

REPORT ON EXAMINATION OF  
FARMERS MUTUAL OF TENNESSEE  
KNOXVILLE, TENNESSEE

RECEIVED

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Dept. of Commerce & Insurance  
Company Examinations

AS OF  
DECEMBER 31, 2011

THE DEPARTMENT OF COMMERCE AND INSURANCE  
STATE OF TENNESSEE  
NASHVILLE, TENNESSEE

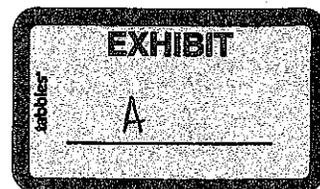


TABLE OF CONTENTS

<u>ITEM</u>	<u>PAGE</u>
SALUTATION .....	1
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY.....	2
CHARTER AND BYLAWS.....	3
CORPORATE RECORDS.....	4
MANAGEMENT AND CONTROL.....	4
AFFILIATED COMPANIES.....	6
FIDELITY BOND AND OTHER INSURANCE .....	7
RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS .....	8
TERRITORY.....	8
PLAN OF OPERATION .....	8
MARKET CONDUCT ACTIVITIES .....	9
GROWTH OF THE COMPANY .....	10
LOSS EXPERIENCE.....	10
REINSURANCE.....	10
ACCOUNTS AND RECORDS.....	11
STATUTORY DEPOSITS.....	11
COMMITMENTS AND CONTINGENCIES .....	11

SUBSEQUENT EVENTS.....	12
FINANCIAL STATEMENT .....	13
RECONCILIATION OF CAPITAL AND SURPLUS FOR THE PERIOD UNDER EXAMINATION.....	16
ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION.....	17
COMMENTS AND RECOMMENDATIONS.....	18
CONCLUSION.....	19
AFFIDAVIT .....	20
ORGANIZATIONAL CHART.....	21

Nashville, Tennessee  
February 8, 2013

Honorable Julie Mix McPeak  
Commissioner of Commerce and  
Insurance  
State of Tennessee  
500 James Robertson Parkway  
Nashville, Tennessee 37243

Dear Commissioner:

In accordance with the Tennessee Insurance Laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners ("NAIC"), a financial examination has been made of the affairs and condition of

FARMERS MUTUAL OF TENNESSEE  
903 NORTH HALL OF FAME DRIVE  
KNOXVILLE, TENNESSEE 37917

hereinafter generally referred to as the "Company", and a report thereon is submitted as follows:

#### SCOPE OF THE EXAMINATION

The Company was last examined as of December 31, 2006, by the State of Tennessee Department of Commerce and Insurance ("TDCI"). The current financial examination covered the intervening period to and included the close of business on December 31, 2011. Material subsequent events and transactions deemed pertinent will be described in this report.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook and the State of Tennessee Insurance Statutes. The Handbook required planning and performing an examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also included

assessments of 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 Tennessee statute and regulations.

The examination was called as of May 23, 2011. All original books and records were kept at 903 North Hall of Fame Drive, Knoxville, Tennessee 37215.

Our full scope examination considered all Company accounts and activities in accordance with the risk-focused examination process. The examination included a review of workpapers prepared by HG&A Associates, the Company's independent auditors, in their examination of the Company's accounts for the year ended December 31, 2011.

### COMPANY HISTORY

The Company was incorporated on June 19, 1913 and commenced business on July 12, 1913, under the statutes of the State of Tennessee, as Farmers Mutual Fire Insurance Company of Knox County, Tennessee. On May 17, 1973, the Charter of Incorporation of the Farmers Mutual Fire Insurance Company of Tennessee was certified by the Secretary of State of Tennessee. The Department of Insurance issued a Certificate of Authority on May 18, 1973, which authorized the Company to commence the business of insurance as a state mutual fire insurance company.

At the close of business on June 30, 1973, the Company reinsured the unearned premiums and all liabilities of the Farmers Mutual Fire Insurance Company of Knox County and assumed title to all assets of said Company. The Company then proceeded with operations on July 1, 1973, and filed a financial statement as of the same date.

