

**PROCEEDINGS BEFORE JANE L. CLINE,
INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA**

**IN RE: EXAMINATION OF
FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY**

Administrative Proceeding No.: 09-AP-FINCON-00003

ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION

COMES NOW Jane L. Cline, Insurance Commissioner of the State of West Virginia, and issues this Order which adopts the REPORT OF FINANCIAL EXAMINATION as of December 31, 2007, of FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY (hereinafter referred to as "The Casualty Company" or the "Company") based upon the following findings, to wit:

JURISDICTION

1. Jane L. Cline is the Insurance Commissioner of the State of West Virginia (hereinafter the "Insurance Commissioner") and is charged with the duty of administering and enforcing the provisions of Chapter 33 of the West Virginia Code of 1931, as amended.
2. The Company is a West Virginia domiciled stock insurance company authorized by the Insurance Commissioner to transact business in the State of West Virginia as permitted and authorized under Chapter 33, Article 5 of the West Virginia Code.

FINDINGS OF FACT

1. An examination of the financial condition and operational affairs of The Company for period beginning July 24, 2006 and ending December 31, 2007, was conducted in accordance with West Virginia Code §33-2-9(c) by the Insurance Commissioner examination department staff.

2. On October 20, 2008, the examiner filed a REPORT OF FINANCIAL EXAMINATION with the Insurance Commissioner pursuant to W.Va. Code § 33-2-9(j) A copy of the REPORT OF FINANCIAL EXAMINATION is attached hereto as Exhibit A and incorporated herein as if set forth in full.

3. On or about November 25, 2008, a true and accurate copy of the REPORT OF FINANCIAL EXAMINATION was forwarded to The Company by certified mail, return receipt requested. On December 1, 2008, The Company received a copy of the REPORT OF FINANCIAL EXAMINATION.

4. Pursuant to W.Va. Code § 33-2-9(j)(2), The Company was notified and afforded a period of thirty (30) days after receipt of the REPORT OF FINANCIAL EXAMINATION within which to make a submission, rebuttal, or objection concerning any matter contained in the REPORT OF FINANCIAL EXAMINATION.

5. By letter dated December 22, 2008, The Company management stated that they had reviewed and commented on the REPORT OF FINANCIAL EXAMINATION. A copy of The Company's December 22, 2008, letter is attached hereto as Exhibit B.

CONCLUSIONS OF LAW

W.Va. Code § 33-2-9(j)(3)(A) provides that following a review of the REPORT OF FINANCIAL EXAMINATION, the examination work papers, and any written submission, rebuttal, or objection the Insurance Commissioner shall enter an ORDER adopting the REPORT OF FINANCIAL EXAMINATION as filed or with modifications or corrections.

ORDER

It is therefore:

1. ORDERED that the REPORT OF FINANCIAL EXAMINATION FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY, attached hereto as Exhibit A, is hereby ADOPTED and APPROVED by the Insurance Commissioner.

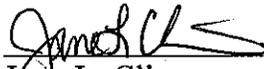
2. ORDERED that a copy of this ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION and the adopted REPORT OF FINANCIAL EXAMINATION shall be mailed to FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY by certified mail.

3. ORDERED that FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY shall file with the Insurance Commissioner, within thirty (30) days of the entry date of this ORDER, affidavits executed by each of its directors stating under oath that they have received a copy of the adopted REPORT OF FINANCIAL EXAMINATION and a copy of this ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION, in accordance with W.Va. Code § 33-2-9(j)(4).

4. ORDERED that FARMERS AND MECHANICS FIRE AND CASUALTY INSURANCE COMPANY take whatever actions are required to comply with the recommendations set forth in the REPORT OF FINANCIAL EXAMINATION and shall demonstrate compliance to the satisfaction of the Insurance Commissioner.

5. ORDERED that this administrative matter be hereby dismissed from the administrative docket of the Insurance Commissioner.

Entered this 9th day of January, 2009.



