

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
GRANGE INSURANCE ASSOCIATION  
SEATTLE, WASHINGTON

NAIC CODE 22101  
December 31, 2011

Order No. 12-301  
Grange Insurance Association  
Exhibit A

**SALUTATION**

Seattle, Washington  
November 13, 2012

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

**Grange Insurance Association**

of

Seattle, Washington

hereinafter referred to as "GIA," or the "Company" at the location of its home office, 200 Cedar Street, Seattle, Washington 98121. This report is respectfully submitted showing the financial condition and related corporate matters of GIA as of December 31, 2011.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Financial Examination of Grange Insurance Association of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2011.



Patrick H. McNaughton

Chief Examiner

11-13-12

Date

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## SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2007 through December 31, 2011 and comprises a risk focused review of the books and records of the Company. The examination followed statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (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 October 8, 2012.

Corporate records, external reference materials, and various aspects of the Company's 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. In addition, the Company's Certified Public Accountant (CPA) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2011 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

## INSTRUCTIONS

The examiners reviewed the Company's filed 2011 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company prepared the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, 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. Custodial Agreement**

The Company responded in its 2011 NAIC Annual Statement, General Interrogatory 28.01, that its custodial agreement with Wells Fargo Bank, N.A., complied with the FCEH. However, the Wells Fargo Bank, N.A., custodial agreement did not contain several provisions which are required by the FCEH and RCW 48.13.480.

**The Company is instructed to execute a revised or amended custodial agreement that complies with the FCEH and RCW 48.13.480. The Company is also instructed to comply with RCW 48.05.250 by following the NAIC Annual Statement Instructions and the AP&P as required by WAC 284-07-050(2).**

## **2. Missing Required Reinsurance Terms**

The Multiple Line Excess of Loss Reinsurance Agreement between GIA and its subsidiary, Rocky Mountain Fire and Casualty Company (RMFCC), did not stipulate that it constituted the entire contract, as required by SSAP No. 62R(8).

**The Company is instructed to comply with WAC 284-07-050(2) which requires adherence to the AP&P, specifically SSAP No. 62R(8), by including all required terms in its reinsurance agreements.**

## **3. Premium Deficiency Reserves**

In Note to Financial Statements No. 30 (Premium Deficiency Reserves) of the Company's 2011 NAIC Annual Statement, the Company did not disclose the date of evaluation or whether anticipated investment income was utilized as a factor in the calculation, as required by the NAIC Annual Statement Instructions.

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

## **COMPANY PROFILE**

### **Company History**

The Company began operations on April 4, 1894 as a fraternal fire association, domiciled in the state of Washington, under the name Washington Fire Relief Association. The Company's Certificate of Authority to act as an insurer was issued on February 26, 1912. On August 6, 1931, the Company incorporated. In 1933, the Company ceased premium operations on an assessment basis and changed to a legal reserve basis. The Company's name was changed in 1936 to the Grange Fire Insurance Association and again in 1943 to its present name, Grange Insurance Association.

### **Capitalization**

GIA was established as a mutual fraternal benefit society pursuant to Chapter 48.09 RCW, and therefore, has not issued any common capital stock or preferred capital stock.

### **Territory and Plan of Operation**

GIA is authorized to do business in California, Colorado, Idaho, Montana, Nebraska, Oregon, Washington, and Wyoming. GIA's authorized lines of business are property, marine, transportation, general casualty and surety.

## Growth of Company

The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below:

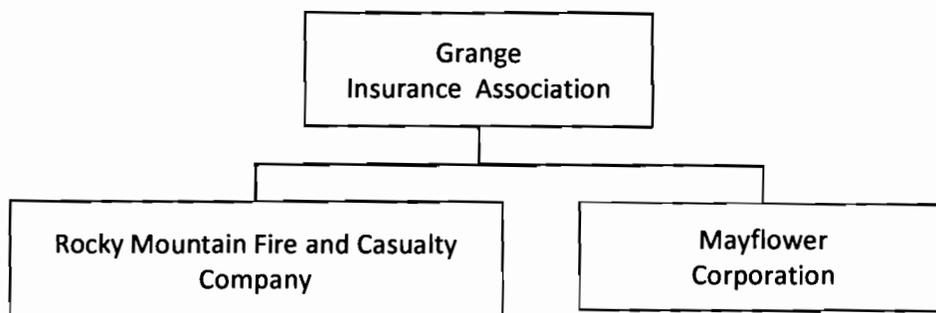
<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	
2011	\$231,842,200	\$114,769,233	\$117,072,967	
2010	223,859,816	111,790,099	112,069,717	
2009	213,329,406	105,127,098	108,202,308	
2008	207,721,119	103,622,226	104,098,893	
2007	212,705,132	107,996,914	104,708,218	

