

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

**GRANGE MUTUAL INSURANCE COMPANY  
BEAVERTON, OREGON**

**NAIC COMPANY CODE 44890**

AS OF

DECEMBER 31, 2000

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July 11, 2001

Honorable Mary C Neidig, Director  
Department of Consumer and Business Services  
State of Oregon  
350 Winter Street NE, Room 440-4  
Salem, Oregon 97301-3883

Dear Director:

In accordance with your instructions and pursuant to ORS 731.300, we have examined the business affairs and financial condition of

**GRANGE MUTUAL INSURANCE COMPANY**  
**9925 SW Nimbus Avenue**  
**Beaverton, Oregon 97008**

**NAIC Company Code 44890**

hereinafter referred to as the "Company." The following report is respectfully submitted.

## **SCOPE OF EXAMINATION**

The examination of the Company was conducted as of December 31, 2000, covering the four year period then ended, and included a review of material transactions or events which occurred subsequent to the examination cut-off date and were noted during the examination.

The examination was conducted pursuant to ORS 731.300 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC) for the purpose of determining the Company's financial condition, ability to fulfill its obligations, the nature of its operations, and compliance with the Insurance Code. Accounting methods, internal control procedures, records and other supporting evidence were examined or tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume and complexity of the accounting system and operations utilized by the Company. A review was also made of the corrective actions taken by the Company in response to recommendations made in the previous examination report.

The independent auditors for the majority of the examination period have been KPMG Peat Marwick (KPMG). For the calendar year 2000, the Company has changed CPA firms to Boldt, Carlisle and Smith (CPAs), a local firm based in Salem, Oregon. The planning phase of this examination began on February 14, 2001, and a meeting with the CPAs revealed that their work papers will not be available for our inspection until April 5, 2001. As a result, it was determined that no reliance will be placed on the CPA work papers.

## **COMPANY HISTORY**

The Company began business on August 14, 1885, as the Lower Columbia Fire Relief Association and operated under that name until January 4, 1924, when the name was changed to the Grange Fire Relief Association. The name was changed to Grange Mutual Fire Insurance Company on August 13,

1952, and at that time the Company incorporated as a non-profit corporation. The present name was adopted on December 6, 1955. The Company is an exempt insurer pursuant to ORS 731.032, operating under a Certificate of Exemption issued by the Oregon Insurance Commissioner on December 18, 1963.

Until January 1, 1988, the Company was a mutual fire insurer, operating on the assessment principle. Each member was subject to an assessment in addition to premiums paid for excessive losses and operating expenses. On April 1, 1987, the Oregon Attorney General rendered an opinion, which stated that ORS 731.032(4) exempts Patrons of Husbandry Associations from the Insurance Code (with certain exceptions) for any line of insurance that a qualifying association chooses to write and the Insurance Commissioner can not limit or restrict this statutory exemption. The Company expanded its writing, beginning January 1, 1988, to include casualty lines of business.

## **MANAGEMENT AND CONTROL**

### **Membership**

Membership is granted to each person, firm, association or corporation for whom a policy of insurance is in effect. Insurance coverages are offered only to members in good standing of the Grange (more specifically known as Patrons of Husbandry), a cooperative association serving Grange members or to a cooperative association affiliated with, or controlled by, members of the Grange. Each member is entitled to one vote regardless of the number of policies of insurance or the total amount of insurance held. Members are represented by elected delegates at the annual meeting of the corporation.

### **Board of Directors**

The Bylaws vest management and control of the Company in a Board of Directors consisting of seven members. The Board of Directors meet all of the requirements of the Company's Bylaws, Section V.

