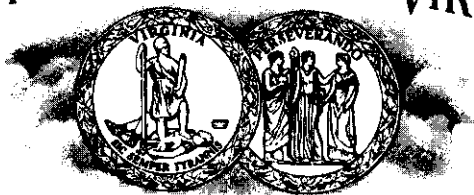


EXAMINATION REPORT
on
THE DAN RIVER FARMERS MUTUAL
FIRE INSURANCE COMPANY
Danville, Virginia
as of
December 31, 2006

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



P.O. BOX 1157
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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Dan River Farmers Mutual Fire Insurance Company as of December 31, 2006, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 13th day of March, 2008

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
December 6, 2007

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and in conformity with § 38.2-1317 of the Code of Virginia, an examination of the affairs and financial condition of

**THE DAN RIVER FARMERS MUTUAL
FIRE INSURANCE COMPANY**
Danville, Virginia

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a mutual assessment property and casualty insurance company licensed under Chapter 25 of Title 38.2 of the Code of Virginia. It was last examined by representatives of the Virginia State Corporation Commission's Bureau of Insurance as of December 31, 2003. The current examination covers a three-year period from January 1, 2004 through December 31, 2006.

HISTORY

The Company was granted a charter on April 8, 1893, by the Corporation Court of the City of Danville, and has been in continuous operation since that time. The Charter has been amended on nine occasions, most recently on February 18, 1987.

According to its Restatement of Articles of Incorporation, as currently amended, the purposes for which the Company was formed are as follows:

- (1) to engage in the business of a mutual assessment property and casualty insurance company as defined in Code 38.1-659(2), as may be amended from time to time, with full authority to transact mutual assessment fire insurance as defined in Code 38.1-659(1), as may be amended from time to time, and to transact such mutual assessment

fire insurance so as to insure perils and property to the full extent permitted by Chapter 15 of Title 38.1 of the Code, as may be amended from time to time.

- (2) to do all acts and everything necessary, suitable, and proper for the accomplishments of any of its purposes and to engage in the transaction of any or all lawful business not required to be specifically stated in these Amended and Restated Articles of Incorporation, provided such acts can lawfully be performed by a mutual fire insurance assessment company as defined in Code 38.1-659(2), as may be amended from time to time.

MANAGEMENT AND CONTROL

According to the Company's bylaws, management is vested in a board of five directors, each of whom shall be a member of the Company. Directors are elected at the annual meeting of members for a term of one year or until a successor is elected and qualified. The board appoints an investment committee, which is responsible for monitoring the Company's adherence to its investment policies and the submission of the minutes of its meetings to the board as soon as practicable.

Officers of the Company are elected by the board and include a president, a vice president, a treasurer, a secretary and a general manager, and other officers as deemed necessary. The president and vice president must be directors of the Company. The president is responsible for presiding at all meetings of the board of directors.

At December 31, 2006, the board of directors and officers were as follows:

<u>Directors</u>	<u>Principal Business Affiliation</u>
Martin G. Lane, Jr.	Chairman of the Board Aegis Security Insurance Company Harrisburg, Pennsylvania
Darleen J. Fritz	President Aegis Security Insurance Company Harrisburg, Pennsylvania
E. M. Avery	Assistant Secretary Aegis Security Insurance Company Harrisburg, Pennsylvania

William J. Wollyung, III

Treasurer
Aegis Security Insurance Company
Harrisburg, Pennsylvania

Ronald K. Thomas

Director
Aegis Security Insurance Company
Harrisburg, Pennsylvania

Investment Committee

Martin G. Lane, Jr.
Ronald K. Thomas
William J. Wollyung, III

Officers

Martin G. Lane, Jr.	President
Darleen J. Fritz	Vice President
E. M. Avery	Secretary
William J. Wollyung, III	Treasurer

REINSURANCE

The Company has an aggregate and excess of loss reinsurance agreement with Aegis Security Insurance Company (Aegis), a Pennsylvania-domiciled insurer licensed in Virginia. The agreement became effective on August 1, 1995 and was amended in 1999 so that the agreement and all addendums would be renewed automatically every calendar year. Termination requires 180 days advance notice by either party wishing to cancel the agreement. Pursuant to the agreement, Aegis agrees to indemnify the Company for 100% of the losses and loss adjustment expenses (for both the physical damage and the liability portion of any claim) incurred during the term of the agreement under any policies issued and/or renewed by the Company. The Company shall pay Aegis a monthly premium based on a rate of 1.00% of the net premiums written by the Company during that month.

For 2006, the Company reported \$7,050 in direct losses paid. However, 100% of the losses were recovered, resulting in net losses paid of \$0.

MANAGEMENT SERVICE AGREEMENT

Effective January 25, 1999, the Company entered into a management service agreement with Aegis under which Aegis agrees to perform the administrative, underwriting and accounting functions on behalf of the Company relative to the operation of the Company's business. While the agreement includes provision for the possible payment of a fee to Aegis for such services, no such fees have been charged the Company to date.

