



RECEIVED

AUG 02 2011

Dept. of Commerce & Insurance
Company Examinations

Report on Examination
of the
Hamblen Mutual Insurance Company

Morristown, TN

as of

December 31, 2009

Department of Commerce and Insurance

State of Tennessee

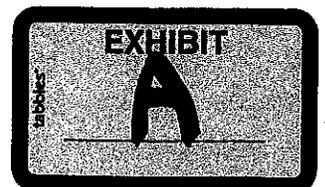


TABLE OF CONTENTS

| <u>Caption</u> | <u>Page</u> |
|--|-------------|
| Salutation | 1 |
| Introduction | 1 |
| Scope of Examination | 2 |
| Location of Books and Records | 2 |
| Status of Prior Examination Findings | 3 |
| History of the Company | 7 |
| Charter and By-Laws | 8 |
| Management and Control | 9 |
| Members | 9 |
| Board of Directors | 9 |
| Executive Committee | 10 |
| Officers | 11 |
| Investments | 11 |
| Investment Management Agreement | 12 |
| Custodian Agreement | 12 |
| Claims Service Agreement | 13 |
| Pecuniary Interest | 13 |
| Conflicts of Interests | 13 |
| Corporate Records | 14 |
| Statutory Deposit | 14 |
| Fidelity Bond and Other Insurance | 15 |
| Territory | 16 |
| Plan of Operation | 17 |
| Market Conduct Activities | 18 |
| Policy Forms and Underwriting Practices | 18 |
| Advertising | 18 |
| Cancellation Policy | 18 |
| Privacy of Non-Public Personal Information | 19 |

| | |
|--|----|
| Reinsurance | 19 |
| Litigation, Contingent Liabilities and Regulatory Action | 22 |
| Financial History | 23 |
| Accounts and Records | 23 |
| Audited Financial Statements | 24 |
| Management Discussion and Analysis | 25 |
| Risk Based Capital Report | 25 |
| Actuarial Opinion | 25 |
| Dividends or Distributions | 25 |
| Subsequent Events | 26 |
| Financial Statement | 26 |
| Analysis of Changes in Financial Statement and Comments | |
| Resulting From Examination | 29 |
| Summary of Examiners' Comments and Recommendations | 30 |
| Conclusion | 32 |
| Affidavit | 34 |



STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
INSURANCE DIVISION
500 JAMES ROBERTSON PARKWAY - 4TH FLOOR
NASHVILLE, TENNESSEE 37243-1135

August 1, 2011

The Honorable Julie M. McPeak
Commissioner
Tennessee Department of Commerce and Insurance
500 James Robertson Parkway, 12th Floor
Nashville, Tennessee 37243

Commissioner McPeak:

Pursuant to your instructions and in accordance with Tennessee statutes and regulations, and resolutions adopted by the National Association of Insurance Commissioners ("NAIC"), a financial examination and market conduct review has been made of the condition and affairs of

Hamblen Mutual Insurance Company

110 North Cumberland Street
Morristown, Tennessee 37814

("the Company") as of December 31, 2009, and the report thereon is hereby respectfully submitted.

SCOPE OF EXAMINATION

This financial examination commenced February 3, 2011, and covers the period from January 1, 2005, through December 31, 2009, and includes any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. The examination was conducted at the Company's office, located at 110 North Cumberland Street, Morristown, Tennessee, 37814 and at the office of the Tennessee Department of Commerce and Insurance ("TDCI"). This examination was conducted by a duly authorized representative of the TDCI.

During the course of the examination, the assets of the Company were verified, and liabilities were determined or estimated as of December 31, 2009, in accordance with procedures as prescribed by Tenn. Code Ann. and Tenn. Comp. R. & Regs. of the State of Tennessee and the NAIC. The Company's financial solvency and degree thereof was thus established. Test checks covering selected periods were made of income and disbursement items, and a general review was made of the Company's operations, practices and compliance with Tenn. Code Ann. and Tenn. Comp. R. & Regs. to the extent hereinafter set forth.

Location of Books and Records:

The Company maintains its Charter, bylaws, corporate minutes, investment records, reinsurance contracts, correspondence files, bank statements, accounting records, statutory statement records, underwriting, marketing, claim files and policy files at its office located at 110 Cumberland Street, Morristown, Tennessee, 37814.

The Company is audited annually by an independent accounting firm ("auditors") that meets the criteria set forth in Tenn. Comp. R. & Regs. R. 0780-01-65.

In addition, the following topics were reviewed:

Status of Prior Examination Findings

Company History

Charter and Bylaws

Management and Control

Pecuniary Interest - Tenn. Code Ann. § 56-3-103

Corporate Records
Statutory Deposit
Fidelity Bond and Other Insurance
Territory
Plan of Operation
Market Conduct Activities
Reinsurance
Litigation and Contingent Liabilities
Loss Experience
Accounts and Records
Dividends
Subsequent Events
Financial Statement

Status of Prior Examination Findings

The previous examination of the Company was made as of June 30, 2006, by an examiner employed by the TDCI. The limited scope target Report of Examination was dated September 18, 2006, and covered the period from January 1, 2005, through June 30, 2006. The Commissioner issued eight (8) directives as set forth in the "Order Adopting Examination Report With Directives" made regarding Hamblen Mutual Insurance Company dated November 30, 2006. A summary of each directive and the corrective actions taken by the Company are as follows:

Directive # 1 Investment Policy:

The Company was directed to amend its investment policy to allow for common stocks or restructure their portfolio to comply with their own investment policy.

Corrective Action: The Company complied with the Commissioner's first directive by adopting a new investment policy which allows for the investment in common stocks. On March 17, 2007, the Company's Board of Directors approved and adopted their "Investment Objectives and Policy Guidelines".

Directive # 2 Conflict of Interest Policy:

The Company was directed to comply with Tenn. Code Ann. § 56-3-103 by preventing any director, officer, or committee member having any investment authority from accepting any fee, brokerage, commission, gift, or other consideration for any loan, deposit, purchase, sale payment, or exchange made by or in behalf of such company or be pecuniarily interested in any such purchase, sale, or loan. This compliance includes, but is not limited to, implementing a conflict of interest policy.

Corrective Action: On March 17, 2007, the Company's Board of Directors approved and adopted a "Conflict of Interest Policy" that incorporates all of the language that composes Tenn. Code Ann. § 56-3-103.

Directive # 3 Investments:

The Company was directed to comply with Tenn. Code Ann. § 56-3-408(b)(1) by not making investments and loans, except premium finance loans, unless the investments and loans have been authorized by the board of directors or by a committee appointed by such board and charged with the duty of supervising such investment or loan.

Corrective Action: The Company complied with Tenn. Code Ann. § 56-3-408(b)(1) and the Commissioner's directive by taking two (2) actions. (1) On March 17, 2007, the Company's Board of Directors approved the creation of an investment committee to review and approve all of the Company's investment transactions quarterly. (2) Also, on March 17, 2007, the Company's Board of Directors approved and adopted an "Investment and Loan Policy" that incorporates all of the language that composes Tenn. Code Ann. § 56-3-408(b)(1) and prevents any director, officer and committee member from making investments and or loans without the authorization of the board of directors and or the investment committee.