The directors serving at December 31, 2000, were as follows:

#### **Name and Address**

#### **Affiliation**

#### **Director Since**

Ned E. Clark\*  
55347 Hwy. 207/Spray  
Heppner, OR 97836

Rancher: Horseshoe Hereford Ranch  
Director – United Heritage Mutual Insurance  
Company and Bank of Eastern Oregon

1993

**Name and Address**

**Affiliation**

**Director Since**

Neil L. Cullison  
13096 S. Spangler Road  
Oregon City, OR 97045

Retired Insurance Agent

1991

Sally R. Limbeck  
PO Box 700  
Canyon City, OR 97820

Retired Insurance Agent

1994

Jack G. Gunn  
c/o Cedar Corner Tax Consultants  
882 NE 7<sup>th</sup> Street  
Grants Pass, OR 97526

Retired Insurance Agent

1982

Donald J. Logan  
20750 NW Dixie Mountain Road  
North Plains, OR 97133

Farmowner

1990

Mike B. Stewart  
643 Union Street NE  
Salem, OR 97301

Grange Master

2000

Gary Prichard  
34099 Del Monte Avenue  
Eugene, OR 97405

Rancher and Retired College Instructor

1992

\*Chairman of the Board

**Officers**

The Company's officers at December 31, 2000, were as follows:

**Name**

**Title**

Philip R. Yount  
Susan Silva  
Douglas J. Lay

President  
Corporate Secretary  
Treasurer, Controller

**MANAGEMENT AFFIRMATION**

## **CONFLICT OF INTEREST**

The Company has a conflict of interest policy that requires officers and directors to report conflicts of interest to the Company. From a review of the completed conflict of interest questionnaires, it appeared that the affected personnel performed due diligence in completing the conflict of interest statements. No material conflicts were noted.

## **CORPORATE RECORDS**

The corporate records, including the Board of Director minutes, Articles of Incorporation, and Bylaws, were reviewed for the period under examination.

### **Board of Director Minutes**

All of the Board meetings during the period examined were conducted with a quorum of directors present. The Board minutes were recorded in sufficient detail to have an understanding of the actions taken by the Board. The minutes reflected the approval of investments even though the Company is not subject to the provisions of ORS 733.730 (investment limitations) and ORS 733.730 (required records of investments). Overall the minutes supported the transactions of the Company and actions taken by the Board of Directors and its officers.

### **Articles of Incorporation**

The Articles of Incorporation were in compliance with Oregon Statutes.

### **Bylaws**

The Bylaws were compliance with Oregon Statutes.

### **Holding Company Registration Statement**

The Company is not subject to the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-27-020(1).

### **FIDELITY BONDS AND OTHER INSURANCE**

The examination of insurance coverages involved a review of adequacy of limits and retentions, and the solvency of the insurers providing the coverages. The Company is insured for up to \$500,000 per occurrence against losses from acts of dishonesty and fraud by its employees. Fidelity bond coverage was found to exceed the minimum coverage recommended by the NAIC. In addition, the Company is covered against director's and officer's liability for \$5,000,000. Other insurance coverages in force at December 31, 2000, were as follows:

Workers' compensation	Commercial property
Commercial general liability	Business auto coverage
Commercial umbrella coverage	Employment practices liability

The above coverages were found to be adequate as of December 31, 2000.

### **PENSION PLANS AND EMPLOYEE BENEFITS**

The Company provides a contributory pension plan covering all eligible employees. Under this plan the Company contributes 4% of the employee's salary. The employee may contribute up to an additional 18% of his/her salary for which the Company will match the first 3%. The Board of Directors passed a resolution on December 5, 1996, to convert its pension plan from a 401(a) to a 401(k).

In addition to pension benefits, the Company provides health, dental, group life, AD&D, and disability benefits. Except for allowing retirees to continue participating in the group dental plan, the Company does not offer post retirement benefits other than pensions to any of its employees.

### **TERRITORY AND PLAN OF OPERATION**

The Company writes fire, farmowners multiple peril, homeowners multiple peril, commercial multiple peril, inland marine, personal liability, auto liability, auto physical damage, burglary and theft coverages.

These coverages are written through commissioned agents and are provided only to Patrons of Husbandry in the State of Oregon. Business is serviced through the home office in Beaverton, Oregon.

Private passenger automobile liability coverage was the largest single line of business written, accounting for 41% of the Company's direct written premium in 2000. Homeowners multiple peril and automobile physical damage coverages comprised 18% and 20% of the 2000 direct written premium respectively. The remaining 21% of direct written premiums were distributed among other personal and commercial property/casualty coverages.

