



ANNUAL STATEMENT
For the Year Ended December 31, 2012
OF THE CONDITION AND AFFAIRS OF THE
SONNENBERG MUTUAL INSURANCE COMPANY

NAIC Group Code 0207, 00207 NAIC Company Code 10271 Employer's ID Number 34-0541185
Organized under the Laws of Ohio, State of Domicile or Port of Entry Ohio
Country of Domicile United States
Incorporated/Organized 01/01/1905 Commenced Business 01/01/1859
Statutory Home Office 1685 Cleveland Road, Wooster, OH, 44691
Main Administrative Office 1685 Cleveland Road, Wooster, OH, 44691-0036 330-262-9060
Mail Address 1685 Cleveland Road, Wooster, OH, 44691-0036
Primary Location of Books and Records 1685 Cleveland Road, Wooster, OH, 44691-0036 330-262-9060
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OFFICERS

Table with 4 columns: Name, Title, Name, Title. Rows include KEVIN W. DAY # (PRESIDENT/CEO), MICHAEL A. SHUTT (TREASURER), KEVIN W. DAY # (SECRETARY).

OTHER OFFICERS

Table with 4 columns: Name, Title, Name, Title. Rows include GREGORY A. BRUNN (VP MARKETING AND UNDERWRITING), GREGORY J. OWEN (VP INFORMATION TECHNOLOGY), GARY W. GWINN # (VP CLAIMS).

DIRECTORS OR TRUSTEES

Table with 4 columns: Name, Name, Name, Name. Rows include ROBERT P. BOGNER, C. MICHAEL REARDON, KEVIN W. DAY, EDDIE L. STEINER, RONALD E. HOLTMAN, KENNETH L. VAGNINI, JOHN P. MURPHY.

State of OHIO

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County of WAYNE

The officers of this reporting entity, being duly sworn, each depose and say that they are the described officers of said reporting entity, and that on the reporting period stated above, all of the herein described assets were the absolute property of the said reporting entity, free and clear from any liens or claims thereon, except as herein stated, and that this statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to, is a full and true statement of all the assets and liabilities and of the condition and affairs of the said reporting entity as of the reporting period stated above, and of its income and deductions therefrom for the period ended, and have been completed in accordance with the NAIC Annual Statement Instructions and Accounting Practices and Procedures manual except to the extent that: (1) state law may differ; or, (2) that state rules or regulations require differences in reporting not related to accounting practices and procedures, according to the best of their information, knowledge and belief, respectively. Furthermore, the scope of this attestation by the described officers also includes the related corresponding electronic filing with the NAIC, when required, that is an exact copy (except for formatting differences due to electronic filing) of the enclosed statement. The electronic filing may be requested by various regulators in lieu of or in addition to the enclosed statement.

KEVIN W. DAY
PRESIDENT/CEO

KEVIN W. DAY
SECRETARY

MICHAEL A. SHUTT
TREASURER

Subscribed and sworn to before me this 28 day of FEBRUARY, 2013

a. Is this an original filing? Yes [] No [X]
b. If no:
1. State the amendment number 3
2. Date filed 05/20/2013
3. Number of pages attached 14

MARY LOU HART, NOTARY PUBLIC
MARCH 08, 2015

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

A. Accounting Practices

The financial statements of Sonnenberg Mutual Insurance Company (SMIC) are presented on the basis of accounting principles prescribed or permitted by the Ohio Department of Insurance.

The Ohio Department of Insurance recognizes only statutory accounting practices prescribed or permitted by the State of Ohio for determining and reporting the financial condition and results of operations of an insurance company for determining its solvency under Ohio Insurance Law. The National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual* (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the State of Ohio.

B. Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements in conformity with Statutory Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

C. Accounting Policy

Premiums are earned over the terms of the related policies and reinsurance contracts. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro rata methods for direct business and are based on reports received from ceding companies for reinsurance.

Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions, are charged to operations as incurred. Expenses incurred are reduced for ceding allowances received or receivable.

In addition, the company uses the following accounting policies:

- (1) Short-term investments are stated at cost.
- (2) Bonds not backed by other loans are stated at amortized cost using the interest method; U.S. Treasury Inflation-Indexed bonds are stated at amortized cost adjusted for unrealized inflation factor gains. Bonds rated at 3 or below by the NAIC are stated at the lower of cost or fair market value.
- (3) Common stocks are stated at market except that investments in stocks of uncombined subsidiaries and affiliates in which the Company has an interest of 20% or more are carried on the equity basis.
- (4) Preferred stocks are stated in accordance with the guidance provided in SSAP No. 32.
- (5) The Company has no mortgage loans.
- (6) The Company has no loan-backed securities.
- (7) The Company carries investments in subsidiaries, Sonnenberg Agencies and Western Reserve Financial Corporation, at statutory equity as reported on Schedule D; these assets are reported as nonadmitted on page 2, column 2.
- (8) The Company has a minor ownership interest in a partnership. The Company carries this interest at fair market value based upon underlying audited GAAP equity of the investee.
- (9) All derivatives are stated at fair value.
- (10) The Company does not utilize anticipated investment income in the premium deficiency calculation.
- (11) Unpaid losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed and any adjustments are reflected in the period determined.
- (12) The Company has not modified its capitalization policy from the prior period.

