

Report of Examination of

**Sonnenberg Mutual Insurance Company**  
Wooster, Ohio

As of December 31, 2011

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Columbus, Ohio  
October 19, 2012

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 Madam:

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

**Sonnenberg 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, 2006. The Department’s current examination covers the period of January 1, 2007 to and including December 31, 2011.

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 KPMG, LLP 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:

<u>Name</u>	<u>Principal Occupation</u>
Ronald E. Holtman	Partner, Logee, Hostetler, Stutzman and Lehman, LLC
Eddie L. Steiner	President and Chief Executive Officer, Commercial and Savings Bank Corporation
C. Michael Reardon	President, United Titanium, Inc.
John P. Murphy Jr.	President and Secretary, Western Reserve Group
Kevin W. Day	Executive Vice President Claims, Western Reserve Group
Robert P. Bogner	Secretary and Treasurer, Bogner Construction Company
Kenneth L. Vagnini	National Account Manager, PSC Metals, Inc.

### Officers

As of the examination date, the following officers were serving in the designated position:

<b>Name</b>	<b>Title</b>
John P. Murphy Jr.	President and Secretary
Kevin W. Day	Executive Vice President Claims
Gregory A. Brunn	Vice President Marketing and Underwriting
Michael A. Shutt	Treasurer
Gregory J. Owen	Vice President Information Technology

## **Insurance Holding Company System**

The Company, along with Lightning Rod Mutual Insurance Company ("Lightning Rod") and Western Reserve Mutual Casualty Company ("Western Reserve"), are members of a holding company system as defined under Section 3901.32 of the ORC by virtue of the common management and employees. Although not a legal entity, the three companies operate under the name of the Western Reserve Group ("WRG"). As mutual insurance companies, each entity is controlled by its respective policyholders.

## **Territory and Plan of Operations**

The Company is licensed to operate in the states of Ohio and Indiana. The three members of the Western Reserve Group ("WRG") specialize in underwriting private passenger automobile and homeowner's coverages in rural and suburban Ohio and Indiana. WRG also offers commercial auto, general liability, inland marine, fire and allied lines, commercial multiple peril, farm owners and workers' compensation coverage. Personal and commercial umbrella coverages are also offered. WRG focuses primarily on automobile and homeowners insurance, which comprises approximately 71% of total written premium. Approximately 71% of all premium revenue is generated in the state of Ohio with the remaining 29% produced in the state of Indiana. The Group sells its insurance products through some 400 independent agents.

## **Reinsurance**

### **Intercompany Pooling Agreement**

The Company is party to an intercompany Reinsurance Pooling Agreement. Under the terms of the agreement, Lightning Rod, Western Reserve and the Company share the results of underwriting operations in specified quota share percentages. The current pool participation is distributed as follows: the Company, 5%, Lightning Rod, 55%, and Western Reserve, 40%.

### **Assumed Reinsurance**

The Company does not assume reinsurance other than through the Reinsurance Pooling Agreement.

### **Ceded Reinsurance**

The Company, Lightning Rod and Western Reserve maintain joint reinsurance programs. Per risk excess of loss reinsurance provides recovery on property losses above \$750,000 up to \$8,000,000. Catastrophe reinsurance is maintained for limits of 95% of up to \$45,000,000 in excess of \$5,000,000 per occurrence. In 2011, the Group also purchased a catastrophe aggregate excess of loss treaty for protection from weather frequency that included a \$5,000,000 limit in excess of a Group retention of \$12,000,000 of aggregated weather events for all net weather events of \$500,000 and greater. Excess of loss reinsurance provides recovery

on casualty losses above \$750,000 up to \$5,000,000 for each occurrence. An excess of loss workers' compensation reinsurance treaty provides \$5,000,000 excess of \$5,000,000 of ultimate net loss each loss occurrence. Casualty umbrella quota share reinsurance provides for limits up to \$5,000,000 with a 10% retention of the first \$2,000,000. In addition, the Group may submit for special acceptance any policy excluded by this agreement. Equipment breakdown coverages under Businessowners and commercial package policies are reinsured with a 100% quota share reinsurance agreement up to \$25,000,000 for any one occurrence. Equipment breakdown coverages insured under Farmowners multiperil policies are reinsured for 100% of losses not to exceed \$20,000,000 on any one risk. Employment practices liability reinsurance provides coverage of 100% of losses including defense costs, not to exceed \$250,000 each occurrence, subject to the annual aggregate policy limit of \$250,000 or up to \$1,000,000 if accepted by the reinsurer.

### Significant Operating Results

The Company reported the following net underwriting results during the examination period, reported in thousands.

