Report of Examination
of
Farmers Aid Association of
Loudon County, Tennessee

RECEIVED
JUN 02 2008
Dept. Of Commerce & Insurance
Company Examinations

Kelly Bilderback, Secretary
804 Mulberry Street
P. O. Box 384
Loudon, TN 37774

Examination made as of: December 31, 2006

Examiner in Charge: James T. Pearce, Examiner III

Examination commenced: May 3, 2007

Examination completed: May 16, 2008

Table of Contents

Caption	Page
Introduction	4
Officers	4
Directors	4
Compensation of officers, directors, appraisers, adjusters, et al	5
Report of changes in the Charter or By-Laws, policy forms, or other agreements during the period covered by this examination	5
If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report	5
Report on reinsurance assumed and / or ceded	5
Appraisal and classification of risks taken	8
Annual rate of assessment per $1,000.00 for period covered	9
Rate of membership, policy and initial fees charged	9
Date of last assessment	9
Amount delinquent	9
Did that assessment provide for all losses, expenses and other liabilities, including borrowed money	10
Amount of money borrowed since date of last assessment	10
Exhibit of Risks	10
Financial Statement	11
Assets	12
Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon	13
Assets pledged or hypothecated	13
Comments on claims, borrowed money and other liabilities	13
Analysis of Changes in Financial Statement and Comments Resulting From Examination	14
Book Value of Real Estate	14
Other Assets, Viz: Savings Certificates	14
Summary Schedule for "Analysis of Changes In Financial Statement"	14

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business 15

SUBSEQUENT EVENTS - New Legislation Requirements for County Mutual Insurance Companies 15

Revision of By-Laws 15

Revision of Policy Forms 15

Revision of Application and Claim Forms 15

Agent's License 16

Premium Billing Transition and Premium "Forgiveness" 16

Director / Officer / Agent Compensation 17

Policy File Information 17

Summary of Examiners' Recommendations 17

1. Investments Held Without a Custodial / Safekeeping Agreement 17

2. Investment In Home Office Land and Building 17

SUBSEQUENT EVENTS 18

3. Revision of By-Laws 18

4. Revision of Policy Forms 18

5. Revision of Application and Claim Forms 18

6. Agent's License 18

7. Director / Officer / Agent Compensation 18

8. Premium Billing 18

Examination Affidavit 20

Date of Report: June 2, 2008

Examined as of: December 31, 2006

Last Examination as of: December 31, 2001

Honorable Leslie S. Newman
Commissioner of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner,

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Farmers Aid Association of Loudon County, Tennessee

Loudon, Tennessee

Officers

Title	**Name**	**Address**	**Term Expires**
President	Carl Smith	Lenoir City, TN	April 2007
Vice President	Larry Longmire	Philadelphia, TN	April 2007
Secretary & Treasurer	Burton Bilderback	Sweetwater, TN	April 2007

Directors:

Name	**Address**	**Term Expires**
Carl A. Smith, President	Lenoir City, TN	April 2011
Larry D. Longmire, V. President	Philadelphia, TN	April 2011
Burton Bilderback, Secretary / Treasurer	Sweetwater, TN	April 2009
Reva S. Ladd	Kingston, TN	April 2008
Janice Gail Simpson	Loudon, TN	April 2010
James D. Weaver	Friendsville, TN	April 2010
James H. Lawhorn	Greenback, TN	April 2008

Compensation of officers, directors, appraisers, adjusters, et al:

Compensation of the Company's agents, officers, directors and employees was reviewed for the period of examination and generally found to be in compliance with Tennessee statutes, except as specifically commented on in the Comments and Recommendations Section of this examination report.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

There were no changes to the By-Laws or policy forms during the period under examination.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

There were no changes to the By-Laws or policy forms during the period under examination to be filed with the Department of Commerce and Insurance.

Report on reinsurance assumed and / or ceded.

Type:	Property First Surplus Reinsurance
Reinsurer:	Farmers Mutual Fire Insurance Company of Tennessee
Coverage:	Cessions shall not exceed two (2) times the Company's net retention or $100,000 on any one risk; Company shall have the option to cede up to 50% of any property risk written by the Company provided the amount ceded to the Reinsurer does not exceed $100,000.
Term:	Continuous coverage, effective January 1, 1997.

On May 2, 2002, the Company and Farmers Mutual of Tennessee (reinsurer) signed a Combination Per Risk / Aggregate Excess of Loss Reinsurance Agreement with an effective date of January 1, 2002. The agreement calls for the reinsurer to accept that portion of the Company's gross liability on any single loss or losses in aggregate which exceeds its net retained liability. This agreement cancels and replaces the Property First Surplus Reinsurance Agreement originally effective January 1, 1997.