### **GROWTH OF THE COMPANY**

The growth of the Company is reflected in the following schedule. The statistics were derived from Company filed annual statements except in those years where a triennial report of examination has been filed with the Oregon Insurance Division.

<b><u>Year</u></b>	<b><u>Admitted Assets</u></b>	<b><u>Liabilities</u></b>	<b><u>Surplus</u></b>	<b><u>Net Income (Loss)</u></b>
1996*	\$15,300,588	\$10,592,885	\$4,707,703	\$ 494,129
1997	18,565,298	12,306,222	6,259,076	399,545
1998	18,136,206	12,777,383	5,358,623	(1,078,625)
1999	16,687,242	10,556,486	6,130,757	1,028,859
2000*	14,836,824	10,174,341	4,662,483	(1,293,781)

\*Per examination

The Company suffered a net loss for 2000 as a result of decreases in premiums earned and investment income and increases in losses incurred and underwriting expenses. Investment income decreased, in part, because of the Company's contribution of \$1.5 million in bonds to capitalize a start-up subsidiary, Timberland States Insurance Company.

### **SUMMARY OF OPERATING RATIOS**

The following exhibit reflects the annual operating results of the Company since 1996. The amounts were compiled from copies of the Company's filed annual statements.

<u>Year</u>	<u>Premium</u>	<u>Operating Expenses</u>	<u>Ratio</u>
1996*	\$ 8,613,530	\$10,070,294	116.91%
1997	9,744,308	11,034,393	113.24%
1998	10,090,533	12,242,609	121.33%
1999	10,559,289	11,234,643	106.39%
2000*	9,939,810	11,945,712	120.18%

\*Per examination

Note: The Company's high operating ratios for the past 5 years is attributable to increases in losses and underwriting expenses while premium income decreased. The Company is aware of this problem and a number of corrective measures were initiated in 2001. In order to reverse the trend the corrective actions will include a rate increase and reduction in the commission structure.

### REINSURANCE

The Company's reinsurance program includes multiple layers of excess of loss and catastrophe coverages. The following is a summary of the agreement in effect as of December 31, 2000.

#### Property

##### Multiple Line Excess of Loss

The Company is provided excess of loss coverage for its property risks through three agreements with four participating reinsurers. The following exhibit displays retention's and limits for each multiple line excess of loss agreement.

#### **Multiple Line Excess of Loss Treaty**

	<b>Company's Retention or <u>Underlying Layer</u></b>	<b><u>Limit</u></b>
First	\$100,000 each and every loss, each and every risk	\$400,000 ultimate net loss each and every loss <u>Aggregate Limit:</u> \$1,200,000 as respects any one loss occurrence
Second	\$500,000 each and every risk for 100% of the ultimate net loss	\$1,500,000 ultimate net loss each and every loss <u>Aggregate Limit:</u> \$4,500,000 as respects any one loss occurrence

Third	Ultimate net loss sustained by the Company which is in excess of \$2,000,000	\$1,000,000 ultimate net loss each and every loss, each and every risk as respects extra contractual obligations only
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**Property Catastrophe Excess Of Loss**

The Company is indemnified against catastrophic loss through four layers of catastrophe reinsurance with multiple reinsurers as follows:

<b><u>Treaty Layer</u></b>	<b><u>Retention or Underlying Layer</u></b>	<b><u>Limit</u></b>
First Layer	\$250,000 each and every loss occurrence	97.5% of 250,000 each and every loss occurrence – not to exceed \$243,750
Second Layer	\$500,000 each and every loss occurrence	97.5% of \$500,000 each and every loss occurrence – not to exceed \$975,000
Third Layer	\$1,500,000 each and every loss occurrence	97.5% of \$4,500,000 each and every loss occurrence – not to exceed \$4,387,500
Fourth Layer	\$6,000,000 each and every loss occurrence	97.5% of \$4,000,000 each and every loss occurrence – not to exceed \$3,900,000

**Liability**

**Multiple Line Excess of Loss Agreements**

The Company is afforded reinsurance protection for its liability risks under the same multiple line excess of loss agreements for its property coverages. Retentions and limits for liability coverage are as follows:

