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Department of Insurance
State of Idaho

Attorneys for Department of Insurance

**BEFORE THE DIRECTOR OF THE DEPARTMENT OF INSURANCE
OF THE STATE OF IDAHO**

In the Matter of:

GEM STATE INSURANCE COMPANY

Certificate of Authority No. 1647
NAIC No. 18457

Docket No. 18-2870-13

**ORDER ADOPTING REPORT
OF EXAMINATION AS OF
DECEMBER 31, 2011**

The State of Idaho, Department of Insurance (Department), having conducted an examination of the affairs, transactions, accounts, records, and assets of Gem State Insurance Company (Gem State), pursuant to Idaho Code § 41-219(1), hereby alleges the following facts that constitute a basis for issuance of an order, pursuant to Idaho Code § 41-227(5)(a), adopting the Report of Examination of Gem State Insurance Company as of December 31, 2011 (Report), as filed.

FINDINGS OF FACT

1. Gem State is an Idaho-domiciled insurance company licensed to transact casualty insurance, excluding workers' compensation; marine and transportation insurance; and property insurance in Idaho under Certificate of Authority No. 1647.

2. The Department completed an examination of Gem State pursuant to Idaho Code § 41-219(1) on or about April 30, 2013. The Department's findings are set forth in the Report.

3. Pursuant to Idaho Code § 41-227(4), a copy of the Report, verified under oath by the Department's examiner-in-charge, was filed with the Department on April 30, 2013, and a copy of such verified Report was transmitted to Gem State on the same date. A copy of the verified Report is attached hereto as Exhibit "A."

4. On or about April 30, 2013, the Department received a Waiver signed by Robert B. Locke, Manager of Gem State. By execution of such Waiver, a copy of which is attached hereto as Exhibit "B," Gem State consented to the immediate entry of a final order by the Director of the Department (Director) adopting the Report without any modifications; waived its right to make a written submission or rebuttal to the Report; and waived its right to request a hearing and to seek reconsideration or appeal from the Director's final order.

5. No written submissions or rebuttals, pursuant to Idaho Code § 41-227(4), with respect to any matters contained in the Report were received by the Department from Gem State.

CONCLUSIONS OF LAW

6. Idaho Code § 41-227(5)(a) provides that "[w]ithin thirty (30) days of the end of the period allowed for the receipt of written submissions or rebuttals, the director shall fully consider and review the report, together with any written submissions or rebuttals and relevant portions of the examiner's work papers" and shall enter an order adopting the report of examination as filed or with modifications or corrections.

7. Having fully considered the Report, the Director concludes that Gem State meets the minimum requirements set forth in Idaho Code § 41-313(1).

ORDER

NOW, THEREFORE, based on the foregoing, IT IS HEREBY ORDERED that the Report of Examination of Gem State Insurance Company as of December 31, 2011, is hereby ADOPTED as filed, pursuant to Idaho Code § 41-227(5)(a).

IT IS FURTHER ORDERED, pursuant to Idaho Code § 41-227(8), that the adopted Report is a public record and shall be exempt from the exemptions from disclosure provided in chapter 3, title 9, Idaho Code.

IT IS FURTHER ORDERED, pursuant to Idaho Code § 41-227(6)(a), that, within thirty (30) days of the issuance of the adopted Report, Gem State shall file with the Department's Deputy Chief Examiner affidavits executed by each of its directors stating under oath that they have received a copy of the adopted Report and related orders.

IT IS SO ORDERED.

DATED this 8TH day of May, 2013.

STATE OF IDAHO
DEPARTMENT OF INSURANCE



WILLIAM W. DEAL
Director

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that, on this 8th day of May, 2013, I caused a true and correct copy of the foregoing ORDER ADOPTING REPORT OF EXAMINATION AS OF DECEMBER 31, 2011 to be served upon the following by the designated means:

Gem State Insurance Company
Attn: Robert B. Locke, Manager
333 Main Street
Gooding, ID 83330-0236
boblocke@cablone.net

☐ first class mail
☒ certified mail
☐ hand delivery
☒ email

Georgia Siehl, CPA, CFE
Bureau Chief / Chief Examiner
Idaho Department of Insurance
700 W. State Street, 3rd Floor
Boise, ID 83720-0043
georgia.siehl@doi.idaho.gov