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Premiums earned	<u>\$ 7,885</u>	<u>\$ 7,523</u>	<u>\$ 7,073</u>	<u>\$ 7,003</u>	<u>\$ 7,027</u>
Losses incurred	5,147	4,563	4,273	4,335	4,124
Loss adjustment exp. incurred	737	739	735	799	733
Underwriting expenses incurred	<u>2,769</u>	<u>2,773</u>	<u>2,604</u>	<u>2,343</u>	<u>2,457</u>
Net underwriting loss	<u>\$ (768)</u>	<u>\$ (552)</u>	<u>\$ (539)</u>	<u>\$ (474)</u>	<u>\$ (287)</u>

### Financial Statements

The financial condition and the results of its operations for the period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors, 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**

Bonds	\$ 12,065,280
Preferred stocks	294,011
Common stocks	5,071,483
Cash, cash equivalents, and short-term investments	403,141
Other invested assets	<u>459,688</u>
Subtotal, cash and invested assets	18,293,603
Investment income due and accrued	124,806
Uncollected premiums and agents' balances in course of collection	306,254
Amounts recoverable from reinsurers	87,664
Current federal and foreign income tax recoverable	34,213
Net deferred tax asset	237,109
Receivables from parent, subsidiaries and affiliates	<u>139,260</u>
Total admitted assets	<u>\$ 19,222,909</u>

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

Losses	\$ 2,536,568
Loss adjustment expenses	495,500
Commissions payable, contingent commissions and other charges	207,342
Other expenses	215,904
Taxes, licenses and fees	104,410
Unearned premiums	3,801,759
Advance premium	43,301
Ceded reinsurance premiums payable	27,394
Amounts withheld or retained by company for accounts of others	563,150
Provision for reinsurance	<u>26,640</u>
Total liabilities	8,021,968
Surplus from SSAP No. 10R	174,829
Unassigned funds (surplus)	<u>11,026,112</u>
Total surplus and other funds	<u>11,200,941</u>
Total liabilities, surplus and other funds	<u>\$ 19,222,909</u>

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

Premiums earned	\$ <u>7,884,960</u>
Losses incurred	5,146,685
Loss adjustment expenses incurred	736,889
Other underwriting expenses incurred	<u>2,768,986</u>
Total underwriting deductions	<u>8,652,560</u>
Net underwriting loss	<u>(767,600)</u>
Net investment income earned	560,321
Net realized capital gains	<u>110,253</u>
Net investment gain	<u>670,574</u>
Net loss from agents' or premium balances charged off	(7,037)
Finance and service charges not included in income	135,931
Other income	<u>1,568</u>
Total other income	<u>130,462</u>
Net income before federal income taxes	33,436
Federal income taxes incurred	<u>(68,023)</u>
Net income	<u>\$ 101,459</u>

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital and surplus, beginning of the year	<u>\$11,163</u>	<u>\$10,781</u>	<u>\$10,025</u>	<u>\$11,200</u>	<u>\$10,710</u>
Net income (loss)	101	182	217	(305)	392
Change in net unrealized capital gains (losses)	(146)	218	431	(807)	81
Change in non-admitted assets	(11)	(1)	(2)	(2)	0
Change in provision for reinsurance	0	0	34	(61)	0
Agg. W/I for gains and (losses) in surplus	175	0	(29)	0	(13)
Other gains (losses) in surplus	<u>(81)</u>	<u>(17)</u>	<u>105</u>	<u>0</u>	<u>30</u>
Change in surplus during the year	<u>38</u>	<u>382</u>	<u>756</u>	<u>(1,175)</u>	<u>490</u>
Capital and surplus, end of the year	<u>\$11,201</u>	<u>\$11,163</u>	<u>\$10,781</u>	<u>\$10,025</u>	<u>\$11,200</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 William D. Hansen, FCAS, MAAA, of Oliver Wyman Actuarial Consulting, Inc., to render the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Hansen 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, Chief Property & Casualty Actuary of the Department, reviewed the actuarial report provided by Mr. Hansen. Based on his review, Mr. Botsko determined that the loss and loss adjustment expense reserves presented in the Company's 2011 Annual Statement are reasonably stated.

## 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 Assets	<u>\$ 19,222,909</u>
Liabilities	8,021,968
Capital and Surplus	<u>11,200,941</u>
Total Liabilities, Capital and Surplus	<u>\$ 19,222,909</u>

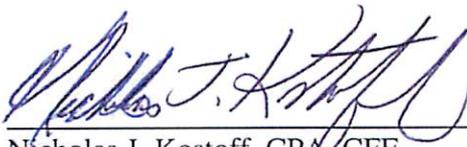
## Subsequent Events

There have been no events subsequent to the examination date which would have a material effect on the financial condition of the Company.

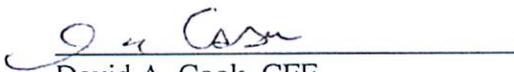
## Acknowledgement

In addition to the undersigned, Jeffrey Ferris, AES, CFE, CISA; David Finkler, CPA, CFE; Louis Radecky, CPA (Inactive), CFE; Thomas Botsko, ACAS, MAAA; and Bradley Schroer, of the Department, participated in this examination.

Respectfully,



Nicholas J. Kostoff, CPA, CFE  
Examiner-In-Charge  
Office of Risk Assessment  
Ohio Department of Insurance



David A. Cook, CFE  
Assistant Chief Examiner  
Office of Risk Assessment  
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.

[Signature] 10/25/12  
Examiner-In-Charge Date

[Signature] 10/25/12  
Assistant Chief Examiner Date

State of Ohio

County of Franklin

Personally appeared before me the above named Nicholas J. Kostoff 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/her knowledge and belief.

Subscribed and sworn to before me this 25 day of October, 2012.

[Signature]  
(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 David A. Cook 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/her knowledge and belief.

Subscribed and sworn to before me this 25 day of October, 2012.

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