<b><u>Multiple Line Excess of Loss Treaty</u></b>	<b><u>Company's Retention or Underlying Layer</u></b>	<b><u>Limit</u></b>
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First	\$100,000 each and every loss, each and every risk	\$400,000 ultimate net loss each and every loss <u>Aggregate Limit:</u> \$1,200,000 as respects any one loss occurrence
Second	\$500,000 each and every risk for 100% of the ultimate net loss	\$1,500,000 ultimate net loss each and every loss <u>Aggregate Limit:</u> \$4,500,000 as respects any one loss occurrence
Third	Ultimate net loss sustained by the Company which is in excess of \$2,000,000	\$1,000,000 ultimate net loss each and every loss, each and every risk

**Calendar Year Aggregate Excess of Loss Reinsurance Contract**

In addition to the excess of loss and catastrophe treaties, the Company has reinsurance in the form of two calendar year aggregate loss ratio excess of loss agreements. The agreements indemnify the Company for 95% of losses that would cause the calendar year subject loss ratio to exceed 80%. The first treaty covers the first 7.5% of loss ratio and the second treaty covers the next 12.5% of the loss ratio.

**Assumed Reinsurance**

As of December 31, 2000, the Company did not assume business.

**Risk Retention**

The Company is not subject to maximum risk retentions set by ORS 731.504. However, the Company's maximum retention on any one risk of \$100,000 is within the limits set by ORS 731.504.

**Insolvency Clauses**

The Company's reinsurance agreements contained insolvency clauses that allow payment to parties other than a statutory successor. However, the Company is not subject to the provisions of ORS 731.508 pursuant to ORS 731.042(4).

#### *Intermediary Clause*

The Company obtains its reinsurance agreements through a reinsurance broker. It was noted the Company has a proper intermediary clause that includes a provision whereby the reinsurer will assume all credit risks of the intermediary related to payments to the intermediary in accordance with the NAIC Examiners Handbook, page 4-13 and ORS 731.302.

### **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the December 31, 2000, annual statement and were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170. However, attention is directed to the following exceptions as a result of this examination.

#### *Cash and Short-term Investments*

The net payroll due employees for the payroll period ending December 31, 2000, was paid on January 4, 2001. The Company reduced the payroll checking account by \$38,101. By recording this entry prior to the actual payday, the Company has understated cash and short-term investments and overstated other expenses. **I recommend the Company properly accrue salaries to the appropriate the year. This recommendation is made pursuant to the provision of ORS 733.170.**

#### *Aggregate Write-ins For Other Invested Assets*

The Company owns all business that it underwrites. As a condition of an agent's appointment, an agent for the Company is usually required to pay an appointment fee to the Company. Some agents finance this transaction through the Company. The balance of aggregate write-ins for invested assets

is comprised of notes outstanding pertaining to these agent appointment fees amounting to \$302,436. The notes are secured by a liability “off-set” provision in the contract. The Director’s position is that the notes are collateralized by an asset which is not an authorized investment (see Chapter 8 of the NAIC Accounting Practices and Procedures Manual, pg. 8-1(b) and ORS 733.010(8)) and therefore, should be nonadmitted. This was brought to the Company’s attention and an officer of the Company agreed, in writing, that if the Company is unable to find an alternate way of funding these transactions, this asset will be nonadmitted in the Company’s filed annual statement for 2001. As a result, no adjustment is being made for the purposes of this examination.

### **Classification of Accruals**

The Company has recorded various liability accruals for other expenses and amounts withheld or retained by Company on account of others. The examination of such accruals indicate that the Company has classified them incorrectly. The Notes to the Financial Statement illustrate the proper classification of accruals. **In the future, I strongly recommend the Company classify accruals in the manner prescribed by the NAIC Annual Statement Instructions, page 35, 36, 37 and ORS 731.574.**

### **Other Expenses**

A search for missing liabilities test revealed that the Company did not properly accrue for all outstanding liabilities at December 31, 2000. **I recommend the Company accrue for all liabilities in accordance with the provisions of ORS 733.030(5).**

### **Safekeeping Agreement**

At December 31, 2000, the Company had a safekeeping agreement with Key Trust Company (Bank) of the Northwest. During the course of this examination, an amendment was added which included the following wording:

Key Trust Company is obligated to indemnify the Grange (Owner) for any loss of securities in the Company's custody, except that, unless Oregon state law requires a stricter standard, the Bank shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the Bank. In the event there is a loss of securities for which the Bank is obligated to indemnify the Owner, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights resulting from such a loss shall be promptly replaced.

