



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**SUBLIMITY INSURANCE COMPANY
SUBLIMITY, OREGON**

NAIC COMPANY CODE 26824

DECEMBER 31, 2008

TABLE OF CONTENTS

| | |
|--|-----------|
| SALUTATION | 3 |
| SCOPE OF EXAMINATION..... | 4 |
| COMPANY HISTORY | 4 |
| <i>Capital Stock.....</i> | <i>5</i> |
| <i>Dividends to Stockholders and Other Distributions</i> | <i>6</i> |
| CORPORATE RECORDS | 7 |
| <i>Board Minutes.....</i> | <i>7</i> |
| <i>Articles of Incorporation.....</i> | <i>7</i> |
| <i>Bylaws</i> | <i>7</i> |
| <i>Insurance Holding Company Registration Statement.....</i> | <i>8</i> |
| <i>Statutory Deposit.....</i> | <i>8</i> |
| MANAGEMENT AND CONTROL | 8 |
| <i>Board of Directors</i> | <i>8</i> |
| <i>Officers.....</i> | <i>9</i> |
| <i>Affiliated Companies.....</i> | <i>9</i> |
| INTERCOMPANY AGREEMENTS..... | 11 |
| <i>Cost Sharing and Allocation Agreement.....</i> | <i>11</i> |
| <i>Income Tax Allocation Agreement</i> | <i>11</i> |
| CONFLICT OF INTEREST..... | 11 |
| FIDELITY BOND AND OTHER INSURANCE..... | 12 |
| PENSION PLANS AND OTHER EMPLOYEE BENEFITS..... | 12 |
| <i>Retirement Plan.....</i> | <i>12</i> |
| <i>Supplemental Executive Retirement Plan</i> | <i>12</i> |
| <i>Post-retirement Benefits.....</i> | <i>13</i> |
| TERRITORY AND PLAN OF OPERATION..... | 13 |
| GROWTH OF THE COMPANY | 13 |
| LOSS EXPERIENCE | 14 |
| REINSURANCE | 14 |
| <i>Facultative Reinsurance.....</i> | <i>15</i> |
| <i>Risk Retention.....</i> | <i>16</i> |
| <i>Insolvency Clause.....</i> | <i>16</i> |
| ACCOUNTS AND RECORDS..... | 16 |
| COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS..... | 16 |
| FINANCIAL STATEMENTS..... | 17 |
| NOTES TO FINANCIAL STATEMENTS | 22 |
| <i>Note 1 – Invested Assets.....</i> | <i>22</i> |
| <i>Note 2 – Actuarial Reserves.....</i> | <i>23</i> |
| SUMMARY OF COMMENTS AND RECOMMENDATIONS | 23 |
| CONCLUSION | 24 |
| ACKNOWLEDGMENT | 25 |
| AFFIDAVIT | 26 |

SALUTATION

April 29, 2010

Honorable 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
Salem, Oregon 97301-3883

Dear Commissioner and Directors:

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

SUBLIMITY INSURANCE COMPANY
100 SW Sublimity Blvd.
Sublimity, Oregon 97385

NAIC Company Code 26824

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

SCOPE OF EXAMINATION

We have performed our single-state examination of Sublimity Insurance Company. The last examination was completed as of December 31, 2003. This examination covers the period of January 1, 2004 to December 31, 2008.

We conducted our examination pursuant to ORS 731.300 and 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 when applicable to domestic state regulations.

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

COMPANY HISTORY

Sublimity Insurance Company started in Sublimity, Oregon, in 1896 as The Farmers Fire Relief Association of Sublimity. The Company was incorporated under the laws of the State of Oregon on November 10, 1897, as a mutual fire insurance company. By amended Articles of Incorporation approved in 1954, the corporate name Sublimity Fire Insurance Company was adopted. In 1972, the name of the Company was changed to Sublimity Insurance Company.

On December 20, 2002, the Company entered into an agreement to be acquired by United Heritage Mutual Holding Company, of Meridian, Idaho. The director of the Oregon Department of Consumer and Business Services (DCBS) approved the plan of merger on May 23, 2003, at which point the Company converted from a mutual insurance company to a for-profit stock company. All shares of common capital stock were ultimately transferred to United Heritage Financial Group, Inc. (UHFG), a downstream holding company that owns 100% of the three subsidiary companies: United Heritage Life Insurance Company, United Heritage Property & Casualty Company, and the Company.

Capital Stock

In the prior examination as of December 31, 2003, the Company reported 3,318,233 shares issued and outstanding. The following table displays transactions made since the Company's demutualization:

| <u>Date</u> | <u>Shares</u> | <u>Common Capital Stock</u> | <u>Paid in and Contributed Surplus</u> |
|-------------|---------------|---------------------------------|--|
| 5/23/03 | \$2,318,233 | \$ 23,182 | \$ 0 |
| 5/23/03 | 1,000,000 | 10,000 | 990,000 |
| 9/22/04 | 387,596 | 3,876 | 496,124 |
| 3/31/05 | 331,125 | 3,311 | 496,689 |
| 6/21/06 | (4,036,954) | (40,369) | (1,982,813) |
| 6/21/06 | 3,000,000 | 3,000,000 | 0 |

Prior to June, 2006, capital shares had no par value, but the stated value was one cent per share. On August 15, 2004, the Board authorized the sale of 387,596 shares to an affiliate, United Heritage Life Insurance Company, in exchange for \$500,000 in cash. On February 16, 2005, the Board approved the sale of 331,125 shares to UHFG in exchange for \$500,000 in cash. United Heritage Life Insurance Company subsequently sold its outstanding shares to UHFG on December 2, 2005, resulting in UHFG becoming the sole shareholder.