Coverage: Combination Per Risk Excess of Loss and Aggregate Excess of Loss

Part 1 – Property Risk Excess of Loss covers each loss in excess of the Company's $50,000 maximum retention up to the Reinsurers $100,000 maximum per risk.

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 75% of the Company's gross assessment and / or premium income or $180,000 and shall not exceed 100% of the lesser of 175% of the Company's gross assessment and / or premium income or $630,000.

On May 2, 2002, the Company and Farmers Mutual of Tennessee (reinsurer) signed a Second Aggregate Excess of Loss Reinsurance Agreement with an effective date of January 1, 2002. The agreement calls for the reinsurer to accept that portion of the Company's gross liability in aggregate which exceeds its net retained liability.

Type: Second Aggregate Excess of Loss Reinsurance Agreement

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 75% of the Company's gross written premium and / or premium income or $180,000, plus the lesser of 175% of gross written premium or $630,000 and then the reinsurer shall be liable for 100% of the Company's ultimate net loss in excess of that amount.

On June 28, 2004 the Company and Farmers Mutual of Tennessee (reinsurer) signed an Excess of Loss Reinsurance Agreement with an effective date of January 1, 2004. The agreement calls for the reinsurer to accept that portion of the Company's gross liability on any risk which exceeds its net retained liability on any one (1) specific risk and in the aggregate for all losses. The terms reflected a continuous contract until cancelled by either party with 60 days advance notice. This agreement cancels and replaces the Excess of Loss Reinsurance Agreements originally effective January 1, 2002.

Type: Exhibit A – Combination Per Risk and Aggregate Layer-2004
Coverage: Exhibit A – Combination Per Risk and Aggregate Layer-2004

Part 1 – Property Risk Excess of Loss covers each loss in excess of the Company's $50,000 maximum retention up to the Reinsurers $100,000 maximum per risk.

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 75% of the Company's gross assessment and / or premium income or $189,000 and shall not exceed 100% of the lesser of 50% of the Company's gross assessment and / or premium income or $189,000.

An annual deposit premium of $6,300 shall be paid to the reinsurer in two (2) equal installments of $3,150 each on January 1 and July 1.

Type: Exhibit B – Second Aggregate Layer-2005
Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 125% of the Company's gross assessment and / or premium income or $315,000 and shall not exceed 100% of the lesser of 125% of the Company's gross assessment and / or premium income or $472,500 in the aggregate during each annual period this Agreement was in effect.
Type: Exhibit C - Third Aggregate Layer-2005
Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 250% of the Company's gross assessment and / or premium income or $630,000 and shall not exceed 100% of the lesser of 750% of the Company's gross assessment and / or premium income or $2,835,000 in the aggregate during each annual period this Agreement was in effect.

On April 29, 2005 and on May 6, 2005 Farmers Mutual of Tennessee (reinsurer) and the Company, respectively, signed Addendum Number 1 (with an effective date of January 1, 2005) as an attachment to the Company's Excess of Loss Reinsurance Agreement effective January 1, 2004. This Addendum amended the aforementioned Excess of Loss Reinsurance Agreement effective January 1, 2004 as follows:
Coverage: Exhibit A – Combination Per Risk and Aggregate Layer-2005

For purposes of calculating the rate for 2005 and future years, the following Gross Net

Assessments and / or Premium Income and Losses Incurred shall be deemed for the years 2001 to 2004. Actual 2005 Gross Net Assessments and / or Premium Income and Losses Incurred shall be included in the 2005 rate calculation when finally determined:

Year	Gross Assessments
2001	$285,913
2002	$298,797
2003	$291,186
2004	$310,454

Estimated Gross Net Assessment and / or premium income for 2005 - $315,000

SUBSEQUENT EVENT:

On February 23, 2007 and on February 26, 2007 Farmers Mutual of Tennessee (reinsurer) and the Company, respectively, signed Addendum Number 2 (with an effective date of January 1, 2007) as an attachment to the Company's Excess of Loss Reinsurance Agreement effective January 1, 2004. This Addendum amended the aforementioned Excess of Loss Reinsurance Agreement effective January 1, 2004 as follows:

Section 2 – Coverage and Limits

Coverage: Exhibit A – Combination Per Risk and Aggregate Layer-2007

Part 2 – Aggregate Excess of Loss covers the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 75% of the Company's gross assessment and / or premium income or $230,000 and shall not exceed 100% of the lesser of 50% of the Company's gross assessment and / or premium income or $230,000.

Section 3 – Rate and Premium

An annual deposit premium of $7,600 shall be paid to the reinsurer in two (2) equal installments of $3,800 each on March 1 and September 1.