Jane L. Cline
Insurance Commissioner

REPORT OF FINANCIAL EXAMINATION

OF

**FARMERS & MECHANICS FIRE & CASUALTY
INSURANCE COMPANY**

AS OF

DECEMBER 31, 2007

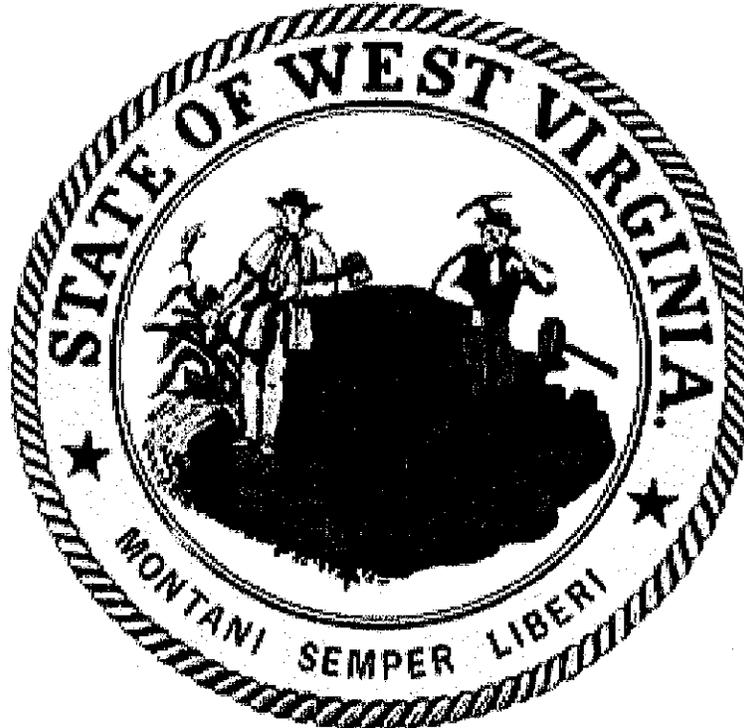


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October 20, 2008

Honorable Jane L. Cline
West Virginia Insurance Commissioner
1124 Smith Street, 4th Floor
Charleston, West Virginia 25301

Dear Commissioner:

Pursuant to the authority vested in the West Virginia Offices of the Insurance Commissioner, an examination has been made of the affairs and financial condition of:

FARMERS & MECHANICS FIRE & CASUALTY INSURANCE COMPANY
25 Administrative Drive
Martinsburg, West Virginia

Farmers & Mechanics Fire & Casualty Insurance Company, hereinafter referred to as "the Company", is a West Virginia domiciled stock insurance company. The financial examination was conducted in Martinsburg, West Virginia at the offices of the parent company, Farmers & Mechanics Mutual Insurance Company, which also serve as the Company's home office.

The Report of Financial Examination, reflecting the status of the Company as of December 31, 2007, is hereby submitted.

Respectfully,



Randall A. Price, CFE
Financial Conditions Division

SCOPE OF FINANCIAL EXAMINATION

The Company is a West Virginia domiciled stock insurance company incorporated May 2, 2006, that received a license to conduct the business of insurance on July 24, 2006 from the West Virginia Offices of the Insurance Commissioner. ("WVOIC") Neither a financial nor a market conduct examination of the Company has been performed since receiving a license to conduct business.

A single-state examination was conducted by a representative of the WVOIC and covered the period from July 24, 2006, through December 31, 2007, and included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination. The parent company is being concurrently examined by a representative of the WVOIC for the five year period from January 1, 2003, through December 31, 2007.

The examination was conducted pursuant to the instruction, procedures and guidelines prescribed by the WVOIC and in accordance with the National Association of Insurance Commissioners' Financial Examiners Handbook ("Handbook"). The Handbook requires that the examination be planned and performed 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. The 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 and required by West Virginia Code.

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

SUMMARY OF SIGNIFICANT FINDINGS

Examination indicated that the Company's Articles of Incorporation do not address statutory limitations on indebtedness as required by Chapter 33, Article 5, Subsection 3 (h) of the West Virginia Code. It is recommended that the Company amend its Articles of Incorporation to comply with W. Va. Code § 33-5-3 (h).

Examination indicated that the Company's Articles of Incorporation do not comply with the provisions of W. Va. Code §31D-8-806. This Code allows that a corporation may elect members of its board of directors to terms of more than one year and on a staggered term basis if there are at least nine members on the board and the authority to so elect the members of the board is delineated in the Articles of Incorporation. Since inception the Company has elected only eight members to its Board of Directors. Since inception the Company has delineated the authority to elect members of its board of directors to terms of more than one year and on a staggered term basis in its Bylaws. It is recommended that the Company take all necessary action to comply with the provisions of W. Va. Code §31D-8-806.