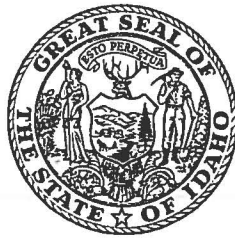
☐ first class mail
☐ certified mail
☐ hand delivery
☒ email



Teresa Jones
Assistant to the Director

DEPARTMENT OF INSURANCE

STATE OF IDAHO



REPORT OF EXAMINATION

of the

GEM STATE INSURANCE COMPANY

(NAIC Company Code 18457)

as of

December 31, 2011

EXHIBIT

A

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State of Idaho
DEPARTMENT OF INSURANCE

C.L. "BUTCH" OTTER
Governor

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WILLIAM W. DEAL
Director

Gooding, Idaho
April 30, 2013

The Honorable William W. Deal
Director of Insurance
State of Idaho
700 West State Street
P. O. Box 83720
Boise, Idaho 83720-0043

Dear Director:

Pursuant to your instructions, in compliance with Idaho Code Section 41-219(1), and in accordance with generally accepted examination practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2011 of:

GEM STATE INSURANCE COMPANY

333 MAIN STREET
GOODING, IDAHO 83330

hereinafter referred to as "the Company," at its offices in Gooding, Idaho. Also the Idaho Department of Insurance is hereinafter referred to as the "Department."

The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period January 1, 2007 through December 31, 2011. The examination was conducted at the Gooding, Idaho office of the Company by an examiner from the State of Idaho. The examination was conducted in accordance with Sections 41-219(1), Idaho Code, the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*, the NAIC *Market Regulation Handbook*, and the NAIC *Accounting Practices and Procedures Manual*.

All accounts and activities of the Company were considered in accordance with the NAIC's risk-focused examination process. The Financial Examiners Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions as governed and prescribed by Idaho law. A letter of representation was signed by the Company attesting to its ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities.

The Company obtained an exemption from the Department for filing an audited CPA report for 2011. Therefore, no reliance was placed on the 2010 CPA audit report and the accompanying work papers during the examination of the Company.

In addition to the Report of Examination, a Management Letter was issued to the Company by the Department which covered items that were not included in the Report, due to the materiality threshold, items that were related to proprietary/operational issues, or minor accounting/annual statement reporting corrections.

PRIOR EXAMINATION

The prior examination was conducted by the Idaho Department of Insurance, and covered the period of January 1, 2002 through December 31, 2006.

A review was made to ascertain what action was taken by the Company with regard to comments and recommendations made by the Department in the prior exam report. Unless otherwise mentioned in the COMMENTS AND RECOMMENDATIONS section of this report, the prior report exceptions were adequately addressed by the Company.

HISTORY AND DESCRIPTION

The Company was incorporated on March 12, 1910, as the Grange Mutual Co-Operative Fire Insurance Company of Idaho, and commenced operations in July of 1910. The initial purpose of the Company was to provide fire, lightning, hail, tornado and windstorm coverages for all "Patrons of Husbandry" (Grange members) who were affiliated with a subordinate Grange in the State of Idaho.

In 1984 the Company was experiencing serious problems with loss of policyholders due to declining Grange membership, and the inability of the Company to provide liability coverage with the property policies it was writing. At that time the Company had adequate assets and surplus to convert from a

county mutual to a domestic property & casualty mutual insurance company, which would allow writing personal and farm and ranch liability. That was accomplished, and in 1985 the Company began writing those additional liability lines, along with property coverage, for all eligible property owners in Idaho with no Grange membership requirement. The conversion to a domestic mutual insurance company was effective April 23, 1985. By amendment to the Articles of Incorporation, the name of Grange Mutual Fire Insurance Company of Idaho was adopted effective March 3, 1986. Effective January 1, 1998, the name of the Company was changed from Grange Mutual Fire Insurance Company of Idaho to its present name, Gem State Insurance Company.

MANAGEMENT AND CONTROL

The management and control of the Company is guided by a Board of Directors consisting of five directors chosen from the members (policyholders) of the Company.

