

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
FRATERNAL BENEFICIAL ASSOCIATION
SPOKANE, WASHINGTON

NAIC CODE 29360
December 31, 2009

Order No. 11-22
Fraternal Beneficial Association
Exhibit A

SALUTATION

Seattle, Washington
February 9, 2011

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building-Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

Dear Commissioner Kreidler:

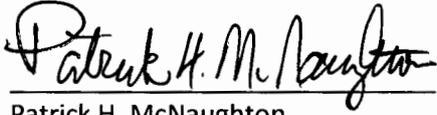
In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Fraternal Beneficial Association
of
Spokane, Washington

hereinafter referred to as "FBA" at its office located at 12414 E. 26th Avenue, Spokane, Washington 99216. This report is respectfully submitted showing the financial condition and related corporate matters of FBA as of December 31, 2009.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Fraternal Beneficial Association of Spokane, Washington. This report shows the financial condition and related corporate matters as of December 31, 2009.



Patrick H. McNaughton
Chief Examiner

2-9-2011
Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2006 through December 31, 2009 and comprises a comprehensive review of the books and records of FBA. The examination was conducted in accordance with statutory requirements contained in the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioner (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of field work on January 10, 2011. The results of the examination are commented upon in the various sections of this report.

FBA's records, external reference materials, and various aspects of the operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following section of this report.

INSTRUCTIONS

The examiners reviewed FBA's filed 2009 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if FBA completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if FBA's accounts and records were prepared and maintained in accordance with Title 48 RCW and the NAIC Statements of Statutory Accounting Principles (SSAP) as outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review:

1. NAIC Annual Statement Errors, Omissions, and Misclassifications

The results of the examination disclosed four instances in which FBA's filing of the 2009 NAIC Annual Statement did not conform to the NAIC AP&P Manual and the NAIC Annual Statement Instructions. While FBA needs to correct these practices, none of the following items in this instruction were believed to be material to the financial statements and no examination adjustments were necessary.

1. FBA improperly recorded the net admitted assets total, on line 24, column 3. The correct total net admitted assets amount was \$463,641 instead of \$436,641.
2. All premiums reported on Schedule T – Exhibit of Premiums Written, were incorrectly allocated to Washington State. The premiums should have been allocated to the states of Idaho and Washington.
3. FBA's cash and cash equivalents were incorrectly reported in Schedule DA – Verification between Years: Short-Term Investments. The cash and cash equivalents should have been reported in Schedule E – Verification between Years: Cash Equivalents and in Schedule E-Part 1-Cash.
4. The Notes to Financial Statements disclosed incorrectly that assets consist of annuities with terms of seven to ten years; however, FBA indicated that all its annuities were redeemed in 2008.

FBA is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC and WAC 284-07-050(2)(a) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

2. Investment Custodian Deficiency

FBA responded in its 2009 NAIC Annual Statement General Interrogatories 26.01 that its custodial agreement with Richards, Merrill & Peterson, Inc. (RMP) complied with the FCEH. However, FBA had no written custodial agreement. Instead, FBA had a written investment management agreement with RMP to provide investment services and to oversee the Depository Trust Company as custodian on behalf of FBA. The investment management agreement did not contain several provisions as required by RCW 48.13.460 and RCW 48.13.480. In addition, RCW 48.05.250 requires a company to file a true statement of its financial condition, transactions, and affairs.

FBA is instructed to execute a custodial agreement that complies with the FCEH and RCW 48.13.480. FBA is also instructed to comply with RCW 48.05.250 by filing a true statement of its financial condition, transactions and affairs and to follow the NAIC Annual Statement instructions and the AP&P, as required by WAC 284-07-050(2).

3. Limitation of a Single Risk

Several properties insured by FBA exceeded ten percent of its surplus. RCW 48.11.140 requires FBA not to retain any risk on any one subject of insurance in an amount exceeding ten percent of its surplus to policyholders. FBA was not in compliance with RCW 48.11.140(1) and (2) because several individual risks limit amounts exceeded ten percent of its surplus as of December 31, 2009. FBA was in compliance with RCW 48.11.140 when the policies were written in January 2009. (See Subsequent Events.)

FBA is instructed to limit and retain the amount of an individual risk to ten percent of its surplus pursuant to RCW 48.11.140(1) and (2).

4. Losses

FBA did not report unpaid fire losses on page 3, line 1 of the 2006 and 2009 NAIC Annual Statements. Losses incurred in 2009 but paid in 2010, amounting to \$1,741, were not reported as losses in 2009; and losses incurred in 2006 but paid in 2007, amounting to \$60,707, were not reported as losses in 2006. As a result, FBA was not in compliance with the requirements pursuant to RCW 48.12.030(2).

FBA is instructed to comply with RCW 48.12.030(2) by including the amount, estimated with the provision of this chapter, necessary to pay all of its unpaid losses and claims incurred on or prior to the date of statement whether reported or unreported.

