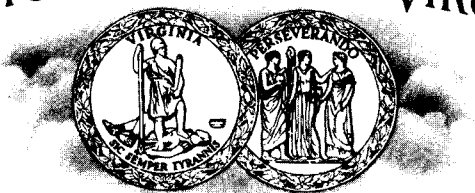


EXAMINATION REPORT
on
SMYTH COUNTY MUTUAL INSURANCE COMPANY
Marion, Virginia
as of
December 31, 2008

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Smyth County Mutual Insurance Company as of December 31, 2008, 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 21st day of December, 2009

Alfred W. Gross
Commissioner of Insurance

(SEAL)

TABLE OF CONTENTS

Description.....1

History.....1

Management and Control.....2

Territory and Plan of Operation.....3

Administrative Services Agreement.....3

Fidelity Bond and Other insurance.....4

Reinsurance.....4

Growth of the Company.....5

Scope.....6

Financial Statements.....6

Recommendations for Corrective Action.....11

Conclusion.....12

Richmond, Virginia
September 4, 2009

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

Dear Sir:

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

SMYTH COUNTY MUTUAL INSURANCE COMPANY

Marion, 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 licensed pursuant to Chapter 25 of Title 38.2 of the Code of Virginia. The Company was last examined by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008.

HISTORY

The Company was granted a charter by the State Corporation Commission on June 22, 1933. The purpose for which the Company was formed, according to its charter, is as follows:

To carry on the business of a mutual assessment fire insurance company throughout the entire Commonwealth of Virginia in the manner prescribed by law.

In December 1984, Craig Mutual Assessment Fire Insurance Company, Inc. merged with the Company.

On May 29, 2002, the Company entered into an Affiliation Agreement with Virginia Farm Bureau Mutual Insurance Company (VFB Mutual) for the purpose of improving the Company's financial condition and underwriting stability and preserving and expanding its insurance business. Under the terms of the Affiliation Agreement, all but one of the Company's former directors resigned from the Board of Directors. The remaining director then appointed qualified persons, each of whom was a director of VFB Mutual, to fill the vacancies created by the resignations. The one remaining director subsequently resigned from the Company's Board. The former officers also resigned and new officers were appointed by the Company's new Board.

The Affiliation Agreement also provided that the Company would enter into two additional agreements with VFB Mutual: a Net Premiums Reinsurance Agreement and an Administrative Services Agreement (both agreements discussed in subsequent sections of this report). The Affiliation Agreement further provided that VFB Mutual would contribute \$100,000 to the Company in the form of a Subordinated Surplus Debenture. The Bureau approved the transaction on May 30, 2002. In 2004, the Subordinated Surplus Debenture was paid back in full following Bureau approval.

MANAGEMENT AND CONTROL

The bylaws of the Company provide that the Board of Directors shall control and manage the affairs and business of the Company. The Board shall consist of no fewer than five members. Directors shall be elected at the annual membership meeting and shall serve for one year terms. Each Board member shall serve until the election and acceptance of his or her duly qualified successor. The bylaws also provide that the Board shall elect a president, executive vice president, vice president, secretary, treasurer and any other officers deemed necessary. The bylaws also provide the Company the option to create an Executive Committee consisting of the president, and two other Board members. The Executive Committee would have and perform all the powers and duties of the Board between meetings.

At December 31, 2008, the Company's Board of directors and officers were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
Archie B. Atwell	Farmer Smyth County
Wayne F. Pryor	President VFB Mutual and Affiliated Companies

Obia B. Lockhart	Farmer Russell County
Gordon R. Metz, Jr.	Farmer Henry County
Edward A. Scharer	Farmer Albemarle County

Officers

President	Wayne F. Pryor
Executive Vice President	Richard L. Rivers
Vice President	Edward A. Scharer
Secretary	Jonathan S. Shouse
Assistant Treasurer	David A. Priddy
Assistant Treasurer	Peggy McClelland

TERRITORY AND PLAN OF OPERATION

The Company is licensed to operate throughout the Commonwealth of Virginia but currently does not write business in the coastal territory of Virginia.

The lines of insurance the Company is licensed to write include fire, homeowners multiple peril, liability other than auto, miscellaneous property, farm multiple peril, commercial multiple peril, inland marine, glass, burglary and theft, and animal. Policies are issued for a period of one year and are continuous upon compliance with all provisions of the policy. The Company's maximum retention on any one risk is \$22,500. New business is solicited by independent agents and is underwritten by management approved office staff. Claims investigations and adjustments are handled by claims adjustors employed by VFB Mutual.

ADMINISTRATIVE SERVICES AGREEMENT

The Company entered into an Administrative Services Agreement with VFB Mutual on May 29, 2002. The agreement states that VFB Mutual will perform and provide accounting, financial, investment, actuarial, underwriting, claims and computer services for the Company. In consideration of the services, the Company shall pay VFB Mutual for the actual cost of its labor and expenses incurred in providing such services.