The annual meetings of the policyholders and of the Board of Directors are held at the same location on the fourth Wednesday of April. Special meetings of the Board may be called by the President or upon the petition of any three board members, in accordance with provisions in the Bylaws.

Directors and Officers

The following persons were serving as directors and officers at December 31, 2011:

Directors:

<u>Name</u>	<u>Residence Address</u>	<u>Principal Occupation</u>
Keith Skaar	Idaho Falls, ID	Retired Farmer
Steve Nielsen	Boise, ID	Retired Insurance Executive
Mark Bulcher	Twin Falls, ID	Farmer
Gene Guilfooy	Moscow, ID	Retired Insurance Agent
Douglas McEwan	Boise, ID	Retired Banker

Officers:

Steve Nielsen	President
Keith Skaar	Vice President
Mark Bulcher	Secretary/Treasurer

Committees

The Bylaws provided for an Executive Committee consisting of three policyholders, including the President of the Company. The committee shall act in compliance with the instructions of the Board, and within the limits of such power as may be transferred to, or withheld from the committee. A Compensation Committee and an Investment Committee were also established by the board.

The following individuals were serving on the Executive, Compensation and Investment Committees as of December 31, 2011:

Executive Committee

Steve Nielsen
Douglas McEwan
Mark Bulcher

Investment Committee

Steve Nielsen
Douglas McEwan
Bob Locke *

Compensation Committee

Steve Nielsen
Douglas McEwan
Keith Skaar

* Not a Director

Conflict of Interest

The Company established conflict of interest procedures. These procedures required each of the directors and officers to complete a disclosure statement of any conflicts or possible conflicts with the performance of their duties and responsibilities on an annual basis. Disclosure statements completed by directors and officers during this examination period were reviewed and indicated no conflicts.

Contracts and Agreements

At December 31, 2011 the Company has one Management Agreement which is summarized as follows:

The Locke Agency (an insurance agency) of Gooding, Idaho serves as manager for the Company, in accordance with the policies and directives of the Board of Directors, to receive and accept proposals for contracts of insurance; to receive premiums; and to deliver policies of insurance to agents of the Company. The Locke Agency shall supervise and manage the insurance business for the Company including underwriting, servicing policies, processing claims, investments, reinsurance and all related functions. The Locke Agency shall maintain a fidelity bond covering all employees transacting insurance business for the Company. This requirement was met through fidelity coverage obtained by the Company (see subsequent section in this report titled "FIDELITY BOND AND OTHER INSURANCE"). The Locke Agency shall also furnish sufficient office space, office equipment and personnel to adequately transact the business in an efficient manner.

The Company shall furnish file cabinets and computer equipment and reimburse Locke Agency for its proportional share of maintenance and rental fees of a copy machine and postage meter. The Company will reimburse for postage, printing, supplies and telephone charges incurred on behalf of the Company, the portion of errors and omissions insurance obtained by the Locke Agency and the premium for the fidelity bond.

The Locke Agency shall receive as compensation for its services a monthly fee to be mutually determined, annually, by the Locke Agency and the compensation committee of the Board of Directors of the Company. The fee will be determined based on income and expense data provided to the Board of Directors within ninety (90) days after the expiration of each calendar year, including all amounts received and expended during the calendar year.

The agreement was effective April 28, 1999 and provides for one-year renewal periods upon mutual consent of the parties and upon terms and conditions agreed by the parties. The contract was so renewed each year under examination (2007 through 2011). Either party may terminate the agreement upon ninety days written notice.

The annual Management Agreement fee in 2011 was \$324,569. The agreement appears fair and reasonable for the services provided. No Director and/or Officer of the Company had any interest in the Locke Agency.

The Company also had a servicing agreement for the maintenance of their automated insurance processing system. In 2000, the Company purchased automated insurance processing software from IMT Computer Services Company (IMT) of Des Moines, Iowa. In this agreement, IMT agrees to furnish all updates and enhancements to the APPS software, including documentation and to furnish a reasonable amount of training and support to the Company. The Company agreed to pay a monthly fee to IMT for the services provided.

The Company entered into a contract in 2002 through ISO Passport to obtain claims information, including loss experience, from A-PLUS and credit information from Transunion. The Company uses these reports in its pre-approval process of accepting applications.

