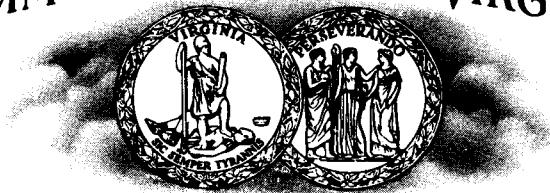


EXAMINATION REPORT
on
LOUDOUN MUTUAL INSURANCE COMPANY
WATERFORD, VIRGINIA
as of
DECEMBER 31, 2009

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF VIRGINIA

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE



P.O. BOX 1157
RICHMOND, VIRGINIA 23218
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STATE CORPORATION COMMISSION BUREAU OF INSURANCE

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Loudoun Mutual Insurance Company as of December 31, 2009, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 9th day of August, 2010

A handwritten signature in cursive script that reads "Alfred W. Gross".

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
May 7, 2010

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Commissioner:

Pursuant to your instructions and by authority of § 38.2-1317 of the Code of Virginia, an examination of the financial condition, records and affairs of the

LOUDOUN MUTUAL INSURANCE COMPANY
Waterford, Virginia

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a mutual assessment property and casualty insurer. The last examination of the Company was made by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2006. The current examination covers the three year period from January 1, 2007 through December 31, 2009.

HISTORY

The Company was chartered by an Act of the General Assembly of Virginia on March 12, 1849. The Company's business was originally limited to fire, lightning and extended coverage until it began issuing homeowners coverage subsequent to an amendment to its charter on November 13, 1961. According to its charter, the Company shall engage in and transact fire insurance and, when issued as a supplemental or comprehensive contract in connection with a fire insurance policy, issue, engage in and transact miscellaneous property insurance, water damage insurance, burglary and theft insurance, glass insurance, personal injury liability insurance, property damage liability insurance, marine insurance and contingent and consequential losses insurance.

MANAGEMENT AND CONTROL

The articles of incorporation provide that the business of the Company shall be managed by a board of not more than thirteen directors divided into three classes. Two classes shall consist of not more than four directors and one class of not more than five. Directors shall be elected to three year terms by the members at the annual meeting. Only one class of directors shall be up for election at each annual meeting. Vacancies are filled by the board with such directors serving until the end of the unexpired term. Only members of the Company may be elected to the board. No person who has attained the age of 72 shall be elected a director and any director who has attained the age of 72 shall be required to resign once a replacement has been elected.

The bylaws stipulate that the Company shall have a chairman of the board who shall be elected at the annual meetings and who shall preside over the board and the executive committee. There shall be a vice chairman of the board who shall be elected at the annual meeting and who shall carry out the duties and functions of the chairman in his or her absence. The officers of the Company shall be elected by the board at each annual board meeting. The officers shall be a president, a secretary, a treasurer, an assistant treasurer and such other officers as the board of directors may deem necessary. The president shall be a member of the board of directors. The treasurer, assistant treasurer, and secretary may or may not be members of the board. Directors, officers and committees of the Company at December 31, 2009, were as follows:

Directors

Principal Occupation

Donald A. Butler

Owner
New Line Virginia Property Group, Inc.
Winchester, Virginia

Christopher G. Shipe

President
Loudoun Mutual Insurance Company
Waterford, Virginia

William C. Orndoff

Treasurer
Frederick County
Clearbrook, Virginia

M. Byrd Inskip

Partner
Battle Park Farms
Culpepper, Virginia

Mary M. Finnell	Retired Co-Manager Edward Jones Brokerage Maurertown, Virginia
Brian S. Montgomery	President Warrenton Foreign Car, Inc. Warrenton, Virginia
Richard C. Oliver	Owner Richard C. Oliver & Sons Dairy Orange, Virginia
Richard C. Shickle	Vice President, Administration and Finance Shenandoah University Winchester, Virginia
Robert W. Smalley, Jr.	President Smalley Packaging Co., Inc. Berryville, Virginia
Marilyn A Jarvis	Loan Officer Farm Credit of Virginia Purcellville, Virginia
Samuel B. Welsh	Retired Dairy Farmer Leesburg, Virginia
John T. Clemens	Retired President Loudoun Mutual Insurance Company Round Hill, Virginia

