

**REPORT ON EXAMINATION
OF
ALLIANCE INDEMNITY COMPANY
1122 NORTH MAIN STREET
MCPHERSON, KANSAS 67460
AS OF
DECEMBER 31, 2017**

FILED
MAY 15 2019
VICKI SCHMIDT
Commissioner of Insurance

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McPherson, Kansas
March 1, 2019

Honorable Vicki Schmidt
Commissioner of Insurance
Kansas Insurance Department
420 SW 9th Street
Topeka, Kansas 66612-1678

Dear Commissioner:

In accordance with your authorization and pursuant to K.S.A. 40-222 – *Examination of condition of company*, an examination has been conducted of the financial condition and business affairs of:

ALLIANCE INDEMNITY COMPANY

with its statutory home and main office at:

**1122 NORTH MAIN STREET
MCPHERSON, KANSAS 67460**

hereinafter referred to as “the Company” or “AlnC”. The following report on such examination is respectfully submitted.

SCOPE OF EXAMINATION

The examiners have performed a multi-state financial examination of Alliance Indemnity Company, a Kansas domiciled stock property and casualty insurance company. The last examination covered the four-year period from January 1, 2010, through December 31, 2013. This examination covers the four-year period from January 1, 2014, through December 31, 2017.

The examination was conducted in accordance with the rules, regulations and directives of the Kansas Insurance Department (“KID”) and the observed guidelines and procedures contained in the National Association of Insurance Commissioners (“NAIC”)

Financial Condition Examiners Handbook ("Handbook"). The Handbook requires the examiners plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, as mentioned in K.S.A. 40-222, *Examination of condition of company*, and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

Independent Audit Reports

The consolidated financial statements of Farmers Alliance Insurance Companies, which are Farmers Alliance Mutual Insurance Company, Alliance Insurance Company, Inc., and Alliance Indemnity Company, were audited by Strohm Ballweg, LLP. for the years ending December 31, 2014, through December 31, 2017. In each of the years

under examination, the auditors concluded that the financial statements of the Companies present fairly, in all material respects, the admitted assets, liabilities and policyholders' surplus of the Companies and the results of their operations and their cash flows for the years then ended in accordance with the accounting practices prescribed or permitted by the KID.

The independent auditor's work papers were reviewed and analyzed by the examiners; whereby significant reliance was placed on select work papers during the course of this examination.

SUMMARY OF SIGNIFICANT FINDINGS

No significant findings were noted during the course of the examination.

COMPANY HISTORY

The Yukon Indemnity Company was incorporated on December 6, 1976, under the laws of the state of Oklahoma and commenced business on December 8, 1976. On April 1, 1978, control of the Company was acquired by Farmers Alliance Mutual Insurance Company from the original founder, Natesco General Agency, Inc., of Dallas, Texas. The current name, Alliance Indemnity Company, was adopted in May of 1988. The Company re-domesticated from the state of Oklahoma to the state of Kansas in 2009 under the provisions of K.S.A. 40-2,162 – *Change of domicile of insurer or mutual holding company, requirements*. The Company is subject to the provisions of K.S.A. 40-901 et seq. – *General Provisions Relating to Fire Insurance Companies* and K.S.A. 40-1101 et seq. – *General Provisions Relative to Casualty, Surety and Fidelity Companies*.

The Company's charter provides for a perpetual existence.

Capital Stock

The Company's articles of incorporation authorize the issuance of 1,000,000 shares of common capital stock with a par value of \$1.00 per share. As of December 31, 2017, Farmers Alliance Mutual Insurance Company ("FAMI"), the parent, owned 100% of the issued and outstanding shares, resulting in a total paid-up common capital stock amount of \$1,000,000. Gross paid in and contributed surplus was \$350,000. No preferred stock is authorized.