The Company entered into a client service agreement with InsVista, LLC (InsVista) on November 21, 2008. In this agreement InsVista agrees to receive, process and send, on behalf of the Company, certain mortgagee and lienholder notification transactions (billing), and identifying the status of insurance policies, to mortgagees and lienholders.

CORPORATE RECORDS

Articles of Incorporation and Bylaws

A review of the Articles of Incorporation and Bylaws indicates that no changes were made during the period under examination (2007-2011).

Minutes of Meetings

The minutes of the meetings of the Directors were reviewed for the period under examination. It was noted that investments were accepted or reviewed by the Board, as evidenced by the record in the minutes. However, the period of the investments accepted or reviewed by the Board was not specified in the minutes. In order to comply with Idaho Code Section 41-705, it is recommended that the Board approve the investments made for each period and that the period approved be recorded in the minutes.

The Minutes of the Directors meeting held April 23, 2008, indicated that the prior Report of Examination as of December 31, 2006 issued by the Idaho Department of Insurance was received and had been reviewed by all Directors.

FIDELITY BOND AND OTHER INSURANCE

Insurance coverage for the protection of the Company had been maintained throughout the period under examination. Coverages in effect as of December 31, 2011, are summarized as follows:

The Company was protected by a fidelity bond that covers dishonest or fraudulent acts by employees up to \$250,000 (single loss and aggregate) with a single loss deductible of \$2,500. The fidelity bond coverage met suggested minimum limits of \$100,000 as recommended by the NAIC Financial Condition Examiners Handbook. It was noted from a review of the policy that the Locke Agency employees, acting on behalf of the Company, would also be covered by the Company's fidelity bond. The Company was also covered for Business Property and Directors & Officers Liability insurance.

The insurance companies providing the coverages to the Company were authorized insurers in the State of Idaho as of the examination date. The certification signed by management, and provided to the examiner, acknowledged that no losses had been suffered due to dishonest or fraudulent acts.

PENSION AND INSURANCE PLANS

The Company does not have any employees except the president who received a small amount of compensation from the Company in 2011.

The Company purchased a preferred *whole life* insurance policy (\$100,000 death benefit) from Jackson National Life Insurance Co, Lansing, Michigan on July 10, 1998 for the manager, Bob Locke. The Company is the owner of the policy.

The Company also purchased a 30 year level *term life* insurance policy from American General Life Insurance Company, Houston, Texas on May 14, 2008 for assistant manager, Adrian Celaya. The death benefit amount for that policy is \$250,000. The Company is the beneficiary of this policy.

TERRITORY AND PLAN OF OPERATION

The Company was licensed only in the State of Idaho as a domestic property and casualty insurer, and the business written was primarily comprehensive homeowners policies (including small farming operations), and rental dwellings.

Operations of the Company were conducted on an agency basis with approximately 75 producers under contract. The commission schedule in current use appeared to be reasonable. A bonus plan based on experience had been in effect since 1990.

The Company has maintained its home office in Gooding, Idaho, since 1918, and all insurance operations and record keeping functions are performed at that location.

STATUTORY AND SPECIAL DEPOSITS

As of December 31, 2011, the Company provided the following securities in trust for the benefit of policyholders and creditors, through the office of the Director of Insurance, State of Idaho:

<u>Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Goldman Sachs CD	\$ 25,000	\$ 25,071	\$ 26,684
GE Money Bank CD	50,000	50,078	53,395
Goldman Sachs CD	50,000	50,078	53,416
HSBC Fin Corp Bond	100,000	100,002	102,045
GCB Genworth Financial Bond	75,000	74,996	68,831
Merrill Lynch Bond	100,000	93,243	82,487
St. Peters Missouri Bond	50,000	50,005	56,673
Idaho Housing & Finance Bond	10,000	10,068	10,008
Idaho Housing & Finance Bond	55,000	55,000	58,733
Idaho Housing & Finance Bond	25,000	25,001	25,155
Idaho Housing & Finance Bond	45,000	45,003	45,120
Idaho Housing & Finance Bond	20,000	20,002	20,097
Idaho Housing & Finance Bond	45,000	45,002	44,263
Idaho Housing & Finance Bond	20,000	20,001	20,245

