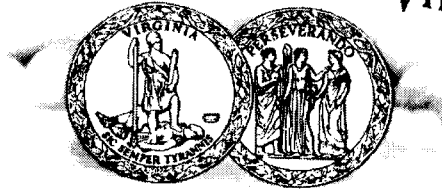


Examination Report
on
FARMERS MUTUAL FIRE INSURANCE COMPANY
OF WASHINGTON COUNTY, VIRGINIA
Abingdon, Virginia
as of
December 31, 2010

COMMONWEALTH OF VIRGINIA

JACQUELINE K. CUNNINGHAM
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



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I, Jacqueline K. Cunningham, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Farmers Mutual Fire Insurance Company of Washington County, Virginia as of December 31, 2010, 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 22nd day of July, 2011

Jacqueline K. Cunningham
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
April 21, 2011

Honorable Jacqueline K. Cunningham
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Madam:

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

**FARMERS MUTUAL FIRE INSURANCE COMPANY
OF WASHINGTON COUNTY, VIRGINIA
Abingdon, 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 under and subject to Chapter 25 of Title 38.2 of the Code of Virginia. It was last examined by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2010.

HISTORY

The Company was granted a charter on December 13, 1910, which has been amended several times. According to the charter, the purpose for which the Company was formed is as follows:

...to carry on a mutual assessment fire insurance company transacting mutual assessment fire insurance as defined by Section 38.1-659 of the Code of Virginia as amended from time to time.

The most recent amendment, which was made on September 8, 1981, restricted the Company's operations to the four adjacent counties of Russell, Scott, Smyth and Washington and the city of Bristol, Virginia.

MANAGEMENT AND CONTROL

The management of the Company is vested in a board of directors consisting of nine members. As provided in the Company's bylaws, directors are elected by members at their annual meeting to serve for a period of three years. A majority of the directors constitutes a quorum for any meeting of the board. The board of directors elects the officers.

At December 31, 2010, the directors and officers of the Company were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
James C. Atwell	Farmer, Retired Abingdon, Virginia
Robert C. Berry	Farmer Abingdon, Virginia
David R. Fore	Retired Abingdon, Virginia
Michael Countiss	Farmer Abingdon, Virginia
Walter R. McNew	Retired Abingdon, Virginia
James W. Hay	Retired Deputy Sheriff Abingdon, Virginia
W. Blair Keller, Jr.	Retired Abingdon, Virginia
Lawrence T. Lester	Farmer Meadowview, Virginia
Russell T. Smith, Jr.	Farmer Meadowview, Virginia

Officers

James C. Atwell	President
Lawrence T. Lester	Vice President
Nannie T. Groseclose	Secretary-Treasurer

FIDELITY BOND AND OTHER INSURANCE

The Company had a fidelity bond in force at December 31, 2010, providing coverage in the amount of \$100,000, subject to a deductible of \$1,000 per occurrence. The Company also had insurance coverages in force that included workers' compensation, professional liability and directors' and officers' liability, commercial property, commercial general liability, inland marine, and commercial excess liability (umbrella) coverage.

TERRITORY AND PLAN OF OPERATION

The Company limits its operations to the four counties of Russell, Scott, Smyth and Washington and the city of Bristol, Virginia. Business is produced through four licensed agents who are either employees or commissioned agents.

The lines of business written include the following:

- Fire, lightning and windstorm on buildings, mobile homes, personal property and livestock and machinery.
- Extended coverage, plate glass, vandalism, malicious mischief and liability as supplements to the basic policy.
- Homeowners and mobile homeowners with a comprehensive personal liability endorsement or a farmer's comprehensive personal liability endorsement.
- Church package policy.

Property is classified primarily according to location, use, type of construction and availability of fire departments. The board of directors sets classifications and assessment rates. Assessments are levied annually during the month of original issue. The Company adjusts claims utilizing the services of independent claims adjusters.

It is the practice of the Company to retain \$20,000 on property insured, and \$25,000 on bodily injury and property damage liability coverage.