At December 31, 2008, Article V of the Company's Restated Articles of Incorporation authorized the Company to issue 20,000,000 shares of common stock, with a par value of \$1 per share. All shares issued and outstanding are owned by UHFG.

Dividends to Stockholders and Other Distributions

From 2004 to 2008, the Company declared and paid dividends to its stockholder as follows:

| <u>Declared Date</u> | <u>Paid Date</u> | <u>Amount</u> | <u>Description</u> |
|----------------------|------------------|---------------|--------------------|
| 05/24/2005 | 06/15/2005 | \$ 50,000 | Ordinary |
| 08/17/2005 | 09/14/2005 | 50,000 | Ordinary |
| 11/15/2005 | 12/07/2005 | 50,000 | Ordinary |
| 02/15/2006 | 03/15/2006 | 50,000 | Ordinary |
| 05/15/2006 | 05/30/2006 | 50,000 | Ordinary |
| 08/16/2006 | 08/31/2006 | 50,000 | Ordinary |
| 11/14/2006 | 11/30/2006 | 50,000 | Ordinary |
| 02/21/2007 | 02/28/2007 | 50,000 | Ordinary |
| 05/23/2007 | 06/07/2007 | 50,000 | Ordinary |
| 09/10/2007 | 09/26/2007 | 50,000 | Ordinary |
| 10/17/2007 | 12/01/2007 | 50,000 | Ordinary |
| 01/16/2008 | 02/29/2008 | 62,500 | Ordinary |
| 04/16/2008 | 06/01/2008 | 62,500 | Ordinary |
| 07/16/2008 | 09/01/2008 | 62,500 | Ordinary |
| 10/15/2008 | 12/01/2008 | 62,500 | Ordinary |

The financial analysts noted all dividends were reported to the director of DCBS within five business days of declaration, as required by ORS 732.554 and OAR 836-027-0170(2). All dividends were approved by the Oregon Insurance Division. The examiners noted inconsistencies in the 2007 dividends, specifically, both the first and second quarter dividends did not allow 10 business days between the declaration date and the paid date, as required by ORS 732.554. It appears these errors were corrected during 2008, so no recommendation will be made in this report.

CORPORATE RECORDS

Board Minutes

In general, the review of 2005 to 2010 Board meeting minutes of the Company, as well as the various committees authorized by the Board, indicated that the minutes support the transactions of the Company and clearly describe the actions taken by its directors and officers. A quorum, as defined by ORS 731.302, met at all of the meetings held during the period under review. Until July 2007 the regular Board meetings were held monthly. After this date the Board converted to a quarterly meeting schedule.

The Board approved investments at each meeting and monitored the investment guidelines in accordance with ORS 733.730. The Board's Executive Committee approved officer salaries. The Company's Board then approved the Executive Committee's actions pursuant to ORS 732.320(3).

Articles of Incorporation

On May 15, 2006, the Board approved a resolution to effect a share combination reducing the number of common shares from 4,036,954 to 3,000,000, resulting in a reverse split of 0.7431345 to 1. On the same date, the Board also approved a resolution to amend the Articles of Incorporation to change the par value to \$1 per share and to increase the authorized number of shares to 20,000,000. No other changes were made during the period under examination. The Articles of Incorporation were in conformance with the Oregon Insurance code.

Bylaws

The Company's Bylaws were not amended during the period under examination. The Bylaws conformed to Oregon statutes.

Insurance Holding Company Registration Statement

An insurance holding company registration statement was 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).

Statutory Deposit

At year-end 2008, the Company maintained deposits with the Idaho Department of Insurance in the sum of \$1,587,201 (par value), for the benefit of all policyholders. These deposits were verified from the records of the Idaho Department of Insurance.

MANAGEMENT AND CONTROL

Board of Directors

Management and control of the Company is vested in a Board of Directors. The Company's Amended Bylaws, Section 4.2, state that the Board shall be comprised of six (6) members. Section 4.9 describes a quorum as a majority of the number of directors. The Company's Board met all of the requirements of ORS 732.305. As of December 31, 2008, the Company was governed by a six member Board of Directors as follows:

| <u>Name and Address</u> | <u>Principal Affiliation</u> | <u>Member Since</u> |
|---|--|----------------------------|
| William L. Bingle Salem, Oregon | Retired VP of Marketing Oregon Mutual Insurance Company | 2008 |
| G. Richer Budke Salem, Oregon | President and CEO Sublimity Insurance Company | 2003 |
| Ray D. Edwards Lake Oswego, Oregon | Retired President Grange Mutual Insurance Company | 1999 |
| Jerome C. Fischer, CPA Salem, Oregon | President Fischer, Hayes & Associates, PC | 2006 |

| <u>Name and Address</u> | <u>Principal Affiliation</u> | <u>Member Since</u> |
|--|---|---------------------|
| James R. Hay* McMinnville, Oregon | Retired VP and Manager Key Bank of Oregon, NA | 1983 |
| Dennis L. Johnson, Esq. Boise, Idaho *Chairman | President and CEO United Heritage Life Insurance Co. | 2003 |