2. Accounting Changes and Corrections of Errors

Accounting changes adopted to conform to the provisions of the NAIC Accounting Practices and Procedures Manual are reported as changes in accounting principles. The cumulative effect of the changes in accounting principles is reported as an adjustment to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principles had been applied retroactively for all periods.

NOTES TO FINANCIAL STATEMENTS

The Company has not made any accounting changes or error corrections for the periods ending December 31, 2012 and 2011, respectively.

3. Business Combinations and Goodwill

Not applicable.

4. Discontinued Operations

Not applicable.

5. Investments

A. Mortgage Loans, including Mezzanine Real Estate Loans

Not applicable.

B. Debt Restructuring

Not applicable.

C. Reverse Mortgages

Not applicable.

D. Loan-Backed Securities

Not applicable.

E. Repurchase Agreements and/or Securities Lending Transactions

Not applicable.

F. Real Estate

Not applicable.

G. Low-income Housing Tax Credits (LIHTC)

Not applicable.

6. Joint Ventures, Partnerships and Limited Liability Companies

A. The Company has no investments in Joint Ventures, Partnerships, or Limited Liability Companies that exceed 10% of its admitted assets.

B. The Company did not recognize any impairment write down for its investments in Joint Ventures, Partnerships, or Limited Liability Companies during the statement periods.

7. Investment Income

The Company has no uncollectible accrued investment income.

8. Derivative Instruments

The Company wrote covered call option contracts on equity securities during 2012 as an income generation strategy to enhance the total return of the invested asset portfolio.

Due to the risk of limiting the potential gain resulting from unexpected increases in security prices, the Company limits the written covered call option contracts to no more than 20% of its total equity investments. The covered call options are typically written on underlying equity securities that the Company believes to be over-valued and/or those securities that no longer meet the objectives for which they were originally purchased.

The Company accounts for the derivatives in accordance with SSAP No. 86, *Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions*.

Premium received on written covered call option contracts is recorded as a deferred liability until expiration. The liability for deferred option income was \$2,363 at December 31, 2012.

Upon exercise, the Company reduces the cost basis of the underlying security by the premium received and recognizes a capital gain (loss). Capital gains on stocks resulting from covered call options in 2012 were \$4,301.

Open covered call option contracts are recorded as a liability at fair market value with changes in value recorded to unassigned surplus. The fair market value of covered call option liabilities was \$2,175 at December 31, 2012.

NOTES TO FINANCIAL STATEMENTS

9. Income Taxes

The Company adopted SSAP No. 101, *A Replacement of SSAP No. 10R*, effective January 1, 2012. The December 31, 2012 balances and related disclosures are presented pursuant to SSAP No. 101; however, 2011 is presented pursuant to SSAP No. 10R.

A. The components of the net deferred tax asset/(liability) at December 31 are as follows:

1.