Directive # 4 Custodial Agreement:

The Company was directed to comply with Tenn. Code Ann. § 56-3-112 and Tenn. Comp. R. & Regs. R. 0780-01-46-.04 by maintaining a custodial agreement that complies with all rules within said chapter, should the Company choose an authorized method of

holding its securities that requires such an agreement.

Corrective Action: On July 31, 2006, the Company mailed to the TDCI a signed, executed copy of a new custodial agreement by and between the Company and its custodian, Regions Bank, which was fully compliant with Tenn. Code Ann. § 56-3-112 and Tenn. Comp. R. & Regs. R. 0780-01-46 and included internal control enhancements requested by the TDCI.

Directive # 5 Audited Financial Statements:

The Company was directed to cease writing general liability insurance for failing to comply with Tenn. Comp. R. & Regs. R. 0780-01-65 by not filing the letter of qualification, the engagement letter and disagreement letter.

Corrective Action: Directive # 5 cited pursuant to Order Number 06-118 signed November 30, 2006, by the Commissioner was lifted or removed by the Commissioner's issuance of "Amendment to Order Adopting Examination Report With Directives" (Order Number 06-152) signed and dated on December 21, 2006.

Furthermore, the Company filed a "Letter of Qualification" pursuant to Tenn. Comp. R. & Regs. R. 0780-01-65-.12, and an "Engagement Letter" pursuant to Tenn. Comp. R. & Regs. R. 0780-01-65-.06 with the Company's 2006 audited financial statements in March 2007.

Directive # 6 Management Discussion and Analysis:

The Company was directed to cease writing general liability insurance for failing to comply with Tenn. Comp. R. & Regs. R. 0780-01-37 by not filing the required Management Discussion and Analysis by March 1 of each year.

Corrective Action: Directive # 6 cited pursuant to Order Number 06-118 signed November 30, 2006, by the Commissioner was lifted or removed by the Commissioner's issuance of "Amendment to Order Adopting Examination Report With Directives" (Order Number 06-152) signed and dated on December 21, 2006.

Furthermore, the Company filed their MD&A report with the TDCI when it filed its 2006 through 2010 Annual Statements as required by Tenn. Comp. R. & Regs. R. 0780-01-37-.04(1) and the MD&A Section of the NAIC Annual Statement Instructions for Property and Casualty Companies.

Directive # 7 Annual and Quarterly Statement Filings:

The Company was directed to cease writing general liability insurance for failing to comply with Tenn. Code Ann. § 56-1-501 and Tenn. Comp. R. & Regs. R. 0780-01-37 by not filing its Annual and Quarterly statements including statement amendments.

Corrective Action: Directive # 7 cited pursuant to Order Number 06-118 signed November 30, 2006, by the Commissioner was lifted or removed by the Commissioner's issuance of "Amendment to Order Adopting Examination Report With Directives" (Order Number 06-152) signed and dated on December 21, 2006.

Furthermore, the Company filed their Annual and Quarterly Statements as mandated by Tenn. Code Ann. § 56-1-501 and Tenn. Comp. R. & Regs. R. 0780-01-37 and the NAIC Annual Statement and Quarterly Statement Instructions for Property and Casualty Companies beginning with the Company's June 30, 2006, Quarterly filing up through the 2010 Annual Statement filing. Furthermore, all statement amendments requested by the TDCI and filed by the Company were in accordance with Tenn. Code Ann. § 56-1-501 and Tenn. Comp. R. & Regs. R. 0780-01-37 and the NAIC Annual Statement and Quarterly Statement Instructions.

Directive # 8 Risk Based Capital Report:

The Company was directed to cease writing general liability insurance for failing to comply with Tenn. Code Ann. § 56-46-110 by not computing its RBC calculation as required.

Corrective Action: Directive # 8 cited pursuant to Order Number 06-118 signed November 30, 2006, by the Commissioner was lifted or removed by the Commissioner's issuance of "Amendment to Order Adopting Examination Report With Directives" (Order Number 06-152) signed and dated on December 21, 2006.

Furthermore, the Company filed a RBC Report exemption request on or before March 1 for the 2006, 2007, 2008 and 2009 policy years and was granted an exemption from filing by the TDCI for each of the aforementioned years in accordance with Tenn. Code Ann. § 56-46-110.

HISTORY OF THE COMPANY

The Company was incorporated on April 13, 1909, as an association under the provisions of the Tennessee Business Corporation Act and was organized as a county mutual fire insurance company ("county mutual") pursuant to Tenn. Code Ann. § 56-22-101 *et seq.* for the purpose of insuring loss or damage to property to residents of Hamblen County and Jefferson County in the State of Tennessee. The Company's charter was registered with the Court of Hamblen, Tennessee on April 8, 1909. It is unknown when the Company was first issued a Certificate of Authority by the TDCI in order to transact business in the State of Tennessee. The Company commenced business in 1909. The previous Certificate of Authority issued by the TDCI was dated August 24, 2001. The current Certificate of Authority issued by the TDCI is dated July 2, 2008, and is valid until suspended or revoked.

The Company in 1909 was originally named "Farmers Mutual Fire Insurance Company of Hamblen and Jefferson Counties, Tennessee".

In January 1999, the Company began preparation for the transition from compliance with Tenn. Code Ann. § 56-22-101(a) and all other Tennessee "County Mutual Fire Insurance Companies" laws found in Title 56, Chapter 22 of Tennessee Code Annotated to compliance with all applicable Tennessee Statutes and Rules and NAIC Accounting Practices and Procedures in accordance with Tenn. Code Ann. § 56-22-101(b). (Note: Former chapter 22, §§ 56-22-101 – 56-22-130 concerning county mutual fire insurance companies was repealed by Acts 2006, ch. 689, § 3, effective January 1, 2007.) On January 5, 1999, the Company's previous manager, Charles Gardner, with the approval of the Board of Directors requested, in a letter addressed to the TDCI, approval to write liability coverage per Tenn. Code Ann. § 56-22-101(b). In April 2004 the Company's former Manager, Charles Gardner, resigned. The Company subsequently hired Lea Fawbush to become the Company's Manager.

CHARTER AND BYLAWS

The Company's original Charter dated April 7, 1909, was filed and recorded with the Tennessee Secretary of State on April 13, 1909. The original Charter was not stamped as being approved by the TDCI. The original Charter indicated a perpetual existence and established an association for the insuring of its members against loss by fire, wind and lightning. Subsequent amendments to the Charter are presented as follows:

Effective Date of Amendment

Purpose of Amendment

April 5, 1991

To change the name of the Company from Farmers Mutual Fire Insurance Company of Hamblen and Jefferson Counties, Tennessee to Hamblen Farmers Mutual Insurance Company.