Idaho Health Facility Rev Bond	100,000	104,175	117,154
Clark Cnty NV Sch Dist Bond	50,000	49,579	53,149
Washoe Cnty Nev Hwy Bond	100,000	103,149	108,541
Idaho Hlth Fac Rev Hosp Bond	<u>100,000</u>	<u>103,690</u>	<u>110,333</u>
Totals	<u>\$1,020,000</u>	<u>\$1,024,143</u>	<u>\$1,056,329</u>

The deposit meets the general requirements and provisions of Idaho Code Sections 41-316A, 41-803 and 41-804. The deposit was verified by the Idaho Department of Insurance.

GROWTH OF THE COMPANY

The Company's Growth for the years indicated, as taken from its Annual Statements (or as adjusted by the examination report) is shown in the following schedule:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Net Income</u>
2007	\$6,950,795	\$ 2,012,122	\$4,938,673	\$515,986
2008	6,465,978	2,197,600	4,268,378	212,531
2009	6,989,604	2,221,866	4,767,738	94,102
2010	7,626,402	2,131,208	5,495,194	354,919
2011 *	\$8,163,566	\$2,228,053	\$5,935,513	\$521,044

* As determined by Examination

Decrease in net income in 2009 was due to a realized loss of \$122,326 on an investment. Other decreases were due to increased losses resulting from natural disasters such as windstorms.

LOSS EXPERIENCE

The ratios of losses and underwriting expenses incurred to premiums earned, as reported in the Company's annual statements for the five year period ending December 31, 2011 are reported below:

<u>Year</u>	<u>Premiums</u> <u>Earned</u>	<u>Losses</u> <u>Incurred</u>	<u>Loss/UW</u> <u>Expenses</u> <u>Incurred</u>	<u>Total</u> <u>Losses &</u> <u>Expenses</u>	<u>Ratio to</u> <u>Premiums</u> <u>Earned</u>
2007	\$2,376,045	\$1,160,792	\$ 849,546	\$2,010,338	84.6%
2008	2,420,108	1,657,467	959,834	2,617,301	108.1%
2009	2,497,238	1,626,188	925,058	2,551,246	102.2%
2010	2,537,194	1,398,145	1,000,967	2,399,112	94.6%
2011	\$2,579,325	\$1,296,680	\$ 931,969	\$2,228,649	86.4%

REINSURANCE

Assumed

The Company did not assume any reinsurance business during the period under examination.

Ceded

At December 31, 2011, the Company's coverage structure for the ceded business is summarized as follows:

Coverage Structure of Reinsurance Program

Type of Agreement	Reinsurer(s)	Company's Retention	Reinsurer's Limits
First Excess of Loss	General Reinsurance Corporation (100%)	\$70,000	\$30,000 per risk; maximum of \$90,000 on all risks per occurrence
Second Excess of Loss	General Reinsurance Corporation (100%)	\$100,000	\$900,000 per risk; maximum of \$2.7 million on all risks per occurrence
Catastrophe Coverage-Property	General Reinsurance Corporation (100%)	\$400,000	Limit of \$1.25 million to each loss event and \$2.5 million to all loss events during the contract term

The Company's reinsurer, General Reinsurance Corporation, a Delaware domiciled company, is authorized to transact business in the State of Idaho.

The examiner's review of the above reinsurance contracts concluded that the contracts did include adequate transfer of risk in compliance with Statement of Statutory Accounting Principal (SSAP) 62R, para 12.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting Practices

The Company utilized three basic policy forms in writing its homeowners, small farming operations, and renters coverages. A review of these forms revealed the use of standard American Association of Insurance Services, Inc. (AAIS) forms along with several other forms approved by the Department of Insurance. Premium rates and servicing fees in effect were contained in the Company's rate manual, along with other general information regarding underwriting and policy issues.

Producers appointed by the Company have binding authority on dwelling and farm risks, subject to those risks meeting the Company underwriting guidelines and do not, in any event, exceed \$500,000 per risk..