GROWTH OF THE COMPANY

The following data, obtained from the Company's annual statements and examination reports, indicates its growth during the ten-year period ending December 31, 2010:

<u>Year</u>	<u>Net Assessments Received</u>	<u>Investment Income</u>	<u>Net Losses Paid</u>	<u>Number of Policies</u>	<u>Amount of Insurance In Force</u>
2001	\$640,617	\$195,825	\$181,604	6,786	\$347,232,791
2002	659,106	175,384	316,455	6,934	375,084,053
2003	563,255	136,357	178,066	7,290	443,913,160
2004	838,130	159,968	336,479	7,884	533,997,094
2005	999,368	153,493	393,922	7,939	565,884,334
2006	963,642	253,542	380,563	7,909	589,634,509
2007	1,014,428	244,444	282,890	7,759	587,884,341
2008	1,005,820	222,681	178,686	7,528	566,465,901
2009	950,018	198,632	252,204	7,334	555,593,409
2010	945,184	189,599	536,561	7,016	527,772,009

<u>Year</u>	<u>Ledger Assets</u>	<u>Net Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
2001	\$3,566,415	\$3,707,121	\$541,253	\$3,165,868
2002	3,650,436	3,721,463	556,878	3,164,585
2003	3,781,539	3,857,603	521,843	3,335,760
2004	4,060,222	4,143,859	630,165	3,513,694
2005	4,321,357	4,426,423	827,906	3,598,517
2006	4,868,221	4,938,420	875,351	4,063,069
2007	5,169,084	5,249,139	747,814	4,501,325
2008	5,458,681	5,488,009	640,011	4,847,998
2009	5,820,680	5,889,387	744,905	5,144,482
2010	5,892,109	5,948,485	651,726	5,296,759

REINSURANCE

The Company had the following reinsurance agreements in force at December 31, 2010:

<u>Type of Agreement</u>	<u>Lines Covered</u>	<u>Net Retention</u>	<u>Reinsurer's Limits</u>
Property and Casualty Excess of Loss	Fire, inland marine and multiple lines (to include the casualty business of these lines)	<u>Property</u> \$20,000 ultimate net loss, each and every risk	\$980,000 ultimate net loss, each and every risk, each and every loss, subject to an occurrence limitation of \$1,960,000
		<u>Casualty</u> \$20,000 ultimate net loss, each and every risk	\$980,000 ultimate net loss, each and every insured, each and every loss
		<u>Combination</u> \$20,000 each and every loss occurrence	\$20,000 each and every loss occurrence
Property and Casualty Aggregate Excess of Loss	Fire, inland marine and multiple lines (to include the casualty business of these lines)		220% of the amount, if any, by which the Company's aggregate net losses exceed 90% of net earned premium income; not to exceed 220% of 95% of net earned premium income

All reinsurance is placed through Axiom Re, Inc., a reinsurance intermediary. All agreements contain an insolvency clause and a guarantee of the intermediary's credit.

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, 2008 through December 31, 2010. Assets were verified and liabilities were established at December 31, 2010. 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 allows flexibility in the conduct of the examination based upon the nature and size of the entity being examined. This flexibility allows the examiners the ability to structure the examination in the manner best suited for each entity.

For this examination, all accounts and activities of the Company were considered in accordance with the risk-focused examination process.

FINANCIAL STATEMENTS

There follows a statement of income and disbursements for the years 2008, 2009 and 2010, and a statement of financial condition at December 31, 2010.

INCOME FOR THE PERIOD UNDER REVIEW

	<u>2008</u>	<u>2009</u>	<u>2010</u>
Net assessments received	\$1,005,820	\$950,018	\$945,184
Interest on bonds	24,052	23,309	21,061
Interest on cash deposits	159,528	159,335	128,630
Dividends on stocks	499	241	431
Real estate	38,350	33,095	38,920
Gain or (loss) on sale of investments	252	(17,348)	557
Other income	3,376	3,441	12,936
	<hr/>	<hr/>	<hr/>
Total Income	\$1,231,877	\$1,152,091	\$1,147,719
Deduct total disbursements for the year	942,280	790,092	1,076,290
	<hr/>	<hr/>	<hr/>
Net Income	\$289,597	\$361,999	\$71,429
Add Ledger Assets December 31, previous year	5,169,084	5,458,681	5,820,680
	<hr/>	<hr/>	<hr/>
Ledger Assets December 31, current year	<u>\$5,458,681</u>	<u>\$5,820,680</u>	<u>\$5,892,109</u>