	12/31/2012		
	(1)	(2)	(3)
	Ordinary	Capital	(Col 1+2) Total
(a) Gross Deferred Tax Assets	\$ 986,726	\$ 113,701	\$ 1,100,427
(b) Statutory Valuation Allowance Adjustments	-	-	-
(c) Adjusted Gross Deferred Tax Assets (1a – 1b)	986,726	113,701	1,100,427
(d) Deferred Tax Assets Nonadmitted	-	-	-
(e) Subtotal Net Deferred Tax Asset (1c – 1d)	986,726	113,701	1,100,427
(f) Deferred Tax Liabilities	(66,076)	(704,791)	(770,867)
(g) Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability) (1e – 1f)	<u>\$ 920,650</u>	<u>\$ (591,090)</u>	<u>\$ 329,560</u>
	12/31/2011		
	(4)	(5)	(6)
	Ordinary	Capital	(Col 4+5) Total
(a) Gross Deferred Tax Assets	\$ 792,397	\$ 115,823	\$ 908,220
(b) Statutory Valuation Allowance Adjustments	-	-	-
(c) Adjusted Gross Deferred Tax Assets (1a – 1b)	792,397	115,823	908,220
(d) Deferred Tax Assets Nonadmitted	-	-	-
(e) Subtotal Net Deferred Tax Asset (1c – 1d)	792,397	115,823	908,220
(f) Deferred Tax Liabilities	(72,205)	(598,906)	(671,111)
(g) Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability) (1e – 1f)	<u>\$ 720,192</u>	<u>\$ (483,083)</u>	<u>\$ 237,109</u>
	Change		
	(7)	(8)	(9)
	(Col 1-4) Ordinary	(Col 2-5) Capital	(Co 7+8) Total
(a) Gross Deferred Tax Assets	\$ 194,329	\$ (2,122)	\$ 192,207
(b) Statutory Valuation Allowance Adjustments	-	-	-
(c) Adjusted Gross Deferred Tax Assets (1a – 1b)	194,329	(2,122)	192,207
(d) Deferred Tax Assets Nonadmitted	-	-	-
(e) Subtotal Net Deferred Tax Asset (1c – 1d)	194,329	(2,122)	192,206
(f) Deferred Tax Liabilities	6,129	(105,885)	(99,756)
(g) Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability) (1e – 1f)	<u>\$ 200,458</u>	<u>\$ (108,007)</u>	<u>\$ 92,451</u>

NOTES TO FINANCIAL STATEMENTS

2. Admission Calculation Components SSAP No. 101

	12/31/2012		
	(1)	(2)	(3)
	Ordinary	Capital	(Col 1+2) Total
(a) Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	\$ -	\$ -	\$ -
(b) Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From 2(a) above) After Application of the Threshold Limitation (The Lesser of 2(b)1 and 2(b)2 Below)	336,825	-	336,825
1. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	336,825	-	336,825
2. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	XXX	XXX	1,682,199
(c) Adjusted Gross Deferred Tax Assets (Excluding The Amount Of Deferred Tax Assets From 2(a) and 2(b) above) Offset by Gross Deferred Tax Liabilities.	<u>763,602</u>	<u>-</u>	<u>763,602</u>
(d) Deferred Tax Assets Admitted as the result of application of SSAP No. 101. (2(a) + 2(b) + 2(c))	<u>\$ 1,100,427</u>	<u>\$ -</u>	<u>\$ 1,100,427</u>
	12/31/2011		
	(4)	(5)	(6)
	Ordinary	Capital	(Col 4+5) Total
(a) Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	\$ -	\$ -	\$ -
(b) Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From 2(a) above) After Application of the Threshold Limitation (The Lesser of 2(b)1 and 2(b)2 Below)	237,109	-	237,109
1. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	237,109	-	237,109
2. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	1,097,359	312,614	1,409,973
(c) Adjusted Gross Deferred Tax Assets (Excluding The Amount Of Deferred Tax Assets From 2(a) and 2(b) above) Offset by Gross Deferred Tax Liabilities.	<u>671,111</u>	<u>-</u>	<u>671,111</u>
(d) Deferred Tax Assets Admitted as the result of application of SSAP No. 101. (2(a) + 2(b) + 2(c))	<u>\$ 908,220</u>	<u>\$ -</u>	<u>\$ 908,220</u>
	Change		
	(7)	(8)	(9)
	(Col 1-4) Ordinary	(Col 2-5) Capital	(Col 7+8) Total
(a) Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	\$ -	\$ -	\$ -
(b) Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From 2(a) above) After Application of the Threshold Limitation (The Lesser of 2(b)1 and 2(b)2 Below)	99,716	-	99,716
1. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	99,716	-	99,716
2. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	XXX	XXX	272,226
(c) Adjusted Gross Deferred Tax Assets (Excluding The Amount Of Deferred Tax Assets From 2(a) and 2(b) above) Offset by Gross Deferred Tax Liabilities.	<u>92,491</u>	<u>-</u>	<u>92,491</u>
(d) Deferred Tax Assets Admitted as the result of application of SSAP No. 101. (2(a) + 2(b) + 2(c))	<u>\$ 197,207</u>	<u>\$ -</u>	<u>\$ 197,207</u>

NOTES TO FINANCIAL STATEMENTS

3.