COMPANY HISTORY

The Company is a West Virginia domiciled stock insurance company and is a wholly owned subsidiary of Farmers & Mechanics Mutual Insurance Company of West Virginia ("FMM"). FMM owns 100% of the Company's issued and outstanding common stock and therefore is the sole stockholder. To initially capitalize the Company FMM purchased 125,000 shares of the

Company's common stock at a price of \$2.5 million dollars. The stated par value of the issued and outstanding common stock is \$8.00 per share.

The Company and FMM ("FM Group or the Group") are members of an insurance holding company system pursuant to W. Va. Code § 33-27-1, et. seq. FMM is organized as a farmer's mutual fire insurer pursuant to W. Va. Code § 33-22-1, et. seq. Both companies are ultimately controlled by the Board of Directors, management and policyholders of FMM.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, and the recorded minutes of annual stockholders meetings and Board of Directors and its Committees meetings were examined for statutory compliance and support. Other than the matters noted in the above Summary of Significant Findings section of this report, the Company appears to comply with all reviewed statutory requirements and to adhere with the provisions of its Articles of Incorporation and Bylaws.

MANAGEMENT AND CONTROL

Examination indicates that administration of the company's affairs is currently under the direction of Dennis McCormick. Mr. McCormick has been President and CEO of the Company since its inception. The Company's Officers and Directors serve in the same capacities for the parent company FMM.

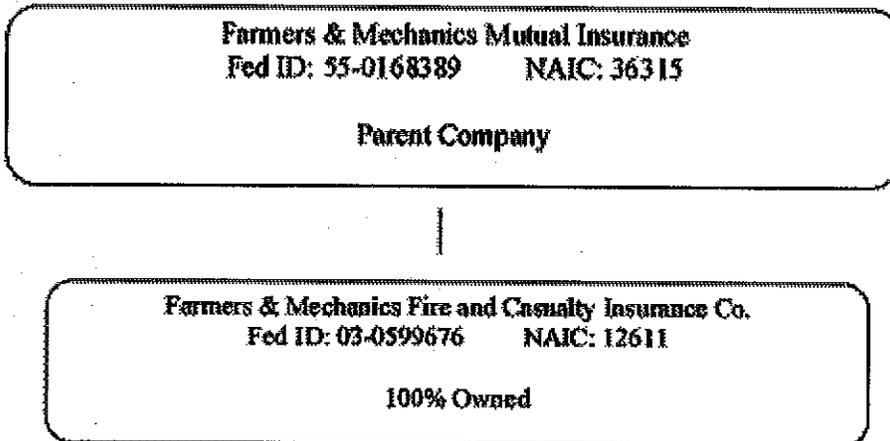
Board of Directors

<u>Name and Address</u>	<u>Principal Occupation</u>
John Wayne Lancaster Martinsburg, WV	Retired, Chairman of the Board, Treasurer
E. Dennis McCormick Martinsburg, WV	CEO, President Director
Martin B. Frye Gerraldstown, WV	Orchardist Secretary, Director
James Wayne Dailey II Martinsburg, WV	Contractor, Vice Chairman of the Board, Director
Bernard Lee Snyder Charlestown, WV	Contractor Director
Debbie J. Dhayer Berkeley Springs, WV	Owner- tire service Director
James Patrick Whitacre Martinsburg, WV	Owner - excavation Director
Kenneth Laign Banks Inwood, WV	Dentist Director

Officers

<u>Name</u>	<u>Position</u>
E. Dennis McCormick	CEO, President
John Wayne Lancaster	Treasurer
Martin B. Frye	Secretary
Richard A. Howard	VP-Claims
Daniel R. Otto	VP-Accounting
Stacy M. Matteson	VP-Underwriting
Foster L. Sirbaugh	VP-Marketing

Organizational Chart



Cost Sharing Agreements

The companies entered an Expense Sharing Agreement ("Agreement") effective August 1, 2006. Pursuant to the Agreement FMM provides Underwriting, Support, Management, Accounting and System services to the Company. The Agreement provides that directly attributable expenses of one company are not shared with the other and that identified shared expenses are allocated pursuant to applicable ratios established in the Agreement. The Agreement was submitted to WVOIC for approval on October 13, 2006. The WVOIC approved the Agreement effective October 31, 2006. Upon amended request of the Company dated November 6, 2006, the WVOIC granted retroactive approval of the Agreement to be effective August 1, 2006.