DISBURSEMENTS FOR THE PERIOD UNDER REVIEW

	<u>2008</u>	<u>2009</u>	<u>2010</u>
Net losses paid	\$178,686	\$252,204	\$536,561
Loss adjustment expense		7,636	44,888
Commission and brokerage	84,266	108,612	78,728
Gross salaries	139,193	116,975	108,897
Directors' fees	31,050	31,300	31,700
Travel and travel items		3,346	2,500
Boards, bureaus and associations	5,059	5,496	5,516
Legal and auditing	13,850	16,260	19,556
Outside inspections, loss prevention and survey services	21,008		
Furniture, fixtures and equipment	7,911	8,657	9,364
Rent, office and equipment maintenance	5,219	5,627	5,191
Advertising	1,124	667	1,854
Printing and stationery	13,064	13,067	12,745
Postage, telephone and express	3,689	2,733	3,185
Insurance and fidelity bonds	17,939	17,275	16,371
Charitable contributions	505	530	420
Utilities	6,417	7,495	8,805
Other general expenses	9,812	8,486	8,587
Taxes, licenses and fees	24,309	16,173	13,398
Payroll items	38,973	42,818	46,568
Federal corporate income tax	334,384	114,149	111,139
Real estate	5,822	10,586	10,317
	<u> </u>	<u> </u>	<u> </u>
Total disbursements	<u>\$942,280</u>	<u>\$790,092</u>	<u>\$1,076,290</u>

ASSETS

	Ledger Assets	Non- Ledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	\$359,987			\$359,987
Common stock	46,701	39,235		85,936
Cash in company's office	200			200
Cash on deposit	5,253,955			5,253,955
Real estate	51,024			51,024
Interest due and accrued				
On bonds		4,489		4,489
On cash deposits		24,733		24,733
Assessments due	4,771			4,771
Reinsurance recoverables	144,679			144,679
Equipment, furniture, and supplies	12,081		12,081	0
Federal income tax refund	18,711			18,711
Totals	<u>\$5,892,109</u>	<u>\$68,457</u>	<u>\$12,081</u>	<u>\$5,948,485</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Net unpaid losses	\$121,267
Loss adjustment expenses unpaid	14,686
Payroll items due or accrued	3,347
Other expenses due or accrued	2,802
Taxes, licenses and fees	12,693
Ceded reinsurance balances payable	31,955
Assessments unearned	448,728
Deferred income tax payable	<u>16,248</u>
Total liabilities	\$651,726
Excess of admitted assets over liabilities (surplus)	<u>5,296,759</u>
Totals	<u>\$5,948,485</u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Accounts and Records

1. During the review of the Company's bond investments, the Examiners noted that the Company receives investment management services from its custodian bank. The custodian determines which bonds to buy for the Company's investment account based on the investment guidelines provided by the Company. However, the current custodial agreement between the Company and the custodian does not include investment management services. The Examiners recommend the Company either revise their current custodial agreement to include investment management services or execute a separate agreement for these services. This is the second consecutive examination in which this recommendation appears.

2. A review of the Company's Schedule D in the filed Annual Statements revealed the following exceptions:
 - a. On Schedule D, Part 2, Column 8, the rate per share used to obtain the market value for all stocks was not reported correctly. A percentage of the market value to the actual cost of the stock was utilized rather than the rate per share. The market value however was reported correctly. This is the fourth consecutive examination in which this recommendation appears.

 - b. On Schedule D, Part 2, the Company reported an investment in the First Virginia Bank Short-Term Investment Pool. A review of the Company's investments revealed that the amount reported was actually invested in a different mutual fund. The market value of the investments was properly reported. The Company should take steps to properly identify its investments in future filings with the Bureau. This is the second consecutive examination in which this recommendation appears.