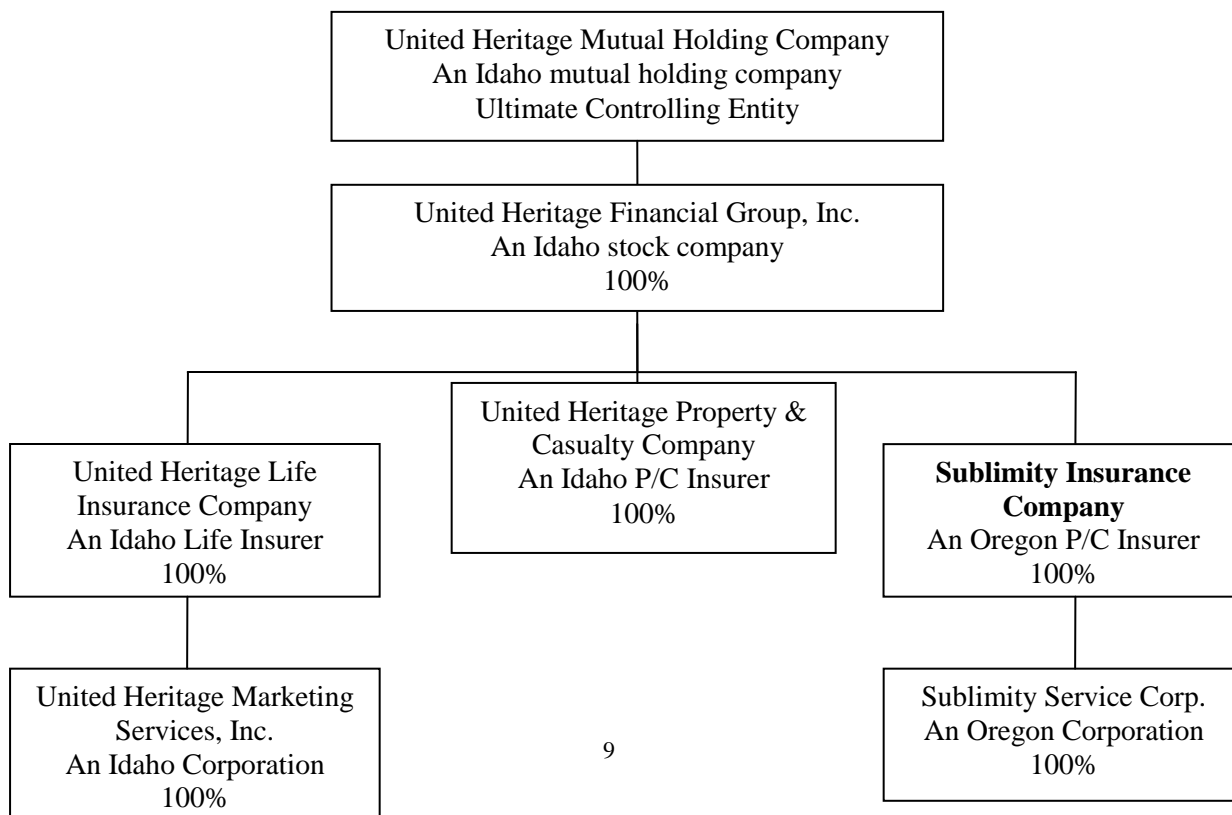
Officers

Principal officers serving at December 31, 2008 were as follows:

| <u>Officer</u> | <u>Office</u> |
|------------------|---|
| G. Richer Budke | President and CEO, Treasurer |
| Andrew L. Trower | Sr. VP, Marketing and Underwriting, Secretary |
| Eric F. Nichols | VP, Information Technology |

Affiliated Companies

As discussed in the Company History section of this report above, on May 23, 2003, the Company became part of an insurance company holding system in which United Heritage Mutual Holding Company is the ultimate controlling entity. The following organizational chart depicts the relationships within the holding company system:



A description of each of the entities above is as follows:

United Heritage Mutual Holding Company (UHMHC) is an Idaho based mutual holding company formed in 2001 as a result of the demutualization of United Heritage Life Insurance Company. It is owned by the policyholders of United Heritage Life Insurance Company and Sublimity Insurance Company.

United Heritage Financial Group, Inc. (UHFG) is an Idaho based for-profit stock corporation owned 100% by UHMHC. It owns 100% of the common stock of the Company, and would be considered the direct parent.