Officers

Richard C. Shickle	Chairman of the Board
Robert W. Smalley, Jr.	Vice Chairman of the Board
Christopher G. Shipe	President
Linda L. Mock	Corporate Secretary
Loyd C. Hutchison, II	Vice President and Treasurer
April O. Bridgeman	Vice President and Claims Manager
Timothy J. Koppenhaver	Vice President and Underwriting Manager
J. David King	Vice President and Marketing Manager
Todd E. Robertson	Vice President and IT Manager/Assistant Treasurer

Executive Committee

Richard C. Shickle, Chairman
 Christopher G. Shipe
 John T. Clemens

Donald A. Butler
 Robert W. Smalley, Jr.

Investment Committee

William C. Orndoff, Chairman
 Mary M. Finnell
 Christopher G. Shipe

Loyd C. Hutchison, II
 Richard C. Shickle

Audit Committee

Donald A Butler, Chairman
 M. Byrd Inskip
 Richard C. Oliver

Marilyn A. Jarvis
 C. William Orndoff
 Richard C. Shickle

Personnel Committee

Richard C. Oliver, Chairman
 Donald A. Butler

Samuel B. Welsh
 Richard C. Shickle

Technology Committee

Brian S. Montgomery, Chairman
 Samuel B. Welsh
 Richard C. Shickle

Marilyn A. Jarvis
 Todd E. Robertson

Reinsurance Committee

Robert W. Smalley, Jr., Chairman
 Mary M. Finnell

John T. Clemens
 Richard Shickle

FIDELITY BOND AND OTHER INSURANCE

The Company had fidelity bond coverage in force at December 31, 2009, with a \$2,000,000 limit of liability subject to a \$20,000 deductible. Additionally, the Company had directors and officers and professional liability, commercial property and liability, commercial auto, commercial umbrella, workers' compensation coverage, and employment practices liability in force at December 31, 2009.

PENSION PLANS

The Company's employees participate in a noncontributory defined benefit pension plan. At December 31, 2009, the actuarial present value of accumulated plan benefits, determined using a 7% assumed rate of return, was \$2,434,834 and the fair value of plan assets available for benefits was \$1,994,388. The Company contributed the following amounts to the plan during the examination period:

2007	\$343,968
2008	\$400,000
2009	\$726,200

TERRITORY AND PLAN OF OPERATION

The Company is licensed by the State Corporation Commission to operate as a mutual assessment property and casualty insurer throughout the Commonwealth of Virginia. Its business is concentrated in the northern, central and western regions of the state.

Policies are marketed through 100 independent agencies which accept applications for fire insurance with optional standard coverages or homeowners insurance. The agent inspects the property and applies rates from a schedule provided by the Company. The agent has the option of increasing the premium as much as 50% for certain higher risk properties. Final approval and authority for all policy issues rests with the underwriting staff. Agents have the authority to pay claims up to \$1,000, however, the adjudication of all claims is done by the home office and final approval rests with the claims department.

REINSURANCE

The Company had the following reinsurance agreements in force at December 31, 2009:

Ceded:

<u>Type of Agreement</u>	<u>Business Covered</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Excess of Loss First Excess Cover	Property	\$200,000	\$300,000 per risk; liability of reinsurer shall not exceed a total payment of net loss and adjustment expense of \$900,000 per occurrence
Excess of Loss Second Excess Cover	Property	\$500,000	\$500,000 per risk; liability of reinsurer shall not exceed \$1,500,000 with respect to all net loss and adjustment expenses per occurrence
Excess of Loss Third Excess Cover	Property	\$1,000,000	\$1,000,000 per risk; liability of reinsurer shall not exceed \$2,000,000 with respect to all net loss and adjustment expenses per occurrence
Excess of Loss First Excess Cover	Liability	\$200,000	\$300,000 per occurrence
Excess of Loss Second Excess Cover	Liability	\$500,000	\$500,000 per occurrence
Excess of Loss Third Excess Cover	Liability	\$1,000,000	\$1,000,000 per occurrence