December 31, 1998

To change the name of the Company from Hamblen Farmers Mutual Insurance Company to Hamblen Mutual Insurance Company.

The April 5, 1991, amendment was received, recorded, and filed by the Secretary of State's office on May 12, 1992. The December 31, 1998, amendment was filed and approved by the TDCI prior to the June 28, 2001, filing with the Secretary of State's office.

It is unknown the exact date the Company's Bylaws were adopted and approved by the Board of Directors. The Company's Bylaws have been amended numerous times since they were originally implemented. The Bylaws are such as generally found in corporations of this type. The Bylaws provide for an annual shareholder meeting at which time the Board of Directors is elected. Officers are elected by the Board of Directors annually at the first Board of Directors' meeting. The Bylaws may be amended or repealed by two-thirds of the Members (policyholders).

MANAGEMENT AND CONTROL

Members:

The Company is owned by its members ("policyholders"). The Company has never in its history issued any shares of "capital stock" or established "guaranteed capital". The Company's Charter indicates that the main responsibility of the members is "to pay his ratable proportion of all losses or expenses accruing against said corporation"; however, the Bylaws state the following:

The annual meeting of the members of this Company for the purpose of electing directors and transacting such other business as may come before the meeting shall be held at 10:00 AM Eastern Standard Time on the 3^d Saturday of March each year.

Special meetings of the members "may be called at any time by a majority of the board of directors" or "on the petition of one-fourth of the members".

The Bylaws provide that each policyholder is entitled to "one (1) vote in person or by ballot transmitted by mail in any election for directors or upon any other issues properly brought to the policyholders for consideration pursuant to Tenn. Code Ann. § 56-22-107. "Policyholders" may not vote by proxy. Also, ten (10) members shall constitute a quorum for any membership meeting.

The "policyholders" held five (5) annual meetings and no (0) special meetings during the examination period.

Board of Directors:

The Company's Bylaws state that "all of the capacity of the Company shall be vested in, and all its power and authority, except as otherwise provided by law, shall be exercised by a Board of Directors". Pursuant to the Company's Bylaws six (6) Directors were elected at the Annual Meeting of the "shareholders" and were "policyholders". Each director elected shall hold office for three (3) years until his successor is elected and (since) qualified." The number of directors that constitutes a quorum was defined as a majority of directors.

The following persons were duly elected by the "policyholders" and were serving as members of the Board of Directors as of December 31, 2009:

| Director | Home City and State | Principal Affiliation |
|---------------------|--|--|
| Larry D. Baker | 635 Three Springs Road, Russellville, Tennessee 37860 | Director and President of the Company. |
| Stancil Ford | 7192 Cedar Hill Road, Talbott, Tennessee 37877 | Director and Vice President of the Company. |
| Herbert M. Bacon | 1135 West Third North Street, Morristown, Tennessee 37814 | Director and Secretary / Treasurer of the Company. |
| Charles D. Thomason | 124 Warrensburg Road, Russellville, Tennessee 37860 | Director of the Company. |
| Brent Walker | 7808 East Andrew Johnson Hwy., Whitesburg, Tennessee 37891 | Director of the Company. |
| Jerry Self | 5059 Barton Springs Road, Morristown, Tennessee 37813 | Director of the Company. |

For the period under examination, annual Board of Directors meetings were held on the same day as the "policyholders" meeting dates as required by the Company's Bylaws. The Bylaws did not permit the payment of a salary to the Directors, but by resolution of the Board, a fixed sum and any expense of attendance was granted.

Executive Committee:

Article VI of the Bylaws establishes an Executive Committee and states "This Committee shall have and may exercise all the power of the Board of Directors which may be lawfully delegated when the Board is not in session." Since March 17, 2007, this committee consisted of the Company's President, Secretary and Treasurer and one (1) other Director that was not an officer. The minutes of the Board of Directors do not reflect the creation of any new committees or the existence of any committee other than the executive committee during the period under examination.

Officers:

The Bylaws provide that after each annual meeting of the "policyholders", "the Board of Directors shall elect a President, Vice President and Secretary / Treasurer." All of the officers were members of the Board of Directors. The Board of Directors may also appoint "such other officers and employees as it may deem necessary". The Bylaws also state, "Vacancies in any office shall be filled by the President."

At December 31, 2009, the following persons had been duly elected to and were serving in the positions indicated:

| | |
|-----------------------|------------------|
| President | Larry D. Baker |
| Vice President | Stancil Ford |
| Secretary / Treasurer | Herbert M. Bacon |

Investments:

Tenn. Code Ann. § 56-3-408(b)(1) states that "No investment or loan except premium finance loans, shall be made by any such insurance company, unless the same shall first have been authorized by the board of directors or by a committee appointed by such board and charged with the duty of supervising such investment or loan."

A review of the meeting minutes of the Board of Directors and the Executive Committee during the period of examination revealed that prior to 2007 neither the Company's Directors nor the Executive Committee appointed by the Directors reviewed and ratified the investment transactions of the Company. However, beginning with the first quarter of 2007, the Company's Executive Committee, consisting of three (3) Directors, approved all of the Company's investment transactions on a quarterly basis.

In August 1990, the Company's Board of Directors adopted the Company's previous Investment Policy. The Company's previous Investment Policy was in effect until March 2007. The previous Investment Policy adopted a conservative investment philosophy and specified that the Company would invest in tax free municipal bonds, certificates of deposit, government agencies, Treasury Notes and Bonds. All bonds must carry an A rating by Moody's or better. Any other investment must be approved by the Board of Directors.

The Company's investment policy was revised by the Board of Directors and a one (1) page Investment Objectives and Policy Guidelines document was signed by the

Company's President in March 2007. The primary objective of the Company's investment portfolio as stated in the Investment Objectives and Policy Guidelines was *"to preserve principal while striving to achieve a modest degree of growth. Growth of principal implies a commitment to equities."* The Company employed an investment manager in order to assist the Company in obtaining its investment objectives.

Investment Management Agreement:

Effective May 9, 2000, the Company entered into an Investment Management Agreement with Martin & Company, Inc. Under this agreement Martin & Company, Inc., shall "render investment advisory services in the supervision and management of the assets in..." the Company's "investment account". Securities are actually held by the Custodian, Regions Bank, duly appointed by the Company. Martin & Company, Inc., "is authorized to give instructions to the Custodian with respect to all investment decisions". The original agreement was revised effective March 17, 2007, and was modified to include equity investments. The revision, titled "Investment Objectives and Policy Guidelines" was approved by the Company's Directors on March 17, 2007.

Martin & Company, Inc., is compensated quarterly in arrears based on the current market value of the account according to the terms presented on Exhibit C of this agreement. The Company shall pay a fee of 0.75% for the first \$5 million of managed investments and a fee of 0.50% for the next \$5 million of managed investments. The minimum annual fee for services is \$15,000. The Company in 2009 paid Martin & Company fees totaling \$36,201. This compensation formula remains unchanged since the inception of this agreement. Martin and Company, Inc., managed approximately 85% of the Company's assets as of year-end 2009.