This amendment, while meeting the majority of the requirements of the NAIC Examiners Handbook, should also incorporate the wording “ the Company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the officers or employees of the custodian, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction.”

In addition, the agreement should include the following: “The owner's securities or a certified listing of the owner's securities through a securities depository or a Federal Reserve book entry system shall be subject to inquiry and examination by the director of the Department of Consumer and Business Services, either at the custodians premises or elsewhere, as provided by ORS 731.296 and 731.308.”

**I recommend the Company amend its agreement for the safekeeping of its securities. The agreement should contain the language prescribed by the NAIC Examiners Handbook, pages 1-70 and 1-71, OAR 836-027-0200(4)(a) and (c) and ORS 731.302.**

#### **Information Systems Internal Controls**

Due to the Company's small size, a number of the information systems controls prescribed by the NAIC Examiners Handbook are not possible because of the lack of personnel and prohibitive cost.

However, the Company should consider establishing the following information system controls:

1. Backup computer files should be stored in an offsite fireproof safe.
2. The Company's disaster recovery plan should be updated and tested.
3. Users should only be given access to those areas pertinent to their jobs, not all areas of information.

During the course of this examination, the Company entered into an agreement (mutual assistance agreement) with Sublimity Insurance Company whereby, each agrees to provide the other with emergency assistance in the area of computer processing and programming (recovery plan). This agreement does not include such essential information as a list of individuals to contact in case of emergency, a phone list for these individuals, a listing of programs and applications in current use and the order of their importance, an inventory of computer equipment and where to assemble after the disaster. In addition, all provisions of this recovery plan should be tested to determine if this is a workable solution for a disaster recovery plan.

**I recommend the Company take the necessary steps to insure that the above three information system controls are in place and test the mutual assistance agreement to determine if it is a workable solution for a disaster recovery plan. This recommendation is made pursuant to the provisions of the NAIC Examiners Handbook (pg. 1-109 to 1-159) and ORS 731.302.**

In addition to the comments and recommendations noted above, several observations considered housekeeping in nature, were mentioned in a separate management letter issued on July 12, 2001.

#### **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

1. I recommend the Company develop a program that shows premiums inforce by individual policy. This recommendation is supported by ORS 733.170 that requires an insurer to keep its records in such manner that the director may readily verify its statements of financial condition.

The Company has developed a report which illustrates premiums inforce by individual policy.

2. I recommend the Company comply with the provision of ORS 733.170 by maintaining an itemized list of its trade payables.

An itemized list of trade payables was prepared at year-end, detailing expenses paid in 2001 which were incurred during 2000.

3. I recommend the Company accrue for all liabilities in accordance with the provisions of ORS 733.020(5).

The Company accrued for liabilities in 2000, however, failed to accrue \$5,489 in miscellaneous expenses which were incurred in 2000. (see accounts and records)

4. I recommend the Company exclude commissions payable from amounts withheld for accounts of others and classify them as other expenses in accordance with the NAIC Annual Statement Instructions, page 32, and ORS 731.574.

As of December 31, 2000, commissions payable were classified as other expenses.

5. I recommend the Company amend its agreement for the safekeeping of its securities. The agreement should contain the language prescribed by the NAIC Examiners Handbook, page 2G-2 and ORS 731.302.

The Company amended its agreement for the safekeeping of its securities, however it is still in need of updating. (see Accounts and Records).

6. I recommend the Company consider establishing certain information system controls as prescribed by the NAIC Examiners Handbook pages I-79 to I-109, and ORS 731.302.

