

REPORT ON EXAMINATION
OF THE
FARMERS MUTUAL INSURANCE COMPANY
OF MILAN, PINE PLAINS AND STANFORD
AS OF
DECEMBER 31, 2005

DATE OF REPORT:

JUNE 16, 2006

EXAMINER:

WAYNE LONGMORE



STATE OF NEW YORK
INSURANCE DEPARTMENT
ONE COMMERCE PLAZA
ALBANY, NEW YORK 12257

George E. Pataki
Governor

Howard Mills
Superintendent

June 16, 2006

Honorable Howard Mills
Superintendent of Insurance
Albany, New York 12257

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22497, attached hereto, I have made an examination into the condition and affairs of Farmers Mutual Insurance Company of Milan, Pine Plains and Stanford as of December 31, 2005 and submit the following report thereon.

Wherever the designations "Company" or "Farmers Mutual" appear herein without qualification, they should be understood to indicate Farmers Mutual Insurance Company of Milan, Pine Plains and Stanford.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's home office located at 64 Simmons Street, Millerton, New York 12546.

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1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2000. This examination covered the five-year period from January 1, 2001 through December 31, 2005 and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, loss and loss adjustment expenses and the provisions for reinsurance. The examination included a review of income, disbursements and Company records deemed necessary to accomplish such analysis or verification.

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was organized on April 19, 1883 for the purpose of transacting business as an assessment co-operative fire insurance company in the Town of Milan, Dutchess County, New York.

Under the terms of an Agreement of Merger approved by this Department in 1957, the Farmers Town Mutual Insurance Company of Red Hook, New York was merged under the title and charter of the Farmers Mutual Insurance Company of Milan, Pine Plains and Stanford.

A. Management

Pursuant to the Company's Charter and By-laws, management of the Company is vested in a board of directors consisting of not less than nine nor more than thirteen members.

As of the examination date, December 31, 2005, the board was comprised of eleven directors divided into three groups as nearly equal as possible with one group being elected at each annual policyholder meeting.

The board meets four times during each calendar year as required by Section 6624(b)(1) of the NYIL. The Directors as of December 31, 2005 were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Frederick Battenfeld Red Hook, NY	Florist and Christmas Tree Plantation Owner; Vice President of the Company
David W. Bulkely Clinton Corners, NY	Farmer
Peter Bulkely Tivoli, NY	Retired Farmer
Sidney W. Byron Millerton, NY	Secretary/Treasurer of the Company; Insurance Broker
K. Barrett Chase Pine Plains, NY	President of the Company Farmer
David Fraleigh Red Hook, NY	Apple Farmer
J. Stephen Odak Red Hook, NY	Gravel Pit operator
Robert Podris Ancramdale, NY	Fuel Oil Dealer
Anthony Pulber Pine Plains, NY	Milk hauler and custom farmer

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Henry Rothvoss* Ancramdale, NY	Farmer
Lloyd Vaill Pine Plains, NY	Farmer

*It should be noted that Henry Rothvoss, was a board member during 2005 but resigned from the board in January 2006. Mr. Rothvoss was excluded from the jurat page of the 2005 Annual Statement.

It is recommended that the Company comply with the requirements of the Annual Statement Instructions and list all directors as of the date of the Annual Statement.

It could not be determined from documentation included in the minutes that the prior report on examination, as of December 31, 2000, was forwarded to the board and that each member of the Board of Directors acknowledged that they had received and read a copy of the report.

According to Section 312(b) of the New York Insurance Law, a copy of the report on examination shall be furnished by the insurer to each member of its board of directors and each member shall sign a statement, which shall be retained in the insurer's files confirming that such member has received and read such report.

The Company should comply with Section 312(b) of the New York Insurance Law and prepare a formal document, to be signed by each of the Board members acknowledging their receipt and review of the report on examination also this review should be indicated in the respective minutes.

The minutes of all meetings of the Board of Directors for the years under examination were reviewed. The meetings were generally well attended.

The principal officers of the Company as of December 31, 2005 were as follows:

<u>Name</u>	<u>Title</u>
K. Barrett Chase	President
Frederick Battenfeld	Vice President
J. Stephen Odak	Second Vice President
Sidney W. Byron	Secretary and Treasurer

B. Territory and Plan of Operation

The Company is licensed to write insurance in Dutchess and Columbia Counties in the State of New York.

As of December 31, 2005, the Company was authorized to transact the kinds of insurance as defined in the following number paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Kinds of Insurance</u>
4	Fire
5	Miscellaneous property

The Company's predominant lines of business are fire and windstorm. Policies are issued by the Company for a term of three years, with applications being taken and inspections made by the Secretary-Treasurer.

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles thirteen and sixty-six of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$100,000.