Custodian Agreement:

The Company's Executive Committee of the Board of Directors approved the prior Custody Agreement with Regions Bank effective as of December 15, 2005. However, as previously stated under the Status of Prior Examination Findings heading, the prior Custody Agreement did not meet all of the specific requirements set forth in Tenn. Comp. R. & Regs. R. 0780-01-46 (Revised July 12, 2005).

On July 31, 2006, the Company mailed to the TDCI a signed, executed copy of a new custodial agreement by and between the Company and its custodian, Regions Bank, which was fully compliant with Tenn. Comp. R. & Regs. R. 0780-01-46 and included internal control enhancements requested by the TDCI.

Under the current agreement, the Company appointed Regions Bank as custodian for the safekeeping of securities in exchange for compensation of 7.5 basis points of the account's fair market value annualized and taken monthly from the custodial account's income. This compensation formula remains unchanged since the effective date of this agreement. Also, the agreement grants approval for specific Company or investment advisor representatives to transact business with the custodian bank.

Claims Service Agreement

The Company during the period of examination engaged Appalachian Claims Service of Knoxville, Tennessee to adjust all of the Company's loss claims. Appalachian Claims Service charged a flat fee for all wind and hail claims. Property fire losses were billed using a fee schedule and liability claims were billed on a time and expense basis.

Pecuniary Interest:

The Company's Directors on March 17, 2007, adopted a formal, written "Conflict of Interest Policy". This policy prevents any director, officer or committee member having any investment authority from accepting any fee, brokerage, commission, gift, or other consideration for any loan, deposit, purchase, sale, payment, or exchange made by or in behalf of Hamblen Mutual or be pecuniarily interested in any such purchase, sale, or loan in accordance with Tenn. Code Ann. § 56-3-103. Prior to March 17, 2007, the Company did not have a "Conflict of Interest Policy". During the course of this examination the Examiner did not detect any violations of Tenn. Code Ann. § 56-3-103.

Conflicts of Interest:

In addition to the Board of Directors and Officers, the Company has an Office Manager and an Agent, which are not required by the Company to complete any type of "Conflicts of Interest Disclosure Form".

CORPORATE RECORDS

Based upon the records provided to the Examiner, it is unknown when the TDCI issued the Company's original Certificate of Authority. The current Certificate of Authority was issued July 2, 2008, by the TDCI and is effective until suspended or revoked.

The minutes of the annual meetings of the Company's Members during the period of examination were provided to the Examiner. As previously stated the Members' primary function is to elect directors to the Board of Directors annually and pay their premiums.

The minutes are well-written, complete as to necessary detail and appear to properly reflect the actions of the Company's Board of Directors. Attachments and exhibits provided to the Board of Directors are maintained with the minutes.

STATUTORY DEPOSIT

On July 31, 2006, the Company's Manager mailed a signed copy of a Safekeeping Receipt, dated July 26, 2006, that was approved by the TDCI on August 7, 2006. This Safekeeping Receipt showed three (3) securities that in totality exceeded the \$200,000 market value requirement. A letter from the TDCI dated August 7, 2006, to the Company's Manager requested the Company to execute in triplicate and return to the TDCI an enclosed Depository Agreement – General Deposit and Form C Custodian Affidavit. On August 22, 2006, the TDCI received the requested signed documents from the Company. On August 29, 2006, the Commissioner of TDCI, in order to finalize the proper execution of the Depository Agreement – General Deposit and Form C Custodian Affidavit, approved and signed the aforementioned documents submitted by the Company and Regions Bank.

The following table reflects the securities that composed the Company's statutory deposit in accordance with Tenn. Code Ann. § 56-2-112 as of December 31, 2009.

| <u>Jurisdiction</u> | <u>Description</u> | <u>Par Value</u> | <u>Statement Value</u> | <u>Market Value</u> |
|---------------------|---|------------------|------------------------|---------------------|
| Tennessee | FNMA, 1.75%, due 08/10/12, CUSIP # 31398AYM8 | \$50,000.00 | \$50,105.00 | \$49,984.50 |
| Tennessee | FNMA, 3.0%, due 09/16/2014, CUSIP # 31398AYY2 | \$50,000.00 | \$50,258.00 | \$50,640.50 |
| Tennessee | U.S. T-Note, 3.375%, due 7/31/2013, CUSIP # 912828JG6 | \$10,000.00 | \$10,023.00 | \$10,496.90 |

| | | | | |
|-----------|--|---------------------|---------------------|---------------------|
| Tennessee | U.S. T-Note, 2.00%, due 11/30/2013, CUSIP # 912828JT8 | \$40,000.00 | \$39,919.00 | \$39,787.60 |
| Tennessee | U.S. T-Note, 1.00%, due 11/30/2013, CUSIP # 912828LVO | \$50,000.00 | \$50,060.00 | \$50,025.50 |
| Tennessee | Regions Trust Money Market Acct. | <u>\$4,958.29</u> | <u>\$4,958.29</u> | <u>\$4,958.29</u> |
| Totals | | <u>\$204,958.29</u> | <u>\$205,323.29</u> | <u>\$205,893.29</u> |

FIDELITY BOND AND OTHER INSURANCE

The Company's coverage is summarized as follows:

Fidelity Bond (Directors & Officers) and Professional Liability Policy

The Company's combination fidelity and professional liability coverage was underwritten by NAMIC Insurance Company, Inc., of Indianapolis, Indiana. The fidelity bond policy has an occurrence/aggregate limit of \$1,000,000, and a \$5,000 retention. The minimum range recommended by the NAIC for a Company of this size is \$75,000 to \$100,000. Therefore, the Company had fidelity coverage which exceeded the minimum fidelity coverage recommended for the protection of the Company's policyholders by a comfortable margin.

The Company's combination fidelity and professional liability policy was underwritten by NAMIC Insurance Company, Inc., which is an approved foreign surplus lines carrier in the State of Tennessee as of the date of this examination.

Commercial General Liability and Business Owners Property Policy

The Company's combination Commercial General Liability and Business Owners Property coverage was underwritten by Travelers Casualty Insurance Company of America, Inc., of Hartford, Connecticut. The policy's commercial general liability limit of insurance was (a) \$2,000,000 for general aggregate and products-completed operations aggregate limit, (b) \$1,000,000 for personal and advertising limit, (c) \$300,000 damage to premises rented and (d) \$5,000 medical payments (any one person).

The policy's business owners property insurance limits were (a) building (replacement cost) \$185,000, (b) business personal property \$35,000, (c) accounts receivable \$25,000 and (d) valuable papers \$25,000.

The Company's commercial general liability and business owners property policy

was underwritten by Travelers Casualty Insurance Company of America, Inc., which is a licensed property and casualty carrier in the State of Tennessee as of the date of this examination.