In 1991, a request for conversion from a state mutual fire insurance company, governed by Title 56, Chapter 21, Tennessee Code Annotated, to a mutual insurance company, governed by Title 56, Chapter 19, Tennessee Code Annotated, was submitted. The request was approved by the TDCI in October, 1991. An amended and restated Charter was submitted to the State of Tennessee in December 1991. The new Charter was approved December 20, 1991, by the TDCI. Subsequently, in June 1992, the amended and restated Charter was filed with the Secretary of State of Tennessee and with the Register of Deeds, Knox County, Tennessee. The new Charter included the following

changes:

- The name of the Corporation was changed to Farmers Mutual of Tennessee
- The Corporation became the successor to and assumed all assets and liabilities of the Farmers Mutual Fire Insurance Company of Tennessee

A Certificate of Authority, with an effective date of June 10, 1992, was issued by the TDCI on July 23, 1992.

In January, 2002, the policyholders of Farmers Mutual Fire Insurance Company of Sumner County approved a plan of merger with the Company. The members of the Company then voted to approve said merger at their annual meeting held on March 9, 2002. The completed articles of merger were approved by the Commissioner of the TDCI on March 27, 2002 and the merger became effective on April 1, 2002.

Under the mutual corporate structure, each insured was a member of the Company by virtue of holding an active policy. In the event of liquidation and dissolution of the Company the balance of all money and other property remaining after the payment of all debts and obligations of the Company would be distributed to its members consistent with the Tennessee Code Annotated Title 48, Chapter 64 for nonprofit corporations.

There have been no regulatory actions noted for the Company since the prior examination was made as of December 31, 2006.

### CHARTER AND BYLAWS

#### Charter:

During the period of examination, the Charter was amended on November 27, 2007. The corporation was and is currently a mutual benefit corporation organized to engage in and carry on the business of a mutual insurance company other than life, pursuant to State of Tennessee Annotated Code Title 56, Chapter 19.

The Charter recites general and specific powers of the Company in detail. The Charter, as currently amended, was inspected and found to have been duly issued and properly recorded.

Bylaws:

The bylaws were reviewed and found to contain key provisions noted in most insurance companies. The bylaws may be amended or repealed, or new bylaws may be made and adopted by a majority of the Board of Directors at a regular or special meeting of the Board. The bylaws of the Company in effect at December 31, 2011 were last amended on November 21, 2000 in order to stipulate that the number of directors serving can be increased or decreased by action of the Board of Directors subject to the constraints set forth in the Charter.

CORPORATE RECORDS

The minutes of the meetings of the members, directors and board committees were reviewed for the period under examination. Documenting compliance and company support, the minutes adequately reflected the acts of the Board of Directors.

MANAGEMENT AND CONTROL

The Company was a not-for-profit mutual insurance company. The primary control of the Company was vested in its policyholders. The policyholders of the Company constituted its membership. The membership of the Company consisted of persons or organizations having insurance therein who elected a Board of Directors to manage the business and affairs of the Company. The annual meeting of members was held on the second Saturday in March of each year. One-twentieth of the members entitled to vote, represented in person or by proxy, constitutes a quorum at the meetings of members.

Board of Directors:

The business and affairs of the Company was managed by the Board of Directors or by such Executive, or other Committees as the Board of Directors may establish. The Directors were elected at the annual meeting of the members. At no time shall the number of directors be greater than eleven or less than six. The Company's Board of Directors, at December 31, 2011, were as follows:

<u>Name</u>	<u>Address</u>	<u>Occupation</u>
Stephen E. Babelay	Knoxville, TN	Nurseryman & Farmer
J. Randall Hodges	Knoxville, TN	Securities Advisor, Fountain Financial Group

Teresa J. Newby	Knoxville, TN	Partner, McMurry and Company CPAs
Brian S. Newkirk	Knoxville, TN	Farmer
Earl R. Ratledge	Knoxville, TN	Securities Advisor, H.D. Vest Investment Services
J. Leslie Spitzer*	Corryton, TN	Retired, Knoxville Utilities Board
James R. Wallenhorst	Christiania, TN	Retired, The Farmers Group
Rufus B. "Gordo" Watson	Maryville, TN	President, Farmers Mutual of Tennessee
William K. Dunn	Knoxville, TN	Marketing

\* Chairman

Committees:

A majority of the Board of Directors may by resolution designate two or more directors to constitute an Executive Committee. Said committee, to the extent resolved by the Board, shall have and may exercise all the authority of the Board of Directors in the management of the Company. The following directors were serving on the Executive Committee at December 31, 2011:

J. Leslie Spitzer  
Earl R. Ratledge  
Brian Newkirk  
Teresa Newby  
Rufus B. "Gordo" Watson

At December 31, 2011, other established committees of the Board of Directors and their respective members were as follows:

Audit Committee

Stephen E. Babelay  
J. Randall Hodges  
Teresa J. Newby  
James R. Wallenhorst

Building Committee

Stephen E. Babelay  
Brian S. Newkirk  
Rufus B. "Gordo" Watson

Governance Committee

William K Dunn  
Rufus B. "Gordo" Watson  
Brian S. Newkirk

Investment Committee

J. Randall Hodges  
Earl R Ratledge  
J. Leslie Spitzer

Earl R. Ratledge

Rufus B. "Gordo" Watson

Nominating Committee

Stephen E. Babelay

William K. Dunn

J. Randall Hodges

Officers:

The officers of the Company consisted of a President, a Secretary, a Treasurer, and such Vice Presidents, Assistant Secretaries, Assistant Treasurers and other officers as shall from time to time be elected by the Board of Directors at its regular meeting following the annual meeting of members. Any two or more offices may be held by the same person, except the offices of President and Vice President, and President and Secretary. The Officers of the Company, at December 31, 2011, were as follows:

<u>Name</u>	<u>Office Held</u>
Rufus B. "Gordo" Watson	President
Earl R. Ratledge	Vice President
Brian S. Newkirk	Secretary & Treasurer
James F. Zwolinski	Assistant Treasurer

Conflict of Interests:

All directors and officers of the Company were required to complete an Annual Conflict of Interest Statement. The statements signed by the Company's directors and officers, for the period under examination, were reviewed. No conflicts were disclosed.

Pecuniary Interest:

A review of the Company's compliance with Tenn. Code Ann. § 56-3-103 found no director or officer of the Company had pecuniary interest in the investment or disposition of Company funds.

AFFILIATED COMPANIES

The Company was a member and ultimate controlling entity in a holding company established in March 1996. The Company owned 100% of Farmers Mutual Agency ("FMA"), an insurance agency.

The following agreement between the Company and its affiliate was in effect at December 31, 2011:

Services Agreement:

The Company entered into a Services Agreement with FMA effective August 1, 1997. Under the terms of the agreement the Company agreed to provide all office space, office equipment, supplies, clerical help and other support services to FMA. As consideration for these services, FMA agreed to pay the Company pro-rata share of the expenses incurred by the Company in providing these services. Additionally, the Company provided payroll and accounting services for FMA, which was required for the payment of agents' commissions. FMA reimbursed the Company 100% of all such payroll expenses, including payroll taxes.

FIDELTY BOND AND OTHER INSURANCE

The following was a summary of the insurance maintained by the Company at December 31, 2011:

<u>Type or Class of Coverage</u>	<u>Limits</u>
Commercial Property	\$333,484 - home office building \$147,526 - personal property
Commercial General Liability	\$2,000,000 - general aggregate \$1,000,000 - personal and advertising injury \$1,000,000 - complete operations \$1,000,000 - each occurrence limit \$300,000 - damage to premises rented
Commercial Crime	\$500,000 - employee theft
Commercial Inland Marine	\$500,000 - accounts receivable
Business Automobile	\$1,000,000 - liability \$2,000 - medical payments \$1,000,000 - uninsured motorists \$1,000,000 - underinsured motorists
Excess Liability – umbrella	\$2,000,000 - each occurrence
Workers' Compensation	\$2,000,000 – aggregate
Employers Liability	\$500,000 - each accident \$500,000 - disease – each accident \$500,000 - disease – policy limit
Directors' and Officers'	\$5,000,000 - each claim and in the aggregate

Directors' and Officers' Liability	\$5,000,000 - each claim and in the aggregate
Agents Errors and Omissions	\$2,000,000 - each claim and in the aggregate
Employment Practices Liability	\$2,000,000 - each claim and in the aggregate

The fidelity coverage was in excess of the suggested minimum amount per the NAIC Financial Condition Examiners Handbook. All of the above insurance policies were written by companies licensed to write in Tennessee.

### RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

The Company made available life insurance, long-term disability and medical coverage to eligible employees. Additionally, all full-time employees were eligible to participate in the Company's retirement plan. The plan consisted of a qualified defined contribution profit sharing plan which was established in 1986. This plan was amended in 1998 by adding a salary reduction feature (401k). Contributions were determined annually based upon the Company's financial results. The annual contribution would be at the discretion of the Board of Directors, but cannot exceed 15% of employee compensation.

### TERRITORY

The Company was licensed in Tennessee as a property and casualty insurance company, and writes business only in the State of Tennessee. The Certificate of Authority issued by the State of Tennessee was inspected and found to be in force both at the time of examination and inspection.

### PLAN OF OPERATION

The Company wrote fire, allied lines, farm owners multiple peril, homeowners multiple peril, commercial multiple peril, other liability, and burglary and theft coverages. Business was produced by 83 independent agencies, having formal contracts with the Company, and two home office agents, operating under the supervision of the Company's President. Additionally, there were 15 Tennessee County Mutuals writing business through the Company under agency contracts. The independent agencies produce approximately 72% of the Company business with no single agency producing more than 5%.

During the period under review and through the date of this report, all underwriting and pricing was performed in the home office and was subject to the underwriting rules adopted by the Company and issued in accordance with approved rates. The Company issues only non-assessable policies. New policies, policy endorsements and renewals were direct billed. Dividends may be paid to policyholders from unassigned surplus; however, no dividends were paid during the period under examination. The adjustment of claims was handled by Company employees and independent adjusters. During the year of 2011, claims adjustments by the Company's employees were approximately 60% of the total claims. The largest net amount at risk by the Company in any one risk was \$200,000.

### MARKET CONDUCT ACTIVITIES

#### Underwriting

The Company's in-house underwriting manuals were reviewed. When new manuals and changes were posted, brokers were notified by mail and through software updates. No instances of unfair competition or deceptive acts were noted.

#### Policy Rate and Form Filings

No rate increases were enacted during the period of the examination. Subsequent to the exam date, the Company submitted and received approval for a rate increase effective April 1, 2012. Policy form filings were reviewed and compared to active insurance policies examined during the underwriting portion of the examination without exception.

#### Claims Review

A claims sample was reviewed. Claims were paid in accordance with policy provisions and settlements were made upon receipt of proper evidence of the liability.

#### Advertising

In the review of Company advertising, materials included print, internet and radio specimens. A sample was reviewed and complied with Tenn. Code Ann. § 56-8-104.

#### Privacy of Non-Public Personal Information

The Company does not have a privacy statement. It appears the Company has not complied with Tenn. Comp. R. & Reg., 0780-1-72 with respect to the privacy of non-public personal information.

### GROWTH OF THE COMPANY

The following comparative data reflected the growth of the Company for the period under review (\$000's omitted)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Admitted assets	19,772	18,662	19,482	18,997	18,532
Total liabilities	5,917	5,372	5,744	5,273	5,527
Surplus	13,854	13,290	13,738	13,724	13,004
Net underwriting gain (loss)	1,769	299	(189)	(1,002)	(1,299)
Net investment gain (loss)	681	116	554	570	628
Net income	1,678	128	274	(239)	(546)

### LOSS EXPERIENCE

The following comparative data reflected the loss experience of the Company for the period under review (\$000's omitted)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Earned Premiums	6,178	6,197	6,232	6,326	6,519
Losses and LAE Incurred	2,274	3,717	4,166	4,949	5,289
Net Loss Ratio	36.81%	59.98%	66.85%	78.23%	81.13%
Other Underwriting Expenses	2,134	2,180	2,254	2,378	2,529
Combined Ratio	71.35%	95.16%	103.02%	115.82%	119.93%

### REINSURANCE

The Company utilized various reinsurance agreements with high quality reinsurers to mitigate both severity and frequency of loss events. The Company maintained excess of loss coverage on property and casualty risks of \$400,000 in excess of the \$100,000 retention. Also, the Company had catastrophe excess coverage and aggregate excess of loss coverage. The Company's principal reinsurers were Farmers Mutual Hail Insurance Company of Iowa, Odyssey American Reinsurance Corp., Platinum Underwriters Reinsurance, Inc., and Lloyd's, London.