It is warranted that the Gross Net Assessment and / or Premium Income and Losses Paid and / or Incurred for both the Property Risk Excess of Loss and Aggregate Excess of Loss Sections or this Exhibit which are reported below shall be deemed to be the figures used to determine the final reinsurance rate for this contract period. Current and immediate prior year premium and loss numbers will be added to this Exhibit when received by the Reinsurer.

Year	Gross Assessments
2003	$291, 186
2004	$310,454
2005	$369,609
2006	to be determined

Estimated Gross Net Assessment and / or premium income for 2007 - $380,000

Type: Exhibit B – Second Aggregate Layer-2007

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 75% of the Company's gross net assessment and / or premium income or $230,000 plus the lesser of 50% of gross net assessment and / or premium income or $230,000 and shall not exceed 100% of the lesser of 125% of the Company's gross assessment and / or premium income or $570,000 in the aggregate during each annual period this Agreement was in effect.

For each annual period this agreement is in effect, the Company shall pay the reinsurer a deposit premium of $11,400 payable $5,700 each at March 1 and September 1.

Type: Exhibit C - Third Aggregate Layer-2007

Coverage: Covers 100% of the Company's ultimate net losses in the aggregate for each calendar year in excess of the greater or 250% of the Company's gross assessment and / or premium income or $760,000 and shall not exceed 100% of the lesser of 750% of the Company's gross assessment and / or premium income or $3,420,000 in the aggregate during each annual period this Agreement was in effect.

For each annual period this agreement is in effect, the Company shall pay the reinsurer a deposit premium of $9,500 payable $4,750 each at March 1 and September 1.

If the reinsurance premium so calculated is less than the deposit premium, this amount shall be due and payable forthwith to the Company, subject to an annual minimum premium of $8,000.

Appraisal and classification of risks taken.

Policies are typically written for 80% of the actual cash value of the property insured subject to policy limits of $50,000 per risk before reinsurance. The maximum amount of risk with reinsurance the Company writes is $150,000. The agent performs the appraisal on the property prior to the issuance of a policy during the application process. Property eligible to be insured includes single dwellings, barns, farm and contents, tractors, farm machinery, well pumps (up to $150) livestock (up to $300), double wide mobile homes, silos and contents, tool houses, store buildings and churches. For the five (5) year period of examination the Company issued a policy covering a period of five (5) years.

The Company writes policies covering property located in Loudon, Monroe, McMinn, Roane, Meigs, Blount and Knox counties.

As of year-end 2006 the Company had seven (7) agents that were issued a special "Limited Insurance Producer" agent's license by the Tennessee Department of Commerce and Insurance that was specifically designed for those agents that worked for "county mutual" insurance companies. All agents at year-end 2006 were Directors of the Company.

Annual rate of assessment per $1,000.00 for period covered:

	2002	2003	2004	2005	2006
All Lines	$5.00	$5.00	$5.00	$6.00	$6.00

The Company's directors voted to raise the Company's rates for all lines from $5.00 per thousand to $6.00 per thousand at their July 26, 2004 meeting. This rate change was approved by the policyholders at the Company's Annual Meeting on April 4, 2005.

Rate of membership, policy and initial fees charged.

The Company as of year-end 2006 charged a $5.00 annual membership or policy fee. Also, the Company charged a "mortgage clause fee" and a "writing fee" of $1.00 per thousand for all new policies and renewal policies.

SUBSEQUENT EVENT:

The Company's Board of Directors on July 2, 2007 approved increasing the annual membership or policy fee from $5.00 per policy to $10.00 per policy at the time of application for a new policy or a policy renewal. Also, the Company's Board of Directors on July 2, 2007 approved the elimination of the "writing fee" of $1.00 per thousand for all new policies and renewal policies.

Date of last assessment.

During the period of examination the Company billed its Members for premiums in arrears. Policyholder premium payments were due semi-annually on April 1 and October 1 of each regardless of the policy anniversary. Premium billing adjustments were made to reconcile the policy anniversary date to the April 1 and October 1 billing date. The Company during the period of examination did not assess its policyholders for any additional premium above the standard amount billed for that specific type of risk based upon their rate schedule.

Amount delinquent.