Workers' Compensation and Employers' Liability Policy

The Company had in effect for the period June 12, 2009, to June 12, 2010, a workers' compensation and employers' liability policy with Farmington Casualty Company of Hartford, Connecticut.

Under the policy's specific coverage, the insurer agrees to indemnify the Company for each accident or employee disease up to the statutory limit for workers' compensation and up to \$1,000,000 for employers' liability. Also, the policy covers each employee up to \$100,000 for bodily injury by disease and up to \$500,000 for all cases of bodily injury by disease incurred by the Company during the policy term.

The Company's workers' compensation and employers' liability policy was underwritten by Farmington Casualty Company, which is a licensed property and casualty carrier in the State of Tennessee, as of the date of this examination.

TERRITORY

As of December 31, 2009, and as of the date of this examination report, the Company was licensed to transact business in the State of Tennessee pursuant to Tenn. Code Ann. § 56-22-106(f)(1).

Tenn. Code Ann. § 56-22-106(f)(1) states "Whenever any county mutual insurance company has a surplus of at least seven hundred fifty thousand dollars (\$750,000), it may be authorized, through the express written permission of the commissioner to extend its operations to counties contiguous to the county in which its principal place of business is located in the second degree".

The previous Certificate of Authority issued by the TDCI on August 24, 2001, and the current Certificate of Authority issued by the TDCI on July 2, 2008, specifically authorized the Company to issue policies in counties to the second degree. The current Certificate of Authority which was issued effective on July 2, 2008, was amended by the TDCI to reflect the Company's lawful authorization to write liability insurance.

In 2009 the Company's gross total direct written premium in the amount of \$405,302 was derived from policies written in Hamblen, Hancock, Hawkins, Cocke, Grainger, Greene, Sevier and Jefferson Counties in Tennessee.

PLAN OF OPERATION

The Company provides insurance against loss by fire, hail, lightning, wind, theft, vandalism and liability.

Policies are typically written for at least 80% of the replacement value of the property insured, subject to policy limits of \$100,000.00 per specific loss. The policy period for each policy was one (1) year. Policyholders have the option of paying premium annually, semi-annually, quarterly or monthly and premiums are first due beginning on the policy anniversary date. There was a \$250 deductible for all losses.

The Company provides its members coverage on dwelling homes (single & multi-family), rental homes (single & multi-family), modular homes, mobile homes, farm buildings, livestock, farm personal property, farm machinery and churches in case of loss due to fire, wind, hail, lightning and theft.

The Company also writes three (3) different types of liability policies and they are as follows: 1) Owner, Landlord & Tenant; 2) Fire Comprehensive Personal Liability and 3) Comprehensive Personal Liability. The Company as of December 31, 2009, had \$37,950,000 in total liability coverage in-force for 227 policies and billed these "policyholders" \$12,197 for this coverage.

The Company writes business through two (2) licensed in-house agents and five (5) local insurance agencies. These agencies are paid a 15% commission for all new and renewal business.

The Company's Agent and Manager perform a visual inspection of the property and photographs the property prior to the issuance of a policy.

The Company's Agent and Company Manager determine the value of the property. Upon the signing of the completed application and collection of the initial billed premium, the policy is bound. The Company's President has the authority to make the final approval for the binding of coverage.

MARKET CONDUCT ACTIVITIES

A market conduct review was made of the Company as of December 31, 2009, in conjunction with this examination. The following items were addressed:

Policy Forms and Underwriting Practices

The Rating Section of the TDCI received a copy of the Company's application, policy form and premium rates. This documentation was stamped "approved" on December 29, 2006 pursuant to Tenn. Code Ann. § 56-22-109(b)(1) and Tenn. Code Ann. § 56-5-303, 304 and 305.

There were no changes to the Company's premium rates or deductible during the period of examination.

Advertising

The Company's advertising during the period of examination consisted of a bill board located on the Company's office building, calendars distributed to the general public, local radio station advertisements and advertisements placed in the local phone book.

Cancellation Policy

Policyholders received renewal notices one (1) month in advance. Policyholders were given ten (10) days to make their premium payment and then Policyholders were given a 7 day grace period before a cancellation notice was sent out. Therefore, a policyholder had 17 days to bring or mail a late premium payment to the Company's office.

After a policyholder is notified that their policy is cancelled due to non payment of premium, they will have 10 days to pay either the balance of the policy premium or the installment payment due. To reinstate the policy the Company requires a \$20 service charge.

The Company did not reinstate a policy after it was cancelled for non-payment. If a policyholder has been cancelled for non-payment and wants insurance coverage after their policy has been cancelled, the policyholder had to start the application process again and was required to pay the full premium on the new policy.

The Company adheres to the non-renewal provisions contained in Tenn. Code Ann. § 56-7-1901 and Tenn. Code Ann. § 56-7-1902 in accordance with Tenn. Code Ann. § 56-22-109(b)(2) (effective January 1, 2007) that relate to the notice of intention to non-renew and the reason for non-renewal.

Privacy of Non-Public Personal Information

The Company's policy for the disclosure of privacy of non-public personal information was reviewed. The examiner noted no instances of non-compliance with Tenn. Comp. R. & Regs. R. 0780-01-72, "Privacy of Consumer Information Regulations."

REINSURANCE

Quota Share Reinsurance

As of October 1, 2001, the Company and TDCI mutually agreed that the Company should cede 100% of its liability insurance coverage to an insurance company licensed to transact business in the State of Tennessee as a condition of approval in order to write liability coverage in accordance with Tenn. Code Ann. § 56-22-101(b). Until December 31, 2007, the Company was afforded casualty quota share reinsurance coverage from Farmers Mutual of Tennessee for 100% of the business as defined under the Company's policies covering Comprehensive Personal Liability, Farmers Comprehensive Personal Liability, Section II of Homeowners, Farmowners and / or Mobile-Homeowners, and Owners, Landlords and Tenants Liability on Dwellings, Churches and Farm Premises only.

In exchange for 100% of the written premium of the above defined business, less a 15% ceding commission, the maximum policy limit subject to this agreement was \$300,000 per occurrence as respects to all liability business covered. The maximum limit for any one (1) policy did not exceed \$2,500 as respects to medical payments coverage.

A letter dated August 8, 2009, from the TDCI granted approval for the Company to reduce the percentage of liability insurance written and ceded by the Company from 100% to 75% for the entire 2008 calendar and policy year.

On November 13, 2008, and November 20, 2008, Farmers Mutual of Tennessee and the Company, respectively, signed a "Quota Share Reinsurance Agreement". This reinsurance agreement became effective January 1, 2008, and allowed for Farmers Mutual

of Tennessee to reinsure the 75% of the Company's liability coverage. The Company ceded 75% of the premium collected for Comprehensive Personal Liability, Farmers Comprehensive Personal Liability, Section II of Homeowners, Farmowners Liability, and / or Mobile-Homeowners and Owners, Landlords and Tenants Liability on Dwellings, Churches and Farm Premises to Farmers Mutual of Tennessee less a 15% ceding commission.