MANAGEMENT AND CONTROL

AlnC's bylaws consist of thirteen articles that provide the framework for the operation, management and control of the Company. AlnC is controlled by FAMI, its stockholder and managed by a common Board of Directors ("Board"). The Board consists of no less than nine persons and no more than thirteen persons. A minimum of three directors are elected by the stockholder at each annual meeting and serve for a term of three years, or until their successors are elected and qualified. Should a vacancy occur on the Board, the remaining directors select a replacement to serve until the next annual meeting, at which time a successor will be elected by a vote of the stockholder to fill the unexpired term.

The exhibit below contains a listing of directors, their principal occupations, and elected terms as of December 31, 2017.

<u>Name</u>	<u>Principal Occupation</u>	<u>Term Expires</u>
L. Keith Birkhead McPherson, Kansas	President, Chief Executive Officer and Chairman of the Board Farmers Alliance Mutual Ins. Co.	2020
Robert M. Alexander Calhan, Colorado	Chief Executive Officer and Chairman of the Board Stockmens Bank	2020
Sheila G. Frahm Colby, Kansas	Retired	2018
Joseph W. Jeter Hays, Kansas	Attorney Jeter Law Firm, LLP	2018
Eric J. Larson Wichita, Kansas	Attorney & CPA Bever Dye, LC	2018
Brett A. Reber McPherson, Kansas	Attorney Wise & Reber, LC	2018
Robert J. Breidenthal, Jr. Bonner Springs, Kansas	President Security Bank	2019
Joe F. Jenkins, II Tonganoxie, Kansas	Retired	2019
Marilyn B. Pauly Wichita, Kansas	Vice Chairman Commerce Bank Wichita	2019
Vincent R. Amanor-Boadu, PhD. Manhattan, Kansas	Associate Professor Dept. of Agricultural Economics Kansas State University	2019
Advisory Director: I. John Cholnoky Big Sky, Montana	Retired	2018

The bylaws provide for the Board to have exclusive power and authority to manage the affairs of the Company and may appoint various committees as it deems necessary. As of December 31, 2017, the Company had established an executive committee, an audit committee, a finance committee, a corporate governance committee, and a compensation committee. The members of these committees are as follows:

Name	Executive	Audit	Finance	Corporate Governance	Compensation
L. Keith Birkhead	Member			Chair	Member
Robert M. Alexander		Member	Chair	Member	
Sheila G. Frahm		Member	Member		Member
Joseph W. Jeter		Member	Member		Member
Eric J. Larson	Member	Chair		Member	
Brett A. Reber		Member		Member	Chair
Robert J. Breidenthal, Jr.	Chair		Member	Member	
Joe F. Jenkins, II	Member		Member		Member
Marilyn B. Pauly	Member		Member		Member
Vincent R. Amanor-Boadu		Member		Member	Member
I. John Cholnoky		Member		Member	

The officers of the Company are a Chairman of the Board, a President, a Secretary and a Treasurer. Various Vice Presidents may be elected as well as other officers that are deemed necessary and expedient. The officers listed below were duly elected as of December 31, 2017.

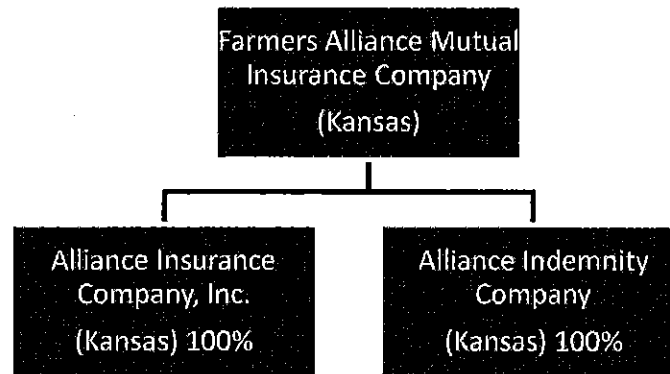
<u>Name</u>	<u>Position</u>
L. Keith Birkhead	President, CEO and Chairman of the Board
W. Paul Taliaferro	CFO, Secretary and Treasurer
John M. Rader	Vice President, Marketing and Reinsurance
Andrew L. Edwardson	Vice President, Information Technology
Ryan P. Hicks	Vice President, Human Resources
Tonya K. Schafer	Vice President, Product and Compliance
Randall L. Lutgen	Vice President, Underwriting

INSURANCE COMPANY HOLDING SYSTEM

K.S.A. 40-3301, et seq. - *Insurance Holding Companies*, requires a domestic insurer that is part of an insurance holding company system to file appropriate registration statements with the Commissioner of Insurance. The Company's parent, FAMI, has submitted Form "B" and "C" registration statements on a consolidated basis

to the KID for each of the years under examination. A review of the registration statements indicated that the Company is properly reporting items and events as required by statute.