Additionally, the Company assumed a small amount of proportional and excess property reinsurance from several Tennessee county mutual fire insurance companies. The Company ceded this business, on a quota share basis, to Farmers Mutual Hail of Iowa.

The Company used BMS Vision Reinsurance as its reinsurance intermediary.

### ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including verification of postings, extensions and footings. Accounting records conformed to generally accepted insurance accounting practices and indicated the Company's operations during the period under examination and the status of the Company at the date of examination.

The Company was audited annually by HG&A Associates, Knoxville, Tennessee. No violations were noted with respects to Tenn. Comp. R. & Reg., 0780-1-65-.07(3).

The Company's Risk-Based Capital Report was reviewed and found to be in compliance with Tenn. Code Ann. § 56-46-101, et seq.

### STATUTORY DEPOSITS

The Company maintained the following deposit at December 31, 2011, for the benefit of all policyholders, claimants and creditors of the Company:

<u>Where Deposited And Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Tennessee - Federal Home Loan Bank 4.630%, Due 06/11/2012	\$275,000	\$274,420	\$291,896

The above deposit was verified by direct correspondence with the regulating jurisdiction.

### COMMITMENTS AND CONTINGENCIES

From the examination data made available, no financially material commitments

and contingencies were reported by the Company or its auditors besides matters arising out of the normal course of business.

#### SUBSEQUENT EVENTS

A rate increase was submitted and approved by TDCI in January 2012. The effective date of the increase was April 1, 2012.

In the fall of 2012, the Company began building a new office building to replace the existing office. Completion of the project should be done in the spring of 2013. The Company plans to use annual installment payments from surplus to pay for this project.

## FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of revenue and expenses at December 31, 2011, together with a reconciliation of reserves and unassigned funds for the period under review, as established by this examination:

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$ 7,952,096	\$ 0	\$ 7,952,096
Preferred stocks	831,753		831,753
Common stocks	3,484,912	30,700	3,454,212
Real estate			
Properties occupied by the company	365,608		365,608
Properties held for the production of income	108,818		108,818
Properties held for sale	119,101		119,101
Cash, cash equivalents and short term investments	1,653,253		1,653,253
Receivables for securities	100,000		100,000
Subtotals, cash and invested assets	<u>14,615,541</u>	<u>30,700</u>	<u>14,584,841</u>
Investment income due and accrued	96,288		96,288
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	546,839		546,839
Deferred premiums, agents' balances and installments booked but deferred	694,230		694,230
Amounts recoverable from reinsurers	1,734,198		1,734,198
Current federal and foreign income tax recoverable and interest thereon	93,658		93,658
Net deferred tax asset	372,100		372,100
Electronic data processing equipment and software	338,068		338,068
Furniture and equipment	59,759	59,759	0
Receivables from parent, subsidiaries and affiliates	4,600		4,600
Aggregate write-ins for other than invested assets:			
Overpayment on Reinsurance Contract refundable	66,837		66,837
Total assets	<u>\$18,622,118</u>	<u>\$90,459</u>	<u>\$18,531,659</u>

LIABILITIES, CAPITAL AND SURPLUS

Losses	\$ 252,014
Reinsurance payable on paid losses and LAE	819,679
Loss adjustment expenses	88,711
Commissions payable, contingent commissions and other similar charges	33,847
Other expenses	170,308
Taxes, licenses and fees	23,407
Net deferred tax liability	24,719
Unearned Premiums	3,663,148
Advance Premium	212,403
Ceded reinsurance payable	211,730
Rounding	27,408
Total liabilities	<u>5,527,374</u>
Unassigned funds	<u>13,004,285</u>
Total capital and surplus	<u>13,004,285</u>
Total liabilities, capital and surplus	<u>\$18,531,659</u>

## STATEMENT OF INCOME

### Underwriting Income

Premium earned		\$ 6,519,975
Deduction:		
Losses incurred	\$4,905,353	
Loss adjustment expenses incurred	384,910	
Other underwriting expenses incurred	<u>2,529,110</u>	
Total underwriting deductions		<u>7,819,373</u>
Net underwriting gain (loss)		<u>(1,299,398)</u>