The maximum policy limit subject to this agreement was deemed to be \$300,000 per occurrence as respects to all liability business covered. The maximum limit for any one (1) policy shall not exceed \$2,500 as respects to medical payments coverage. Also, Farmers Mutual of Tennessee provided all liability claim adjustment services at no charge to the Company.

The "Quota Share Reinsurance Agreement" agreement in effect as of December 31, 2009, was standard in form and contained acceptable clauses for insolvency, arbitration and termination. The agreement also appeared to have effectuated proper transfer of risk in accordance with NAIC guidelines.

Specific and Aggregate Excess of Loss Reinsurance

Prior to January 1, 2007, the Company, pursuant to Tenn. Code Ann. § 56-22-106(c) was allowed to insure a single risk up to \$25,000. This \$25,000 single risk limitation was reflected in the Company's Excess of Loss Reinsurance Agreement with Farmers Mutual of Tennessee (Knoxville, TN) effective up through December 31, 2006.

The "County Mutual" insurance company statutes located in Title 56, Chapter 22 of Tennessee Code Annotated were revised and beginning effective January 1, 2007, Tenn. Code Ann. § 56-22-106(c)(1) allows a "county mutual" insurance company to issue "a policy of insurance covering those risks found in subsection (a) where the retained amount of risk by the county mutual insurance company on any single risk exceeds the lesser of: (A) twenty thousand dollars (\$20,000), plus three percent (3%) of the county mutual insurance company's surplus; or (B) one hundred thousand dollars (\$100,000)".

Due to the fact that the Company's surplus exceeded \$2,666,667 by over \$2,000,000 as disclosed in its 2007, 2008 and 2009 Annual Statements, the Company in accordance with Tenn. Code Ann. § 56-22-106(c)(1) was allowed to cover a single risk up to \$100,000 beginning effective January 1, 2007 through December 31, 2009.

During the period of examination (January 1, 2005 through December 31, 2009) the Company entered into three (3) different Excess of Loss Reinsurance Agreements with Farmers Mutual of Tennessee (Knoxville, TN). Each of the three (3) different reinsurance agreements had an Exhibit A - Combination Per Risk and Aggregate Layer and Exhibit B – Second Aggregate Layer. The first of the three (3) Excess of Loss Reinsurance Agreements, effective from January 1, 2004 through December 31, 2006, had an Exhibit C – Third Aggregate Layer.

The Company and Farmers Mutual of Tennessee (Knoxville) entered into an Excess of Loss Reinsurance Agreement with an effective date of January 1, 2008. This agreement was in effect continuously from January 1, 2008, through December 31, 2009, and beyond. The agreement calls for the Reinsurer to accept that portion of the Company's gross liability on any risk which exceeds its net retained liability on any one (1) specific risk and in the aggregate for all losses. The terms reflected a continuous contract until cancelled by either party with 60 days advance notice. This agreement is further summarized as follows:

Type: Exhibit A – Combination Per Risk and Aggregate Layer - 2008

Reinsurer: Farmers Mutual Fire Insurance Company of Tennessee

Coverage: Part 1 – Property Risk Excess of Loss: covers each loss in excess of the Company's \$100,000 maximum retention up to the Reinsurers \$100,000 maximum per risk, each loss occurrence.

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 125% of the Company's gross assessment and / or premium income or \$410,000 and shall not exceed 100% of the lesser of 125% of the Company's gross assessment and / or premium income or \$615,000.

The agreement provides that recoveries under Part 1 shall inure to the benefit of Part 2.

An annual deposit premium of \$10,250 shall be paid to the Reinsurer in two (2) equal installments of \$5,125 each on March 1 and September 1.

Estimated Gross Net Assessment and / or premium income for 2008 - \$410,000

Type: Exhibit B – Second Aggregate Layer-2008

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater of 125% of the Company's gross assessment and / or premium income or \$410,000 and the Reinsurer shall be liable for 100% of the Company's ultimate net loss in excess of the greater of 125% of the Company's gross assessment and / or premium income or \$410,000 but the Reinsurer's liability shall not exceed 100% of the lesser of 750% of the Company's gross net assessment and / or premium income or \$3,690,000 in the aggregate, during each annual period this agreement is in effect.

An annual deposit premium of \$10,250 shall be paid to the Reinsurer in two (2) equal installments of \$5,125 each on March 1 and September 1.

Term: Continuous coverage, effective January 1, 2007 through December 31, 2009 and beyond.

Estimated Gross Net Assessment and / or premium income for 2008 and 2009 - \$410,000

LITIGATION, CONTINGENT LIABILITIES AND REGULATORY ACTION

Based upon data provided during the course of this examination, it appears that there were no matters at law in which the Company was involved during the period under review. The examiners also noted no agreements or pending matters of a contingent nature that would materially affect its financial position or operating results as of December 31, 2009.

On November 30, 2006, an Order Adopting Examination Report with Directives was issued by former Commissioner Paula Flowers that ordered the Company to cease writing general liability insurance within thirty (30) days. This order from Commissioner was issued as a result of the findings of the Company's limited scope target Report of Examination that was dated September 18, 2006, and covered the period from January 1, 2005, through June 30, 2006.

The Company complied with the directives found in the November 30, 2006, Order Adopting Examination Report with Directives and on December 21, 2006, former Commissioner Paula Flowers issued an Amendment to Order Adopting Examination Report with Directives. This amended order stated "...the directive ordering the Company

to cease writing general liability insurance is hereby lifted and the Company may continue to write general liability business, both new and renewal.”

There was no other regulatory action taken by TDCI against the Company during the period under review.

FINANCIAL HISTORY

The following exhibit depicts certain aspects of the growth and financial history of the Company during the period of examination based upon the Company's annual statements filed with the TDCI.

| <u>Year</u> | <u>Net Premiums Earned</u> | <u>Net Losses & LAE Incurred</u> | <u>Loss Ratio</u> | <u>Admitted Assets</u> | <u>Liabilities</u> | <u>Surplus</u> |
|-------------|------------------------------------|--|-----------------------|----------------------------|--------------------|----------------|
| 2005 | \$339,824 | \$257,506 | 75.78% | \$5,220,864 | \$353,708 | \$4,867,156 |
| 2006 | 356,806 | 74,291 | 20.82% | 5,590,675 | 310,846 | 5,279,829 |
| 2007 | 318,929 | 208,959 | 65.52% | 5,668,539 | 341,485 | 5,327,054 |
| 2008 | 372,271 | 80,937 | 21.74% | 5,220,023 | 344,148 | 4,875,875 |
| 2009 | 368,684 | 205,810 | 55.82% | 5,667,255 | 371,429 | 5,295,826 |

ACCOUNTS AND RECORDS

A review of the Company's accounting system indicates that records appear to conform to generally accepted insurance accounting practices as prescribed by the NAIC and appear to accurately reflect the operations of the Company during the period covered by this examination, except as noted below and otherwise commented upon in the section marked "Analysis of Changes in Financial Statement and Comments Resulting From Examination" and "Recommendations".