<u>Type of Agreement</u>	<u>Business Covered</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Excess of Loss	Property (Facultative)	\$2,000,000	10 times the Company's net retention plus the amount ceded to the Company's working reinsurance, subject to a minimum retention of \$50,000 and to a maximum cession of \$3,000,000 any risk
Excess of Loss First Excess Cover	Property (Catastrophe)	\$2,000,000	\$3,000,000 of ultimate net loss in excess of company retention of \$2,000,000 any one loss occurrence
Excess of Loss Second Excess Cover	Property (Catastrophe)	\$5,000,000	\$5,000,000 of ultimate net loss in excess of company retention of \$5,000,000 any one loss occurrence
Excess of Loss Third Excess Cover	Property (Catastrophe)	\$10,000,000	\$10,000,000 of ultimate net loss in excess of company retention of \$10,000,000 any one loss occurrence
Fourth Property Catastrophe Excess	Property (Catastrophe)	\$20,000,000	\$5,000,000 of ultimate net loss in excess of company retention of \$20,000,000 any one loss occurrence
Quota Share and Excess of Loss (Umbrella Facultative)	Liability	5% of first \$1,000,000 each loss occurrence	95% of first \$1,000,000 each loss occurrence and up to 100% of the next \$4,000,000 each loss occurrence

The Company also offers optional identity theft coverage on all its homeowners, mobile homeowners, and farmowners policies through The Hartford Steam Boiler Inspection and Insurance Company (Hartford). The Company cedes 100% of the premium and 100% of the liability under the identity theft coverage to Hartford.

All reinsurance agreements contain an insolvency clause.

Assumed:

The Company assumes a small amount of reinsurance from the Regional Reciprocal Catastrophe Pool (RRCP), a pool of reinsurers, all who are a party to this agreement and all are licensed or qualified in Virginia.

The Company assumes a small amount of reinsurance from the National Association of Mutual Insurance Company's (NAMIC) as part of a retrocessional pool. The Company's participation allows it to have access to NAMIC's directors and officers and professional liability coverage.

GROWTH OF THE COMPANY

The following data, taken from annual statements filed with the Bureau of Insurance and the financial statements contained in examination reports, reflects the growth of the Company for the ten-year period ending December 31, 2009:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Unassigned Funds</u>
2000	\$28,709,151	\$8,613,234	\$20,095,917
2001	28,114,502	10,052,381	18,062,121
2002	28,107,519	11,808,734	16,298,785
2003	29,454,279	13,287,863	16,166,416
2004	34,251,676	15,481,213	18,770,463
2005	39,502,024	17,975,116	21,526,908
2006	41,850,214	17,440,029	24,410,185
2007	48,128,284	19,146,646	28,981,638
2008	45,761,404	19,339,765	26,421,639
2009	49,333,625	20,554,115	28,779,510

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses and Loss Adjustment Expenses</u>	<u>Other Underwriting Expenses</u>	<u>Gain or (Loss)</u>
2000	\$8,115,229	\$6,546,845	\$3,586,975	(\$2,018,591)
2001	9,464,746	6,919,016	4,201,115	(1,655,385)
2002	11,421,934	7,671,098	5,095,409	(1,344,573)
2003	13,892,598	9,786,474	5,906,505	(1,800,381)
2004	16,267,488	8,350,399	6,585,526	1,331,563
2005	18,409,625	8,762,791	7,167,498	2,479,336
2006	19,567,264	7,857,639	7,705,397	4,004,228
2007	21,629,884	10,135,571	8,486,696	3,007,617
2008	22,508,384	13,104,892	8,173,351	1,230,141
2009	23,263,837	13,515,145	8,493,690	1,255,002

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2007 through December 31, 2009. Assets were verified and liabilities were established at December 31, 2009. A review of income and disbursements for the period was made to the extent deemed necessary.