United Heritage Life Insurance Company (UHLIC) is an Idaho domiciled life and health insurer owned 100% by UHFG. Formed as the Grange Mutual Life Company in 1934, UHLIC was licensed in 36 states, including Oregon, at December 31, 2008.

United Heritage Property & Casualty Company (UHPC) is an Idaho domiciled property and casualty insurer owned 100% by UHFG. Formed as the Canyon County Farmers Mutual Fire Insurance Company in 1908, it became Idaho Mutual Insurance Company in 1992 and was acquired by UHFG in 2000. UHPC was licensed in five states, including Oregon, at December 31, 2008.

United Heritage Marketing Services, Inc. (UHMS) is an Idaho based for-profit stock insurance agency that facilitates the sale of life insurance products through independent agents in the states in which United Heritage Life Insurance Company writes business. It is owned 100% by UHLIC.

Sublimity Service Corporation (SSC) is a dormant Oregon for-profit stock corporation formed to offer warranty contracts. This business was terminated some time ago, and its

Board of Directors approved a dividend that effectively moved most of the assets into Sublimity Insurance Company. It is owned 100% by the Company.

INTERCOMPANY AGREEMENTS

Cost Sharing and Allocation Agreement

Effective August 15, 2003, the Company and its affiliates entered into a cost-sharing and allocation arrangement with UHFG. Under this agreement, various operating expenses of the Company, UHLIC, UHPC, and United Heritage Financial Service, Inc. (since disbanded and merged into UHFG), were paid by UHFG and charged to the individual companies based upon its share of usage. Effective September 7, 2008, this agreement was replaced with another agreement removing investment transaction processing and clearing services, combining payroll processing with operating expenses, and including P&C software sharing. The agreement clearly stated that no markup or overhead charge will be earned by UHFG.

Income Tax Allocation Agreement

Effective January 1, 2006, the Company became party to a tax allocation agreement with UHMHC and all its subsidiaries, with the exception of UHLIC. Under the terms of the agreement, each party shall compute its separate tax liability or benefit, as applicable, for federal income taxes on a separate return tax liability method. UHFG will pay all consolidated quarterly tax estimates on or before the date required by the Internal Revenue Code. In the event any member of the holding company incurs a tax liability, payments shall be paid to UHFG at least two days prior to the quarterly due date by wire transfer. Any subsequent adjustments shall be due within 30 days.

CONFLICT OF INTEREST

The Company requires officers and directors to report annually any conflicts of interest or violations of ethical business practices to the Company. From a review of the completed

conflict of interest statements, it appeared that the affected personnel performed due diligence in completing the statements. No material conflicts of interest were noted.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2008, the Company was covered for up to \$750,000 per occurrence, after a \$10,000 deductible, against losses from acts of dishonesty and fraud by its employees. This fidelity bond coverage exceeds the minimum coverage recommended by the NAIC. In addition, the Company was covered against professional liability for losses up to \$1,000,000 aggregate limit with \$10,000 loss retention. Other insurance risks covered included property (including earthquake, business personal property and computer equipment), commercial automobile, umbrella liability, and workers' compensation. All coverages appeared adequate.

PENSION PLANS AND OTHER EMPLOYEE BENEFITS

Retirement Plan

The Company's employees are eligible to join a qualified 401(k) plan sponsored by UHFG after their 90th day of service. The plan provides for UHFG to match 100% of employee salary-deferred contributions up to 4% of each participating employee's base pay. The plan also includes a discretionary profit sharing component in addition to the Company match. Profit sharing is at the discretion of UHFG's Board of Directors. The Company contributed \$41,809 and \$39,544 for 2008 and 2007, respectively.

Supplemental Executive Retirement Plan

The Company has established a Supplemental Executive Retirement Plan (SERP) for its CEO. The plan is funded in an amount equal to the cash surrender values and loan value of a key-man life insurance policy issued on the life of the participant, and owned by the

Company. The estimated value of the plan was \$18,002 in 2008 and 2007, based on current assumptions regarding interest rates.

Post-retirement Benefits

The Company does not offer post-retirement benefits.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was authorized to write property, casualty excluding workers' compensation, marine and transportation, and surety business in Oregon. The Company was also authorized to write business in Idaho and, during the period under examination, became authorized in Utah and Washington. Direct premiums written were:

| | |
|----------------------|----------------------|
| Idaho | \$ 3,153,284 |
| Oregon | 10,563,336 |
| Utah | 1,759 |
| Washington | <u>0</u> |
| Total Direct Premium | <u>\$ 13,718,379</u> |

During 2008 the Company wrote the following lines of business:

| | <u>Direct Premium</u> | <u>Percentage</u> |
|-----------------------------|-----------------------|-------------------|
| Personal automobile | \$ 7,396,445 | 53.9% |
| Homeowner's | 5,078,675 | 37.0% |
| Fire | 403,748 | 2.9% |
| Umbrella | 359,038 | 2.6% |
| Farm owner's multiple peril | 356,928 | 2.6% |
| Other lines | <u>123,545</u> | <u>1.0%</u> |
| Total | <u>\$13,718,379</u> | <u>100.0%</u> |

The Company markets its business through independent agents.

