



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**OREGON MUTUAL INSURANCE COMPANY
MCMINNVILLE, OREGON**

NAIC COMPANY CODE 14907

AS OF

DECEMBER 31, 2008

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SALUTATION

February 1, 2010

Alfred W. Gross, Commissioner
Chairman, NAIC Financial Condition (E) Committee
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, Virginia 23218

Honorable Cory Streisinger, Director
Department of Consumer and Business Services
State of Oregon
350 Winter Street NE, Room 440
Salem, Oregon 97301

Dear Director:

In accordance with your instructions and guidelines in the National Association of Insurance Commissioners (NAIC) Examiners Handbook, pursuant to ORS 731.300 and 731.302, respectively, we have examined the business affairs and financial condition of

OREGON MUTUAL INSURANCE COMPANY
400 NE Baker Street
McMinnville, Oregon 97128
NAIC Company Code 14907

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

SCOPE OF EXAMINATION

Our multi-state financial examination of the Company as of December 31, 2008, covers the four year period then ended. Material transactions or events occurring subsequent to the examination cut-off date were reviewed and noted during the examination.

We considered the provisions of ORS 731.300 and the NAIC procedures and guidelines during our examination. We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook. The handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company and evaluating 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, management' s compliance with Statutory Accounting Principles and annual statement instructions. Corrective actions taken by the Company in response to comments and recommendations in the December 31, 2004, report of examination were reviewed.

All accounts and activities of the Company were considered in accordance with the risk focused examination process.

David F. Dahl, FCAS MAAA, actuary for the State of Oregon, Department of Consumer and Business Services, Insurance Division, evaluated losses, loss adjustment expenses for this report. His conclusions are included in the notes to the financial statements section of this report.

COMPANY HISTORY

The Company was incorporated on December 29, 1894, as Oregon Fire Relief Association for the purpose of writing fire insurance. In 1930, the Articles of Incorporation were amended changing the Company's name to Oregon Mutual Fire Insurance Company. In 1948, the Company became

licensed to write casualty insurance. On January 28, 1955, the Articles of Incorporation were amended changing the Company's name to Oregon Mutual Insurance Company.

MANAGEMENT AND CONTROL

Board of Directors

The Bylaws vest management and control of the Company in a Board of Directors. The Board of Directors meets all of the requirements of ORS 732.305. Directors serving at December 31, 2008, were as follows:

<u>Name and Address</u>	<u>Affiliation</u>	<u>Director Since</u>
Betty J. Atteberry McMinnville, OR 97128	Retired Director Westside Economic Alliance	1995
Elliott C. Cummins McMinnville, OR 97128	Retired Attorney-Partner Cummins, Goodman, Fish, Denley & Vickers	1985
Rosemari J. Davis McMinnville, OR 97128	CEO Willamette Valley Medical Center	2003
Michael E. Keyes McMinnville, OR 97128	President & Chief Executive Officer Oregon Mutual Insurance Company	1999
Michael J. McNamara PhD Pullman, WA 99164	Professor Washington State University	2004
Anthony Meeker McMinnville, OR 97128	Retired Director Victory Capital Management	2001
John W. Mitchell PhD McMinnville, OR 97128	Retired State Economist	2006
James P. Tate Boise, ID 83706	Owner M & W Markets Inc	1998
Denis J. Walker McMinnville, OR 97128	Chairman, Retired President and Chief Executive Officer - Oregon Mutual Insurance Company	1988

Officers

The Company's officers at December 31, 2008, were as follows:

<u>Name</u>	<u>Title</u>
Denis J. Walker	Chairman of the Board
Michael E. Keyes	President and CEO
Toni L. Chodrick	Corporate Secretary
Edward J. Yorty	Vice President, Product Development CFO/Treasurer
Steven L. Patterson	Vice President General Counsel
Charles S. Katter	Vice President, Claims
Mary L. Hargis	Vice President, Personal Lines
Richard B. Prouser	Vice President, Information Systems
Brian M. Steffel	Vice President Marketing and Underwriting

Subsidiary Companies

The Company is a member of an insurance holding company system in which it owns 100% of the common stock of the following companies:

Western Protectors Insurance Company (WPIC) - WPIC is an Oregon domiciled insurer licensed in Oregon, Washington, and Idaho.

OMI General Agency, Inc. - This Company is an Oregon corporation. As of December 31, 2008, this agency did not produce any business.