The Company has established several of the controls as suggested in the previous examination. (See Accounts and Records)

7. I recommend that all check signers on the Company's bank account be authorized by the Board of Directors as prescribed by the NAIC Examiners Handbook page 2G-6 and ORS 731.302.

Authorized check signers are reflected in the Board of Director minutes.

**GRANGE MUTUAL INSURANCE COMPANY**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**  
**As of December 31, 2000**

<u>ASSETS</u>	<u>Ledger</u> <u>Assets</u>	<u>Adjustments</u>	<u>Examination</u>
Bonds (Note 1)	\$ 9,281,860		\$ 9,281,860
Common stocks	1,974,288		1,974,288
Cash and short-term investments	591,543		591,543
Other invested assets	15,000		15,000
Aggregate write-ins for invested assets	302,436		302,436
Premiums and agents balances in the course of collection	701,070		701,070
Premiums, agents balances deferred and not yet due	1,665,913		1,665,913
Reinsurance recoverable	15,448		15,448
EDP equipment	92,795		92,795
Interest & investment income due and accrued	195,702		195,702
Aggregate write-ins for other than invested assets	769		769
Total Assets	<u>\$14,836,824</u>	<u>0</u>	<u>\$14,836,824</u>
 <b><u>LIABILITIES</u></b>			
Losses (Note 2)	\$ 3,713,729		\$ 3,713,729
Loss adjustment expenses	765,000		765,000
Contingent commissions	120,000		120,000
Other expenses (Note 3)	247,842	56,648	304,490
Taxes, licenses and fees (Note 4)		5,581	5,581
Unearned premiums	4,889,627		4,889,627
Amounts withheld by Company for account of others (Note 5)	295,143	(255,619)	39,524
Remittance and items not allocated (Note 6)		22,366	22,366
Excess of statutory reserves over statement	143,000		143,000
Aggregate write-ins for liabilities (Note 7)	<u>0</u>	<u>171,024</u>	<u>171,024</u>
Total Liabilities	<u>\$10,174,341</u>	<u>\$ 0</u>	<u>\$10,174,341</u>
 <b><u>SURPLUS AND OTHER FUNDS</u></b>			
Surplus notes	\$ 1,500,000		\$ 1,500,000
Unassigned funds	<u>3,162,483</u>	<u>0</u>	<u>3,162,483</u>
Total surplus and other funds	<u>\$ 4,662,483</u>	<u>\$ 0</u>	<u>\$ 4,662,483</u>
Total Liabilities, Surplus and other funds	<u>\$14,836,824</u>	<u>\$ 0</u>	<u>\$14,836,824</u>

**THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL  
STATEMENTS**

**GRANGE MUTUAL INSURANCE COMPANY**  
**UNDERWRITING AND INVESTMENT EXHIBIT**  
**STATEMENT OF INCOME**  
**For the Year Ended December 31, 2000**

**UNDERWRITING INCOME**

Premiums earned	\$ 9,839,810
Losses incurred	6,959,800
Loss adjustment expenses incurred	1,408,288
Other underwriting expenses incurred	<u>3,577,624</u>
Total underwriting deductions	<u>\$11,945,712</u>
Net Underwriting Gain	(2,105,902)

**INVESTMENT INCOME**

Net investment income earned	552,043
Net realized capital gains	<u>83,672</u>
Net Investment Gain	\$ 635,715

**OTHER INCOME**

Net loss from premium balances charged off	1,107
Finance and service charges not included in premiums	163,827
Aggregate write-ins for miscellaneous income	<u>11,472</u>
Total other income	<u>176,406</u>
Net income before Federal taxes and dividends to policyholders	(1,293,781)
Dividends to policyholders	<u>-0-</u>
Net income after dividends to policyholders but before Federal taxes	(1,293,781)
Federal income taxes incurred	<u>0</u>
Net Income	<u><u>\$(1,293,781)</u></u>

**SURPLUS ACCOUNT**

Surplus as regards policyholders, December 31, 1999	\$ 6,130,757
Net income	(1,293,781)
Net unrealized gain	(243,162)
Change in nonadmitted assets	38,669
Change in excess of statutory reserves over statement reserves	<u>30,000</u>
Change in surplus as regards policyholders for the year	<u>(1,468,274)</u>
Surplus as regards policyholders, December 31, 2000	<u><u>\$ 4,662,483</u></u>

**THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL  
STATEMENTS**

**GRANGE MUTUAL INSURANCE COMPANY  
RECONCILIATION OF EXAMINATION CHANGES  
As Of December 31, 2000**

After evaluation of the assets and providing for all known liabilities and reserves, the following reflects an examination reclassification that resulted in no change to the surplus reported by the Plan, as of December 31, 2000.