GROWTH OF THE COMPANY

Growth of the Company over the past five years is reflected in the following schedule. Amounts were derived from Company's filed annual statements, except in those years where a report of examination was published by the Oregon Insurance Division.

| <u>Year</u> | <u>Assets</u> | <u>Liabilities</u> | <u>Capital and Surplus</u> | <u>Net Income (Loss)</u> |
|-------------|---------------|--------------------|----------------------------|--------------------------|
| 2003* | \$ 9,738,421 | \$5,934,056 | \$3,804,365 | \$ 529,384 |
| 2004 | 11,769,751 | 6,450,671 | 5,319,080 | 1,030,694 |
| 2005 | 13,933,981 | 6,665,103 | 7,268,878 | 1,731,065 |
| 2006 | 15,706,523 | 7,433,639 | 8,272,883 | 1,174,966 |
| 2007 | 16,757,879 | 8,029,280 | 8,728,599 | 932,797 |
| 2008 * | 17,670,509 | 9,235,763 | 8,434,746 | 59,451 |

*Per examination

LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Company over the last five years. The amounts were compiled from copies of the Company's filed annual statements and, where indicated, from the previous examination reports.

| <u>Year</u> | <u>(1) Premium Earned</u> | <u>(2) Losses and LAE Incurred</u> | <u>(3) Other Underwriting Expenses Incurred</u> | <u>(2)+(3)/(1) Combined Ratio</u> |
|-------------|-------------------------------|--|---|---|
| 2003* | \$ 6,240,721 | \$3,710,546 | \$2,260,051 | 95.7% |
| 2004 | 6,876,805 | 3,483,417 | 2,529,565 | 87.4% |
| 2005 | 8,384,250 | 3,534,495 | 2,970,252 | 77.6% |
| 2006 | 9,137,034 | 4,915,724 | 3,298,970 | 89.9% |
| 2007 | 10,102,065 | 6,089,191 | 3,569,398 | 95.6% |
| 2008* | 11,172,376 | 7,201,640 | 3,889,863 | 99.3% |

*Per examination

REINSURANCE

The Company's reinsurance coverages are obtained directly. At December 31, 2008, the Company's reinsurance program was comprised of three agreements that included excess of loss coverage for both property and casualty business, a catastrophe coverage for property business, and a separate agreement for umbrella risks.

Effective January 1, 2008, the Company was covered under a Multi-line Excess of Loss Agreement with General Reinsurance Corporation (NAIC #22039), with the following terms:

| <u>Coverage</u> | <u>Retention or Underlying Limit</u> | <u>1st Excess Cover</u> | <u>2nd Excess Cover</u> | <u>3rd Excess Cover</u> |
|--------------------|--------------------------------------|---|--|------------------------------------|
| Liability business | \$100,000 each occurrence | \$200,000 each occurrence after retention | \$700,000 each occurrence excess \$300,000 | |
| Property business | \$100,000 each risk | \$200,000 each risk after retention | \$700,000 each risk XS \$300,000 | \$500,000 each risk XS \$1,000,000 |

Effective January 1, 2008, both the Company and its affiliate, UHPC, were covered under a property catastrophe excess of loss treaty with Swiss Reinsurance America Corporation (NAIC #25364), with the following terms:

Property Catastrophe

| <u>Coverage</u> | <u>Retention</u> | <u>Limits</u> |
|-----------------|-----------------------|---|
| First Layer | \$1,000,000 each risk | 95% of \$1,000,000 limited to 95% of \$2,000,000 for aggregate losses |
| Second Layer | \$2,000,000 each risk | 95% of \$4,000,000 limited to 95% of \$8,000,000 for aggregate losses |

The agreement specified that 5% of the ultimate net loss in each loss occurrence shall be retained by the Company, above and beyond the retention at its own risk and not reinsured in any way.

Effective November 1, 2000, the Company was covered under a Quota Share and Excess of Loss Reinsurance Agreement for personal umbrella business with General Reinsurance Corporation. The reinsurer agreed to pay the Company, with respect to each personal umbrella policy of the Company, 98% of the first \$1,000,000 each occurrence of each net loss sustained by the Company.

Facultative Reinsurance

In addition to treaty coverage, each of the agreements offered a special acceptance arrangement for the Company to cede certain risks not specifically covered by the agreement.

Risk Retention

The highest risk the Company retained on any one insured was \$100,000. As such, the Company did not retain risk on any one subject in excess of 10% of its surplus as regards policyholders. The Company, therefore, complied with the provisions of ORS 731.504.

Insolvency Clause

The reinsurance agreements each contained a proper insolvency clause that specified payments would be made to a statutory successor without diminution in the event of insolvency.