INTERCOMPANY AGREEMENTS

Management Agreement

The Company entered into a management agreement with WPIC on May 27, 1987. The terms of the agreement provide that the Company will perform the operations of WPIC with its personnel and facilities, except those functions that are “nondelegable” by law. Effective January 1, 2004, WPIC agreed to pay the Company an underwriting fee of 9.5% of direct written premiums, unallocated loss adjustment expense fees of 12.5% of gross paid loss, and 6.25% of the change in direct case loss outstanding each month.

Tax Allocation Agreement

The Company signed a tax allocation agreement with WPIC. Under this agreement, the Company's income tax provision is calculated on a consolidated basis and its respective share of the liability is allocated on a separate return basis.

A review of the agreements discussed above concluded the fees and terms appeared reasonable. In addition, as of December 31, 2008, the Company did not have any management contract or exclusive agency contracts in effect that are prohibited by ORS 732.215 and ORS 732.220, respectively.

CONFLICT OF INTEREST

Company policy requires directors and officers disclose personal and business interests that are in conflict with their responsibilities to the Company. Each officer and director completed a conflict of interest statement. There were no material disclosures during the period subject to this examination.

CORPORATE RECORDS

Corporate records, including the Articles of Incorporation, Bylaws, insurance holding company registration statement and Board minutes, were reviewed for the period under examination.

Board of Director Minutes

A review of the Board minutes indicated that the Board approved investments in accordance with the provisions of ORS 733.730 and ORS 733.740. In addition, the minutes indicated the Board approved officer salaries in accordance with the provisions of ORS 732.320(3). A quorum met at all meetings.

Articles of Incorporation

The Articles of Incorporation conformed to Oregon statutes. No amendments were made to the articles during the period covered by this examination.

Bylaws

The Bylaws permit the number of directors to be seven, eight or nine. The Bylaws conformed to Oregon statutes.

Holding Company Registration Statement

Timely and complete insurance holding company registration statements were filed by the Company in accordance with the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-027-0020(1).

FIDELITY BONDS AND OTHER INSURANCE

Insurance coverage was reviewed for adequacy of limits and retentions and the solvency of the insurers providing the coverages. A crime policy covers the Company up to \$5,000,000 net of \$50,000 retention. A fidelity bond covers the Company for losses up to \$2,000,000 net of \$100,000 retention. Fidelity bond coverage was found to exceed the minimum coverage recommended by the NAIC. In addition, the Company is covered against directors' and officers' liability up to an aggregate limit of \$5,000,000. Other insurance coverages in force at December 31, 2008, were as follows:

General liability	Workers' compensation
Property & casualty	Business automobile
Umbrella	

The above coverages were found to be adequate as of December 31, 2008.

PENSION PLANS AND EMPLOYEE BENEFITS

The Company sponsors a noncontributory supplemental retirement plan for some of the Company's officers. The Company also sponsors a noncontributory post-retirement medical/dental insurance plan for employees hired prior to March 6, 2006. Both plans are unfunded.

The Company has an Employee Savings Plan for which all employees are eligible. The Company contributed 4.25% of each employee's eligible compensation to the plan in 2008. In addition, the plan provides that a qualified employee may elect to contribute a percentage of eligible compensation up

to a predetermined maximum percentage and subject to the limits required by the Internal Revenue Code. The Company matches employee contributions by a percentage amount determined annually by the Board of Directors. The current matching percentage is 50% of each employee's pre-tax contribution up to 8% (maximum 4% match). The Company's contributions totaled \$1,014,347 in 2008 and \$989,258 in 2007. The plan is a qualified benefit plan as defined by the Internal Revenue Service.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was authorized to transact property and casualty business in California, Idaho, Nevada, Oregon and Washington. The Company's premium volume by state is as follows:

	<u>Direct Premium Written</u>	<u>Premium Volume</u>
California	\$ 36,120,966	26%
Idaho	17,264,315	13%
Nevada	4,556,193	3%
Oregon	50,467,229	37%
Washington	<u>29,644,402</u>	<u>21%</u>
Total	<u>\$138,053,105</u>	<u>100%</u>

The Company employs 204 people in its office in McMinnville, Oregon along with 32 outside employees who service policyholders and agents. Independent agents sell the Company's policies.