Treatment of Policyholders

Credit Scoring:

Credit scoring was not a factor in determining the premium rate for existing policyholders. However, during the Company's pre-approval process for new applicants, the credit score of potential applicant(s) may be accessed/checked if other risk factors are considered high. Company practice is to weight the

credit score less than 50% in deciding if the Company would accept the application or not. The examiner reviewed a sample of pre-approval forms filled-out by the Company's agents where the credit score was a factor. The review indicated that the Company complied with Idaho Code Section 41-1843 and IDAPA 18.01.19.

Claims:

A sample of 25 claims paid in 2011 was selected and reviewed based on a 90% confidence level during the course of this examination. The review indicated that the claims were being settled properly and that payments were being made in a timely manner.

Complaints:

The Company maintains a complaint register. It was determined that the complaint register did contain a complete record of all complaints that the Company had received since the date of its last examination, as well as a complete record of the disposition of the complaints, as prescribed by Idaho Code Section 41-1330. The Company has a fraudulent claim procedure in place, in compliance with Idaho Code Section 41-290.

Advertising and Sales Materials

The Company did a minimal amount of advertising during the period under examination, and did not utilize radio or television in its business promotion. Occasionally, the Company distributes promotional items bearing its name and logo. All of the advertising reviewed appeared to comply with Idaho Code Section 41-1304,

ACCOUNTS AND RECORDS

General Accounting

The Company utilized computerized accounting software, Automatic Policy Processing System (APPS) maintained by IMT Computer Services to generate accounting and financial information.

Independent Accountants

The annual independent audits of the Company for years 2007 through 2010 were performed by:

France, Basterrechea, Wagner, & Bunn, Chtd.
714 Main Street
Gooding, Idaho 83330

The independent auditor's reports were based on statutory accounting principles and reflected unqualified opinions for calendar years 2007 through 2010.

As mentioned earlier, the Idaho Department of Insurance granted the Company an exemption from filing the December 31, 2011 audited financial statement pursuant to IDAPA 18.01.62(024)(01). Therefore, no reliance was placed on the auditor's workpapers during the examination.

Actuarial Opinion

The loss and loss adjustment reserves and related liabilities were calculated by the Company and reviewed by Joseph L. Petrelli, ACAS, MAAA, FCA, consulting actuary with Demotech, Inc. of Dublin, Ohio. The actuary using standard actuarial procedures then determined the incurred loss reserves and issued a statement of opinion. The opinion stated that the amounts of the reserves:

- a. meet the requirements of the insurance laws of Idaho;
- b. are consistent with unpaid loss and loss adjustment expenses computed in accordance with accepted actuarial standards and principles;
- c. make a reasonable provision for all unpaid loss and loss expense obligations of the Company as of December 31, 2011 under the terms of its contracts and agreements.
- d. do not require a provision for the unearned premium reserves for long duration contracts of the Company under the terms of its contracts and agreements.

The identified actuarial items are listed as follows:

Note: Pages and schedules referenced below pertain to the 2011 Annual Statement.

Loss Reserves

A	Reserves for Unpaid Losses (Page 3, Line 1)	\$269,259
B	Reserve for Unpaid Loss Adjustment Expenses (Page 3, Line 3)	\$ 91,083
C	Reserve for Unpaid Losses – Direct and Assumed (Schedule P-Part 1, Total of Columns 13 and 15)	\$436,000
D	Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Schedule P-Part 1, Total of Columns 17, 19, and 21)	\$113,000
E	Retroactive Reinsurance Reserve Ceded or Assumed (Page 3, Write-in Item)	Not Applicable
F	Other Loss Reserve Items	Not Applicable

Premium Reserves

G	Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	Not Applicable
H	Reserve for Net Unearned Premiums for Long Term Duration Contracts	Not Applicable
I	Other Premium Reserve Items	Not Applicable

Please see the “NOTES TO FINANCIAL STATEMENTS – Note 1” near the end of this report for discussion of the examiner’s testing of the adequacy of the Company’s loss reserves.

SUBSEQUENT EVENTS

Mark Bulcher resigned his position as director, secretary and treasurer in October, 2012. John Thomas Jones, CPA was appointed director in November, 2012 replacing Mark Bulcher; and Adrian Celaya was appointed secretary and treasurer at the same time. A new external auditor, Deagle, Ames & Co., was appointed by the board to perform the 2012 audit for the Company.

FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

- Assets as of December 31, 2011
- Liabilities, Surplus and Other Funds as of December 31, 2011
- Statement of Income, For the Year Ending December 31, 2011
- Capital and Surplus Account, For the Year Ending December 31, 2011
- Reconciliation of Capital and Surplus, December 31, 2006 through December 31, 2011

ASSETS
As of December 31, 2011

	<u>Ledger</u>	<u>Non Admitted</u>	<u>Net Admitted</u>
Bonds	\$5,265,528	\$ 0	\$5,265,528
Preferred Stock	457,392	0	457,392
Common Stock	1,026,580	0	1,026,580
Cash and Short Term Investments	1,172,416	0	1,172,416
Investment Income Due and Accrued	81,369	0	81,369
Premiums Deferred and not yet due	155,874	0	155,874
Furniture and Equipment	<u>4,407</u>	<u>0</u>	<u>4,407</u>
Total Assets	<u>\$8,163,566</u>	<u>\$ 0</u>	<u>\$8,163,566</u>

LIABILITIES, SURPLUS AND OTHER FUNDS
As of December 31, 2011

Losses (Note 1)		\$ 269,259
Loss Adjustment Expenses (Note 1)		91,083
Commissions Payable		119,517
Other Expenses		29,672
Taxes, Licenses and Fees		5,896
Current Federal Income Taxes		98,732
Unearned Premiums		1,430,478
Ceded Reinsurance Premiums payable		183,002
Amounts Withheld for Accounts of Others		<u>414</u>
Total Liabilities		<u>\$2,228,053</u>
Unassigned funds (surplus)	<u>\$5,935,513</u>	
Surplus as Regards Policyholders		<u>5,935,513</u>
Total Liabilities, Surplus and Other Funds		<u>\$8,163,566</u>

STATEMENT OF INCOME
For The Year Ending December 31, 2011

Underwriting Income

Premiums earned	<u>\$2,579,325</u>
Deduct:	
Losses Incurred	\$1,296,680
Loss Adjustment Expenses Incurred	134,195
Other Underwriting Expenses Incurred	<u>797,774</u>
Total Underwriting Deductions	<u>\$2,228,649</u>
Net Underwriting Gain (Loss)	<u>\$ 350,676</u>

Investment Income

Net Investment Income Earned	\$ 372,138
Net Realized Capital Gains (Losses)	<u>(3,038)</u>
Net Investment Gain (Loss)	<u>\$ 369,100</u>
Net Income Before Dividends and Federal Income Taxes	\$ 719,776
Dividends to policyholders	<u>0</u>
Net Income After Dividends and Before Federal Income Taxes	\$ 719,776
Federal Income Taxes Incurred	<u>198,732</u>
Net Income	<u><u>\$ 521,044</u></u>

CAPITAL AND SURPLUS ACCOUNT
For the Year Ending December 31, 2011

Surplus as Regards Policyholders, December 31, 2010	<u>\$5,495,194</u>
Net Income	\$ 521,044
Change in Net Unrealized Capital Gains or (Losses)	<u>(80,725)</u>
Change in Surplus as Regards Policyholders for the Year	<u>\$ 440,319</u>
Surplus as Regards Policyholders, December 31, 2011	<u><u>\$5,935,513</u></u>

RECONCILIATION OF CAPITAL AND SURPLUS
December 31, 2006 through December 31, 2011

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Prior Year Surplus, December 31	<u>\$4,453,213*</u>	<u>\$4,938,673</u>	<u>\$4,268,378</u>	<u>\$4,767,738</u>	<u>\$5,495,194</u>
Net income	515,986	212,531	94,102	354,919	521,044
Change in unrealized gains (losses)	(70,339)	(884,986)	593,450	190,097	(80,725)
Change in net deferred income tax	39,813	2,160	(188,192)	320,339	0
Change in non-admitted assets	0	0	0	(137,899)	0
Net Change for the Year	<u>\$ 485,460</u>	<u>\$ (670,295)</u>	<u>\$ 499,360</u>	<u>\$ 727,456</u>	<u>\$ 440,319</u>
Current Year Surplus, December 31	<u>\$4,938,673</u>	<u>\$4,268,378</u>	<u>\$4,767,738</u>	<u>\$5,495,194</u>	<u>\$5,935,513*</u>