ACCOUNTS AND RECORDS

In general, the Company's records and source documentation supported the amounts presented in the Company's December 31, 2008, annual statement and were maintained in a manner by which the financial condition was readily verifiable pursuant to the provisions of ORS 733.170. The Company has a system in place to account for unclaimed funds and the Company has filed the reports on abandoned property pursuant to the provisions of ORS 98.352. From a review of the Company's disaster recovery plan, it was determined that the current information system possessed the physical and internal controls as prescribed by the NAIC.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company has taken corrective action with respect to one of the two recommendations made in the 2003 report of examination. A follow-up report was prepared on January 19, 2006. The Company continues to report the value of a subsidiary as an admitted asset contrary to the provisions of ORS 733.210. Please refer to Note 1 in this report.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Sublimity

Insurance Company as of December 31, 2008:

Statement of Assets

Statement of Liabilities, Surplus, and Other Funds

Statement of Income

Reconciliation of Capital and Surplus Since the last Examination

SUBLIMITY INSURANCE COMPANY
ASSETS
As of December 31, 2008

| <u>Assets</u> | <u>Balance per Company</u> | <u>Examination Adjustments</u> | <u>Balance per Examination</u> | <u>Notes</u> |
|--|--------------------------------|------------------------------------|------------------------------------|--------------|
| Bonds | \$ 11,727,276 | \$ - | \$ 11,727,276 | 1 |
| Stocks: | | | | |
| Preferred stocks | 734,104 | - | 734,104 | 1 |
| Common stocks | 427,179 | (20,094) | 407,085 | 1 |
| Real Estate | | | | |
| Properties occupied by the company | 729,050 | - | 729,050 | |
| Cash, cash equivalents and short-term investments | 1,333,462 | - | 1,333,462 | 1 |
| Aggregate write-ins for invested assets | - | - | - | |
| Subtotal, cash and invested assets | <u>\$ 14,951,071</u> | <u>\$ (20,094)</u> | <u>\$ 14,930,977</u> | |
| Investment income due and accrued | 228,090 | - | 228,090 | |
| Agents' balances or uncollected premiums: | | | | |
| Premiums and agents' balances in course of collection | 962,694 | - | 962,694 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 987,538 | - | 987,538 | |
| Reinsurance | | | | |
| Amounts recoverable from reinsurers | 62,256 | - | 62,256 | |
| Federal and foreign income tax recoverable | 15 | - | 15 | |
| Net deferred tax asset | 400,104 | - | 400,104 | |
| Electronic data processing equipment and software | 63,866 | - | 63,866 | |
| Furniture and equipment | 1,698 | - | 1,698 | |
| Receivable from parent, subsidiaries and affiliates | 33,261 | - | 33,261 | |
| Aggregate write-ins for other than invested assets | 10 | - | 10 | |
| Total Assets | <u><u>\$ 17,690,603</u></u> | <u><u>\$ (20,094)</u></u> | <u><u>\$ 17,670,509</u></u> | |

SUBLIMITY INSURANCE COMPANY
LIABILITIES, SURPLUS AND OTHER FUNDS
As of December 31, 2008

| | <u>Balance per Company</u> | <u>Examination Adjustments</u> | <u>Balance per Examination</u> | <u>Notes</u> |
|--|--------------------------------|------------------------------------|------------------------------------|--------------|
| Liabilities, Surplus and other Funds | | | | |
| Losses | \$ 2,757,194 | \$ - | \$ 2,757,194 | 2 |
| Loss adjustment expenses | 633,972 | - | 633,972 | 2 |
| Commissions payable, contingent commissions and other similar charges | 386,589 | - | 386,589 | |
| Other expenses | 75,262 | - | 75,262 | |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | 113,382 | - | 113,382 | |
| Unearned premiums | 4,562,837 | - | 4,562,837 | |
| Advanced premium | 150,429 | - | 150,429 | |
| Ceded reinsurance premiums payable | 396,703 | - | 396,703 | |
| Amounts withheld or retained for account of others | 50,884 | - | 50,884 | |
| Remittances and items not allocated | 11,173 | - | 11,173 | |
| Payable to securities | 97,338 | - | 97,338 | |
| Total Liabilities | <u>\$ 9,235,763</u> | <u>\$ -</u> | <u>\$ 9,235,763</u> | |
| Common capital stock | 3,000,000 | - | 3,000,000 | |
| Unassigned funds (surplus) | 5,454,840 | (20,094) | 5,434,746 | |
| Surplus as regards policyholders | <u>\$ 8,454,840</u> | <u>\$ (20,094)</u> | <u>\$ 8,434,746</u> | |
| Total Liabilities, Surplus and other Funds | <u><u>\$ 17,690,603</u></u> | <u><u>\$ (20,094)</u></u> | <u><u>\$ 17,670,509</u></u> | |