Capital & surplus reported by the Company as of December 31, 2000	<u>\$4,662,483</u>
Other expenses ( <b>Note 3</b> )	56,648
Taxes, licenses & fees ( <b>Note 4</b> )	5,581
Amounts withheld by Company for account of other ( <b>Note 5</b> )	(255,619)
Remittances and items not allocated ( <b>Note 6</b> )	22,366
Aggregate write-ins for liabilities ( <b>Note 7</b> )	<u>171,024</u>
Total examination adjustments to reserves and unassigned funds	<u>0</u>
Reserves and unassigned funds per examination as of December 31, 1999	<u>\$4,662,483</u>

Although a number of adjustments to the amounts reported by the Company were determined during the course of this examination, no adjustments were made to the financial statement contained herein because, in the aggregate, the sum of all adjustments were less than the 5% surplus materiality rule adopted by the Insurance Division.

## NOTES TO THE FINANCIAL STATEMENTS

### Note 1 - Bonds

The Company's bond portfolio is primarily comprised of investments in high quality corporate bonds. A quality distribution of bonds is presented below:

<u>Year</u>	<u>Total Book Value</u>	<u>Market Value</u>	<u>Noninvestment Grade Securities*</u>	<u>Percentage of Portfolio</u>
1996	\$ 8,640,350	\$ 8,693,881	\$ 30,362	0.35%
1997	\$12,597,612	\$13,126,729	0	0.00%
1998	\$11,764,337	\$12,572,976	0	0.00%
1999	\$12,064,414	\$11,338,806	\$199,434	1.60%
2000*	\$ 9,903,931	\$ 9,461,631	\$160,408	0.96%

Includes Short-term investments

\*\*Investment grade is defined by the NAIC as those securities with an NAIC Security Valuation Office (SVO) rating of "1" or "2." Noninvestment grade securities are those bonds with a NAIC SVO rating of less than "2."

Investments in bonds, stocks and short-term investments represent 66.75% of the total assets of the Company.

### Note 2 – Loss and Loss adjustment Expense Reserves:

The reported December 31, 2000, balances of \$3,713,729 for losses, \$765,000 for loss adjustment expenses, were determined to be adequate by the Oregon Insurance Division's actuary, Michael Lamb, FCAS, MAAA. The results of his findings are summarized in the actuarial examination memorandum contained in the supporting work papers.

### Note 3 – Other Expenses

Per Company	\$247,842
Per examination	<u>304,490</u>
Difference	<u>\$ 56,648</u>

The Company, in its interpretation of liabilities, has categorized expense accruals incorrectly.

The majority of this difference is the result of incorrect classifications as follows:

1. The Company recorded a liability for deferred compensation in the amount of \$60,000, as amounts withheld or retained by company for account of others (**See Note 5**).
2. A suspense account in the amount \$3,352 was reported as other expenses. This amount should be classed as remittances and item not allocated (**See Note 6**).

**Note 4 - Taxes, License and Fees**

Per Company	\$ 0
Per examination	<u>5,581</u>
Difference	<u>\$ 5,581</u>

The Company recorded employer liabilities for payroll taxes as amounts withheld on account of others which should have been recorded as taxes, license and fees (See Note 5).