The Company sends a past due notice approximately 30 days after the due date, and cancels coverage 60 days after the premium due date (policy anniversary date) the Company cancels the coverage. The Company sends the policyholder a certified letter stating the policy was cancelled.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

The Company's profitability during the period of examination is reflected in the following table:

	2002	2003	2004	2005	2006*
Gross Assessments	$299,342.60	$307,718.90	$310,453.83	$369,609.23	$350,375.06
Less: Losses & Expenses	(439,478.29)	(352,572.68)	(408,613.16)	(208,455.22)	(325,579.07)
Underwriting Gain/(Loss)	(140,135.69)	(44,853.78)	(98,159.33)	161,154.01	24,795.99
Investment & Other Income	149,855.91	92,832.79	87,257.87	35,634.47	47,686.08

Net Income / (Loss)	$9,720.22	$47,979.01	$(10,901.46)	$196,788.48	$72,482.07

* The 2006 income, expense, profit and loss totals were determined as a result of this examination and do not include examination adjustments for depreciation and non-admitted assets.

Amount of money borrowed since date of last assessment.

The Company borrowed money to pay claims in 2002, 2003 and 2004. The Company's directors determined that it was more cost efficient to borrow and repay money in order to pay claims than it was to redeem or sell the Company's investments to pay claims during years of above average aggregate claim expenditures.

Exhibit of Risks

		Number	Amount
1.	In force, December 31, 2005		$58,993,335.50
2.	New Business Written		6,052,595.00
3.	Business Renewed		10,615,450.00
4.	Total		65,045,930.00
5.	Deduct those expired and marked off as terminated		(6,062,775.00)
6.	In force, December 31, 2006	1,207	$58,983,155.50

Financial Statement As Determined By This Examination

Income

Ledger Assets per Company, December 31, 2005		$1,413,398.53
Gross Membership Fees	$18,037.69	
Gross Assessments	332,337.37	
Deduct : Reinsurance Premiums Ceded	(27,720.69)	
Net Assessments	322,654.37	
Investment Income Received	47,257.88	
Other Income (Prems. received in place of NSF check)	428.20	
Total Income		370,340.45
Total Income and Balance		1,783,738.98

Disbursements

Gross amount paid policyholders for losses	188,943.24	
Expenses of adjustment and settlement of losses	2,000.00	
Agents Commissions	14,688.90	
Salaries and compensation of employees	46,697.31	
Advertising	505.32	
Postage	2,182.75	
New office equipment	2,075.66	
Office Supplies	1,398.83	
Telephones	4,945.06	
Utilities	2,169.95	
Directors Meetings Expense	1,291.84	
Insurance department licenses and fees (Premium & Payroll Tax)	7,298.25	
All other licenses, fees and taxes (City & County Taxes)	1,051.67	
Other (Miscellaneous) disbursements	5,421.00	
Dues & Subscriptions (NAMIC & TN Assoc. of Farm Mutuals)	2,904.00	
Insurance of Officers, Directors & Employees (D.&O. & Health)	10,116.56	
Office Building & Maintenance Expense	2,702.25	
Mileage Paid to Directors	1,465.79	
Total disbursements		(297,858.38)
Ledger Assets before Adjustment		1,485,880.60
Examination Adjustment to Assets and Surplus		(295,914.24)
Ledger Assets per Exam after Adjustment		$1,189,966.36

Assets

Book Value of Real Estate per Exam	$72,375.50	
Cash in Company's Office	109.50	
Cash in Banks	105,481.36	
Certificates of Deposit	1,012,000.00	
Marketable Certificates of Deposit (held through Edward Jones)	285,000.00	
Total Assets per Examination		$1,474,966.36

Non-Ledger Assets

Other Assets (office furniture)	4,692.05
Gross Assets	1,479,658.41

Assets Not Admitted

Marketable Certificates of Deposit (held through Edward Jones)	(285,000.00)
Other Assets (office furniture)	(4,692.05)
Total Non-Admitted Assets per Examination	(289,962.05)

Admitted Assets per Exam

Total Admitted Assets per Examination	$1,189,966.36

Liabilities

Total Liabilities per Examination	-0-
Surplus Over all Liabilities per Exam	$1,189,966.36
Total per Examination	$1,189,966.36

Assets

Schedule of Bank Deposits:

Name of Bank	Amount on Bank Statement	Amount of O/S Checks	Adj. Items	Balance
First National Bank , Business Checking	$106,117.47	($636.11)	0.00	$105,481.36

Certificates of Deposit :

American Trust	$100,000.00
AmSouth Bank	100,000.00
Athens Federal	100,000.00
B B & T	50,000.00

B B & T	50,000.00
Citizens National Bank	97,000.00
FSG	100,000.00
First National Bank	100,000.00
Green Bank	50,000.00
Peoples Bank	100,000.00
Suntrust Bank	65,000.00
United Community Bank	30,000.00
United Community Bank	70,000.00
TOTAL CERTIFICATES OF DEPOSIT HELD IN BANKS	$1,012,000.00

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Certificates of Deposit (held through Edward Jones) Non-Admitted Per Exam:

Discover (book value)	$95,000.00
First Security (book value)	95,000.00
Independent (book value)	95,000.00
TOTAL CDs HELD THROUH BROKERAGE FIRM	$285,000.00

Real Estate:

Land (at original cost July 16, 1997)	$12,000.00
Building (at original cost July 16, 1997)	54,000.00
Roof (at original cost July 19, 2005)	11,495.00
Windows and Siding (at original cost July 19, 2005)	5,895.00
Pavement (at original cost July 28, 2005)	5,000.00
Total Real Estate (before depreciation)	88,390.00
Less Accumulated Depreciation	(16,014.50)
Total Real Estate per Exam	$72,375.50

Assets pledged or hypothecated:

The Company did not have any assets pledged or hypothecated as of year-end 2006.

Comments on claims, borrowed money and other liabilities:

Claims appeared to be paid promptly and to the satisfaction of policyholders.

The Company has not borrowed any money to pay claims since 2004.

The Company had no other liabilities to accrue for as of December 31, 2006. (No unsettled claims)

Analysis of Changes in Financial Statement and Comments Resulting From Examination

Book Value of Real Estate **$72,375.50**

The above amount is $10,914.52 less than the $83,290.02 amount reported by the Company on line 42 in its 2006 Annual Statement. This $83,290.02 statement value as of year-end 2006 did not include adjustments for depreciation and did not include all land and building improvement costs incurred by the Company. The total amount of depreciation for the Company's real estate per examination was $16,014.50. The depreciated value of the Company's home office land and building was determined in accordance with Tennessee Code Annotated 56-3-405 and NAIC Statements of Statutory Accounting Principals SSAP # 19 and SSAP # 40.

Other Assets, Viz: Savings Certificates **$1,012,000.00**

The above amount is $285,000.00 less than the $1,297,000.00 amount reported by the Company on line 51 in its 2006 Annual Statement. The Company at year-end 2006 held three (3) marketable certificates of deposit through Edward Jones with an examination value of $285,000.00 (cost). These investments were being held by a broker / dealer, Edward Jones without a proper custodial / safekeeping agreement in violation of Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46 (revised effective July 12, 2005).

Edward Jones does not qualify to hold the Company's securities in accordance with Tenn. Code Ann. § 56-3-112 and Tenn. Code Ann. § 47-8-102. Edward Jones does not meet the definition of a clearing corporation or clearing agency registered under federal security laws or a federal reserve bank.

Two (2) of the three (3) marketable certificates of deposit held through Edward Jones matured in June 2007. The Company moved the proceeds from these investments out of its Edward Jones account and invested directly with banks in accounts that are insured up to $100,000 by the Federal Deposit Insurance Corp. The remaining marketable certificate of deposit held through Edward Jones will mature in January 2008 and the remaining proceeds from this investment will be reinvested in a manner that complies with Tennessee Code Annotated.

Summary Schedule for "Analysis Of Changes In Financial Statement"

The following depicts the change in surplus as outlined in the previous section of this report:

Item	Surplus Increase	Surplus Decrease
Book Value of Real Estate		$10,914.52
Other Assets, Viz: Certificates of Deposit & Savings		285,000.00
Totals	$0.00	$295,914.52
Net Change In Surplus		$295,914.52

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Subsequent Events:

New Legislation Requirements for County Mutual Insurance Companies

"The Tennessee County Mutual Insurance Company Act of 2006" required the Company to make certain changes to their Charter, By-Laws, Application Forms, Policy Forms, Claim Forms, Stationary, etc. with the approval of the Tennessee Department of Commerce and Insurance (TDCI) prior to the January 1, 2007 effective date. Another important change involves the submission of future annual statements in accordance with NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual.

Revision of By-Laws:

The Company's Board of Directors on March 16, 2007 introduced new By-Laws in an effort to make sure they complied with "The Tennessee County Mutual Insurance Company Act of 2006". The Company's members approved these new By-Laws at the annual members meeting on April 2, 2007. These newly approved By-Laws as well as rates, underwriting guidelines and policy forms were submitted to the Property & Casualty Rating Section of the Tennessee Department of Commerce and Insurance (P & C Section of the Department) and were stamped approved on July 25, 2007. They were found to be in compliance with statutes except as follows:

The Company's By-Laws did not include the non-renewal provisions denoted in Tenn. Code Ann. § 56-7-1902 in accordance with Tenn. Code Ann. § 56-22-109(b)(2) (effective January 1, 2007). Tenn. Code Ann. §56-7-1902(a) states "(a) Unless the non-renewal notice contains a reason for such non-renewal action, such notice shall advise the insured that upon written request of the named insured, mailed or delivered to the insurer not later than fifteen (15) days after the effective date of the non-renewal, the insurer will within twenty (20) days mail to the named insured a written statement specifying a reason for such non-renewal action."