FIDELITY BOND AND OTHER INSURANCE

Examination determined that the Company does not directly employ any individuals nor does it own any real property. All fidelity and other insurance coverage are provided by the parent company through the Expense Sharing Agreement. The Examiner relied upon evaluation of the

parent's fidelity and other insurance coverage performed by David Eley, CFE, acting Examiner in Charge of the concurrent examination being conducted of FMM. Mr. Eley determined that the Company has fidelity coverage exceeding the NAIC recommended minimum insurance limits via extended coverage from policies insuring FMM and all of its affiliates and/or subsidiaries.

EMPLOYEE WELFARE

Examination determined that the Company does not directly employ any individuals. The Company does not directly provide pension, stock ownership or insurance plans to employees. All salary and related expenses are allocated in accordance to the inter-company expense sharing agreement. All salaries and salary increases are at the discretion of the Board of Directors and are voted on by the Board of Directors. Review of the pension, stock ownership and/or insurance plans provided to employees is being conducted during the concurrent examination of FMM. This Examiner reviewed and determined that the methods of allocating the shared expenses are reasonable and fair to both parties.

TERRITORY AND PLAN OF OPERATION

The Company solely operates in the State of West Virginia. The Company initially wrote personal automobile coverage. Examination indicates that FMM management organized the Company as a growth vehicle in personal auto writings since FMM is restricted from insuring auto lines of business by West Virginia Code. The Company was organized with a stated goal of obtaining a substantial book of West Virginia personal auto business due to the insolvency of a foreign licensed insurer in 2006. Examination indicates that the Company was successful in obtaining a substantial amount of that business. In 2007 the Company began issuing auto policies to new customers in addition to renewing business obtained from the insolvent company.

In late 2007 the Company began issuing Personal Umbrella policies. Examination also indicates that subsequent to December 31, 2007, the Company has increased premiums written in the personal lines, as well as introducing new lines such as Commercial Umbrella, Artisans, and Homeowners products.

The Company utilizes an independent agency system to market its policies. Per WVOIC records there were 372 agents appointed by the Company as of December 31, 2007.

GROWTH OF COMPANY

The following exhibit depicts the growth of the Company throughout the exam period.

Year	Net Admitted Assets	Policyholder Surplus	Net Premium Written	Net Income
2006	3,585,352	2,452,369	2,343,420	101,161
2007	3,734,022	2,369,061	2,771,864	(186,714)

REINSURANCE

To limit risk exposure the Company has entered into various reinsurance agreements whereby the Company cedes premiums and losses to other insurance or reinsurance companies. The ceded

losses are treated as the risk and liability of the assuming companies. These agreements cover various lines of business and vary in terms and duration and are summarized below. The Company does not assume reinsurance.

At December 31, 2007, the Company maintained a personal automobile quota share agreement, a personal automobile excess cessions agreement and an umbrella facultative reinsurance agreement solely for its protection.

At December 31, 2007, the Company and its parent company, FMM, maintained jointly for their mutual protection a general excess of loss agreement, a third property per risk excess of loss agreement, a casualty clash excess of loss agreement and a property catastrophe excess of loss reinsurance agreement. These agreements apply only to that portion of any loss that the Company retains net for its own account (prior to deduction of any reinsurance that inures solely to the benefit of the Company).

Quota Share Reinsurance:

Under the Quota Share agreement the Company retains up to the first \$25,000 (its 50% share of \$50,000) of auto physical damage liability each loss, each policy. The Company also retains up to \$125,000 (its 50% share of \$250,000) of all other liability each loss each policy. The reinsurer will cover 50% of each loss each policy for auto physical damage liability and all other liability subject to a limit of \$250,000 each loss, each policy. The Reinsurer shall pay to the Company the Reinsurer's quota share of losses under the Policies, Loss Adjustment Expense, Extra Contractual Obligations subject to a maximum amount equal to one additional cession, and Loss in Excess of Policy Limits subject to a maximum amount equal to one additional cession, covered under the Contract. If the Company issues Policies with limits greater than \$250,000, the excess liability thereof shall be covered elsewhere on an excess cessions basis or so deemed.