Direct written premium by line of business written in 2008 is as follows:

Line of Business

Commercial multiple peril	\$ 35,974,496	26.1%
Homeowners multiple peril	22,308,634	16.2%
Private passenger auto liability	22,395,768	16.2%
Auto physical damage	15,896,279	11.5%
Commercial auto liability	9,957,384	7.2%
Other	<u>31,520,544</u>	<u>22.8%</u>
Total	<u>\$138,053,105</u>	<u>100.0%</u>

GROWTH OF THE COMPANY

The following schedule illustrates the Company's growth. Statistics were derived from the Company filed annual statements except in those years where the Oregon Insurance Division published an examination report.

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Net Income</u>
2004*	\$158,909,793	\$100,030,149	\$58,879,644	\$6,646,804
2005	174,297,630	109,537,813	64,759,817	6,400,247
2006	187,723,543	117,228,971	70,494,572	6,935,962
2007	206,192,931	132,328,612	73,864,319	4,382,537
2008*	202,115,093	127,312,046	74,803,047	7,530,865

*Per examination

Net income in 2008 was the result of a net underwriting gain of \$4,760,311, a net investment gain of \$3,075,919 and other income of \$1,621,925, offset by federal income tax incurred of \$1,927,290.

LOSS EXPERIENCE

Annual underwriting results for the Company since 2004 are shown in the following table. Amounts were compiled from the Company's filed annual statements except for those years when the Oregon Insurance Division published an examination report.

<u>Year</u>	<u>Premium</u>	<u>Loss & Loss Adjustment Expense</u>	<u>Ratio</u>
2004*	\$ 81,288,409	\$49,693,201	61.13%
2005	90,342,063	55,249,938	61.16%
2006	105,942,532	64,040,945	60.45%
2007	111,781,003	68,230,916	61.04%
2008*	122,249,805	79,089,084	64.69%

*Per examination

REINSURANCE

Assumed Reinsurance

Beginning January 1, 2002, the Company signed a quota share assumption treaty with WPIC to assume 75% of all direct premiums written by WPIC. Effective January 1, 2003, the premiums assumed were increased to 80% of WPIC's direct premium written. Effective January 1, 2007, the premiums assumed were increased to 100% of WPIC's direct premium written. Reinsurance

commission allowed WPIC was 30% of all direct written premiums. Premiums assumed from WPIC in 2008 were \$11,086,965.

Below is a brief summary of the Company's reinsurance program with non-affiliated reinsurers in effect as of December 31, 2008:

Multiple Line Quota Share

A multiple line quota share reinsurance contract with GMAC Motors Insurance Corporation effective November 1, 2008, covered all lines written except for employment practices liability insurance, umbrella, boiler and machinery. Under this treaty the Company cedes 30% of covered premiums after application of the multiple line excess of loss program.

Multiple Line Excess of Loss Program

2008 Agreements			
Agreement	Coverage	Reinsurers	Rate
Multiple Line Excess	Property 97% of \$7,000,000 excess of \$500,000 Liability 97% of \$1,500,000 excess of \$500,000 per Occurrence	Axis Re Partner Re QBE Re Hannover Ruckversicherung Toa Re	3.0%
Multiple Line Clash-Layer 1	Property \$5,000,000 excess \$7,500,000 Liability \$5,000,000 excess of \$2,000,000	Odyssey Re Platinum Re QBE Re Hannover Ruckversicherung Various Syndicates at Lloyds of London	.307%
Multiple Line Clash-Layer 2	Property \$5,000,000 excess of \$12,500,000 Liability \$5,000,000 excess of \$7,000,000	Hannover Ruckversicherung Various Syndicates at Lloyds of London	0.152%

Catastrophe Excess of Loss Program

2008 Agreements			
Property Catastrophe	95% of \$37,000,000 excess of \$3,000,000 Plus 100% of \$36,000,000 excess of \$40,000,000	Axis Specialty Renaissance Re Montpelier Re Various Syndicates at Lloyds of London Odyssey Re QBE Re Hiscox Ins. Bda Shelter Mutual Ins Hannover Re., Bda	5.657%
Property Facultative	Up to \$10,000,000 excess of \$7,500,000 per risk	General Re	Rates vary by risk

EPLI

Employment Practices Liability Quota Share	70% of loss plus ALAE Reinsurer pays 25% ceding commission	General Re	70%
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Equipment Breakdown

Employment Practices Liability Quota Share	100% cession limited to \$50,000,000 per occurrence Reinsurer pays 34% ceding commission	Hartford Steam Boiler	100%
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Umbrella

Umbrella Quota Share	95% of prem < \$1 mil policy limits 100% of prem > \$1 mil policy limits	General RE	95% of first 1 million 100% of 2-10 million Less comm. Allow 32%
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Reinsurance Cost Sharing Agreements

Effective January 1, 2008, the Company signed an Intercompany Reinsurance Allocation Agreement with Western Protectors Insurance Company covering multiple line excess of loss, multiple line clash excess of loss, and catastrophe excess of loss reinsurance treaties, effective January 1, 2008.