TERRITORY AND PLAN OF OPERATION

The Company is licensed as a mutual assessment property and casualty insurance company and as such may operate in any and all areas of the Commonwealth of Virginia. The Company has chosen to operate statewide; however, the majority of its business remains in the counties of Dickenson, Henry, Lee, Pittsylvania, Russell, Washington and Wise and the city of Danville.

Applications for insurance are processed and underwritten at Aegis' facility in Harrisburg, Pennsylvania, under provisions of the management service agreement outlined above. A continuous type policy is written covering fire and lightning with extended coverage available as an option. All policies are subject to a \$100 or \$250 deductible clause and the amount of coverage written is limited to \$100,000, or 100% of the actual cash value, whichever is less. Liability coverage is also written for amounts up to \$100,000.

Assessment rates are set by the board of directors. Annual assessments are levied by the board of directors on the anniversary date each calendar year. Risks are classified according to usage, type of construction, location, and moral risk.

Claims are adjusted by Aegis, or assigned, at the discretion of Aegis, to an independent adjuster.

FIDELITY BOND AND OTHER INSURANCE

The Company has \$800,000 of fidelity bond coverage through endorsement to a policy issued to Aegis. It is also covered for property and general liability risk under the same policy.

GROWTH OF THE COMPANY

The following data obtained from the Company's annual statements and from examination reports reflect the growth of the Company for the ten-year period ending December 31, 2006.

<u>Year</u>	<u>Number of Policies</u>	<u>Amount of Insurance In-force</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus as Regards Policyholders</u>
1997	245	\$2,174,000	\$160,634	\$3,061	\$157,573
1998	279	2,480,000	183,185	14,551	168,634
1999	332	2,957,000	226,242	26,048	200,194
2000	315	2,835,000	269,051	22,666	246,385
2001	420	16,940,000	360,865	77,534	283,331
2002	726	36,615,695	535,459	137,423	398,036
2003	599	29,962,273	698,695	111,302	587,393
2004	554	31,913,518	853,881	125,201	728,680
2005	507	31,260,558	992,951	100,730	892,221
2006	424	25,935,849	1,119,771	81,469	1,038,302

<u>Year</u>	<u>Net Assessments</u>	<u>Investment Income</u>	<u>Other Income</u>	<u>Net Losses Paid</u>
1997	\$13,947	\$9,590	\$20	\$0
1998	24,996	8,937	306	332
1999	44,273	9,397	913	0
2000	49,291	9,726	1,308	0
2001	96,240	12,776	6,449	0
2002	216,766	0	4,311	0
2003	197,632	0	4,329	0
2004	200,732	36,576	4,063	0
2005	181,073	16,586	4,290	0
2006	143,313	26,280	3,502	0

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2004, through December 31, 2006. Assets were verified and liabilities were established at December 31, 2006. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet had a medium or low risk assessment as determined from the principles of the risk-based examination approach contained in the *National Association of Insurance Commissioners Financial Condition Examiners Handbook*. Analytical review procedures were applied to non-material items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report:

History
Management and Control
Territory and Plan of Operation
Conflict of Interest
Fidelity Bond
Reinsurance
Growth of the Company
Financial Statements

FINANCIAL STATEMENTS

There follows a statement of income and disbursements for the period under review and a statement of financial condition as of December 31, 2006.

INCOME FOR THE PERIOD UNDER REVIEW

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Net assessments received	\$200,732	\$181,073	\$143,313
Interest on cash deposits/bonds	36,576	16,586	26,280
Service fees collected	<u>4,063</u>	<u>4,290</u>	<u>3,502</u>
 Total Income	 \$241,371	 \$201,949	 \$173,095
 Deduct total disbursements for the year	 <u>63,022</u>	 <u>64,602</u>	 <u>48,838</u>
 Net Income	 \$178,349	 \$137,347	 \$124,257
 Add Ledger Assets December 31, previous year	 <u>672,281</u>	 <u>850,630</u>	 <u>987,977</u>
 Ledger Assets December 31, current year	 <u><u>\$850,630</u></u>	 <u><u>\$987,977</u></u>	 <u><u>\$1,112,234</u></u>

DISBURSEMENTS FOR THE PERIOD UNDER REVIEW

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Commission and brokerage	\$46,050	\$48,801	\$36,219
Directors' fees		550	600
Boards, bureaus and associations	341	321	312
Legal, and auditing, not in connection with losses	3,681	4,857	1,830
Printing and stationery	203	167	435
Agent appointments	4,578	3,287	3,539
Guaranty fund assessments	1,743	131	28
Taxes, licenses and fees	4,451	4,514	4,113
Reinsurance premium payment	<u>1,975</u>	<u>1,974</u>	<u>1,762</u>
 Total disbursements	 <u>\$63,022</u>	 <u>\$64,602</u>	 <u>\$48,838</u>