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2011	\$119,354,273	(\$1,745,778)	\$6,618,758	\$4,052,204
2010	114,216,119	(4,644,534)	7,252,617	3,318,107
2009	108,799,059	(4,809,295)	7,543,955	2,247,544
2008	104,430,299	3,818,096	3,292,955	4,203,509
2007	104,632,803	665,547	7,080,404	6,218,680

## Affiliated Companies

The following organization chart is taken from GIA's filed 2011 NAIC Annual Statement:



## Intercompany Agreements

As of December 31, 2011, GIA had the following intercompany agreements in force, with the effective dates indicated:

- Consolidated Federal Income Tax Liability Allocation Agreement January 1, 1995
- Multiple Line Excess of Loss Reinsurance Agreement No. 1 January 1, 1995
- Intercompany Expense Sharing Agreement November 1, 2003

## **MANAGEMENT AND CONTROL**

### **Board of Directors**

Directors as of December 31, 2011:

Dee T. McKern	Chairman of the Board
Frederick P. Church	
Frederick D. Crowell	
Rosemary K. Hansen	
Dareld G. Larrigan	
Ronald G. Miller	
Arthur R. Peterson	
Paul C. Redner	
Robert L. Shea	
Larry D. Tanneberg	

### **Officers**

Officers as of December 31, 2011:

Ryan M. Dudley	President
Sean I. McGourty	Treasurer
Todd C. Merkley	Secretary
Ralph W. Carlile	Vice President, Information Technology
Rudy F. Werle	Vice President, Claims
Charles T. Mullen	Vice President, Marketing

### **Conflict of Interest**

The Company has an established procedure for disclosure to its BOD of any affiliation on the part of its officers, directors and key employees that is in conflict with their official duties. The corporate secretary, chief executive officer, and chairman of the board, review the conflict of interest statements annually for conflicting situations and take appropriate action, if necessary. No exceptions were noted.

### **Fidelity Bond and Other Insurance**

The Company and its affiliated companies are the named insureds on various insurance policies including property and general liability loss, commercial excess umbrella liability, excess liability, workers' compensation and employers' liability, fidelity, fiduciary liability, errors and omissions and directors and officers' liability coverage. The Company's fidelity coverage of \$2 million meets the suggested NAIC minimum coverage.

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

As of December 31, 2011, the Company sponsored the following plans:

- A non-contributory defined benefit pension plan covering approximately half of all employees, which was frozen effective February 29, 2004.
- A non-contributory post retirement medical and life insurance plan covering retired employees, and active and retired directors. Employees who retired subsequent to January 31, 2004, and all current employees, are no longer eligible for post retirement benefits. In addition, the plan was amended effective January 1, 2009, to phase out the benefit for the covered retired employees over a 10-year period.
- A non-contributory agents' retirement plan covering certain retired agents.
- A 401(k) plan and profit sharing plan. Under the 401(k) component of the plan, employees may voluntarily contribute up to 75 percent of their annual salary, subject to annual limitations, with the Company matching 100 percent of employee contributions up to three percent, and 50 percent of employee contributions between three and five percent. There is no vesting period related to the Company's contributions.

The Company accrued expenses and liabilities in accordance with actuarially determined amounts.

## CORPORATE RECORDS

The Company's Articles of Incorporation, Bylaws, and minutes of the BOD and committees, were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes.

## UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

<u>Year</u>	<u>Losses</u>	<u>Loss Adjustment Expenses</u>
2011	\$43,117,489	\$6,981,027
2010	42,869,046	6,496,085
2009	38,995,390	6,150,521
2008	39,326,998	5,861,926
2007	43,897,382	7,717,874

As shown above, the reserves carried by the Company for unpaid losses and loss adjustment expenses were \$43,117,489 and \$6,981,027, respectively, as of December 31, 2011.

The OIC actuaries reviewed the unpaid losses and loss adjustment expense reserves of the Company and concluded that the reserves were within a range of reasonable estimates. Therefore, the Company's loss and loss adjustment expense reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2011 NAIC Annual Statement.

## REINSURANCE

GIA participates in quota share and excess loss treaties. These treaties are spread across a portfolio of authorized reinsurers. The Company assumes business from its subsidiary, RMFCC, through a multiple line excess of loss reinsurance agreement.

Reinsurance agreements were found to be in compliance with Washington State reinsurance statutes with the exception of one treaty which did not include the entire contract clause. (See Instruction No. 2.) The reinsurers are either authorized to do business in Washington State or the Company holds an approved letter of credit. They are all properly classified in Schedule F of the 2011 NAIC Annual Statement. The Company has appropriate controls in place to monitor its reinsurance program including the financial condition of the reinsurers.

GIA utilizes the services of a reinsurance intermediary, Guy Carpenter & Company, LLC (Guy Carpenter), to solicit, negotiate and place reinsurance cessions on its behalf. Guy Carpenter is an international reinsurance intermediary owned by Marsh & McLennan Companies, Inc. and licensed in Washington State.