The external reinsurance treaties are priced to cover both companies at a single rate, or, in the case of the quota share, a single ceding commission. These agreements serve to allocate the cost of external reinsurance to line and entity. The terms are modified as part of the reinsurance placement process to reflect changing exposures and reinsurance market pricing.

Equipment Breakdown or Boiler and Machinery

The Company writes equipment breakdown or boiler and machinery on a direct basis. The Company cedes 100% of this business to The Hartford Steam Boiler Inspection and Insurance Company through a quota share reinsurance agreement.

Umbrella

The Company's commercial and personal umbrella business is reinsured through a quota share loss treaty. The Company cedes 95% of the its subject written premium for policies up to and including \$1,000,000 and 100% of its subject written premium in excess of \$1,000,000. Retention is 5% of the first \$1,000,000 of loss, or a maximum of \$50,000.

Insolvency Clause

All the Company's reinsurance agreements contained insolvency clauses which comply with the provisions of ORS 731.508.

Risk Retention

The Company does not retain risk on any one subject in excess of 10% of its surplus to policyholders as prohibited by ORS 731.504.

ACCOUNTS AND RECORDS

In general, the Company's records and source documentation supported the amounts presented in the December 31, 2008, annual statement and were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company has complied with all recommendations made in the 2004 report of examination.

OREGON MUTUAL INSURANCE COMPANY
BALANCE SHEET
AS OF DECEMBER 31, 2008

<u>ASSETS</u>	<u>Annual Statement</u>	<u>Examination Adjustments</u>	<u>Net Admitted Assets</u>
Bonds (Note 1)	\$ 115,799,595	\$ 0	\$ 115,799,595
Preferred stocks	2,550,998		2,550,998
Common stocks	15,036,554		15,036,554
Real estate	12,558,157		12,558,157
Cash & short-term investments	<u>10,904,710</u>		<u>10,904,710</u>
Subtotal, cash and invested assets	156,850,014		156,850,014
Investment income due and accrued	1,443,304		1,443,304
Uncollected premiums	4,781,346		4,781,346
Deferred premiums, agents balances and installments booked but deferred and not yet due	22,438,501		22,438,501
Amounts recoverable from reinsurers	1,954,410		1,954,410
Funds held by or deposited with reinsured companies	313		313
Current federal and foreign income tax recoverable	1,123,217		1,123,217
Net deferred tax asset	6,202,968		6,202,968
Guaranty funds receivable or on deposit	9,264		9,264
Electronic data processing equipment	316,540		316,540
Receivable from subsidiaries	590,369		590,369
Aggregate write-ins for other than invested assets	<u>6,404,847</u>	<u>0</u>	<u>6,404,847</u>
Total Assets	<u>\$202,115,093</u>	<u>\$0</u>	<u>\$202,115,093</u>
 <u>LIABILITIES</u>			
Losses (Note 2)	\$ 51,186,370	\$0	\$ 51,186,370
Reinsurance payable on paid loss and LAE	1,348,325		1,348,325
Loss adjustment expenses (Note 2)	12,921,359		12,921,359
Commissions payable & contingent commissions	3,998,054		3,998,054
Other expenses	2,322,953		2,322,953
Taxes, licenses and fees	369,767		369,767
Unearned premiums	41,718,083		41,718,083
Advance premiums	1,352,097		1,352,097
Ceded reinsurance premiums payable	5,019,657		5,019,657
Funds held by company under reinsurance treaties	377,403		377,403
Amounts withheld for account of others	152,414		152,414
Provision for reinsurance	79,841		79,841
Aggregate write-ins for liabilities	<u>6,465,723</u>	<u>0</u>	<u>6,465,723</u>
Total Liabilities	<u>127,312,046</u>	<u>0</u>	<u>127,312,046</u>
 <u>SURPLUS</u>			
Unassigned funds (surplus)	<u>74,803,047</u>	<u>0</u>	<u>74,803,047</u>
Surplus as regards policyholder	<u>74,803,047</u>	<u>0</u>	<u>74,803,047</u>
Total Liabilities and Surplus	<u>\$202,115,093</u>	<u>\$0</u>	<u>\$202,115,093</u>