As of January 1, 2007, under the Quota Share agreement the Company was to pay to the Reinsurer its exact proportion of the Gross Net Written Premium Income accounted for by the Company. The Reinsurer allowed the Company a 35% provisional commission on all premiums ceded to the Reinsurer. The Company allowed the Reinsurer return commission on return premiums at the same rate. The agreement allowed that the provisional commission be adjusted based upon the ratio of Losses Incurred to Premiums Earned. The range of adjusted provisional commission is between 25% and 45%. If the ratio of Losses Incurred to Premiums Earned is greater than 66% or is less than 46%, the difference in percentage points between 66% or 46% and the actual ratio of Losses Incurred to Premiums Earned shall be multiplied by Premiums Earned and the product shall be respectively carried forward to the successor contract either as a debit or credit to Losses Incurred. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force.

Excess Cessions Reinsurance:

Under the Excess Cessions agreement the reinsurer is liable for each policy, each loss occurrence with an Ultimate Net Loss in excess of \$250,000. Only those policies classified as private passenger auto liability insuring bodily injury limits greater than \$250,000 are ceded to this agreement. Under this agreement the reinsurer's liability each policy, each loss occurrence is subject to a limit of \$250,000.

As of January 1, 2007, under the Excess Cessions agreement the Company was to pay to the Reinsurer its exact proportion of the Gross Net Written Premium Income accounted for by the Company. The Reinsurer allowed the Company a 15% commission on all premiums ceded to the Reinsurer. The Company allowed the Reinsurer return commission on return premiums at the same rate. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force.

Umbrella Facultative Reinsurance:

For those policies classified by the Company as Personal and Farm Umbrella liability insurance the Umbrella Facultative agreement applies to each loss occurrence, each policy. The Company retains up to \$50,000 (5% share) of liability each loss occurrence, each policy and the Reinsurer(s) retains up to \$950,000 (95% share) of initial Ultimate Net Loss up to \$1,000,000 each loss occurrence, each policy. The Reinsurer(s) is subject to 100% retention up to an additional \$1,000,000 of Ultimate Net Loss each loss occurrence, each policy. The Reinsurer shall be bound to pay to the Company the Reinsurer's proportion of Loss Adjustment Expense in the ratio that the Reinsurer's loss payment bears to the total Ultimate Net Loss. Such payment shall be in addition to the stated limits.

As of January 1, 2007, under the Umbrella Facultative agreement the Company was to pay the Reinsurer a premium of 95% of Gross Net Written Premium allocated by the Company to the first \$1,000,000 of limit subject to the Quota Share coverage hereunder, and 100% of Gross Net Written Premium allocated by the Company to the amount of coverage greater than \$1,000,000, subject to the limit of this Contract. The Reinsurer allowed the Company a 27.5% commission on annual Gross Net Written Premium and the Company allowed the Reinsurer return commission on return premiums at the same rate. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force.

General Excess of Loss Reinsurance:

Under the General Excess of Loss agreement the Company is indemnified in respect of the liability that may accrue as a result of loss or losses under Policies classified by the Company as Property and/or Casualty insurance. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force. If the Company elects to run-off the business in force it is required to pay the Reinsurer an additional premium equal to the rate set forth in the Premium Article, multiplied by Gross Net Earned Premium Income during the runoff period. There are two levels of excess coverage afforded under this agreement.

Under the First Excess level for property insurance the reinsurer(s) is liable for Ultimate Net Loss over and above an initial Ultimate Net Loss of \$100,000 each loss, each risk, subject to a limit of liability to the Reinsurer of \$200,000 each loss, each risk, and further subject to a limit of liability to the Reinsurer of \$400,000 each Loss Occurrence.

Under the First Excess level for casualty insurance the reinsurer(s) is liable in respect of each Loss Occurrence, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$100,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$200,000 each Loss Occurrence. In addition to the retention in paragraph A of the First Excess, the Company

shall retain \$200,000 of aggregate excess losses (i.e., the total of excess losses and Loss Adjustment Expense) otherwise recoverable under paragraph A of the First Excess occurring during the term of this Contract.