	2012	2011
(a) Ratio Percentage Used To Determine Recovery Period And Threshold Limitation Amount.	15%	15%
(b) Amount Of Adjusted Capital And Surplus Used To Determine Recovery Period And Threshold Limitation In 2(b) 2 Above.	\$ 10,922,849	\$ 10,963,832

4. Impact of Tax-Planning Strategies

	12/31/2012		
	(1)	(2)	(3)
	Ordinary Percent	Capital Percent	(Col 1+2) Total Percent
(a) Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	-	-	-
(b) Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	-	-	-

	12/31/2011		
	(4)	(5)	(6)
	Ordinary Percent	Capital Percent	(Col 4+5) Total Percent
(a) Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	-	-	-
(b) Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	-	-	-

	Change		
	(7)	(8)	(9)
	Ordinary Percent	Capital Percent	(Col 7+8) Total Percent
(a) Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	-	-	-
(b) Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	-	-	-
(c) Does the Company's tax-planning strategies include the use of reinsurance?	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>	

B. The Company has no temporary differences for which deferred tax liabilities are not recognized.

C. Current income taxes incurred consist of the following major components:

	(1)	(2)	(3)
	12/31/2012	12/31/2011	(Col 1-2) Change
1. Current Income Tax			
(a) Federal	\$ (12,886)	\$ (68,023)	\$ 55,137
(b) Foreign	\$ -	\$ -	\$ -
(c) Subtotal	\$ (12,886)	\$ (68,023)	\$ 55,137
(d) Federal income tax on net capital gains	\$ 12,886	\$ 56,797	\$ (43,911)
(e) Utilization of capital loss carry-forwards	\$ -	\$ -	\$ -
(f) Other (incl. prior year over/under accrual)	\$ -	\$ -	\$ -
(g) Federal and foreign income taxes incurred	\$ -	\$ (11,226)	\$ 11,226

NOTES TO FINANCIAL STATEMENTS

	(1)	(2)	(3)
	12/31/2012	12/31/2011	(Col 1-2) Change
2. Deferred Tax Assets			
(a) Ordinary			
(1) Discounting of unpaid losses	\$ 61,159	\$ 65,794	\$ (4,635)
(2) Unearned premium reserve	\$ 281,303	\$ 258,519	\$ 22,784
(3) Policyholder reserves	\$ -	\$ -	\$ -
(4) Investments	\$ -	\$ -	\$ -
(5) Deferred acquisition costs	\$ -	\$ -	\$ -
(6) Policyholder dividends accrual	\$ -	\$ -	\$ -
(7) Fixed assets	\$ -	\$ -	\$ -
(8) Compensation and benefits accrual	\$ 130,507	\$ 187,071	\$ (56,564)
(9) Pension accrual	\$ 30,424	\$ 31,707	\$ (1,283)
(10) Receivables – nonadmitted	\$ -	\$ -	\$ -
(11) Net operating loss carry-forward	\$ 312,603	\$ 102,186	\$ 210,417
(12) Tax credit carry-forward	\$ -	\$ -	\$ -
(13) Other (including items > 5% of total ordinary tax assets):			
Salvage and subrogation anticipated	\$ 91,641	\$ 85,522	\$ 6,119
Other	\$ 79,089	\$ 61,598	\$ 17,491
(99) Subtotal	\$ 986,726	\$ 792,397	\$ 194,329
(b) Statutory valuation allowance adjustment	\$ -	\$ -	\$ -
(c) Nonadmitted	\$ -	\$ -	\$ -
(d) Admitted ordinary deferred tax assets (2a99 – 2b – 2c)	<u>\$ 986,726</u>	<u>\$ 792,397</u>	<u>\$ 194,329</u>
(e) Capital:			
(1) Investments	\$ -	\$ -	\$ -
(2) Net capital loss carry-forward	\$ -	\$ -	\$ -
(3) Real estate	\$ -	\$ -	\$ -
(4) Other (including items <5% of total capital tax assets):			
Unrealized capital losses for Impaired securities	\$ 113,701	\$ 115,823	\$ (2,122)
(99) Subtotal	\$ 113,701	\$ 115,823	\$ (2,122)
(f) Statutory valuation allowance adjustment	\$ -	\$ -	\$ -
(g) Nonadmitted	\$ -	\$ -	\$ -
(h) Admitted capital deferred tax assets (2e99 – 2f – 2g)	<u>\$ 113,701</u>	<u>\$ 115,823</u>	<u>\$ (2,122)</u>
(i) Admitted deferred tax assets (2d + 2h)	<u>\$ 1,100,427</u>	<u>\$ 908,220</u>	<u>\$ 192,207</u>
3. Deferred tax liabilities:			
(a) Ordinary			
(1) Investments	\$ (54,581)	\$ (72,205)	\$ 17,624
(2) Fixed assets	\$ -	\$ -	\$ -
(3) Deferred and uncollected premium	\$ -	\$ -	\$ -
(4) Policyholder reserves	\$ -	\$ -	\$ -
(5) Other (including items <5% of total ordinary tax liabilities):			
Accumulated amortization on capitalized software	\$ (11,495)	\$ -	\$ (11,495)
(99) Subtotal	\$ (66,076)	\$ (72,205)	\$ 6,129
(b) Capital:			
(1) Investments	\$ -	\$ -	\$ -
(2) Real estate	\$ -	\$ -	\$ -
(3) Other (including items <5% of total capital tax liabilities):			
Unrealized capital gains	\$ (704,791)	\$ (598,906)	\$ (105,885)
(99) Subtotal	\$ (704,791)	\$ (598,906)	\$ (105,885)
(c) Deferred tax liabilities (3a99 + 3b99)	<u>\$ (770,867)</u>	<u>\$ (671,111)</u>	<u>\$ (99,756)</u>
4. Net deferred tax assets/liabilities (2i – 3c)	<u>\$ 329,560</u>	<u>\$ 237,109</u>	<u>\$ 92,451</u>