OREGON MUTUAL INSURANCE COMPANY
INCOME STATEMENT
For the Year Ended December 31, 2008

UNDERWRITING INCOME

Premiums earned	<u>\$122,249,805</u>
Deductions:	
Losses incurred	67,355,857
Loss adjustment expenses incurred	11,733,227
Other underwriting expenses incurred	<u>38,400,410</u>
Total Underwriting Deductions	<u>117,489,494</u>
Net Underwriting Gain (Loss)	<u>4,760,311</u>

INVESTMENT INCOME

Net investment income earned	5,851,010
Net realized capital gains	<u>(2,775,091)</u>
Net Investment Gain	<u>3,075,919</u>

OTHER INCOME

Net loss from premium balances charged off	(206,021)
Finance and service charges not included in premiums	957,429
Aggregate write-ins for miscellaneous income	<u>870,517</u>
Total Other Income	<u>1,621,925</u>
Net income before federal taxes and dividends to policyholders	9,458,155
Dividends to policyholders	<u>0</u>
Net income after dividends to policyholders but before federal taxes	9,458,155
Federal income taxes incurred	<u>1,927,290</u>
Net Income	<u>\$ 7,530,865</u>

SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2007	<u>\$ 73,864,319</u>
Net income	7,530,865
Change in net unrealized capital gains (losses)	(2,355,761)
Change in net deferred income tax	45,968
Change in nonadmitted assets	(3,940,177)
Change in provision for reinsurance	(73,842)
Aggregate write-ins for gains and losses in surplus	<u>(268,325)</u>
Change in surplus as regards policyholders for the year	<u>938,728</u>
Surplus as regards policyholders, December 31, 2008	<u>\$74,803,047</u>

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Bonds

Bonds comprise 57% of the total admitted assets. Most of the bonds are industrial and miscellaneous bonds, special revenue bonds, political subdivision bonds and US government-backed instruments. A quality distribution of bonds is presented below. All amounts were derived from the Company's filed annual statements, except for those years that were examined by the Insurance Division.

<u>Year</u>	<u>Total Book Value</u>	<u>Market Value</u>	<u>Noninvestment Grade Securities*</u>	<u>Percentage of Portfolio</u>
2004**	\$ 89,473,975	\$ 88,843,296	0	0.00%
2005	113,923,977	111,229,098	0	0.00%
2006	113,441,634	110,685,810	0	0.00%
2007	120,677,421	119,129,367	0	0.00%
2008**	115,799,595	113,236,631	0	0.00%

*Noninvestment grade is defined by the NAIC as those bonds with an NAIC SVO rating of less than "2."

**Per examination

Note 2 - Loss and Loss Adjustment Expense Reserves

David F. Dahl, FCAS, MAAA, casualty actuary for the Oregon Insurance Division, reviewed the loss and loss adjustment expenses in the company's filed financial statements as of December 31, 2008. He determined the Company's liability for losses and loss adjustment expenses was found to be reasonably stated as of December 31, 2008. Results of his findings are summarized in the actuarial report contained in the supporting examination work papers.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

There were no comments or recommendations made as a result of this examination.

CONCLUSION

During the four year period covered by this examination, the surplus of the Company has increased from \$58,879,644, as presented in the December 31, 2004, report of examination, to \$74,803,047, as shown in this report of examination. The comparative assets and liabilities are shown below:

	<u>December 31,</u>		
	<u>2008</u>	<u>2004</u>	<u>Change</u>
Assets	\$202,115,093	\$158,909,793	\$43,205,300
Liabilities	<u>127,312,046</u>	<u>100,030,149</u>	<u>27,281,897</u>
Surplus	<u>\$ 74,803,047</u>	<u>\$ 58,879,644</u>	<u>\$15,923,403</u>

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, Greg Lathrop CFE, Timothy R. Hurley, CFE, insurance examiners and David F. Dahl, FCAS, MAAA, actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in this examination.

Respectfully submitted,

Mike P. Phillips, CFE, CPA, AES
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

State of Oregon)
) ss
Marion County)

Mike P. Phillips, CFE, CPA, AES, being duly sworn, states as follows:

1. I am authorized to represent the state of Oregon in the examination of Oregon Mutual Insurance Company.

2. The State of Oregon, Department of Consumer and Business Services, Insurance Division is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of Oregon Mutual Insurance Company, was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

Mike P. Phillips, CFE, CPA, AES
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to before me this _____ day of _____, 2010.

Notary Public in and for the State of Oregon
My Commission Expires: _____