Under the Second Excess level for property insurance the reinsurer(s) is liable in respect of each loss, each risk, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$300,000 each loss, each risk, subject to a limit of liability to the Reinsurer of \$700,000 each loss, each risk, and further subject to a limit of liability to the Reinsurer of \$1,400,000 each Loss Occurrence

Under the Second Excess level for casualty insurance the reinsurer(s) is liable in respect of each Loss Occurrence, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$300,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$700,000 each Loss Occurrence.

Additionally in the event of a Loss Occurrence involving at least one Casualty Policy and at least one Property Policy subject to this Contract, the Reinsurer shall be liable in respect of each Loss Occurrence for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$100,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$100,000 each Loss Occurrence. Recoveries under the First Excess and the Second Excess above shall reduce the Ultimate Net Loss subject to this paragraph.

As of January 1, 2007, under the First Excess level of the General Excess of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$757,000 for the term of the Contract in the amount of \$63,083.33 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 4.00% multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$605,480. Additionally the contract allowed a contingent profit commission of 35% paid to the Company if the Reinsurer's First Excess level income exceeded defined costs ("outgo") including a 25% allowance for the reinsurer's management expenses.

As of January 1, 2007, under the Second Excess level of the General Excess of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$136,260 for the term of the Contract in the amount of \$11,355 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 0.72% multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$109,000.

Third Property Excess of Loss Reinsurance:

Under the Third Property Excess of Loss agreement, the Company is indemnified in respect of liability that may accrue as a result of loss or losses under Policies classified by the Company as Property insurance. The Reinsurer shall be liable in respect of each loss, each risk, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$1,000,000 each loss, each risk, subject to a limit of liability to the Reinsurer of \$500,000 each loss, each risk, and further subject

to a limit of liability to the Reinsurer of \$1,000,000 each Loss Occurrence. With respect to any risk covered in whole or in part under a form of Policy that provides additional insurance beyond the stated Policy limit (e g, business income under a commercial property form of Policy, additional amounts due for replacement costs and costs to comply with laws or ordinances) the liability of the Reinsurer hereunder shall be increased by an amount equal to such additional insurance, but in no case shall the liability of the Reinsurer as respects such additional insurance exceed an amount equal to 20% of the retention plus the limit.

As of January 1, 2007, under the Third Property Excess of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$28,400 for the term of the Contract in the amount of \$2,366.67 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 0.15% multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$22,680. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force. If the Company elects to run-off the business in force it is required to pay the Reinsurer an additional premium equal to the rate set forth in the Premium Article, multiplied by Gross Net Earned Premium Income during the runoff period.

Casualty Clash Excess of Loss Reinsurance:

Under the Casualty Clash Excess of Loss agreement the Company is indemnified in respect of the liability that may accrue to the Company as a result of loss or losses under Policies classified by the Company as Casualty insurance. The Reinsurer shall be liable in respect of each Loss Occurrence, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$1,000,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$1,000,000 each Loss Occurrence.

As of January 1, 2007, under the Casualty Clash Excess of Loss agreement the Company was to pay the Reinsurer a minimum and deposit premium of \$35,000 in the amount of \$2,917.67 on the first day of each month. The Agreement does not address affirmative termination or cancellation since the Agreement is for only a one year term, however, in the event the Agreement is not renewed the Company has the option to either cut-off or run-off of the business in force. If the Company elects to run-off the business in force it is required to pay the Reinsurer an additional premium equal to the rate set forth in the Premium Article, multiplied by Gross Net Earned Premium Income during the runoff period.

Property Catastrophe Excess of Loss Reinsurance:

Under the Property Catastrophe Excess of Loss agreement the Company is indemnified in respect of the liability that may accrue to the Company as a result of loss or losses under Policies classified by the Company as Property and Automobile Physical Damage insurance. There are four levels of excess coverage afforded under this agreement.

Under the First Excess level the reinsurer(s) is liable in respect of each Loss Occurrence, for 95% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$500,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$475,000 (being 95% of \$500,000) each Loss Occurrence.

As of January 1, 2007, under the First Excess level of the Property Catastrophe Excess of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$102,000 for the term of the Contract in the amount of \$8,566.67 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 0.639% multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$82,300.

Under the Second Excess level the reinsurer(s) is liable in respect of each Loss Occurrence, for 95% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$1,000,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$950,000 (being 95% of \$1,000,000) each Loss Occurrence.

As of January 1, 2007, under the Second Excess level of the Property Catastrophe of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$ 92,800 for the term of the Contract in the amount of \$ 7,733.33 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 0.577 % multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$74,300.