### Investment Income

Net investment income earned	491,156	
Net realized capital gains (loss)	<u>136,865</u>	
Net investment gain (loss)		<u>628,021</u>

### Other Income

Net gain (loss) from agents' or premium balances charged off	<u>(1,029)</u>	
Total other income		<u>(1,029)</u>
Net income before federal income taxes		(672,406)
Federal income taxes incurred		<u>(126,504)</u>
Net income (loss)		<u>\$ (545,902)</u>

RECONCILIATION OF CAPITAL AND SURPLUS FOR THE PERIOD UNDER EXAMINATION

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Capital and surplus December 31 previous year	\$12,036,322	\$13,854,406	\$13,290,395	\$13,737,825	\$13,723,891
Net income (loss)	1,677,902	127,513	274,388	(239,121)	(545,902)
Change in net unrealized capital gains or (losses)	153,766	(697,285)	176,518	278,638	(190,763)
Changed in nonadmitted assets	(20,789)	5,761	(3,476)	(53,451)	17,059
Paid in capital					
Paid in surplus					
Aggregate write ins	7,205				
Capital and surplus December 31 current year	<u>\$13,854,406</u>	<u>\$13,290,395</u>	<u>\$13,737,825</u>	<u>\$13,723,891</u>	<u>\$13,004,285</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS  
RESULTING FROM EXAMINATION

During the period covered by this examination, there were no changes in the financial statement.

## COMMENTS AND RECOMMENDATIONS

### Recommendations:

The Company should adopt and provide a privacy statement to all policyholders as defined in Tenn. Comp. R. & Reg., 0780-1-72 with respect to the privacy of non-public personal information.

## CONCLUSION

The customary insurance examination practices and procedures, as established by the NAIC, have been utilized in connection with the verification and valuation of assets and the determination of liabilities in the financial statement of this report.

In such manner, it was determined that, as of December 31, 2011, the Company had net admitted assets of \$18,531,659 and liabilities, exclusive of capital and surplus, of \$5,527,374. Thus, there existed for the additional protection of the policyholders, the amount of \$13,004,285 in the form of statutory reserves and unassigned funds.

In addition to the undersigned, Rebecca Walker, State of Tennessee, participated in the work of this examination.

Respectfully submitted,



Brian H Sewell, CFE  
Examiner-in-Charge  
State of Tennessee  
Southeastern Zone, NAIC

AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Farmers Mutual of Tennessee dated March 6, 2013, and made as of December 31, 2011, on behalf of the TDCI. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

*Brian H Sewell*

Brian H. Sewell, CFE  
Examiner-in Charge  
State of Tennessee  
Southeastern Zone, NAIC

Subscribed and sworn to before me this

6<sup>th</sup> day of March, 2013

Notary B McOne

County Hamilton

State Tennessee

Commission Expires 2-15-15





**FARMERS MUTUAL**  
OF TENNESSEE

P.O. Box 3428 • Knoxville, TN 37927 • (865) 523-5153  
www.fmtinsurance.com

April 1, 2013

James E. York, Jr.  
Insurance Examinations Director  
The State of Tennessee  
Department of Commerce and Insurance  
500 James Robertson Parkway  
Nashville TN 37243

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APR 05 2013

Dept. of Commerce & Insurance  
Company Examinations

Re: Quinquennial Examination as of December 31, 2011  
Completed March 14, 2013

Mr. York:

We have reviewed the report on examination, including its conclusions and recommendations. We believe the report fairly and accurately reflects the condition of Farmers Mutual of Tennessee as of December 31, 2011. With respect to recommendation number one found on page eighteen, I have included a sample of our privacy policy which is sent to our policyholders at renewal. I apologize for not providing this during the examination. If this does not comply with the appropriate statute, please advise us of any changes we must make.

With the concurrence by the Department of the above consideration, we have no objection to the adoption of the examination report by Commissioner McPeak. Examiners Brian H. Sewell and Rebecca Walker conducted the examination in a very professional manner.

Sincerely,

Gordo Watson  
President