SUBLIMITY INSURANCE COMPANY
STATEMENT OF INCOME
For the Year Ended December 31, 2008

| | <u>Balance per Company</u> | <u>Examination Adjustments</u> | <u>Balance per Examination</u> | <u>Notes</u> |
|---|--------------------------------|------------------------------------|------------------------------------|--------------|
| Underwriting Income | | | | |
| Premiums earned | \$ 11,172,376 | \$ - | \$ 11,172,376 | |
| Deductions: | | | | |
| Losses incurred | 6,200,844 | - | 6,200,844 | |
| Loss adjustment expenses incurred | 1,000,796 | - | 1,000,796 | |
| Other underwriting expenses incurred | 3,889,863 | - | 3,889,863 | |
| Aggregate write-ins for underwriting deductions | - | - | - | |
| Total underwriting deductions | <u>11,091,503</u> | <u>-</u> | <u>11,091,503</u> | |
| Net underwriting gain or (loss) | <u>80,873</u> | <u>-</u> | <u>80,873</u> | |
| Investment Income | | | | |
| Net investment income earned | 908,788 | - | 908,788 | |
| Net realized capital gains or (losses) | <u>(682,054)</u> | <u>-</u> | <u>(682,054)</u> | |
| Net investment gain or (loss) | <u>226,734</u> | <u>-</u> | <u>226,734</u> | |
| Other Income | | | | |
| Net gain or (loss) from agents' or premium balances charged off | (17,155) | - | (17,155) | |
| Finance and service charges not included in premiums | 128,843 | - | 128,843 | |
| Aggregate write-ins for miscellaneous income | - | - | - | |
| Total other income | <u>111,688</u> | <u>-</u> | <u>111,688</u> | |
| Net income before dividends to policyholders and income taxes | 419,295 | - | 419,295 | |
| Dividends to policyholders | - | - | - | |
| Federal and foreign income taxes incurred | <u>359,844</u> | <u>-</u> | <u>359,844</u> | |
| Net income | <u>\$ 59,451</u> | <u>\$ -</u> | <u>\$ 59,451</u> | |

SUBLIMITY INSURANCE COMPANY
RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE THE LAST
EXAMINATION
For the Year Ended December 31

| | 2008 | 2007 | 2006 | 2005 | 2004 |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Surplus as regards policyholders, December 31, previous | <u>\$ 8,728,599</u> | <u>\$ 8,272,883</u> | <u>\$ 7,268,878</u> | <u>\$ 5,319,080</u> | <u>\$ 3,804,365</u> |
| Net income | 59,451 | 932,797 | 1,174,966 | 1,731,065 | 1,030,694 |
| Change in net unrealized capital gains or (losses) | (172,483) | (323,766) | (10,247) | (113,123) | (32,552) |
| Change in net deferred income tax | 369,552 | 91,000 | 22,000 | 63,000 | 18,000 |
| Change in nonadmitted assets | (280,279) | (44,315) | 17,286 | (81,143) | (1,426) |
| Change in provision for reinsurance | - | - | - | - | - |
| Change in surplus notes | - | - | - | - | - |
| Cumulative effects of changes in accounting principles | - | - | - | - | - |
| Capital changes: | | | | | |
| Paid in | - | - | - | 3,312 | 3,876 |
| Transferred from surplus (Stock Dividend) | - | - | 2,959,631 | - | - |
| Transferred to surplus | - | - | - | - | - |
| Surplus adjustments: | | | | | |
| Paid in | - | - | - | 496,687 | 496,123 |
| Transferred to capital (Stock Dividend) | - | - | (2,959,631) | - | - |
| Transferred from capital | - | - | - | - | - |
| Net remittances from or (to) Home Office | - | - | - | - | - |
| Dividends to stockholders (cash) | (250,000) | (200,000) | (200,000) | (150,000) | - |
| Change in treasury stock | - | - | - | - | - |
| Examination changes | (20,094) | - | - | - | - |
| Aggregate write-ins for gains and losses in surplus | - | - | - | - | - |
| Change in surplus as regards policyholders for the year | <u>(293,853)</u> | <u>455,716</u> | <u>1,004,005</u> | <u>1,949,798</u> | <u>1,514,715</u> |
| Surplus as regards policyholders, December 31 current year | <u><u>\$ 8,434,746</u></u> | <u><u>\$ 8,728,599</u></u> | <u><u>\$ 8,272,883</u></u> | <u><u>\$ 7,268,878</u></u> | <u><u>\$ 5,319,080</u></u> |

NOTES TO FINANCIAL STATEMENTS

Note 1 – Invested Assets

Most of the Company's long-term bond investments were in US obligations, US federal agency bonds, municipal obligations, and corporate issues. The Company did have a moderate exposure to mortgaged-backed securities (MBS) and asset-backed securities (ABS). All MBS/ABS issues were investment rated at year-end 2008, but the carrying book value of \$5.8 million comprised over 49% of the total long-term bond portfolio, or almost 39% of all invested assets. An additional \$385,800 was invested in bonds of banking and financial corporations.

Preferred and common stocks included banks and other financials, miscellaneous industrials, a wholly-owned subsidiary, and mutual funds.

Cash, cash equivalents and short-term deposits consisted of cash on deposit, a Federated US Government Obligations fund and a Wells Fargo Treasury money market fund.