Under the Third Excess level the reinsurer(s) is liable in respect of each Loss Occurrence, for 95% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$2,000,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$2,850,000 (being 95% of \$3,000,000) each Loss Occurrence.

As of January 1, 2007, under the Third Excess level of the Property Catastrophe of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$118,100 for the term of the Contract in the amount of \$ 9,841.67 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for the term of the Contract and calculated a premium at a rate of 0.734 % multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$94,500.

Under the Fourth Excess level the reinsurer(s) is liable in respect of each Loss Occurrence, for 95% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$5,000,000 each Loss Occurrence, subject to a limit of liability to the Reinsurer of \$4,750,000 (being 95% of \$5,000,000) each Loss Occurrence.

As of January 1, 2007, under the Fourth Excess level of the Property Catastrophe of Loss agreement the Company was to pay the Reinsurer a deposit premium of \$118,100 for the term of the Contract in the amount of \$ 9,841.67 on the first day of each month. At year end the Company furnished to the Reinsurer a statement of the Gross Net Earned Premium Income for

the term of the Contract and calculated a premium at a rate of 0.734 % multiplied by the Company's Gross Net Earned Premium Income. If the premium so calculated exceeded the deposit premium paid the Company was required to pay the Reinsurer the difference. If the premium so calculated was less than the deposit premium paid the Reinsurer was required to pay the Company the difference, subject to a minimum premium for the term of the Contract of \$94,500.

ACCOUNTS AND RECORDS

The Company maintains its books and records at its home office in Martinsburg, West Virginia. In general, the Company's accounting and corporate records were maintained in a manner in which the financial condition was readily verifiable. The Company utilizes Microsoft Access and Excel software and Peachtree Accounting for basic accounting, accounts payable and general ledger postings. Garvin Allen AIS software is utilized for the Company's Premium and Claims Processing system. The Company's accounting procedures, practices and account records were reviewed and tested to the extent necessary. The trial balance prepared from the Company's general ledger and work papers for the year ended December 31, 2007, was agreed to the Annual Statement.

STATUTORY DEPOSITS

The Company is licensed and operates only in the State of West Virginia. The statutory deposit as of December 31, 2007, consisted of a U. S. Treasury Note, with par value of \$98,000 and book adjusted carrying value of \$99,057.

FINANCIAL STATEMENTS

The following pages contain financial statements showing the Company's financial position as of December 31, 2007, as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

FARMERS & MECHANICS FIRE & CASUALTY INSURANCE COMPANY

Assets

December 31, 2007

<u>Assets</u>	Per Annual Statement	Examination Adjustments	Per Examination
Bonds	\$ 2,096,300	-	\$2,096,300
Cash and Short-term investments (1)	654,420		654,420
Subtotals, Cash and Invested Assets	2,750,720	0	2,750,720
Investment income due and accrued	29,933		29,933
Uncollected premiums and agents' balances in the course of collection (premiums and considerations)	21,522		21,522
Deferred premiums and agents balances in course of collection	821,659		821,659
Other amounts receivable under reinsurance contracts	27,684		27,684
Current federal and foreign income tax recoverable and interest thereon	17,337		17,337
Net deferred tax asset	48,398		48,398
Aggregate write-ins for other than invested assets	16,769		16,769
Totals	\$3,734,022	\$ -	\$3,734,022

FARMERS & MECHANICS FIRE & CASUALTY INSURANCE COMPANY
Liabilities, Surplus and Other Funds
December 31, 2007

<u>Liabilities</u>	Per Annual Statement	Examination Adjustments	Per Examination
Losses	\$236,599	\$ -	\$236,599
Loss adjustment expenses	47,031		47,031
Commissions payable	227,746		227,746
Other expenses	11,535		11,535
Unearned premiums (after deducting unearned premiums for ceded reinsurance of \$852471 and including warranty reserves of \$0)	731,973		731,973
Ceded reinsurance premiums payable (net of ceding commissions)	14,582		14,582
Payable to parent, subsidiaries and affiliates	12,187		12,187
Total Liabilities	1,281,653	0	1,281,653
<u>Surplus as Regards Policyholders</u>			
Common Stock	1,000,000		1,000,000
Gross paid in and contributed surplus	1,500,000		1,500,000
Unassigned Surplus	(47,631)		(47,631)
Total Surplus as Regards Policyholders	2,452,369	0	2,452,369
Total Liabilities, Surplus and Other Funds	\$3,734,022	\$ -	\$3,734,022