Tenn. Code Ann. §56-7-1902(b) states "(b) There shall be no liability on the part of, and no cause of action of any nature shall arise against, any insurer, its authorized representative, its agents, its employees, or against any firm, person or corporation furnishing information to the insurer, as to the reason for non-renewal".

Revision of Policy Forms:

The Company's policy forms did not reflect the cancellation and non-renewal provisions disclosed in Tenn. Code Ann. § 56-7-1902(a) Tenn. Code Ann. § 56-7-1902(b) and in accordance with Tenn. Code Ann. § 56-22-109(b)(2) (effective January 1, 2007). See the "Revision of By-Laws" comment above for the non-renewal provisions disclosed in Tenn. Code Ann. § 56-7-1902.

Revision of Application and Claim Forms:

The Company's application and claim forms did not contain the fraud warnings required by Tenn. Code Ann. § 56-53-111(b), which states: "It is a crime to knowingly provide false, incomplete or misleading information to an insurance company for the purpose of defrauding the company. Penalties include imprisonment, fines and denial of insurance benefits" on the Company's applications and claim forms."

Agent's License:

All seven (7) of the Company's agents as of December 31, 2006 were issued a special "Limited Insurance Producer" agent's license specifically designed for those agents that worked for "county mutual" insurance companies. Also, at year-end 2006 each of the Company's seven (7) agents were Directors of the Company. As of July 1, 2007 these "Limited Insurance Producer" agent's licenses were no longer effective and all county mutual agents must be licensed to sell "property" and/or "casualty" insurance, depending on the type of coverage sold, as required by Tenn. Code Ann. § 56-22-113. In May 2007 the Company's new Office Manager and Secretary / Treasurer received their property and casualty agent's licenses. Currently these are the Company's only two (2) licensed agents.

Premium Billing Transition and Premium "Forgiveness":

In 2007 the Company began to implement a plan to bill premiums in advance and collect premiums on or around the policy issue and anniversary date instead of in arrears. Part of this plan involved the "forgiveness" of the last six months assessment for the April 1, 2007 to September 30, 2007 policy period, which was immediately prior to the Company's first advance premium billing beginning in October 2007. This plan was formulated and discussed by officers, directors and employees during Board of Director's meetings beginning October 9, 2006, and was officially approved December 10, 2007 by the Board of Directors.

The Company's Directors acted based upon their understanding that the "The Tennessee County Mutual Insurance Company Act of 2006" required the Company to bill its policyholders at the beginning of the policy period on the policy anniversary date in addition to eliminating the Company's ability to assess premiums from policyholders. A letter sent to policyholders dated October 2007 stated "Due to a mandate made this year by the Tennessee State Department of Commerce and Insurance, all county mutual insurance companies are required to collect advance premiums." However this statement contained within the letter sent to the Company's policyholders dated October 2007 is not accurate. No Tennessee statute, rule, bulletin issued by the Commissioner or NAIC accounting guideline requires a "county mutual" insurance company to bill its policyholders at the beginning of the policy period and on the policy anniversary date.

The aforementioned letter sent to policyholders dated October 2007, disclosed that the Company, since 1902, has collected assessments from its members (policyholders) every April and October for the preceding six (6) months of coverage, regardless of the policy anniversary date.

In an effort to begin billing each policyholder in advance and collect premiums on the policy anniversary date on a semi-annual billing cycle the Company required payment for six (6) months of coverage beginning effective October 1, 2007, including those policies that had an April 1 or October 1 policy anniversary date. Furthermore, each policyholder was notified in October 2007 or November 2007 that an additional "one-time advance premium" amount was due no later than March 1, 2008, for those policies that did not have an April 1 or October 1 policy anniversary date, in order to bring each policyholder's account current on their policy anniversary date in 2008. This "one-time advance premium" amount ranged from one (1) to five (5) months advanced premium depending on the policy anniversary date and is essentially the same as offering a partial period policy. Policyholders were given several options by which they could pay the advanced coverage and the "one-time advance premium" amount.

Based upon the rate filing approved by the P & C Section of the Department on July 25, 2007 the Company did not receive approval to waive any premium payments. The Company was only approved to bill and collect $6.00 per thousand for all risks insured for the full policy period. The Company did not disclose in their rate filing submitted to the Department its intentions to bill and collect premium in advance beginning on October 1, 2007, or any of the changes in premium billing listed above. Therefore, the Company billed and collected premiums at a rate that was contrary to the rates filed and approved by the Department in violation of Tenn. Code Ann. § 56-22-109(b)(1) and Tenn. Code Ann. § 56-5-305. (See the Recommendations Section of this examination report for further discussion of this issue.)