ASSETS

	<u>Ledger Assets</u>	<u>Non- Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$841,648			\$841,648
Cash in company's office	100			100
Cash on deposit	254,751			254,751
Interest due and accrued:				
On bonds		7,537		7,537
Assessments due	15,735			15,735
Totals	<u>\$1,112,234</u>	<u>\$7,537</u>	<u>\$0</u>	<u>\$1,119,771</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Net unpaid losses	\$4,500
Fees or commissions payable	5,956
Taxes, licenses and fees	3,338
Assessments unearned	66,284
Reinsurance premium payable	<u>1,391</u>
Total liabilities	\$81,469
Excess of admitted assets over liabilities (surpl)	<u>1,038,302</u>
Totals	<u>\$1,119,771</u>

EXAMINERS' CHANGES IN SURPLUS

	<u>Amount Per Company</u>	<u>Amount Per Examiners</u>	<u>Increase (Decrease) in Surplus</u>
<u>Assets:</u>			
Bonds	\$0	\$841,648	\$841,648
Certificates of Deposit	841,648	0	<u>(841,648)</u>
Examiners' net increase (decrease) in surplus			<u><u>\$0</u></u>
Surplus as regards policyholders per Examiners			\$1,038,302
Surplus as regards policyholders per Company			<u>1,038,302</u>
Examiners' net increase (decrease) in surplus			<u><u>\$0</u></u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Management and Control

1. The NAIC *Financial Condition Examiners Handbook* specifies controls for the insurer's information systems. The Company did indicate that each employee was aware of the steps to take in the event of a disaster. However, the Company was unable to provide the Examiners with a written disaster recovery plan nor a written business continuity plan.

The Examiners recommend that the Company develop a comprehensive disaster recovery plan that encompasses all areas of the Company and all types of disasters.

Accounts and Records

2. Bonds \$841,648

The asset, as reported in the Company's 2006 Annual Statement, is \$841,648 more than reported by the Company. This increase resulted from a reclassification of Certificates of Deposit (CDs) to Bonds. The assets were reclassified because the maturity dates were in excess of one year from the date of purchase.

The Examiners recommend that the Company ensure such certificates be reported in future filings as Bonds in accordance with SSAP No. 2 and No. 26 as stated in the NAIC *Accounting Practices and Procedures Manual*.

3. Certificates of Deposit \$0

The asset, as reported in the Company's 2006 Annual Statement, is \$841,648 less than reported by the Company. This decrease resulted from a reclassification of Certificates of Deposit (CDs) to Bonds. The assets were reclassified because the maturity dates were in excess of one year from the date of purchase.

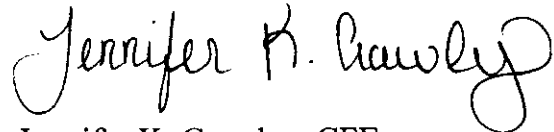
The Examiners recommend that the Company ensure such certificates be reported in future filings as Bonds in accordance with SSAP No. 2 and No. 26 as stated in the NAIC *Accounting Practices and Procedures Manual*.

CONCLUSION

The courteous cooperation extended by the officers of the Company during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Mario A. Cuellar, CFE, of the Examination Section of the State Corporation Commission Bureau of Insurance Financial Regulation Division participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "Jennifer K. Crawley". The signature is written in a cursive style with a large, looping initial "J".

Jennifer K. Crawley, CFE
Insurance Examiner

THE DAN RIVER FARMERS MUTUAL FIRE
INSURANCE COMPANY

08 FEB 22 AM 8:55

2407 PARK DRIVE / SUITE 200 / P.O. BOX 3153, HARRISBURG, PENNSYLVANIA 17105
TELEPHONE (717) 657-9671 / (800) 233-2160 FAX (717) 657-0340

February 19, 2008

Mr. David H. Smith, CFE, CPA, CPCU
Chief Examiner
Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, Virginia 23218

**RE: Dan River Farmers Mutual Fire Insurance Company
Examination Report as of December 31, 2006**

Dear Mr. Smith:

This letter is in response to your correspondence dated February 5, 2008 regarding the examination report of the Dan River Farmers Mutual Fire Insurance Company for the three years ending December 31, 2006.

Recommendation #1 Management and Control

As you are aware Dan River is one of the companies included in the family of companies operated, managed and directed by Aegis Security Insurance Company. Each of the personnel responsible for the duties of carrying out business on behalf of all the companies within the Aegis Group know and understand what steps to take in the event of a disaster. The Aegis Group is currently working on reducing these verbal understandings to writing to ensure compliance and business continuity. **It is our goal to have this written plan completed within the next year.**

Recommendation #2 and #3 Accounts and Records – Bonds and Certificates of Deposit

All of the investments of Dan River consist of Certificates of Deposit which are invested with various financial institutions across Central Pennsylvania. Initially the certificates had renewals of one year and were correctly reported as short term investments on Schedule E. When the investment committee made the decision to invest in certificates that are longer than one year in duration I did not catch the reclassification. **In all future**

annual statements I will determine based on the duration of each certificate of deposit as to whether it belongs on Schedule D or Schedule E.

I would like to request three copies of the final examination report for the Company's files.

Thank you for your time and the courtesousness extended by the examiners. If you have any additional questions or concerns please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, reading "W. J. Wollyung, III" with a stylized flourish at the end.

William J. Wollyung, III CPA
Treasurer

cc: Darleen Fritz