NOTES TO FINANCIAL STATEMENTS

- D. The provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate to income before income taxes. Among the more significant book to tax adjustments were the following:

	<u>12/31/2012</u>	<u>Effective Tax Rate</u>
Provision computed at statutory rate	\$ (124,163)	(34.0%)
Tax exempt income deduction	(50,983)	(14.0%)
Dividends received deduction	(29,199)	(8.0%)
Tax differentials on foreign earnings	-	0.0%
Nondeductible goodwill	-	0.0%
Other	6,009	1.7%
Total	<u>\$ (198,336)</u>	<u>(54.3%)</u>
Federal and foreign income taxes incurred	\$ (12,886)	(79.5%)
Tax on capital gains (losses)	12,886	79.5%
Change in net deferred income taxes	<u>(198,336)</u>	<u>(54.3%)</u>
Total statutory income taxes	<u>\$ (198,336)</u>	<u>(54.3%)</u>

- E. Carry-forwards, recoverable taxes, and IRC §6603 deposits:

(1) As of December 31, 2012, the Company had net operating loss carry-forwards available for tax purposes:

<u>Origination Year</u>	<u>Expiration Year</u>	<u>Amount</u>
2010	2030	\$ 61,479
2011	2031	\$ 210,752
2012	2032	<u>\$ 647,187</u>
Total		<u>\$ 919,418</u>

As of December 31, 2012, the Company had no net capital loss carry-forwards available for tax purposes.

As of December 31, 2012, the Company had alternative minimum tax (AMT) credit carry-forwards in the amount of \$35,950 which do not have an expiration date.

- (2) As of December 31, 2012, the Company had no federal income taxes incurred available for recoupment in the event of future net losses.
- (3) The Company has no deposits reported as admitted assets under IRC §6603 as of December 31, 2012.

- F. The Company files an individual federal income tax return.

10. Information Concerning Parent, Subsidiaries, Affiliates and Other Related Parties

- A. Not applicable.
- B. Not applicable.
- C. Not applicable.
- D. At December 31, 2012, there was an intercompany payable of \$212,129 due to its Subsidiaries and Affiliates. The intercompany balances due from and/or due to its Subsidiaries and Affiliates are reimbursed quarterly on an as made basis.
- E. Not applicable.
- F. The Company (SMIC) participates in a pooling agreement with Western Reserve Mutual Casualty Company, (WRMCC) and Lightning Rod Mutual Insurance Company, (LRMIC) whereby net premiums, losses, underwriting expenses and related balance sheet amounts (except premiums receivable) are shared on a 5% / 40% / 55% basis, respectively. LRMIC assumes 100% of the business from WRMCC and SMIC and cedes 40% to WRMCC and 5% to SMIC.
- G. The Company owns one-hundred percent of Sonnenberg Agencies, an insurance agency. The stock is carried at \$41,762 (unaudited statutory basis) as reported in Schedule D, Part 2, Section 2. In accordance with SSAP No. 25, management elected to nonadmit this subsidiary.
- H. Not applicable.
- I. Not applicable.

NOTES TO FINANCIAL STATEMENTS

J. Not applicable.

K. Not applicable.

L. The Company owns five percent of Western Reserve Financial Corp., an inactive holding company. The stock is carried at \$3,373 (unaudited statutory basis) as reported in Schedule D, Part 2, Section 2. In accordance with SSAP No. 97, management elected to nonadmit this subsidiary.

11. Debt

Not applicable.

12. Retirement Plans, Deferred Compensation, Postemployment Benefits and Compensated Absences and Other Postretirement Benefit Plans

A. Defined Benefit Plan / Other than Postretirement Benefit Plans

The Company has a non-qualified, unfunded, directors' retirement plan and a retiree healthcare plan both of which are closed to new participants. The related liabilities and expenses are not material to the Company's financial position.