## STATUTORY DEPOSITS

The Company maintained the following statutory deposits as of December 31, 2011:

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
California	Bond	\$111,630	\$120,689
Oregon	Bond	300,519	354,717
Washington	Bond	2,527,593	2,737,250
<b>Total</b>		<b><u>\$2,939,742</u></b>	<b><u>\$3,212,656</u></b>

## ACCOUNTING RECORDS AND INFORMATION SYSTEM

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) basis and is audited annually by the certified public accounting firm of Ernst & Young LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The Company's Information Technology (IT) environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT system and controls were evaluated to gain an understanding of the IT general control risks and assess the effectiveness of these controls to determine if appropriate mitigating and internal controls have been implemented. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. The Company has an effective Business Continuity Plan and Disaster Recovery Plan, which have been tested on a regular basis and includes the availability of an alternate site.

#### **SUBSEQUENT EVENTS**

There were no additional material events impacting the Company between the examination date and the last day of our field work on October 8, 2012.

#### **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

The Company did not comply with the following instruction from the last examination report dated December 31, 2006:

The Company did not adequately modify the Multiple Line Excess of Loss Reinsurance Agreement between GIA and RMFCC to stipulate that it constituted the entire contract, as required by SSAP No. 62R(8). (See Instruction No. 2.)

#### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of Grange Insurance Association as of December 31, 2011:

Assets, Liabilities, Surplus and Other Funds  
Statement of Income and Capital and Surplus Account  
Five Year Reconciliation of Surplus

**Grange Insurance Association**  
**Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2011**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Assets</b>			
Bonds	\$171,140,609	\$0	\$171,140,609
Stocks:			
Preferred stocks	286,128		286,128
Common stocks	18,765,454		18,765,454
Real Estate:			
Properties occupied by the company	4,092,201		4,092,201
Cash and short-term investments	10,522,018		10,522,018
Receivables for securities	7,541		7,541
<b>Subtotals, cash and invested assets</b>	<u><b>204,813,951</b></u>	<u><b>0</b></u>	<u><b>204,813,951</b></u>
Investment income due and accrued	1,722,223		1,722,223
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	16,188,601		16,188,601
Current federal and foreign income tax recoverable and interest thereon	1,140,580		1,140,580
Net deferred tax asset	7,555,992		7,555,992
Guaranty funds receivable or on deposit	28,894		28,894
Electronic data processing equipment and software	317,355		317,355
Receivables from parent, subsidiaries and affiliates	74,604		74,604
<b>Total Assets</b>	<u><b>\$231,842,200</b></u>	<u><b>\$0</b></u>	<u><b>\$231,842,200</b></u>
<b>Liabilities, Surplus and Other Funds</b>			
Losses	\$43,117,489	\$0	\$43,117,489
Loss adjustment expenses	6,981,027		6,981,027
Commissions payable, contingent commissions and other similar charges	2,299,825		2,299,825
Other expenses	2,680,310		2,680,310
Taxes, licenses and fees	469,893		469,893
Unearned premiums	47,881,926		47,881,926
Advance premium	1,400,670		1,400,670
Ceded reinsurance premiums payable	222,524		222,524
Amounts withheld or retained by company for account of others	498,971		498,971
Aggregate write-ins for liabilities	9,216,598		9,216,598
<b>Total Liabilities</b>	<u><b>114,769,233</b></u>	<u><b>0</b></u>	<u><b>114,769,233</b></u>
Unassigned funds (surplus)	117,072,967		117,072,967
<b>Surplus as regards policyholders</b>	<u><b>117,072,967</b></u>	<u><b>0</b></u>	<u><b>117,072,967</b></u>
<b>Total Liabilities, Surplus and Other Funds</b>	<u><b>\$231,842,200</b></u>	<u><b>\$0</b></u>	<u><b>\$231,842,200</b></u>