The following schedule shows the direct premiums written by the Company in New York for the period under examination:

<u>Calendar Year</u>	<u>Direct Written Premiums</u>
2001	49,052
2002	50,435
2003	50,804
2004	55,335
2005	52,371

C. Reinsurance

The Company did not assume any reinsurance business as of December 31, 2005.

The Company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

Property per Risk Excess of Loss(1 layer)	100% of \$98,000 in excess of \$14,000, per risk, per loss. The liability of the reinsurers shall not exceed \$210,000 by reason of any one loss occurrence.
Windstorm Catastrophe Excess of Loss	100% of the amount by which net retained losses exceeds 10% of the Company's policyholders' surplus per occurrence.

Since the previous examination, the Company's retention has remained at \$14,000 per risk, per loss on property risks and is currently at 10% of surplus per occurrence for windstorm catastrophe.

The Schedule F's data as contained in the Company's filed Annual Statement was found to accurately reflect its reinsurance transactions.

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the NYIL.

All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 25 and 26 of the NAIC Statements of Statutory Accounting Practices and Procedures Manual (“SSAP”) No. 62.

D. Holding Company System

The Company was independent with no affiliations or pooling agreements in force at December 31, 2005, and was not a member of any holding company system.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2005 based upon the results of this examination:

Net premiums written in 2005 to surplus as regards policyholders	0.018 to 1
Liabilities to liquid assets(cash and invested assets less investments in affiliates)	1.68%

The above ratios fall within the benchmark ranges as set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned-incurred basis and encompass the five-year period covered by this examination (January 1, 2001 to December 31, 2005):

	<u>Amounts</u>	<u>Ratios</u>
Loss and loss adjustment expenses	\$ 53,023	24.6%
Other underwriting expenses	116,937	54.1%
Net underwriting gain/loss	<u>46,053</u>	<u>21.3%</u>
Premiums earned	<u>\$216,013</u>	<u>100.0%</u>

F. Abandoned Property

Section 1316 of the New York State Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Property Law.

G. Accounts and Records

i. Investment Limitation

At 12/31/05, the Company holds three certificates of deposit at First Niagara Bank that, in aggregate, exceeds the \$100,000 in coverage offered by the Federal Deposit Insurance Corporation ("FDIC"). These three First Niagara Bank certificates were valued at \$297,146 on Schedule E Part 1 of the 2005 filed Annual Statement.

In addition, it is noted that the Company has four Certificates of Deposit at Canandaigua National Bank with a 2005 filed Annual Statement Schedule E Part 1 reported value of \$171,404.

Section 6623 allows an assessment corporation to invest in certificates of deposit in any one institution in an amount not to exceed the amount guaranteed by the FDIC. Since the aggregate investment in Certificates of Deposit exceeds the FDIC guaranteed amount, the Company should limit its exposure as required by Section 6623(c). It is recommended that the

Company comply with Section 6623(c) of the New York Insurance Law and limit its investment in Certificates of Deposit of any one institution to the amount guaranteed by the FDIC.

ii. Long-term Certificate of Deposit Misclassification

The Company is noted to have misclassified and listed in the 2005 filed Annual Statement on Schedule Part 1 Cash, various certificates of deposit.

Pursuant to the Statements of SSAP No. 26 Paragraph 2, “certificates of deposit and commercial paper that have fixed schedule of payments and a maturity date in excess of one year from the date of acquisition” shall be classified as bonds, also SSAP No. 2 “Cash, Drafts, and Short-term Investments” paragraph 3 states that “... classified as cash for financial statement purposes, although not falling within the above definition of cash, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date, and cash equivalents.”

It is recommended that the Company comply with SSAP No. 26 paragraph 2, as well as, SSAP No. 2 paragraph 3 and classify certificates of deposit that have a maturity date in excess of one year from the date of acquisition as bonds.

iii. Checking Account Reconciliation

The prior examination as of December 31, 2000 included the following recommendation:

“It is recommended that the Company prepare a monthly bank reconciliation that will reconcile the balance per bank to the Company’s book balance as required by Section 6611(a) (1) of the New York Insurance Law.”

It was noted that the Company’s cash balance of \$32,220 in the checking account per Schedule E Part 1 of the 2005 filed Annual Statement is \$3,488 less than the \$35,708 balance per the First Niagara Bank statement at 12/31/2005. It should also be noted that the Company was

unable to provide a monthly bank reconciliation that will show whether there was a deposit in transit or outstanding checks. It is therefore again recommended that the Company prepare, or have prepared, a monthly bank reconciliation that will reconcile the balance per bank to the Company's books as required by Section 6611(a)(1) of the New York Insurance Law.

iv. Annual Statement Page 2 Reporting

The Company is reporting on page 2 line 1 Column 2 of the 2005 filed Annual Statement under caption "non-admitted" \$1,846. That non-admitted amount represents what the Company considers amortization for the year 2005 on its bond investments. Also included in the "Nonadmitted Assets" column on the asset page of the 2005 Annual Statement for Preferred and Common Stocks as well as Interest Income due and accrued are non-ledger items. The non-ledger column was used on page 2 in previous Annual Statements but has since been removed from page 2 of the Annual Statement.