Director / Officer / Agent Compensation

Tenn. Code Ann. § 56-22-107(b)(1) states "No officer, director or other person whose duty it is to determine the character of risk and upon whose decision the application for insurance shall be accepted or rejected shall receive as any part of the person's compensation a commission upon the premium, but the compensation shall be a fixed salary, and / or a share of the net profits of the county mutual insurance company that the board of directors may determine appropriate".

The Company's Secretary / Treasurer determined whether or not an application for insurance was approved or denied and was also an Agent responsible for accepting or rejecting insurance applications. The Company in 2007 paid each of its two (2) agents a flat fee for each new policy written and existing policy rewritten and a set fee for every mile driven for risk inspection directly related to each new policy written and each existing policy re-written.

Policy File Information

Beginning in September 2007 the Company started the process of transferring all policy data from its old database and manual files to a Microsoft Access Database. This was done in order to fully maintain its policy files electronically and to aid in the Company's efforts to bill premiums in advance and collect premiums on the policy anniversary date instead of in arrears.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements and accepted insurance accounting procedures, pursuant to Tenn. Code Ann. § 56-22-109(a)(4):

1. Investments Held Through a Broker / Dealer without a Proper Custodial Agreement:

It is recommended that the Company become compliant with Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46 (revised effective July 12, 2005) by either moving its investments out of its Edward Jones account and investing directly with banks in accounts that are insured up to $100,000 by the Federal Deposit Insurance Corp. or establish a proper custodial relationship with a bank that is a member of the federal reserve system and transferring these investments that are currently held by investment brokers into a custodial account that meets the requirements of Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46. Furthermore, any investments held through Edward Jones are to be reported as non-admitted assets on future annual statement filings per Tennessee Regulation 0780-1-46-.03(4).

2. Investment in Home Office Land and Building:

It is recommended that the Company record on future Annual Statements the depreciated value of its home office land and building including improvement costs in accordance with Tennessee Code Annotated §56-3-405 and NAIC Statements of Statutory Accounting Principals SSAP # 19 and SSAP # 40.

Subsequent Events:

New Legislation Requirements for County Mutual Insurance Companies

3. Revision of By-Laws:

It is recommended that the Company update its By-Laws to include the non-renewal provisions contained in Tenn. Code Ann. § 56-7-1902 in accordance with Tenn. Code Ann. § 56-22-109(b)(2) (effective January 1, 2007).

4. Revision of Policy Forms:

It is recommended that the Company update its policy forms to reflect the cancellation and non-renewal provisions of Tenn. Code Ann. § 56-7-1901 and 1902 in accordance with Tenn. Code Ann. § 56-22-109(b)(2) (effective January 1, 2007).

5. Revision of Application and Claim Forms:

It is recommended that the Company revise its application and claim forms by adding the fraud warnings required by Tenn. Code Ann. § 56-53-111.

6. Agent's License:

It is recommended that the Company take the necessary steps to have all new or renewal policies written through properly licensed agents as required by Tenn. Code Ann. § 56-22-113.

7. Director / Officer / Agent Compensation

The Company should cease from compensating their agents who are responsible for accepting or rejecting insurance applications by any other method except by a fixed salary or share of the net profits as determined by the directors in accordance with Tenn. Code Ann. § 56-22-107(b)(1).

8. Premium Billing:

It is recommended that the Company bill premium in compliance with the rates submitted and approved by the Rating Section of the Department pursuant to Tenn. Code Ann. § 56-22-109(b)(1), Tenn. Code Ann. § 56-5-303, 304, 305 and 308. Also, future rate changes must be approved by the Department prior to implementation.

Furthermore, it is recommended that the Company formally submit a plan to the Department disclosing its intentions to bill and collect premium in advance beginning on October 1, 2007 and its plan to bill its policyholders on the policy anniversary date instead of requiring all policyholders to pay semi-annually in April and October. Also, the Company should disclose to the Department that in order to accomplish these goals it will continue the process of charging a "one-time advance premium" amount to those policyholders that do not have an April or October policy anniversary date. Additionally, approval should be sought in order to charge premium for a fraction of a policy year and the issuance of partial period policies.

There were no other apparent violations of the Company's By-Laws, Tennessee Insurance Code or NAIC Accounting Practices and Procedures during the period under examination.