The Company had expenses under this agreement of \$84,181, \$104,041 and \$67,381 for 2008, 2007 and 2006 respectively.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2008, the Company was a named insured on a fidelity bond in force to insure against losses arising from fraudulent or dishonest acts by any employee of the Company. The bond provides coverage in the amount of \$2,000,000 with a \$20,000 deductible. Additionally, the Company had workers' compensation, commercial liability, professional liability, and directors' and officers' liability coverage in effect at December 31, 2008.

REINSURANCE

At December 31, 2008, the Company had a reinsurance agreement in place with American Agricultural Insurance Company that contained the following provisions:

<u>Agreement Provisions</u>	<u>Business Covered</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Excess of Loss	Property	\$450,000	\$1,500,000; Limit of liability for a single loss event is \$3,000,000
Excess of Loss	Liability	\$450,000	\$1,500,000; Limit of liability for a single loss event is \$3,000,000

The above reinsurance agreement contained an insolvency clause.

As stated previously, the Company entered into a Net Premiums Reinsurance Agreement with VFB Mutual effective May 29, 2002. Pursuant to the agreement, the Company agrees to cede 95% of its net premiums earned and net losses incurred to VFB Mutual. In addition, VFB Mutual will reimburse the Company for 95% of the net underwriting expenses incurred by the Company and will pay the Company a ceding commission of 0.5% of net premiums written by and assumed from the Company. This agreement contains an insolvency clause.

GROWTH OF THE COMPANY

The following data, obtained from annual statements filed with the Bureau and from examination reports, indicates the growth of the Company for the ten-year period ending December 31, 2008.

Year	Admitted Assets	Liabilities	Surplus
1999	\$1,318,620	\$666,558	\$652,062
2000	1,252,243	783,582	468,661
2001	1,156,717	812,120	344,597
2002	862,199	297,402	564,797
2003	1,179,274	553,198	626,076
2004	1,071,753	715,373	356,380
2005	1,263,187	563,939	699,248
2006	1,286,881	549,784	737,097
2007	1,338,798	547,506	791,292
2008	1,422,201	568,052	854,149

Yes	Net Assessments Received	Investment Income	Net Losses Paid	Number of Policies	Insurance in Force
1999	\$956,230	\$86,513	\$462,681	5,234	\$471,959,026
2000	924,239	100,357	523,554	5,191	501,731,417
2001	902,720	76,595	701,072	5,267	566,535,162
2002	35,742	52,975	492,296	5,495	653,440,006
2003	296,456	43,398	40,981	4,814	625,568,361
2004	960	133,619	28,913	4,607	636,847,743
2005	89,291	12,445	40,025	4,304	637,157,604
2006	54,704	20,925	27,867	4,150	661,776,247
2007	80,078	25,336	28,330	4,006	718,572,184
2008	80,447	14,542	22,851	3,961	780,378,764

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, 2006 through December 31, 2008. Assets were verified and liabilities were established at December 31, 2008. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet had a low or medium risk assessment as determined from the principles of the risk-based examination procedures contained in the National Association of Insurance Commissioners *Examiners' Handbook*. Analytical review procedures were applied to non-material items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History
Corporate Records
Management and Control
Territory and Plan of Operation
Contracts and Underwriting
Fidelity Bond
Conflict of Interest
Growth of the Company
Reinsurance
Accounts and Records
Financial Statements

FINANCIAL STATEMENTS

There follows a statement of income and disbursements for the period under review and a statement of financial condition as of December 31, 2008.

INCOME

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net assessments received	\$54,704	\$80,078	\$80,447
Interest on bonds	1,895	5,599	3,842
Interest on cash deposits	16,566	17,225	3,760
Dividends on stocks	2,464	2,446	6,940
Gain on sale of investments		66	
Other income	<u>10,905</u>	<u>11,001</u>	<u>11,419</u>
 Total income	 \$86,534	 \$116,415	 \$106,408
 Deduct total disbursements for the year	 <u>38,590</u>	 <u>74,173</u>	 <u>44,149</u>
 Net income	 \$47,944	 \$42,242	 \$62,259
 Add ledger assets December 31, previous year	 <u>1,265,381</u>	 <u>1,313,325</u>	 <u>1,355,567</u>
 Ledger assets December 31, current year	 <u><u>\$1,313,325</u></u>	 <u><u>\$1,355,567</u></u>	 <u><u>\$1,417,826</u></u>