A comparison of the major investments over the past five years shows the following:

| <u>Year</u> | <u>A</u> | <u>B</u> | <u>C</u> | <u>Ratio</u> | <u>Ratio</u> | <u>Ratio</u> |
|-------------|--------------|------------------------------------|----------------------------|------------------------|------------------------|------------------------|
| | <u>Bonds</u> | <u>Common and Preferred Stocks</u> | <u>Cash and Short-term</u> | <u>A/ Total Assets</u> | <u>B/ Total Assets</u> | <u>C/ Total Assets</u> |
| 2004 | \$ 7,684,134 | \$1,428,714 | \$ 412,520 | 65.3% | 12.1% | 3.5% |
| 2005 | 9,207,766 | 1,379,475 | 828,077 | 66.1% | 9.9% | 5.9% |
| 2006 | 10,944,772 | 1,932,716 | 272,303 | 69.7% | 12.3% | 1.7% |
| 2007 | 11,588,697 | 1,785,599 | 489,603 | 69.2% | 10.7% | 2.9% |
| 2008 * | 11,727,276 | 1,141,189 | 1,333,462 | 66.4% | 6.5% | 7.5% |

The Board of Directors approved the investment transactions in each of the years under review, pursuant to ORS 733.740. As of December 31, 2008, invested assets with a book value of \$3,484,348, representing 23.3% of the total invested assets, were invested in amply secured obligations of the United States, obligations of the State of Oregon, or in FDIC insured cash deposits. The Company was in compliance with ORS 733.580.

Effective July 23, 2008, the Company entered into a custodial agreement with Wells Fargo Bank, NA. The agreement appears to contain all of the relevant protections described in OAR 836-027-0200(4)(a) through (l). It was noted, however, that the agreement requires the bank to notify the Idaho Department of Insurance if the agreement is terminated or if 100% of the assets have been withdrawn. Because the assets are held in an Idaho bank under a custodial agreement that satisfies the provisions of OAR 836-027-0200, notification of the Idaho commissioner in the event the agreement is terminated or assets have been withdrawn is acceptable.

The Company reported investments of common stocks on Schedule D – Part 2 – Section 2 in the amount of \$20,094, which represented the book value of a wholly-owned subsidiary. The last Report of Examination recommended the Company submit the subsidiary to the SVO for

proper valuation, and the Company responded the cost of the analysis was not justified given the immaterial value of the subsidiary. The Company admitted the full value in each of the Annual Statements during the period under examination, however, there continued to be no independent valuation pursuant to the provisions of SSAP No. 97, paragraph 8. Beginning with the 2009 Annual Statement, the Company began nonadmitting the value of its subsidiary, so no examination recommendation will be made.

Note 2 – Actuarial Reserves

David Dahl, FCAS, MAAA, Property/Casualty actuary for the Oregon Insurance Division, reviewed the liabilities established as of the December 31, 2008. His review consisted of the following:

1. The data, methods, and calculations used in the Actuarial Report supporting the Actuarial Opinion as of December 31, 2008.
2. The data, methods, and calculations used by the Company to establish its liabilities as of December 31, 2008.

Joseph L. Petrelli of Demotech, Inc., Columbus, Ohio, prepared the Company's actuarial report. The Company's Board of Directors appointed Mr. Petrelli in 2008. The Company's liabilities were found to be redundant by approximately \$174,000 on a net basis. This amount is 2.0% of the Company's reported surplus as of December 31, 2008, and consequently, not material. The Actuarial Report used paid and incurred developments, and hindsight techniques consisting of paid and incurred Bornhuetter-Ferguson methods to estimate the loss and defense and cost containment expense on a combined basis. Separate estimates were made for other loss adjustment expense using loss payment patterns and the common assumption that 50% of the other loss adjustment expense is paid when opening a claim and 50% paid when closing a claim. The experience for loss and defense and cost containment was grouped by annual statement line, and the experience for other loss adjustment expense is on an overall basis.

Sublimity's liability for Losses and Loss Adjustment Expenses was found to be reasonably stated as of December 31, 2008.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

There were no adjustments made to the Company's surplus as a result of this examination and no recommendations or comments made.

CONCLUSION

During the five year period covered by this examination, the surplus of the Company has increased from \$3,804,365 as presented in the December 31, 2003 Report of Examination to \$8,434,736 as shown in this report. The comparative assets and liabilities are:

| | <u>2008</u> | <u>December 31,</u> | <u>2003</u> | <u>Change</u> |
|-------------|---------------------|---------------------|--------------------|--------------------|
| Assets | \$17,670,509 | | \$9,738,421 | \$7,932,088 |
| Liabilities | <u>9,235,763</u> | | <u>5,934,056</u> | <u>3,301,707</u> |
| Surplus | <u>\$ 8,434,746</u> | | <u>\$3,804,365</u> | <u>\$4,630,381</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, Timothy R. Hurley, CFE, insurance examiner, and David Dahl, FCAS, MAAA, actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

Greg A. Lathrop, CFE
Supervising Financial Examiner
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Greg A. Lathrop, CFE, being duly sworn, states as follows:

1. I have authority to represent the state of Oregon in the examination of Sublimity Insurance Company, Sublimity, Oregon.

2. The Insurance Division of the Department of Consumer and Business Services of the State of Oregon 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 Sublimity Insurance Company was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

Greg A. Lathrop, CFE
Supervising Financial Examiner
Department of Consumer and Business Services
State of Oregon

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

Notary Public for the State of Oregon

My Commission Expires: _____