The Company engaged H G & A Associates, P. C., a Knoxville, Tennessee CPA firm to provide certain accounting services. The Company's Office Manager assisted this CPA firm in the maintenance of all accounting records, preparation of income tax returns, and promulgation of certain regulatory filings including all required NAIC financial statements.

For the five (5) year period of examination, the Company prepared computer-generated statutory trial balances. These balances were reconciled, proved in balance and traced to various exhibits and schedules of the respective annual and quarterly statements by the Company and their auditors. The Company's assets, liabilities, cash receipts and disbursements were recorded using PeachTree Software, which enabled the Company to produce a detailed general ledger. Policy files were maintained in paper form and electronically. Policy information, premium billing and premium receipts for each policy were recorded electronically using a software package developed and maintained by Automated Insurance Management Systems (AIMS) of Richmond, Virginia.

During the course of the examination, such tests and audit procedures were made as were considered to be necessary, including substantial verification of supporting documentation to balance sheet and income statement items. General ledger trial balances, including adjusting journal entries were reconciled by the Examiner with a copy of the 2009 Annual Statement.

The 2006, 2007, 2008 and 2009 Annual Statements originally submitted to the TDCI were each amended and resubmitted once due to minor errors and omissions.

Audited Financial Statements

The Company's auditors, Craine, Thompson and Jones, P. C. filed 2005 through 2009 annual audited financial reports on a statutory basis with the TDCI on or before June 1 pursuant to Tenn. Comp. R. & Regs. R. 0780-01-65. The Company did not meet the filing exemption disclosed in Tenn. Comp. R. & Regs. R. 0780-1-65-.03 due to having more than 1,000 policyholders during each year under examination. The auditors issued a management letter upon completion of their audit in accordance with Statement on Auditing Standards (SAS) Number 114 as established by the American Institute of Certified Public Accountants (AICPA). No issues of material weaknesses in the Company's internal control over financial reporting under standards established by the AICPA were noted. The Company last changed auditors when it filed its 2005 audited financial report.

Management Discussion and Analysis

The Company is required to file a Management Discussion and Analysis ("MD&A") Report with the TDCI pursuant to Tenn. Comp. R. & Regs. R. 0780-01-37-.04(1) and the MD&A Section of the NAIC Annual Statement Instructions for Property and Casualty Companies. The MD&A Report and the Annual Statement are both due on March 1 as required by Tenn. Code Ann. § 56-1-501(b). The Company filed a MD&A Report each year during the period of examination.

Risk Based Capital Report

Tenn. Code Ann. § 56-46-103 requires every domestic insurer to file a Risk Based Capital ("RBC") Report with the commissioner on or before March 1. The Examiner determined that the Company during the period of examination met the requirements set forth in Tenn. Code Ann. § 56-46-110 to request an exemption from filing a Risk Based Capital Report based upon the fact that the Company 1) writes direct business only in the State of Tennessee; 2) writes less than \$2,000,000 in direct annual premiums; 3) and assumes no reinsurance.

Actuarial Opinion

Tenn. Code Ann. § 56-1-501(d) requires every property and casualty insurer doing business in Tennessee to file an opinion by a qualified actuary with their Annual Statement with the commissioner on or before March 1. However, the Company, during the period of examination met the exemption requirements set forth in the Actuarial Opinion Section of the NAIC Annual Statement Instructions for Property and Casualty Companies. The Department requested and the Company submitted an affidavit signed by an officer of the Company and notarized attesting to the fact that the Company's direct plus assumed written premiums during the 2005 through 2009 policy years were less than \$1,000,000 and the Company's direct plus assumed loss and loss adjustment expense reserves at year end were less than \$1,000,000.

DIVIDENDS OR DISTRIBUTIONS

No dividends or distributions have been declared or paid to the policyholders during the period of examination.

SUBSEQUENT EVENTS

Audit Committee

In order to become compliant with Tenn. Comp. R. & Regs. R. 0780-01-65-.05(4) the Company's Executive Committee met on August 6, 2010, and established the Company's Audit Committee as defined by Tenn. Comp. R. & Regs. R. 0780-01-65-.04(3). The Directors, designated as members of the Audit Committee, are Larry D. Baker, President, Herbert M. Bacon, Secretary/Treasurer and Jerry Self. The appointments met the independence rule requirement set forth by Tenn. Comp. R. & Regs. R. 0780-01-65-.15.

FINANCIAL STATEMENT

There follows a statement of assets, liabilities, surplus and statement of income at December 31, 2009, as established by this examination:

ASSETS

| | <u>Current Year</u> |
|---|---------------------|
| Bonds | \$3,756,488 |
| Common Stock | 1,279,551 |
| Real Estate | 70,591 |
| Cash, Cash Equivalents and Short-Term Investments | 420,769 |
| Investment Income Due and Accrued | 59,420 |
| Uncollected Premiums & Agents' Balances in the Course of Collection | 11,128 |
| Deferred Premiums, Agents Balances & Installments Booked but Deferred & Not Yet Due | 63,239 |
| Funds Held By or Deposited With Reinsured Companies | 537 |
| Electronic Data Processing Equipment and Software | 1,763 |
| Aggregate Write-Ins For Other Than Invested Assets | 3,769 |
| Total Admitted Assets | <u>\$5,667,255</u> |

LIABILITIES, SURPLUS, AND OTHER FUNDS

| | <u>Current Year</u> |
|--|---------------------|
| Losses | \$26,939 |
| Other Expenses | 11,279 |
| Unearned Premiums | 241,484 |
| Advance Premiums | 74,143 |
| Funds Held by Company Under Reinsurance Treaties | <u>17,584</u> |
| Total Liabilities | 371,429 |
| Surplus as Regards Policyholders | <u>5,295,826</u> |
| Total Liabilities and Surplus | <u>\$5,667,255</u> |

STATEMENT OF INCOME & POLICYHOLDERS' SURPLUS ACCOUNT

| UNDERWRITING INCOME | |
|---|-----------------|
| Premiums Earned | \$368,684 |
| DEDUCTIONS: | |
| Losses Incurred | 196,210 |
| Net Adjustment Expenses Incurred | 9,600 |
| Other Underwriting Expenses Incurred | <u>194,079</u> |
| Total Underwriting Deductions | <u>399,889</u> |
| Net Underwriting Gain (Loss) | (31,205) |
| INVESTMENT INCOME | |
| Net Investment Income Earned | 143,612 |
| Net Realized Capital Gains (Losses) | <u>(98,036)</u> |
| Net Investment Gain (Loss) | 45,576 |
| OTHER INCOME | |
| Net Gain or (Loss) From Agents' or Premium Balances Charged Off | (1,911) |
| Financial and Service Charges Not Included In Premium | 0 |
| Aggregate Write-Ins For Miscellaneous Income | <u>635</u> |
| Total Other Income | (1,276) |
| Net Income Before Dividends To Policyholders, After Capital Gains Tax and Before All Other Federal and Foreign Income Taxes | 13,095 |
| Dividends To Policyholders | 0 |
| Net Income After Dividends To Policyholders, After Capital Gains Tax and Before All Other Federal and Foreign Income Taxes | 13,095 |
| Federal and Foreign Income Taxes Incurred | 0 |
| Net Income | <u>13,095</u> |