The Company also has a non-qualified voluntary deferred compensation plan for senior executive officers. The plan allows for deferral of payouts under the Annual Incentive Plan and Performance Share Plan for Key Executives. As of December 31, 2012 and 2011, amounts held for these deferrals were \$10.0 million and \$12.9 million, respectively.

B. Defined Contribution Plan

The Company's employees are eligible to participate in a 401(k) plan sponsored by the Company after completion of three months of continuous service.

The Company matches a portion of employee contributions and may make additional discretionary contributions. The Company's contribution for the plan was \$517 thousand and \$714 thousand for 2012 and 2011, respectively. At December 31, 2012, the fair value of the plan assets was \$24.8 million.

C. Multiemployer Plans

Not applicable.

D. Consolidated/Holding Company Plans

Not applicable.

E. Postemployment Benefits and Compensated Absences

Not applicable.

F. Impact of Medicare Modernization Act on Postretirement Benefits (INT 04-17)

Not applicable.

13. Capital and Surplus, Dividend Restrictions and Quasi-Reorganizations

a. Not applicable.

b. Not applicable.

c. Not applicable.

d. Not applicable.

e. Not applicable.

f. Not applicable.

g. Not applicable.

h. Not applicable.

i. Not applicable.

j. The portion of unassigned funds (surplus) represented or reduced by cumulative unrealized gains and losses before tax is \$2.1 million.

k. Not applicable.

l. Not applicable.

m. Not applicable.

NOTES TO FINANCIAL STATEMENTS

14. Contingencies

A. Contingent Commitments

Not applicable.

B. Assessments

In the ordinary course of business, the Company receives notification of potential assessments as a result of the insolvency of insurance companies. It is expected that the insolvencies will result in a retrospective-based guaranty fund assessment against the company. The liabilities for known potential assessments are not considered material to the financial position of the company.

C. Gain Contingencies

Not applicable.

D. Claims Related Extra Contractual Obligation and Bad Faith Losses Stemming from Lawsuits

Various lawsuits against the Company have arisen in the course of the Company's business. Contingent liabilities arising from litigation are not considered material to the financial position of the Company.

E. Product Warranties

Not applicable.

F. All Other Contingencies

Not applicable.

15. Leases

The Company's lease agreements are limited to office and electronic data processing equipment. Rent expense for the years ending December 31, 2012 and 2011 was not considered material to the Company's financial position.

16. Information about Financial Instruments With Off-Balance-Sheet Risk and Financial Instruments With Concentrations of Credit Risk

Not applicable.

17. Sale, Transfer, and Servicing of Financial Assets and Extinguishment of Liabilities

A. Transfers of Receivables Reported as Sales

Not applicable.

B. Transfer and Servicing of Financial Assets

Not applicable.

C. Wash Sales

Not applicable.

18. Gain or Loss to the Reporting Entity from Uninsured A&H Plans and the Uninsured Portion of Partially Insured Plans

A. Administrative Services Only (ASO) Plans

Not applicable.

B. Administrative Services Contract (ASC) Plans

Not applicable.

C. Medicare or Other Similarly Structured Cost Based Reimbursement Contract

Not applicable.

19. Direct Premium Written/Produced by Managing General Agents/Third Party Administrators

Not applicable.

NOTES TO FINANCIAL STATEMENTS

20. Fair Value Measurements

- A. The Company's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by FASB ASC 820 (SFAS No. 157), *Fair Value Measurements*. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1:

Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2:

Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3:

Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

(1) Fair Value Measurements at December 31, 2012:

Description for each class of asset or liability	(Level 1)	(Level 2)	(Level 3)	Total
a. Assets at fair value:				
Perpetual Preferred stock:				
Industrial and Misc	\$ 204,800	\$ -	\$ -	\$ 204,800
Total Perpetual Preferred Stock	204,800	-	-	204,800
Redeemable Preferred stock:				
Industrial and Misc	73,457	-	-	73,457
Total Redeemable Preferred Stock	73,457	-	-	73,457
Bonds:				
Industrial and Misc	210,485	-	-	210,485
Total Bonds	210,485	-	-	210,485
Common stock:				
Mutual Funds	674,169	-	-	674,169
Money Market Funds	-	-	-	-
Industrial and Misc	4,900,691	67,593	-	4,968,284
Parent, Subsidiaries, and Affiliates	-	-	-	-
Total Common Stocks	5,274,860	67,593	-	5,342,453
Other Invested Assets	-	-	468,504	468,504
Total assets at fair value	\$ 5,626,395	\$ -	\$ 468,504	\$ 5,831,195
b. Liabilities at fair value:				
Derivative liabilities	2,175	-	-	2,175
Total liabilities at fair value	\$ 2,175	\$ -	\$ -	\$ 2,175