FARMERS & MECHANICS FIRE & CASUALTY INSURANCE COMPANY
Summary of Operations
December 31, 2007

Total Underwriting Deductions	1,272,240	0	1,272,240
Net Underwriting Gain	<u>13,783</u>	<u>0</u>	<u>13,783</u>
Investment Income			
Net Investment Income Earned	148,652		148,652
Net Realized Capital Gains	<u>127</u>		<u>127</u>
Net Investment Gain	<u>148,779</u>	<u>0</u>	<u>148,779</u>
<u>Other Income</u>			
Net gain (loss) from agents' or premium balances charged off	<u>(56,180)</u>		<u>(56,180)</u>
Finance and service charges not included in premiums	17277		17277
Total Other Income	<u>(38,903)</u>	<u>0</u>	<u>(38,903)</u>
Net Income Before Dividends to Polic holders and Federal Income Taxes	123,659	0	123,659
Federal Income Taxes Incurred	<u>22,598</u>		<u>22,598</u>
Net Income	<u>\$101,061</u>	<u>0</u>	<u>\$101,061</u>

FARMERS & MECHANICS FIRE & CASUALTY INSURANCE COMPANY
Comparative Analysis of Changes in Surplus
 December 31, 2007

The following is a reconciliation of surplus between the amount reported by the Company and as determined by examination:

Surplus as Regards Policyholders per December 31, 2007 Annual Statement			\$2,452,369
Item:	Adjustments to Surplus Increase	Adjustments to Surplus Decrease	
No adjustments proposed	\$ -	\$ -	
Totals	0	0	
Net Adjustments to Surplus as Regards Policyholders			0
Surplus as Regards Policyholders per Examination			\$2,452,369

SUMMARY OF RECOMMENDATIONS

Examination indicated that the Company's Articles of Incorporation do not address statutory limitations on indebtedness as required by Chapter 33, Article 5, Subsection 3 (h) of the West Virginia Code. It is recommended that the Company amend its Articles of Incorporation to comply with W. Va. Code § 33-5-3 (h).

Examination indicated that the Company's Articles of Incorporation do not comply with the provisions of W. Va. Code §31D-8-806. This Code allows that a corporation may elect members of its board of directors to terms of more than one year and on a staggered term basis if there are at least nine members on the board and the authority to so elect the members of the board is delineated in the Articles of Incorporation. Since inception the Company has elected only eight members to its Board of Directors. Since inception the Company has delineated the authority to elect members of its board of directors to terms of more than one year and on a staggered term basis in its Bylaws. It is recommended that the Company take all necessary action to comply with the provisions of W. Va. Code §31D-8-806.

EXAMINERS ACKNOWLEDGMENT AND SIGNATURE

The cooperation and assistance extended by the CEO/President and staff of the Company during the course of the financial examination is hereby acknowledged.

In addition to the undersigned, David E. Eley, CFE, participated in this examination

EXAMINERS AFFIDAVIT AS TO STANDARDS AND PROCEDURES USED IN AN EXAMINATION

State of West Virginia
County of Kanawha

Randall A. Price, being duly sworn, states as follows:

1. I have authority to represent the West Virginia Offices of the Insurance Commissioner in the examination of Farmers & Mechanics Fire & Casualty Insurance Company.
2. The West Virginia Offices of the Insurance Commissioner are accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report, and the examination of Farmers & Mechanics Fire & Casualty Insurance Company was performed per instruction of the Chief Examiner and in a manner consistent with the standards and procedures required by the West Virginia Offices of the Insurance Commissioner.

The affiant says nothing further

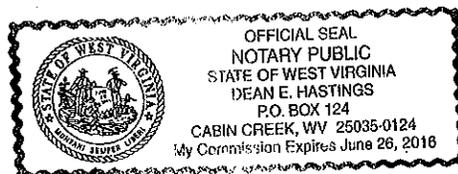
Randall A. Price

Randall A. Price, CFE

Subscribed and sworn before me by Randall A. Price on this
20th day of October 2008.

Dean E. Hastings

Notary Public



My Commission expires June 26, 2016 (Date)