement of changes in policyholders' surplus. In the Company's annual statement, the change is reported as a change in net deferred income taxes.

At December 31, 2010, differences exist between the annual statement prepared by the Company and the audited financial report – statutory basis, related to the calculation of the current and deferred tax assets and liabilities. The deferred tax asset related to the net operating loss of the Company was not considered or reported as a nonadmitted asset in the annual statement. This nonadmitted asset was reflected in the audited financial statements and the resulting differences were reflected in the change in net deferred income taxes and change in nonadmitted assets on the statement of changes in policyholders' surplus.

On the annual statement prepared by the Company and on the audited financial report – statutory basis, the net effect of these adjustments were such that the statutory capital and surplus were not restated.

The financial condition and the results of its operations for the three-year period under examination as reported and filed by the Company with the Department are reflected in the following:

- Statement of Assets, Liabilities, Surplus and Other Funds
- Statement of Income
- Statement of Changes in the Capital and Surplus Account

**Statement of Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2011**

**Assets**

Bonds	\$ 670,586,889
Preferred stocks	26,183,106
Common stocks	227,703,624
Real estate occupied by the Company	50,272,907
Real estate held for the production of income	304,448
Cash, cash equivalents and short term investments	5,328,210
Other invested assets	<u>676,574</u>
Subtotal, cash and invested assets	981,055,758
Investment income due and accrued	14,661,728
Uncollected premiums in course of collection	28,566,347
Deferred premiums and installments booked but deferred	94,574,465
Amounts recoverable from reinsurers	6,641,091
Other amounts receivable under reinsurance contracts	5,040,000
Current federal income tax recoverable	595,186
Net deferred tax asset	29,314,890
Guaranty funds receivable or on deposit	479,173
Electronic data processing equipment	117,626
Receivable from affiliates	232,652
Equities and deposits in pools and associations	<u>1,771,418</u>
Total assets	<u>\$ 1,163,050,334</u>

**Statement of Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2011**

**Liabilities**

Losses	\$ 329,428,541
Loss adjustment expenses	122,426,684
Commissions payable	7,813,645
Other expenses	11,875,704
Taxes, licenses and fees	3,270,409
Unearned premiums	207,418,218
Advance premiums	3,388,325
Dividends declared and unpaid to policyholders	744,145
Ceded reinsurance premiums payable	3,256,935
Amounts withheld or retained by company for account of others	13,331,797
Provision for reinsurance	94,539
Derivatives	305,686
Reserve for bad faith claims	100,097
Reserve for escheats	<u>1,772,167</u>
Total liabilities	<u>705,226,892</u>

**Capital and Surplus**

Unassigned funds	<u>457,823,442</u>
Total capital and surplus	<u>457,823,442</u>
Total liabilities, capital and surplus	<u>\$ 1,163,050,334</u>

**Statement of Income**  
**As of December 31, 2011**

Premiums earned	\$ <u>393,370,372</u>
Losses incurred	288,299,916
Loss adjustment expenses incurred	23,644,777
Other underwriting expenses incurred	120,267,505
2009 private passenger auto escrow – North Carolina	<u>(313,350)</u>
Total underwriting deductions	<u>431,898,848</u>
Net underwriting gain (loss)	<u>(38,528,476)</u>
Net investment income earned	33,146,025
Net realized capital gains	<u>2,729,561</u>
Net investment gain	<u>35,875,586</u>
Net gain (loss) from premium balances charged off	(977,244)
Finance and service charges not included in premiums	2,782,113
Miscellaneous income	<u>604,857</u>
Total other income	<u>2,409,726</u>
Net income (loss) before federal income taxes and dividends to policyholders	(243,164)
Dividends to policyholders	<u>1,748,281</u>
Net income (loss) before federal income taxes	(1,991,445)
Federal income taxes incurred	<u>925,276</u>
Net income (loss)	<u>\$ (2,916,721)</u>

**Statement of Changes in the Capital and Surplus Account**  
(In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Capital and surplus, prior year end	\$467,679	\$500,607	\$483,087
Net income (loss)	(2,917)	(33,977)	(5,264)
Change in net unrealized capital gains (losses)	(3,156)	(210)	19,445
Change in net deferred income tax	36,369	3,027	432
Change in nonadmitted assets	(40,084)	(1,746)	2,675
Change in provision for reinsurance	(68)	(22)	232
Net change in capital and surplus	<u>(9,856)</u>	<u>(32,928)</u>	<u>17,520</u>
Capital and surplus, current year end	<u>\$457,923</u>	<u>\$467,679</u>	<u>\$500,607</u>

**Notes to Financial Statements**

**Investments**

The Company's investments were in compliance with ORC Section 3925.08 and valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

**Loss and Loss Adjustment Expense Reserves**

The Company's Board of Directors appointed Jeffrey L. Hanson, FCAS, MAAA, Chief Financial Officer, to render a Statement of Actuarial Opinion ("Opinion") on the pooled reserves. Mr. Hanson prepared an Actuarial Report supporting the Opinion in connection with the preparation of the Company's December 31, 2011 Annual Statement.

Thomas S. Botsko, ACAS, MAAA, the Department's Property and Casualty Actuary, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the pooled reserves. On the basis of his analysis, Mr. Botsko concluded the pooled reserves fall within a reasonable range of reserve estimates at December 31, 2011.

## Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2011, and is summarized as follows:

Total Admitted Assets	<u>\$1,163,050,334</u>
Liabilities	\$ 705,226,892
Capital and Surplus	<u>457,823,442</u>
Total Liabilities, Capital and Surplus	<u>\$1,163,050,334</u>

## Acknowledgement

Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: Jeffrey J. Ferris, AES, CFE, CISA; Ryan S. Gibson, CFE, FLMI; Aaron R. Hibbs, CFE, ChFC, CPA, FLMI; Leroy J. Moster, AES, CFE, CISA, CPA; and Zachary L. Wheatley, CPA.

Respectfully,



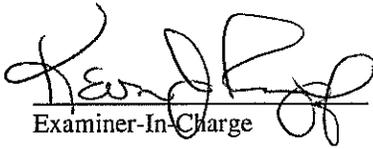
Kevin J. Rupp, CFE  
Examiner-in-Charge  
Ohio Department of Insurance



Jeffrey K. Ebert, CFE  
Assistant Chief Examiner  
Ohio Department of Insurance

**Verification**

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2011.

  
Examiner-In-Charge

2/28/13  
Date

  
Assistant Chief Examiner

2/28/13  
Date

State of Ohio  
County of Franklin

Personally appeared before me the above named, Kevin J. Rupp, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 28 day of February, 2013.

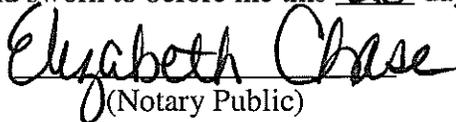


(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017  
My Commission Expires

State of Ohio  
County of Franklin

Personally appeared before me the above named Jeffrey K. Ebert, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 28 day of February, 2013.



(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2017  
My Commission Expires