**Grange Insurance Association**  
**Statement of Income and Capital and Surplus Account**  
**For the Year Ended December 31, 2011**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Underwriting Income</b>			
Premiums earned	\$119,354,273	\$0	\$119,354,273
<b>Deductions</b>			
Losses incurred	72,901,050		72,901,050
Loss adjustment expenses incurred	12,370,247		12,370,247
Other underwriting expenses incurred	35,828,754		35,828,754
Total underwriting deductions	<u>121,100,051</u>	<u>0</u>	<u>121,100,051</u>
<b>Net underwriting gain or (loss)</b>	<b><u>(1,745,778)</u></b>	<b><u>0</u></b>	<b><u>(1,745,778)</u></b>
<b>Investment Income</b>			
Net investment income earned	6,528,155		6,528,155
Net realized capital gains or (losses)	90,603		90,603
<b>Net investment gain or (loss)</b>	<b><u>6,618,758</u></b>	<b><u>0</u></b>	<b><u>6,618,758</u></b>
<b>Other Income</b>			
Net gain or (loss) from agents' or premium balances charged off	(66,357)		(66,357)
Finance and service charges not included in premiums	917,135		917,135
Aggregate write-ins for miscellaneous income	7,405		7,405
<b>Total other income</b>	<b><u>858,183</u></b>	<b><u>0</u></b>	<b><u>858,183</u></b>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	5,731,163		5,731,163
Federal and foreign income taxes incurred	1,678,959		1,678,959
<b>Net income</b>	<b><u>\$4,052,204</u></b>	<b><u>\$0</u></b>	<b><u>\$4,052,204</u></b>
<b>Capital and Surplus Account</b>			
<b>Surplus as regards policyholders, December 31 prior year</b>	<b><u>\$112,069,717</u></b>	<b><u>\$0</u></b>	<b><u>\$112,069,717</u></b>
<b>Gains and (losses) in surplus</b>			
Net income	4,052,204		4,052,204
Change in net unrealized capital gains or (losses)	807,209		807,209
Change in net deferred income tax	(59,263)		(59,263)
Change in nonadmitted assets	1,254,476		1,254,476
Change in provision for reinsurance	262,410		262,410
Aggregate write-ins for gains and losses in surplus	(1,313,786)		(1,313,786)
<b>Change in surplus as regards policyholders for the year</b>	<b><u>5,003,250</u></b>	<b><u>0</u></b>	<b><u>5,003,250</u></b>
<b>Surplus as regards policyholders, December 31 current year</b>	<b><u>\$117,072,967</u></b>	<b><u>\$0</u></b>	<b><u>\$117,072,967</u></b>

**Grange Insurance Association  
Five Year Reconciliation of Surplus  
For the Years Ended December 31,**

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital and Surplus, December 31, previous year	\$112,069,717	\$108,202,308	\$104,098,893	\$104,708,219	\$97,168,888
Net income or (loss)	4,052,204	3,318,107	2,247,544	4,203,509	6,218,680
Change in net unrealized capital gains or (losses)	807,209	923,283	(816,994)	(4,386,462)	(6,837,264)
Changes in net deferred income tax	(59,263)	707,248	141,656	3,398,525	(451,630)
Change in nonadmitted assets	1,254,476	(465,755)	3,061,011	(2,960,569)	8,109,350
Change in provision for reinsurance	262,410	(250,543)	392,135	(279,643)	(124,247)
Aggregate write-ins for gains and losses in surplus	(1,313,786)	(364,931)	(921,937)	(584,685)	624,441
Change in surplus as regards policyholders for the year	<u>5,003,250</u>	<u>3,867,409</u>	<u>4,103,415</u>	<u>(609,326)</u>	<u>7,539,331</u>
Capital and Surplus, December 31, current year	<u>\$117,072,967</u>	<u>\$112,069,717</u>	<u>\$108,202,308</u>	<u>\$104,098,893</u>	<u>\$104,708,219</u>

## **NOTES TO THE FINANCIAL STATEMENTS**

### **1. Special Consent**

The Company holds a special consent, issued by the state of Washington, with an effective date of January 1, 2011, and subsequently renewed effective January 1, 2012, that allows GIA to own and purchase mutual funds if certain statutory requirements have been met. GIA is allowed to acquire and hold a single entity's NAIC non-exempt listed mutual funds totaling not more than four percent of the Company's admitted assets. As of December 31, 2011, GIA's mutual fund investments represented 0.63 percent of its admitted assets.

The Company has no additional special consents, permitted practices, or orders from the state of Washington.

## **ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Grange Insurance Association and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, CFE, FLMI, Reinsurance Specialist; D. Lee Barclay, FCAS, MAAA, Senior Actuary; Timothy F. Hays, CPA, JD, Investment Specialist; Dan Forsman, Actuarial Analyst; Tarik Subbagh, MSBA, CPA, CFE, Property and Casualty Field Supervising Examiner; Randy E. Fong, CFE, Examiner-in-Charge; Edsel R. Dino, Financial Examiner; Katy Bardsley, CPA, AFE, Financial Examiner; and James R. Gill, CPA, MBA, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



Albert Karau, Jr., CPA, CFE, FLMI  
Examiner-in-Charge  
State of Washington

AFFIDAVIT

STATE OF WASHINGTON        }  
  } ss  
COUNTY OF KING            }

Albert Karau, Jr., CPA, CFE, FLMI, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Grange Insurance Association was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners.

Albert Karau, Jr.  
Albert Karau, Jr., CPA, CFE, FLMI  
Examiner-in-Charge  
State of Washington

Subscribed and sworn to before me this 13th day of November, 2012.

Colleen Jansen  
Notary Public in and for the  
State of Washington