The organizational chart below illustrates the identities and intercompany relationships among the Farmers Alliance Insurance Companies, and the controlling entities thereof, as of December 31, 2017.



Intercompany/Cost Sharing Agreements

In 1979, AInC and its affiliates entered into an intercompany pooling agreement, which is detailed in the “Reinsurance” section of this report.

AInC files a consolidated tax return with its affiliates in accordance with a tax allocation agreement, which was last reaffirmed in 2004.

In 2015, AInC and its affiliates entered into an Administrative Services Agreement to share all costs allocated among each company based upon the percentages in the intercompany pooling agreement.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company is authorized to transact business in the following states; Kansas, Nebraska, Oklahoma and South Dakota. The NAIC Schedule

T Exceptions Report was reviewed for each of the states where the Company is licensed. No exceptions were noted.

As of December 31, 2017, the Company's largest lines of business were auto physical damage at 37% of direct premiums written, other private passenger auto liability at 32% and home owners multiple peril at 27%. The remaining 4% represented private passenger auto no-fault and inland marine.

GROWTH OF COMPANY

The exhibit below shows the Company's financial growth (in thousands) for the period of December 31, 2013, through December 31, 2017. The financial growth amounts were obtained from annual statements filed by the Company.

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
<i>(in thousands)</i>					
Admitted Assets	9,285	9,621	10,105	10,445	10,495
Liabilities	3,268	3,309	3,500	3,521	3,487
Capital and Surplus	6,017	6,312	6,605	6,924	7,008
Net Underwriting Gain/(Loss)	(46)	94	205	(61)	(8)
Net Income	155	291	283	83	135
Net Premiums Written	3,534	3,699	3,778	3,817	3,977

REINSURANCE

FAMI is the lead company in an intercompany quota share reinsurance agreement with its subsidiary companies, Alliance Insurance Company, Inc. ("AIC") and AlnC. Under the provisions of the agreement, both subsidiary companies, AIC and AlnC cede 100% of their premiums to FAMI. Of the business remaining after cessions to non-affiliated insurance companies, FAMI retains 87.5% of the pooled business and then retro-cedes 10% to AIC and 2.5% to AlnC. All expenses directly attributable to the

business ceded by AIC and AInC are divided in the same proportions as indicated above. The current agreement has been in place since 1979.

All reinsurance agreements reviewed during the course of the examination contained insolvency and cancellation clauses as required by paragraph (c) of K.S.A. 40-221a—*Reinsurance of risks of and by Kansas companies*. All reinsurance agreements reviewed provided for the transfer of risk.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Kansas Insurance Department and present the financial condition of the Company for the period ending December 31, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

**ALLIANCE INDEMNITY COMPANY
ANALYSIS OF ASSETS
AS OF DECEMBER 31, 2017**

	Assets	Assets Nonadmitted	Net Admitted Assets
Bonds	\$ 8,978,035		\$ 8,978,035
Cash and short-term investments	964,003		964,003
Investment income due & accrued	56,503		56,503
Amounts recoverable from reinsurers	402,189		402,189
Net deferred tax asset	94,750		94,750
Totals	\$ 10,495,480	\$ -	\$ 10,495,480

ALLIANCE INDEMNITY COMPANY
LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2017