This examination was conducted in accordance with the NAIC *Financial Condition Examiners' Handbook* (Handbook). The Handbook requires that the Bureau plan and perform the examination to evaluate the Company's financial condition and identify prospective risks of the Company, assess corporate governance, identify and assess inherent risks within the Company, 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, and 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.

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2009, a statement of income for the period ending December 31, 2009, a reconciliation of surplus for the period under review, and a statement of cash flow as of December 31, 2009. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$27,247,767		\$27,247,767
Common stocks	12,658,249		12,658,249
Properties occupied by the company	943,833		943,833
Cash and short-term investments	4,165,713		4,165,713
Other invested assets	211,085	211,085	
Investment income due and accrued	255,147		255,147
Uncollected premiums and agents' balances in the course of collection	2,911,180		2,911,180
Amounts recoverable from reinsurers	40,160		40,160
Other amounts receivable under reinsurance contracts	87,226		87,226
Federal income tax recoverable	360,000		360,000
Net deferred tax asset	568,927		568,927
Guaranty funds receivable or on deposit	82,181		82,181
Electronic data processing equipment and software	71,851	66,333	5,518
Furniture and equipment	59,122	59,122	
Aggregate write-ins for other than invested assets	7,724		7,724
Totals	<u>\$49,670,165</u>	<u>\$336,540</u>	<u>\$49,333,625</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$4,036,477
Loss adjustment expenses		352,000
Commissions payable, contingent commissions and other similar charges		1,092,969
Other expenses		92,897
Taxes, licenses and fees		282,265
Current federal income taxes		123,500
Unearned premiums		12,935,635
Advanced premiums		1,147,534
Ceded reinsurance premiums payable		37,360
Aggregate write-ins for liabilities		<u>453,478</u>
 Total liabilities		 \$20,554,115
 Unassigned funds (surplus)	<u>\$28,779,510</u>	
 Surplus as regards policyholders		 <u>28,779,510</u>
 Totals		 <u><u>\$49,333,625</u></u>

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	<u>\$23,263,837</u>
Deductions:	
Losses incurred	\$11,556,276
Loss adjustment expenses incurred	1,958,869
Other underwriting expenses incurred	<u>8,493,690</u>
Total underwriting deductions	<u>\$22,008,835</u>
Net underwriting gain	<u>\$1,255,002</u>

INVESTMENT INCOME

Net investment income earned	\$329,752
Net realized capital gains	<u>117,032</u>
Net investment gain	<u>\$446,784</u>

OTHER INCOME

Finance and service charges not included in premiums	\$173,677
Aggregate write-ins for miscellaneous income	<u>5,513</u>
Total other income	<u>\$179,190</u>
Net income before federal income taxes	\$1,880,976
Federal income taxes incurred	<u>533,208</u>
Net income	<u><u>\$1,347,768</u></u>

RECONCILIATION OF CAPITAL AND SURPLUS
FOR PERIOD UNDER REVIEW

	<u>2007</u>	<u>2008</u>	<u>2009</u>
Surplus as regards policyholders, December 31, previous year	<u>\$24,410,185</u>	<u>\$28,981,638</u>	<u>\$26,421,639</u>
Net income	\$3,575,073	(\$526,945)	\$1,347,768
Change in net unrealized capital gains or (losses)	1,255,100	(2,873,844)	1,729,455
Change in net deferred income tax	(16,066)	1,014,246	(534,656)
Change in nonadmitted assets	(379,204)	466,675	121,657
Change in provision for reinsurance Aggregate write-ins for gains and losses in surplus	<u>136,550</u>	<u>(640,131)</u>	<u>(306,353)</u>
Change in surplus as regards policyholders for the year	<u>\$4,571,453</u>	<u>(\$2,559,999)</u>	<u>\$2,357,871</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$28,981,638</u></u>	<u><u>\$26,421,639</u></u>	<u><u>\$28,779,510</u></u>

CASH FLOW**Cash From Operations**

Premiums collected net of reinsurance	\$22,976,616
Net investment income	538,487
Miscellaneous income	179,190
Total	<u>\$23,694,293</u>
Benefit and loss related payments	\$10,906,746
Commissions, expenses paid and aggregate write-ins for deductions	10,508,202
Federal income taxes paid	(295,792)
Total	<u>\$21,119,156</u>
Net cash from operations	<u>\$2,575,137</u>