DISBURSEMENTS

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net losses paid	\$27,867	\$28,330	\$22,851
Loss adjustment expenses	10,049	8,389	6,295
Commissions and brokerage	(16,550)	6,921	(15,450)
Gross salaries	143,551	174,507	175,940
Directors' fees	1,680	1,523	2,131
Travel and travel items	3,467	6,780	5,468
Boards, bureaus and associations	10,797	11,091	11,376
Legal and auditing	2,900	1,733	30,000
Outside inspection, loss prevention and survey services	1,534	1,452	2,193
Furniture, fixtures and equipment	6,681	10,996	14,717
Rent, office and equipment maintenance	8,646	9,527	9,737
Advertising	4,399	4,984	4,954
Printing and stationery	4,728	3,394	2,746
Postage, telephone and express	7,447	6,344	7,657
Insurance and fidelity bonds	839	1,139	988
Charitable contributions	750	850	750
Miscellaneous	1,422	13,357	2,962
Expenses reimbursed by affiliates	(182,755)	(230,023)	(252,530)
Taxes, licenses and fees	1,703	1,464	1,501
Payroll items	20,211	25,628	28,587
Other employee benefits	(20,871)	(23,662)	(27,754)
Federal corporate income tax	1	9,334	8,910
Investment expenses	94	115	120
	<u>94</u>	<u>115</u>	<u>120</u>
Total disbursements	<u>\$38,590</u>	<u>\$74,173</u>	<u>\$44,149</u>

ASSETS

	<u>Ledger Assets</u>	<u>Non- Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$300,000			\$300,000
Common stocks	154,103	5,092		159,195
Cash in company's office	225			225
Cash on deposit	701,638			701,638
Interest due and accrued		5,889		5,889
Dividends and real estate income due and accrued		279		279
Assessments due	210,058			210,058
Reinsurance recoverable on paid losses	29,678			29,678
Equipment, furniture and supplies	3,443		3,443	
VA guaranty association	10,614			10,614
EDP equipment	6,641		6,641	
Net deferred tax asset		8,904	4,279	4,625
Prepaid expenses	1,426		1,426	
	<u>1,417,826</u>	<u>20,164</u>	<u>15,789</u>	<u>1,422,201</u>
Total assets	<u>\$1,417,826</u>	<u>\$20,164</u>	<u>\$15,789</u>	<u>\$1,422,201</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Net unpaid losses		\$5,559
Loss adjustment expenses unpaid		21,790
Fees or commissions payable		33,866
Salaries due or accrued		22,220
Payroll items		4,256
Other expenses due or accrued		179
Taxes, licenses and fees		18,481
Ceded reinsurance balances payable		201,824
Assessments unearned		41,752
Federal corporate income tax		13,000
Advanced premiums		94,958
Due to affiliates		<u>110,167</u>
Total liabilities		\$568,052
Unassigned funds	<u>\$854,149</u>	
Excess of admitted assets over liabilities (surplus)		<u>854,149</u>
Total liabilities and surplus		<u><u>\$1,422,201</u></u>

RECOMMENDATIONS FOR CORRECTIVE ACTION**Management and Control**

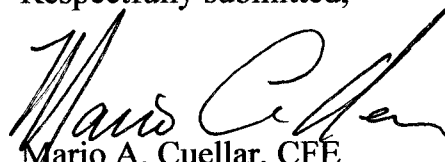
During a review of the Company's reserve process, it was noted that the Company utilizes the services of VFB Mutual's claim adjusters to provide claim adjustment services. In return for this service, VFB Mutual charges the Company a percentage of paid losses. However, there is no written agreement between the entities that describes the services provided, the rate to be charged, and the terms of settlement.

The Examiners recommend that the Company execute a written agreement that provides for the terms of this arrangement between the entities.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the course of the examination is gratefully acknowledged. In addition to the undersigned, T. Bradford Earley, Jr., CFE, Theresa C. Lewis, CFE, Jennifer K. Crawley, CFE, and Gina M. Gainer of the Bureau participated in the work of the examination.

Respectfully submitted,



Mario A. Cuellar, CFE
Senior Insurance Examiner

Smyth County Mutual Insurance Company

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November 20, 2009

STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

09 NOV 30 AM 10:11

Mr. David H. Smith, CFE, CPA, CPCU
Chief Examiner
State Corporation Commission
Bureau of Insurance
P. O. Box 1157
Richmond, Virginia 23218

Dear Mr. Smith:

RE: Smyth County Mutual Insurance Company
Examination Report as of December 31, 2008

The following is in response with respect to the recommendations for corrective action in the above referenced examination report.


Management and Control

In recognition of the economics of scale and business expertise, Smyth County Mutual Insurance Company does utilize the services of Virginia Farm Bureau Mutual's claims adjustors to provide claim adjustment services. We agree that the terms and services provided should be more formalized; therefore, a written agreement between the two parties describing the services, rate to be charged, and terms of settlement will be executed by the end of 2009.

We appreciate the guidance and cooperation extended by all participating throughout the course of the examination. We would appreciate receiving five copies of the final report.

Sincerely,

SMYTH COUNTY MUTUAL INSURANCE CO.



Jeff Dillon
Senior Vice President and Treasurer