3. The Examiners' review of the Company's claim files revealed that the files were lacking important information such as dates and updates to claims status. It is the Company's policy to maintain a claims log where all claims are listed in the order in which they are reported. However, it appeared that a claim selected for review was not recorded in the claims log. The discrepancy noted by the Examiners did not have a material effect on loss reserves at year-end. The Examiners recommend the Company maintain complete and accurate claim files and ensure that all claims are included in the claims log.

4. During the review of the Company's Information Systems, it was noted the Company does not have a disaster recovery plan in place for the Accounting and Claims Files which are maintained manually. The Examiners recommends the Company develop, implement and maintain an Information System and a disaster recovery plan that will allow the Company to utilize a more updated form of recordkeeping and have the ability to recover data in the event of a catastrophe.

SUBSEQUENT EVENT

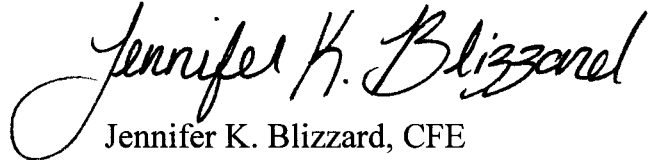
In April 2011, Southwestern Virginia experienced severe weather conditions leading to the destruction of property and the loss of lives. As a result of these storms, the Company received a significant number of claims which includes several total losses. At the conclusion of the examination fieldwork, an estimate of the total amount of incurred losses was unknown.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the examination is gratefully acknowledged.

In addition to the undersigned, Mario A. Cuellar, CFE, George E. Morgan, CFE and Milton Parker, Jr. of the Bureau participated in the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "Jennifer K. Blizzard". The signature is written in a cursive style with a large, looping initial "J".

Jennifer K. Blizzard, CFE
Senior Insurance Examiner

FARMERS MUTUAL FIRE INSURANCE COMPANY
OF
WASHINGTON COUNTY, VIRGINIA
P. O. Box 827
Abingdon, Virginia 24212
Telephone - 628-2351

11 JUN 30 AM 8:47

June 24, 2011

David H. Smith, CFE, CPA, CPCU
Chief Examiner
STATE CORPORATION COMMISSION
Bureau of Insurance
P. O. Box 1157
Richmond, VA 23218

Re: Corrective recommendations
recent examination

Dear Mr. Smith,

We have reviewed the examination report mailed to us on June 21, 2011, and in regard to the recommendations for corrective action you mentioned, please note:

ACCOUNTS AND RECORDS

Item #1 We agree that the current custodial agreement does not account for investment management services. We tried after the last examination to correct this and thought we had, we sent a letter detailing what our investment custodian did for our account, and asked if it was not sufficient to notify us, we did not hear anything so assumed it was sufficient, we have sent a letter to the examiner who was working with us on this matter again detailing everything and including accounting for the investment management services and to date we have heard nothing so I am again assuming that what we have done has corrected this matter and if it does not we will get it corrected.

Item #2 Schedule D:

- A. On Schedule D, Part 2, Column 8, we agree that the rate was not reported correctly. We have addressed this matter with our auditor and was assured that it would be corrected for future filings.
- B. Schedule D, Part 2, we agree that the the investment amount was reported incorrectly, this has been addressed with our auditor and we have been assured


that this matter will be corrected for future filings.

Item #3 We agree that our claims files were lacking important information, and we have taken steps to make sure that the claims are completely filled out when the losses are taken. There should not be any problem at the next examination.

Item #4 We agree that the Company does not have a disaster recovery plan in place for files maintained manually, we have addressed this matter with our computer person and have been assured that the balance of our records should be computerized in the immediate future and should allow us to utilize a more updated form of record keeping.

Your examiners, Jennifer Blizzard, Milton Parker, Jr., George Morgan and Mario Cuellar were very pleasant and courteous and was very helpful to us.

We will need 10 copies of the report, one for our files and we have nine directors.

Sincerely,

Nannie Groseclose,
Sec. - Treas.
FARMERS MUTUAL FIRE INS. CO.