**Note 5 - Amounts Withheld Or Retained By Company On Account Of Others**

Per Company	\$ 295,143
Per examination	<u>39,524</u>
Difference	<u>(\$255,619)</u>

The difference is the result of the Company classifying various expense accruals to the wrong account per the NAIC Annual Statement Instructions for property and casualty companies. The detail is as follows:

1. The Company recorded a liability in the amount of \$60,000, for deferred compensation which should be categorized as other expenses (See Note 3).
2. The Company recorded employer liabilities for payroll in the amount of \$5,582 which should be categorized as taxes, licenses, and fees (See Note 4).
3. A suspense account for \$19,013 for “premium refunds/not applied” which should be categorized as remittances and items not allocated (See Note 6).
4. The aggregate liabilities in the amount of \$171,024 for escheat items, deferred payments to agents and claims approved for payment which should be classed as aggregate write-ins for other liabilities (See Note 7).

**Note 6 – Remittances and Items Not Allocated**

Per Company	\$ 0
Per examination	<u>22,366</u>
Difference	<u>\$ 22,366</u>

The difference represent a reclassification from amounts withheld or retained by company on account of others and from other expenses (See Note 3 and Note 5).

**Note 7 - Aggregate Write-ins For Other Liabilities**

Per Company	\$ -0-
Per examination	<u>171,024</u>
Difference	<u>\$ 171,024</u>

(See Note 5)

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

Page

- 15 I recommend the Company properly accrue salaries to the appropriate the year. This recommendation is made pursuant to the provision of ORS 733.170.
- 15 I strongly recommend the Company classify accruals in the manner prescribed by the NAIC Annual Statement Instructions, page 35, 36, 37 and ORS 731.574.
- 16 I recommend the Company accrue for all liabilities in accordance with the provisions of ORS733.030(5).
- 17 I recommend the Company amend its agreement for the safekeeping of its securities. The agreement should contain the language prescribed by the NAIC Examiners Handbook, pages 1-70 and 1-71, OAR 836-027-0200 (4(a)(c) and ORS 731.302.
- 17 I recommend the Company take the necessary steps to insure that the above three information system controls are in place and test the mutual assistance agreement, to determine if it is a workable solution for a disaster recovery plan. This recommendation is made pursuant to the provisions of the NAIC Examiners Handbook (pgs. 1-109 to 1-159) and ORS 731.302.

## CONCLUSION

During the four year period covered by this examination, the surplus of the Company has decreased from \$4,707,703, as presented in the December 31, 1996, report of examination, to \$4,662,183, as shown in this report of examination. The comparative assets and liabilities are shown below:

	<b><u>2000</u></b>	<b>December 31,</b>	<b><u>1996</u></b>	<b><u>Change</u></b>
Assets	\$14,836,524		\$15,300,588	\$(464,064)
Liabilities	<u>10,174,341</u>		<u>10,592,885</u>	<u>(418,544)</u>
Surplus	<u>\$ 4,662,183</u>		<u>\$ 4,707,703</u>	<u>\$ (45,520)</u>

## SUBSEQUENT EVENT

During the course of this examination the Company contributed \$1.5 million in bonds, stocks and cash to form Timberland States Insurance Company. In forming TSIC, the Company plans to write

business for prospective policyholders who are not members of the Grange. TSIC was formed during 2000, however, received its certificate of authority on March 15, 2001.

## ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Company during the examination process are gratefully acknowledged.

In addition to the undersigned, Patricia G. Neesham, CPA, CFE, Thomas Farrelly, CFE, and Michael P. Phillips, CPA, CFE, AES, insurance examiners for the State of Oregon, Department of Consumer and Business Services, Insurance Division, and Roger Michael Lamb, FCAS, MAAA, actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

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Timothy R. Hurley, CFE  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

**AFFIDAVIT**

STATE OF OREGON            )  
  )  ss  
County of Marion            )

Timothy R. Hurley, CFE, being duly sworn, deposes and says the preceding report of financial examination as of December 31, 2000, of Grange Mutual Insurance Company, Beaverton, Oregon, subscribed by him is true and correct to the best of his knowledge and belief.

\_\_\_\_\_  
Timothy R. Hurley, CFE  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

Subscribed and sworn to before me this \_\_\_\_\_ day of \_\_\_\_\_, 2001.

\_\_\_\_\_  
NOTARY PUBLIC for the State of Oregon

My Commission Expires:\_\_\_\_\_