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurements at December 31, 2011:

Description for each class of asset or liability	(Level 1)	(Level 2)	(Level 3)	Total
a. Assets at fair value:				
Perpetual Preferred stock:				
Industrial and Misc	\$ 218,640	\$ -	\$ -	\$ 218,640
Total Perpetual Preferred Stock	218,640	-	-	218,640
Redeemable Preferred stock:				
Industrial and Misc	75,371	-	-	75,371
Total Redeemable Preferred Stock	75,371	-	-	75,371
Bonds:				
Industrial and Misc	-	-	-	-
Total Bonds	-	-	-	-
Common stock:				
Mutual Funds	2,089,508	-	-	2,089,508
Money Market Funds	1,286	-	-	1,286
Industrial and Misc	2,980,689	-	-	2,980,689
Parent, Subsidiaries, and Affiliates	-	-	-	-
Total Common Stocks	5,071,483	-	-	5,071,483
Other Invested Assets	-	-	459,687	459,687
Total assets at fair value	\$ 5,365,494	\$ -	\$ 459,687	\$ 5,825,181
b. Liabilities at fair value:				
Derivative liabilities	-	-	-	-
Total liabilities at fair value	\$ -	\$ -	\$ -	\$ -

(2) Fair Value Measurements in (Level 3) of the Fair Value Hierarchy:

	Balance 01/01/2012	Transfers In/(out) Level 3	Total Gain/(Loss) Included in Net Income	Total Gain/(Loss) Included in Surplus	Purchases/ Issuances/ (Sales/ Settlements)	Balance 12/31/2012
a. Assets:						
Other Invested Assets	459,687	-	-	8,817	-	468,504
Total Assets	\$ 459,687	\$ -	\$ -	\$ 8,817	\$ -	\$ 468,504
b. Liabilities:						
Not applicable.						

(3) The Company's policy is to recognize transfers in and out as of the end of the reporting period.

(4) As of December 31, 2012, the reported fair value of the entity's investments categorized within Level 3 of the fair value hierarchy is as follows:

Other Invested Assets – The Company holds an investment in one partnership that is valued according to the underlying assets. The underlying assets are primarily investments in private limited partnerships in which the fair value is determined by each partnership's audited GAAP financial statements and adjusted for the Company's proportional share of the entity's earnings.

21. Other Items

A. Extraordinary Items

Not applicable.

B. Troubled Debt Restructuring: Debtors

Not applicable.

C. Other Disclosures

Not applicable.

D. At December 31, 2012 and 2011 the Company had admitted assets of \$0.3 million in uncollected premiums. The Company routinely assesses the collectability of these receivables. Based upon Company experience, less than 1% of the balance may become uncollectable and the potential loss is not material to the Company's financial condition.

E. Business Interruption Insurance Recoveries

Not applicable.

NOTES TO FINANCIAL STATEMENTS

F. State Transferable and Non-transferrable Tax Credits

Not applicable.

G. Subprime Mortgage Related Risk Exposure

Not applicable.

22. Events Subsequent

Type I – Recognized Subsequent Events:

Subsequent events have been considered through February 28, 2013 for the statutory statement issued on March 1, 2013 for the year ending December 31, 2012. There were no Type I events identified that would have a material effect on the financial condition of the Company.

Type II – Nonrecognized Subsequent Events:

Subsequent events have been considered through February 28, 2013 for the statutory statement issued on March 1, 2013 for the year ending December 31, 2012. There were no Type II events identified that would have a material effect on the financial condition of the Company.

23. Reinsurance

A. Unsecured Reinsurance Recoverables

Not applicable.

B. Reinsurance Recoverable in Dispute

Not applicable.

C. Reinsurance Assumed and Ceded

If the Company cancelled its umbrella reinsurance program, the return commission would not have a material impact on the financial condition of the Company.

D. Uncollectible Reinsurance

In 2008, the Company recorded a liability for catastrophe losses recoverable net of reinstatement due to the Lehman Re bankruptcy. The balance at December 31, 2012 and 2011 was \$26,640.

E. Commutation of Ceded Reinsurance

Not applicable.

F. Retroactive Reinsurance

Not applicable.

G. Reinsurance Accounted for as a Deposit

Not applicable.

H. Disclosures for the Transfer of Property and Casualty Run-off Agreements

Not applicable.

24. Retrospectively Rated Contracts and Contracts Subject to Redetermination

Not applicable.