* Per Examination

NOTES TO FINANCIAL STATEMENTS

<u>Losses (Note 1)</u>	<u>\$269,259</u>
<u>Loss Adjustment Expenses (Note 1)</u>	<u>\$ 91,083</u>

The examiner performed a run-off test/lag analysis as of October 2, 2012 to determine if the loss and loss adjustment expense reserves reported by the Company were adequate as of December 31, 2011. The result of this test indicated that the loss and loss adjustment expenses reserves established by the Company, and opined upon by the Company's appointed actuary, were adequate.

SUMMARY, COMMENTS AND RECOMMENDATIONS

Summary

The results of the examination disclosed that as of December 31, 2011, the Company had admitted assets of \$8,163,566, liabilities of \$2,228,053, and surplus as regards policyholders of \$5,935,513. There were no examination adjustments made on the financial statements and the Company was in compliance with the "Capital funds required" criteria for a property & casualty mutual insurer found in Idaho Code Section 41-313.

Comments and Recommendations

<u>Page</u>	<u>Description</u>
5	<u>Minutes of Meetings</u> : The period of the investments accepted or reviewed by the Board was not specified in the minutes. In order to comply with Idaho Code Section 41-705, it is recommended that the Board approve the investments made for each period and that the period approved be recorded in the minutes.

CONCLUSION

The courteous assistance and cooperation extended by the Company's Manager and staff during the course of this examination is acknowledged and appreciated.

Respectfully submitted,



Kelvin Ko, CFE
Senior Insurance Examiner
Department of Insurance
State of Idaho

C. L. "BUTCH" OTTER
Governor

State of Idaho
DEPARTMENT OF INSURANCE


700 West State Street, 3rd Floor
P.O. Box 83720
Boise, Idaho 83720-0043
Phone (208)334-4250
FAX # (208)334-4398

WILLIAM W. DEAL
Director

AFFIDAVIT OF EXAMINER

State of Idaho
County of Ada

Kelvin Ko, being duly sworn, deposes and says that he is a duly appointed Examiner for the Department of Insurance of the State of Idaho, that he has made an examination of the affairs and financial condition of the Gem State Insurance Company for the period from January 1, 2007 through December 31, 2011, including subsequent events, that the information contained in the report consisting of the foregoing pages is true and correct to the best of his knowledge and belief, and that any conclusions and recommendations contained in the report are based on the facts disclosed in the examination.


Kelvin Ko, CFE
Examiner-in-Charge
Department of Insurance
State of Idaho

Subscribed and sworn to before me the 30th day of April, 2013 at Boise, Idaho




Notary Public

My commission Expires: 7/24/2018

C.L. "BUTCH" OTTER
Governor

State of Idaho
DEPARTMENT OF INSURANCE

700 West State Street, 3rd Floor
P.O. Box 83720
Boise, Idaho 83720-0043
Phone (208)334-4250
FAX # (208)334-4398

WILLIAM W. DEAL
Director

WAIVER

In the matter of the Report of Examination as of December 31, 2011, of:

**Gem State Insurance Company
333 Main Street
Gooding, Idaho**

By executing this Waiver, the Company hereby acknowledges receipt of the above-described examination report, verified as of the 30th day of April 2013, and by this Waiver hereby consents to the immediate entry of a final order by the Director of the Department of Insurance adopting said report without any modifications.

By executing this Waiver, the Exchange also hereby waives:

1. its right to examine the report for up to thirty (30) days as provided in Idaho Code section 41-227(4),
2. its right to make a written submission or rebuttal to the report prior to entry of a final order as provided in Idaho Code section 41-227(4) and (5),
3. any right to request a hearing under Idaho Code sections 41-227(5) and (6), 41-232(2)(b), or elsewhere in the Idaho Code, and
4. any right to seek reconsideration and appeal from the Director's order adopting the report as provided by section 41-227(6), Idaho Code, or elsewhere in the Idaho Code.

Dated this 30 day of April, 2013

Robert B. Locke

Name (print)

Robert B. Locke

Name (signature)

Mgr.

Title

Equal Opportunity Employer

EXHIBIT

B