The Company should comply with the 2005 Annual Statement instructions when completing page 2 and include in the non-admitted asset column only those amounts for which the Department does not allow the Company to take credit.

v. Custodial Agreement

The Company maintains a custodial agreement with First Niagara Bank, formerly Hudson River Bank & Trust Company.

After a review of the Company's current custodial agreement, several provisions and safeguards required by Department guidelines, as set forth in the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook, reinforced by the Department's Circular Letter No. 2 of 1977, were not included in the agreement. Therefore, it is recommended that the Company comply with Department guidelines, as set forth by NAIC

guidelines, reinforced by Circular Letter No. 2 of 1977 and obtain a custodial agreement that includes the suggestions specified by the NAIC and New York Insurance Department.

Before the examination was completed, the Company management had contacted the custodial bank and is in the process of revising the custodial agreement to comply with the suggestions specified by the NAIC and New York Insurance Department.

vi. Rent and Travel Expenses

The prior report on examination included the following recommendation:

It is recommended that the rent and travel payments to the Secretary/Treasurer be broken down between these two accounts and that the rent payments be reasonably justified, as required by Section 6611(a)(1).

It was noted during the examination period that at least \$364.50 a month was paid to the Company's Secretary/Treasurer for rent and travel. This expense was not broken down between these two accounts when booked in the ledger. Accordingly, the amounts reported in the Annual Statement-Underwriting and Investment Exhibit, Part 3 for Line 12, Travel and Travel Items of \$1,742 and Line 13, Rent and Rent Items of \$8,087 could not be traced directly to the ledger. Therefore, it is again recommended that all payments for rent and travel be broken down between these two accounts in the ledger, reconciled to the Annual Statement Expense Exhibit and that the rent payments be reasonably justified, as required by Section 6611(a)(1).

vii. Authorized Signors and Deposit Accounts

The review of the bank confirmation received from both First Niagara Bank and Canandaigua National Bank and Trust for deposits in those institutions at December 31, 2005 revealed that some of the Company's Certificates of Deposit did not have at least two authorized signors. It is as such recommended that Company management ensure that there are at least two officers listed as signatories on all current and future deposit accounts as this is a good internal control.

viii. Common Stock

At December 31, 2005, the Company is noted to have Coca Cola stock holdings of 7000 shares valued at \$282,170 (\$40.31 per share) as well as Exxon Mobil Corp Holdings of 5000 shares valued at \$280,850 or \$56.17 per share. The Company's holdings in both these two stocks exceeded the 10% limitation prescribed in Section 1409(a) of the New York Insurance Law, which states that no domestic insurer shall have more than 10% of its admitted assets in any one institution.

It is recommended that the Company comply with Section 1409(a) of the New York Insurance Law by limiting investments in any one institution to ten percent of admitted assets.

It should be noted that a similar recommendation was included in the prior report on examination as of December 31, 2000.

3. FINANCIAL STATEMENTSA. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2005 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$100,192	\$0	\$100,192
Stocks:		0	
Preferred	33,315		33,315
Common	1,878,896		1,878,896
Cash and short term investments	500,590	0	500,590
Other assets	<u>16,166</u>	<u>0</u>	<u>16,166</u>
Total Assets	<u>\$2,529,159</u>	<u>\$0</u>	<u>\$2,529,159</u>
<u>Liabilities and Surplus</u>			
Loss and loss adjustment expenses			\$1,000
Unearned premiums			41,460
Amounts withheld or retained by company for account of others			<u>144</u>
Total liabilities			\$42,604
Required Surplus		\$100,00	
Unassigned Funds(surplus)		<u>2,386,555</u>	
Surplus as regards policyholders			<u>2,486,555</u>
Total liabilities and surplus			<u>\$2,529,159</u>

Note: The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$391,055 during the five-year examination period January 1, 2001 through December 31, 2005, detailed as follows:

STATEMENT OF INCOME

Underwriting Income

Premiums earned		\$216,013
Losses and loss adjustment expenses incurred	\$ 53,023	
Other underwriting expenses incurred	<u>116,937</u>	
Total underwriting deductions		<u>169,960</u>
Net underwriting gain(loss)		\$ 46,053

Investment Income

Net investment income earned	\$329,291	
Net realized capital gain or (loss)	<u>(57,583)</u>	
Net investment gain		271,708