25. Changes in Incurred Losses and Loss Adjustment Expense

Reserves as of December 31, 2011 were \$3.1 million. During 2012, \$1.8 million has been paid for incurred losses and loss adjustment expenses attributable to insured events of prior years. Reserves remaining for prior years are now \$1.3 million as a result of re-estimation of unpaid claims and claim adjustment expenses for commercial auto liability, auto physical damage, commercial multi-peril and special property lines of insurance. These decreases were offset by increases in workers' compensation, homeowners/farmowners and private passenger auto liability lines of insurance. Therefore, there has been no prior-year development from December 31, 2011 to December 31, 2012. The re-estimation is generally the result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims. The estimates are not affected by prior year loss development on retrospectively rated policies, as the company does not write this type of policy.

NOTES TO FINANCIAL STATEMENTS

26. Intercompany Pooling Agreements

A.	<u>NAIC No.</u>	<u>Pool Share</u>
Lightning Rod Mutual Insurance Company (Lead)	26123	55.0%
Western Reserve Mutual Casualty Company	26131	40.0%
Sonnenberg Mutual Insurance Company	10271	5.0%
B. All transactions and balances in the underwriting accounts of the companies are pooled except premiums in the course of collection.		
C. All lines of business are subject to the intercompany pooling agreement. Cessions to non-affiliated reinsurers are prior to the cession of pooled business from the affiliated pool members to the lead entity.		
D. All pool members are subject to the same non-affiliated reinsurance treaties and have the contractual right of direct recovery per the terms of the reinsurance agreement.		
E. There are no discrepancies between the reinsurance schedules of the lead and other members of the pool.		
F. The Provision for Reinsurance (Schedule F, Part 7) and the write-off of uncollectible reinsurance is in accordance with the pool participation percentages.		
G. There was \$212,129 due from the Company to the affiliated entities participating in the intercompany pool as of December 31, 2012.		

27. Structured Settlements

Not applicable.

28. Health Care Receivables

Not applicable.

29. Participating Policies

Not applicable.

30. Premium Deficiency Reserves

1. Liability carried for premium deficiency reserves	\$	(1) -
2. Date of most recent evaluation of this liability		12/31/2012
3. Was anticipated investment income utilized in the calculation?		Yes () No (x)

31. High Deductibles

Not applicable.

32. Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses

The Company does not discount liabilities for unpaid losses nor unpaid loss adjustment expenses in calculating statutory surplus.

33. Asbestos/Environmental Reserves

- A. Does the company have on the books, or has it ever written an insured for which you have identified a potential for the existence of a liability due to asbestos losses? Yes () No (x)
- B. Not applicable.
- C. Not applicable.
- D. Does the company have on the books, or has it ever written an insured for which you have identified a potential for the existence of a liability due to environmental losses? Yes (x) No ()

NOTES TO FINANCIAL STATEMENTS

The company's exposure to environmental losses arises from the sale of general liability insurance. The company estimates the full impact of the environmental exposure by establishing full case basis reserves on all known losses and computing incurred but not reported losses based on previous experience. The company's estimate of the environmental related losses for each of the five most recent years were as follows after intercompany pooling:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
(1) Direct basis:					
a. Beginning reserves	\$ -	\$ -	\$ 1	\$ 1	\$ 1
b. Incurred losses and LAE	1	2	6	2	4
c. Calendar year payments for losses and LAE	<u>1</u>	<u>1</u>	<u>6</u>	<u>2</u>	<u>1</u>
d. Ending reserves	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 4</u>
(2) Assumed reinsurance:					
a. Beginning reserves	\$ -	\$ -	\$ -	\$ -	\$ -
b. Incurred losses and LAE	-	-	-	-	-
c. Calendar year payments for losses and LAE	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
d. Ending reserves	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
(3) Net of ceded reinsurance:					
a. Beginning reserves	\$ -	\$ -	\$ 1	\$ 1	\$ 1
b. Incurred losses and LAE	1	2	6	2	4
c. Calendar year payments for losses and LAE	<u>1</u>	<u>1</u>	<u>6</u>	<u>2</u>	<u>1</u>
d. Ending reserves	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 4</u>
E. State the amount of ending reserves for Bulk + IBNR included in D (Loss and LAE):					
(1) Direct basis			\$ -		
(2) Assumed reinsurance basis			\$ -		
(3) Net of ceded reinsurance basis			\$ -		
F. State the amount of ending reserves for loss adjustment expenses included in D (Case, Bulk + IBNR):					
(1) Direct basis			\$ -		
(2) Assumed reinsurance basis			\$ -		
(3) Net of ceded reinsurance basis			\$ -		

34. Subscriber Savings Accounts

Not applicable.

35. Multiple Peril Crop Insurance

Not applicable.

36. Financial Guaranty Insurance

Not applicable.