COMMENTS AND RECOMMENDATIONS

NONE

COMPANY PROFILE

Company History

FBA was originally organized under the name of Unterstutzungs Verein von Spokane and Whitman Counties (literally translated: German Mutual Assistance Association of Spokane and Whitman Counties) in 1891 as a fraternal mutual property insurer organization. The name was changed in 1918 to Fraternal Beneficial Association. The original certificate of authority was issued by the OIC in 1918 to transact the business of insurance as a fraternal mutual property insurer. To date, FBA only offers fire and smoke protection property coverage.

Territory and Plan of Operation

FBA is organized and authorized to transact the business of property insurance in the state of Washington. FBA provides fire and smoke damage insurance to its members who are primarily farmers of eastern Washington and northern Idaho.

The territory covered by FBA is divided into districts, each district having an appraiser appointed by the president. The duties of the appraisers, as defined by FBA's Constitution and Bylaws are: to receive applications for membership; to inspect all properties offered for an appraisal; to examine carefully all fire hazards, and either approve or reject applicants for membership; to re-inspect insured property at least every ten years; to submit reports of all fire losses to the secretary-treasurer; to make a complete report of findings if arson is suspected; and to re-appraise property if so requested by members.

Growth

The following reflects the growth of FBA as reported in its filed NAIC Annual Statements for the four year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2009*	\$463,641	\$8,012	\$455,629
2008	2,331,086	34,244	2,296,842
2007	2,517,971	8,178	2,509,793
2006	2,463,892	0	2,463,892

*Capital and surplus dropped from 2008 to 2009 by \$1,841,213 because FBA was required to non-admit a portion of its investments due to non-compliance with RCW 48.13. FBA is not required to maintain a minimum capital and surplus in accordance with RCW 48.36A.390(6)(a) which provides for an exemption from minimum capital and surplus requirements for fraternal mutual insurers doing business on the assessment premium plan.

Loss Experience

The following exhibit reflects the underwriting operations of FBA by year, beginning in 2006. The amounts shown were compiled from FBA's NAIC Annual Statements as of December 31:

Year	Premium Earned	Net		Net Income
		Underwriting Gain (Loss)	Net Investment Gain (Loss)	
2009	\$62,289	\$692	\$60,897	\$53,676
2008	65,991	24,170	87,069	85,288
2007	67,450	(60,559)	114,571	54,088
2006	67,865	13,060	70,273	83,398

MANAGEMENT AND CONTROL

Ownership

There were approximately 366 shareholders as of December 31, 2009. To become a shareholder, members must have applied and been accepted as a policyholder. Prospective members must be farmers and have the potential of producing five hundred dollars of agricultural crops that could be sold. Shares are not actively traded and each stockholder has an ownership interest in an amount equal to the face value of the policy.

Executive Committee and Officers

The Constitution and Bylaws of FBA vest the management and control of the affairs of FBA in an Executive Committee. The Executive Committee consists of a president, first vice president, second vice president, secretary, treasurer, assistant secretary, and two FBA members appointed by the president. In addition, the president has appointed an Audit Committee consisting of the president, second vice president and treasurer. All officers must be members of FBA and are elected annually at the June meeting by ballot of the members. Members of the Executive Committee as of December 31, 2009 were:

<u>Name</u>	<u>Position</u>
Joe Schmitz	President
Lawrence Baumgartner	First Vice President
Tom Solbrack	Second Vice President
David Buob	Treasurer
Linda Cupp	Secretary
Sharon McCoy	Assistant Secretary
Glenn Leitz	Appointed Member
Ben Wolf	Appointed Member

Conflict of Interest

FBA has a policy concerning conflict of interest and confidentiality. No exceptions were noted.

Fidelity Bond and Other Insurance

FBA is the named insured on a fidelity bond issued by Travelers. The coverage is a \$100,000 fidelity bond on the Secretary of FBA. This amount exceeds the minimum suggested by the National Association of Insurance Commissioners of \$25,000 for a company of this size.

Officers', Employees', and Agents' Welfare and Pension Plans

FBA does not have any paid employees and therefore, does not offer a pension plan or any other employee welfare plans or benefits.

Internal Controls

FBA contracts all of its accounting and policy service functions to LC Accounting Service which is owned by FBA's Secretary. The contract duties include bookkeeping, maintaining and keeping records of claims, premiums, and minutes of meetings. The FBA's Treasurer has taken over the duties of submitting Internal Revenue Service filings and NAIC Quarterly and Annual Statements to the OIC.

In order to ensure an appropriate internal control environment, the Audit Committee performs a detailed quarterly review of FBA's accounts and records maintained by LC Accounting Service.

ASSOCIATION RECORDS

The corporate records were reviewed for the period under examination. FBA's Constitution and Bylaws were amended on June 17, 2008 to increase the maximum policy limits to \$225,000.