The complete and courteous cooperation of Barbara Bilderback, Burton Bilderback, Secretary & Treasurer, Kelly Bilderback and Michelle Wortham, Office Manager, extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce

James T. Pearce,
Insurance Examiner in Charge
State of Tennessee

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of the Farmers Aid Association of Loudon County, Tennessee dated June 2, 2008 and made as of December 31, 2006, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce

James T. Pearce
Insurance Examiner III, EIC
State of Tennessee

County Davidson
State Tennessee
Subscribed and sworn to before me
this 2nd day of
June, 2008.

Helen W. Dorsey
(Notary)

HELEN W. DORSEY
STATE OF TENNESSEE NOTARY PUBLIC
DAVIDSON COUNTY, TENN.

My Commission Expires MAY 22, 2010

FARMERS AID ASSOCIATION
OF LOUDON COUNTY, TENNESSEE
A County Mutual Insurance Company

June 18, 2008

RECEIVED
JUN 1 9 2008
Dept. Of Commerce & Insurance
Company Examinations

Philip Blustein, CFE
Insurance Examination Director
State of Tennessee
Department of Commerce and Insurance
500 James Robertson Pkwy
Nashville, TN 37243

Dear Philip:

Thank you for the opportunity to respond to the Financial Condition Examination report made as of December 31, 2006. Enclosed, please find our response to the reported recommendations made by James T. Pearce, Insurance Examiner III, EIC, State of Tennessee.

Any further questions can be directed to me at 865-458-2533. Our office hours are from 9:00 AM – 5:00 PM, Monday through Friday.

Sincerely,

Kelly R. Bilderback

Kelly R. Bilderback
Secretary / Treasurer

KRB/mmw
Enclosures:

P.O. Box 384
804 Mulberry Street
Loudon, TN 37774
Phone: 865-458-2533 ~ Fax: 865-458-2504

FARMERS AID ASSOCIATION
OF LOUDON COUNTY, TENNESSEE
A County Mutual Insurance Company

RECEIVED
JUN 19 2008
Dept. Of Commerce & Insurance
Company Examinations

DATE: June 18, 2008

TO: State of Tennessee
Department of Commerce and Insurance
500 James Robertson Pkwy
Nashville, TN 37243

RE: Responses made by Farmers Aid Association of Loudon County, A County Mutual Insurance Company, regarding the Financial Condition Examination made by the State of Tennessee Dept. of Commerce and Insurance made as of December 31, 2006.

RECOMMENDATION 1; Page 17
Investments Held through Broker/Dealer Without Proper Custodial Agreement:

This issue was cleared up in January 2008 when the last of our assets held with Edward Jones matured. The account was closed at that time.

RECOMMENDATION 2; Page 17
Investment In Home Office Land and Building:

This activity was established in July 2007 as is being implemented in our accounting procedures.

RECOMMENDATION 3, 4, 5; Page 18
Revision of By-Laws, Revision of Policy Forms, Revision of Application & Claim Forms:

These items are in the process of being corrected.

RECOMMENDATION 6; Page 18
Agents License:

This matter was resolved as of June 21, 2007 with licensing of the following agents:

Kelly Rose Bilderback, State of Tennessee, License# 0000976569
Michelle Mlynn Wortham, State of Tennessee, License# 0000976593

P.O. Box 384
804 Mulberry Street
Loudon, TN 37774
Phone: 865-458-2533 ~ Fax: 865-458-2504

FARMERS AID ASSOCIATION
OF LOUDON COUNTY, TENNESSEE
A County Mutual Insurance Company

RECEIVED
JUN 1 9 2008
Dept. Of Commerce & Insurance
Company Examinations

RECOMMENDATION 7, Page 18
Director / Officer / Agent Compensation:

This matter is currently under review by our Board of Directors. This is only an issue for one individual who serves as Agent, Director and Officer.

RECOMMENDATION 8, Page 18
Premium Billing:

The intent of Farmers Aid Association of Loudon County, TN, a County Mutual Insurance Company, in making changes to our billing process, was to fulfill the new State requirements according to our understanding of what that meant. It was never our intent to go against State regulations but to comply with them. Our actions were based on example of other county mutuals who had already made the transition from billing in arrears to billing forward.

In retrospect, with 2007 being the first time county mutuals were required to file rates with the State, it was not understood on our part how this new requirement would impact our billing changes.

This change affected those policyholders current as of July 1, 2007 which were in various stages of their 5-year policy. Since then, all new and renewal policies have been written for a period of 1-year. There were no partial-period policies issued. We did allow for partial premium payment to be made if the policyholder needed help in making the transition to the new billing cycle. This billing process was completed in March 2008. All policyholders are now in a billing cycle corresponding with the anniversary date on the policy.

P.O. Box 384
804 Mulberry Street
Loudon, TN 37774
Phone: 865-458-2533 ~ Fax: 865-458-2504