CAPITAL AND SURPLUS ACCOUNT

| | |
|--|--------------------|
| Surplus as Regards Policyholders, December 31 Prior Year | 4,875,875 |
| Net Income | 13,095 |
| Change In Net Unrealized Capital Gains (Losses) | 405,392 |
| Change In Non-Admitted Assets | 1,464 |
| Change In Surplus As Regards Policyholders | 419,951 |
| Surplus As Regards Policyholders as of December 31, 2009 | <u>\$5,295,826</u> |

**Analysis of Changes in Financial Statement and Comments Resulting
From Examination**

Assets

Investment Income Due and Accrued **\$59,420**

The above balance is the same amount reflected by the Company on line 12 of the Assets Page in its 2009 Annual Statement. The Examiner found three (3) instances where the Company accrued interest for bonds that matured prior to December 31, 2009, that were previously held in the Company's Regions, Morgan, Keegan Trust custody account. This caused the Company to overstate the amount of "Investment Income Due & Accrued" by \$7,556.00. However, the \$7,556.00 difference was not considered material for purposes of this examination.

Electronic Data Processing Equipment & Software **\$1,763**

The above balance is the same amount reflected by the Company on line 18 of the Assets Page in its 2009 Annual Statement. Based on the examination procedures performed, the total depreciated value of the Company's "Electronic Data Processing Equipment and Software" was determined to be \$824.00 or \$939.00 less than the \$1,763.00 depreciated total for E.D.P. Equipment and Software as disclosed on page 2, line 18 in the 2009 Annual Statement. The \$939.00 difference was due to the Company not adhering to NAIC Accounting Practices and Procedures - SSAP # 16. However, the \$939.00 difference was not considered material for purposes of this examination. See the Recommendations Section of this report for further discussion of E.D.P. Equipment and Software.

Liabilities

Advance Premiums **\$74,143**

The above balance is the same amount reflected by the Company on line 10 of the Liabilities, Surplus and Other Funds Page in its 2009 Annual Statement. Out of the forty-three (43) policies randomly sampled and tested by the Examiner, sixteen (16) policies showing "Advance Premium" as of December 31, 2009, were cancelled in 2006 and 2007.

The total amount of "Advance Premium" as of December 31, 2009, for these sixteen (16) policies cancelled in 2006 and 2007 was \$8,828.00.

The Examiner determined that the amount of "Advance Premium" as of December 31, 2009, for each of these sixteen (16) policies cancelled in 2006 and 2007 was disclosed in error. Therefore, the Company overstated its liability for "Advance Premium" as of December 31, 2009, for these sixteen (16) policies cancelled in 2006 and 2007 by \$8,828.00. The \$8,828.00 difference was not considered material for purposes of this examination.

COMMENTS AND RECOMMENDATIONS

Comments:

None

Recommendations:

Statutory Reporting of E. D. P. Equipment

NAIC Accounting Practices and Procedures - SSAP # 16, Section 2, states "Non-operating system software are non-admitted assets". Also, NAIC Accounting Practices and Procedures - SSAP # 16, Section 3 requires an insurance company to calculate the depreciated amount of its computer equipment and operating software using a three (3) year depreciation schedule.

Out of the nine (9) pieces of E.D.P. Equipment and Software assets the Company listed as of year-end 2009 on its depreciation schedule that were in use, three (3) were non-operating system software assets. The Company's "AIMS" premium accounting and billing software purchased on December 21, 2006, was depreciated over three (3) years; their "Peachtree" accounting and tax software purchased on August 12, 2006, was depreciated over five (5) years; and a "Peachtree" accounting & payroll tax software upgrade package purchased on February 12, 2009, was depreciated over three (3) years. All three (3) non-operating system software assets should have been accounted for and disclosed as non-admitted assets on the Company's quarterly and annual statutory

statements pursuant to NAIC Accounting Practices and Procedures - SSAP # 16, Section 2.

Furthermore, all six (6) E.D.P. Equipment assets that were listed as of year-end 2009, on the Company's depreciation schedule were depreciated over a period of five (5) years. All of these six (6) E.D.P. Equipment assets should have been depreciated using a three (3) year depreciation schedule in accordance with NAIC Accounting Practices and Procedures - SSAP # 16, Section 3.

CONCLUSION

Insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of Hamblen Mutual Insurance Company of Morristown, Tennessee.

In such manner, it was determined that, as of December 31, 2009, the Company had admitted assets of \$5,667,255 and liabilities, exclusive of unassigned funds, of \$371,429. Thus, there existed for the additional protection of the policyholders unassigned funds (surplus) of \$5,295,826.

Tenn. Code Ann. § 56-22-106(b)(1) requires the Company to provide "the same financial security to "policyholders", and meet all other requirements applicable to stock insurance companies writing the same insurance transactions" in order to "provide comprehensive personal liability, farmers comprehensive personal liability, premises liability for dwellings of up to four (4) families, and medical payments coverage associated therewith, subject to the same limitations that apply to stock companies".

The minimum amount of capital and surplus necessary for a stock insurance company to be licensed in Tennessee is \$1,000,000 and \$1,000,000, respectively, as required by Tenn. Code Ann. § 56-2-114 and Tenn. Code Ann. § 56-2-115.. Therefore, based upon the 2005 through 2009 Annual Statements filed with the TDCI and the results of this financial examination the Company exceeded the \$2,000,000 minimum amount of capital and surplus requirement imposed upon stock insurance companies licensed in Tennessee and thus provides "the same financial security to policyholders..." that is "applicable to stock insurance companies writing the same insurance transactions...".

Finally, Tenn. Code Ann. § 56-22-101(b) also requires the Company to "meet all other requirements applicable to stock insurance companies writing the same insurance transactions". Except for the above stated "Recommendation" the Examiner found the Company to be fully compliant with Tenn. Code Ann. § 56-22-101(b).

The courteous cooperation of the officers, directors, Office Manager and Agent of the Company extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner
State of Tennessee
Southeastern Zone, NAIC

Examination Affidavit

The undersigned deposes and says that he has duly executed the attached examination report of the Hamblen Mutual Insurance Company, dated August 1, 2011, and made as of December 31, 2009, on behalf of "The Tennessee Department of Commerce and Insurance". 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.

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner
State of Tennessee
Southeastern Zone, NAIC

County Davidson
State Tennessee

Subscribed and sworn to before me
this 2nd day of
August, 2011

Helen W. Dorsey
(Notary)