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$7,920,307
Stocks	30,777,390
Miscellaneous proceeds	69,498
Total investment proceeds	<u>\$38,767,195</u>
Cost of investments acquired (long-term only):	
Bonds	\$10,845,038
Stocks	30,977,268
Total investments acquired	<u>\$41,822,306</u>
Net cash from investments	<u>(\$3,055,111)</u>

Cash From Financing and Miscellaneous Sources

Cash provided (applied):	
Other cash applied	<u>(\$22,808)</u>
Net cash from financing and miscellaneous sources	<u>(\$22,808)</u>
Net change in cash and short-term investments	<u>(\$502,782)</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	\$4,668,495
End of year	4,165,713
Net change in cash and short-term investments	<u>(\$502,782)</u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Management and Control

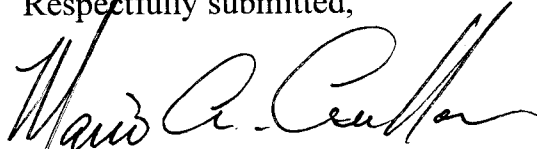
1. During the review of the Company's Information Systems, it was noted the Company does not have a comprehensive disaster recovery plan. Agreements are in place to provide the technological needs of the Company in the event of a disaster. However, the Company does not have a plan in place to address all its business functions. The Examiners recommend the Company develop, implement and maintain a disaster recovery plan to include all essential departments within the Company.
2. During the review of Information Technology, the Examiners noted that the server room is kept open and accessible to all employees. Access to the server room should be kept controlled and limited to certain employees. The Examiners recommend the Company take the necessary steps to close off the server room to all employees except those few that require access in order to carry out their job duties.

CONCLUSION

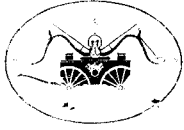
The courteous cooperation extended by the officers and employees of the Company during the course of the examination was sincerely appreciated.

In addition to the undersigned, Theresa C. Lewis, CFE, Jennifer K. Crawley, CFE and T. Bradford Earley, CFE participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mario A. Cuellar". The signature is fluid and cursive, with a large initial "M" and "C".

Mario A. Cuellar, CFE
Senior Insurance Examiner
Commonwealth of Virginia



LOUDOUN MUTUAL

INSURANCE COMPANY

STATE CORP. COMMISSION
BUREAU OF INSURANCE
10 JUL 16 AM 10:01

July 13, 2010

David H. Smith, CFE, CPA, CPCU
Chief Examiner
Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

RE: Loudoun Mutual Insurance Company,
Examination Report as of December 31, 2009

Dear Mr. Smith:

We take no exceptions with the findings in the draft examination report submitted for our review. Please provide us with 15 copies of the final examination report so that we may provide a copy to each of the Loudoun Mutual Directors and maintain several on file for future use.

In response to the recommendations for corrective action found on page 17 of the examination report, we have taken the following steps:

Response to Recommendation #1

Immediately upon the completion of the 2009 examination, Senior Management at Loudoun Mutual began the process of developing a more comprehensive disaster recovery plan. Each manager has been documenting their department operations and identifying the critical processes in the department that need to be recovered as well as the procedures needed to recover the operations. Additionally the company has purchased software from TAMP systems to assist with the documentation of a more comprehensive plan. It is the goal of the company to have the current plan updated by the fourth quarter of 2010.

Response to Recommendation #2

The computer room is being divided off so that access to the servers will be better controlled.

We would like to note and express our appreciation for the professionalism demonstrated by the Examiners while they were onsite here at Loudoun Mutual.

If there are any further questions, comments, or concerns, please feel free to contact me.

Sincerely,

A handwritten signature in black ink that reads "Christopher G. Shipe". The signature is written in a cursive style with a large initial 'C' and 'S'.

Christopher G. Shipe AIT, CPCU
President/CEO