Losses	\$ 1,080,750
Loss adjustment expenses	194,484
Commissions payable, contingent commissions and other similar charges	121,178
Other expenses	9,524
Taxes, licenses and fees	28,929
Current federal and foreign income taxes	13,747
Unearned premiums	2,038,898
Total liabilities	<u>3,487,510</u>
Common capital stock	1,000,000
Gross paid in and contributed surplus	350,000
Unassigned funds	5,657,967
Surplus as regards policyholders	<u>7,007,967</u>
Totals	<u><u>\$ 10,495,477</u></u>

**ALLIANCE INDEMNITY COMPANY
STATEMENT OF INCOME
CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2017**

<u>Underwriting Income:</u>	
Premiums earned	\$ 3,863,937
<u>Deduct:</u>	
Losses incurred	2,288,464
Loss adjustment expenses incurred	365,958
Other underwriting expenses incurred	1,217,522
Total underwriting deductions	<u>3,871,944</u>
Net underwriting gain or (loss)	(8,007)
<u>Investment Income:</u>	
Net investment income earned	136,983
Net realized capital gains or (losses)	8,195
Net investment gain or (loss)	<u>145,178</u>
<u>Other Income:</u>	
Aggregate write-ins for miscellaneous income	9,078
Total other income	<u>9,078</u>
Net income after dividends to policyholders and before federal income taxes	146,249
Federal income taxes incurred	10,856
Net income	<u>\$ 135,393</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2016	\$ 6,924,269
Net income	135,393
Change in net deferred income tax	(56,819)
Change in nonadmitted assets	5,124
Change in surplus as regards policyholders for the year	<u>83,698</u>
Surplus as regards policyholders, December 31, 2017	<u>\$ 7,007,967</u>

**ALLIANCE INDEMNITY COMPANY
CAPITAL AND SURPLUS ACCOUNT
RECONCILIATION OF CAPITAL AND SURPLUS SINCE LAST EXAMINATION**

Surplus as regards policyholders, December 31, 2013			<u>\$ 6,016,670</u>
Net income	2014	291,338	
	2015	282,743	
	2016	82,652	
	2017	<u>135,393</u>	792,126
Change in net deferred income tax	2014	453	
	2015	(5,543)	
	2016	(952)	
	2017	<u>(56,819)</u>	(62,861)
Change in nonadmitted assets	2014	3,657	
	2015	15,382	
	2016	(2,912)	
	2017	<u>5,124</u>	21,251
Aggregate write-ins for gains and losses in surplus	2014	-	
	2015	-	
	2016	240,782	
	2017	<u>-</u>	<u>240,782</u>
Surplus as regards policyholders, December 31, 2017			<u>\$ 7,007,967</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

No adjustments were made to surplus as a result of this examination. The capital and surplus of the Company, as of December 31, 2017, was \$7,007,967, which was the same amount, reported by the Company in its 2017 filed Annual Statement.

COMMENTS ON FINANCIAL STATEMENTS

There were no significant or material findings resulting from the examination that warranted inclusion in the Report on Examination.

SUBSEQUENT EVENTS

There were no significant or material subsequent events resulting from the examination that warranted inclusion in the Report on Examination.

SUMMARY OF RECOMMENDATIONS

There were no significant or material recommendations resulting from the examination that warranted inclusion in the Report on Examination.

CONCLUSION

The assistance and cooperation by the officers of the Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Ms. Tamara House, CFE, a financial examiner representing the Kansas Insurance Department and Mr. Shane Mead, CISA, CISM, CRISC, an information technology examiner representing the Kansas Insurance Department, participated in this examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'C. Buchanan', written over a horizontal line.

Christopher W. Buchanan, CPA, CFE
Senior Insurance Examiner
Examiner-in-Charge

EXHIBIT S
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION

State of Kansas,

County of Shawnee,

Christopher W. Buchanan, being duly sworn, states as follows:

1. I have authority to represent the Kansas Insurance Department in the examination of Alliance Indemnity Company.
2. The Kansas Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Alliance Indemnity Company was performed in a manner consistent with the standards and procedures required by K.S.A. 40-222.

The affiant says nothing further.



Examiner's Signature

Subscribed and sworn before me by Christopher W. Buchanan on this
25th day of March, 2019.




Notary Public

My commission expires 8-11-21
(date)