REINSURANCE

FBA does not utilize reinsurance protection, nor does it currently anticipate a need for reinsurance.

ACCOUNTING RECORDS AND INFORMATION SYSTEM

FBA's accounts and records are maintained on Generally Accepted Accounting Principles (GAAP) basis of accounting and are converted to Statutory Accounting Practices (SAP) accrual basis for reporting purposes.

SUBSEQUENT EVENTS

According to FBA's NAIC Quarterly Statement as of September 30, 2010, FBA sold all its mutual funds and the proceeds were reinvested in 2,600,000 shares of the Fidelity Institutional Government Portfolio in order to bring FBA into compliance with the investment limitation rules. The Fidelity Institutional Government Portfolio is classified as a U.S. Direct Obligation/Full Faith and Credit Exempt by the NAIC Securities Valuation Office. FBA's total assets and total surplus as of September 30, 2010 were reported as \$2,776,539 and \$2,776,539, respectively.

FOLLOW UP ON PREVIOUS EXAMINATION REPORT

Our examination noted that all previous report instructions and comments were corrected.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of Fraternal Beneficial Association as of December 31, 2009:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Four Year Reconciliation of Surplus

**Fraternal Beneficial Association
Assets, Liabilities, Capital and Surplus
December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
ASSETS			
Bonds	\$27,124	\$0	\$27,124
Stocks:			
Preferred stocks	73,486		73,486
Common stocks	271,238		271,238
Cash and short term investments	91,008		91,008
Uncollected premium and agents' balances in the course of collection	785	0	785
Total Assets	<u>\$463,641</u>	<u>\$0</u>	<u>\$463,641</u>
LIABILITIES, SURPLUS AND OTHER FUNDS			
Current federal income taxes	\$8,012	\$0	\$8,012
Total liabilities	<u>8,012</u>		<u>8,012</u>
Unassigned funds (surplus)	455,629		455,629
Total Liabilities, Surplus and Other Funds	<u>\$463,641</u>	<u>\$0</u>	<u>\$463,641</u>

**Fraternal Beneficial Association
Statement of Revenue and Expenses
For the Year Ended December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Underwriting Income			
Premiums earned	\$62,289	\$0	\$62,289
Deductions:			
Loss incurred	(16,000)		(16,000)
Loss adjustment expenses incurred	(200)		(200)
Other underwriting expenses incurred	(45,397)		(45,397)
Total underwriting deductions	(61,597)		(61,597)
Net underwriting gain (loss)	692	0	692
Investment Income			
Net investment income earned	46,704		46,704
Net realized capital gains (losses)	14,193		14,193
Net investment gain or (loss)	60,897	0	60,897
Other Income			
Finance and service charges not included in premiums	99		99
Total other income	99		99
Federal income taxes incurred	(8,012)		(8,012)
Net income	\$53,676	\$0	\$53,676
CAPITAL AND SURPLUS ACCOUNT			
Capital and Surplus December 31, 2008	\$2,296,842	\$0	\$2,296,842
Net income or (loss)	53,676		53,676
Changes in capital and surplus (See page 9)	(1,894,889)		(1,894,889)
Net change in capital & surplus	(1,841,213)		(1,841,213)
Capital and Surplus, December 31, 2009	\$455,629	\$0	\$455,629

**Fraternal Beneficial Association
Four Year Reconciliation of Surplus
December 31, 2009**

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital and Surplus, December 31, prior year	<u>\$2,296,842</u>	<u>\$2,509,793</u>	<u>\$2,463,892</u>	<u>\$2,377,947</u>
Net income or (loss)	<u>53,676</u>	<u>85,288</u>	<u>45,901</u>	<u>83,398</u>
Changes in capital and surplus:				
Change in net unrealized capital gains (losses) less capital gain tax	353,847	(298,239)	0	2,547
Change in nonadmitted assets	<u>(2,248,736)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Changes in capital and surplus*	<u>(1,894,889)</u>	<u>(298,239)</u>	<u>0</u>	<u>2,547</u>
Net change in capital & surplus for the year	<u>(1,841,213)</u>	<u>(212,951)</u>	<u>45,901</u>	<u>85,945</u>
Capital and Surplus, December 31, current year	<u><u>\$455,629</u></u>	<u><u>\$2,296,842</u></u>	<u><u>\$2,509,793</u></u>	<u><u>\$2,463,892</u></u>

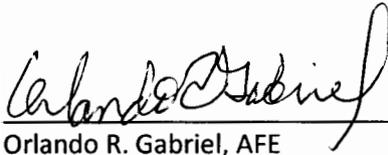
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ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Fraternal Beneficial Association during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner and Susan Campbell, CPA, CFE, FLMI, Life and Disability Field Supervising Examiner, both from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



Orlando R. Gabriel, AFE
Examiner-in-Charge
State of Washington