Other Income

Net gains or (loss) from write off of agents balance	0	
Finance and service charges	0	
Aggregate write-ins for miscellaneous income	<u>538</u>	
Total other income		<u>538</u>
Net income before dividends to policyholders and federal; and foreign income taxes		\$318,299
Net income before federal and foreign income taxes		<u>0</u>
Net income		<u>\$318,299</u>

Surplus as regards policyholders per report on examination as of December 31, 2000			\$2,095,500
	<u>Gains in</u> <u>Surplus</u>	<u>Losses in</u> <u>Surplus</u>	
Net income	\$318,299		
Net unrealized capital gains or (losses)		(145,674)	
Change in non-admitted assets	214,612		
Aggregate write-ins for gains and losses in surplus	3,818		
Net increase in surplus			<u>\$ 391,055</u>
Surplus as regards policyholders per report on Examination as of December 31, 2005			<u>\$2,486,555</u>

4. LOSS AND LOSS ADJUSTMENT EXPENSES

The examination liability of \$1,000 is the same as the amount reported by the Company as of the examination date.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation.

The general review was directed at practices of the Company in the following major areas:

- 1) Sales and advertising
- 2) Underwriting
- 3) Rating
- 4) Treatment of policyholders and claimants.

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained twelve comments and recommendations detailed as follows (page numbers refers to the prior report):

<u>Item</u>	<u>Page No.</u>
A. <u>Management</u>	
<ul style="list-style-type: none"> i. It is recommended that the Company consistently indicate the directors' attendance at each meeting in the minutes as required by Section 6611(a) (3) of the New York Insurance Law. <p>The Company has complied with this recommendation</p>	4-5
<ul style="list-style-type: none"> ii. It is recommended that the Company fully comply with Section 1411(a) of the New York Insurance Law and that going forward the Financial Committee's minutes of meetings relative to approvals of investment be submitted to the board. <p>The Company has complied with this recommendation.</p>	
<ul style="list-style-type: none"> iii. It is recommended that the Company comply with its by-laws as regard the number of its directors and fill any board vacancies in a timely and correct manner. <p>The Company has complied with this recommendation.</p>	
B. <u>Abandoned Property</u>	
<p>It is recommended that the Company file Abandoned Property Report Annually to the State Comptroller's Office as required by Section 1316 of the Abandoned Property Law.</p> <p>The Company has complied with this recommendation.</p>	8

<u>Item</u>	<u>Page No.</u>
C. <u>Accounts and records</u>	8-11
i. <u>Custodian Agreement</u> It is recommended that the Company amend its custodian agreement with Hudson River Bank & Trust Company to include all the protective covenants and provisions in order to meet the minimum guidelines established by the New York Insurance Department for the contents of such agreement. The Company did not comply with this recommendation. A similar recommendation is included in the current report (see Section 7.B. v).	
ii. <u>Fidelity Insurance Coverage</u> It is recommended that the Company calculate and maintain an appropriate amount of fidelity bond as set forth in the NAIC Examiners Handbook. The Company has complied with this recommendation.	
iii. <u>Cash-Bank Reconciliation</u> It is recommended that the Company prepare a monthly bank reconciliation that will reconcile the balance per bank to the Company's book balance as required by Section 6611(a)(1) of the New York Insurance Law. The Company has not complied with this recommendation. A similar recommendation is contained in this report (see Section 7.B.iii).	
iv. <u>Losses-Claim Files</u> It is recommended that the Company keep in the claims file all pertinent Documentation supporting claims paid, as required by Section 6611(a)(1) of the New York Insurance Law. The Company has complied with the recommendation.	
v. <u>Rent expense</u> It is recommended that the rent and travel payments to the Secretary/Treasurer be broken down between these two accounts and that the rent payments be reasonably justified, as required by Section 6611(a) (1). The Company has not complied with this recommendation. A similar recommendation is contained in this report (see Section 7.B.vi).	

<u>Item</u>	<u>Page No.</u>
D. <u>Common Stocks</u> It is recommended that the Company comply with Section 1409(a) of the New York Insurance Law by limiting investments in any one institution to ten percent of admitted assets. The Company has not complied with this recommendation. A similar recommendation is contained in this report (see Section 7.B.viii).	16
E. <u>Interest, Dividends and Real Estate Income Due and Accrued</u> It is recommended that the Company accurately calculate the accrual of interest income as of the statement date and record the correct investment income that will show fully and truly the financial condition of the Company as required by Section 6611(a)(1) of the New York Insurance Law. The Company has complied with this recommendation.	16-17
F. <u>Other Expenses</u> It is recommended that the Company comply with Section 1306 of the New Insurance Law and establish a liability for expenses incurred as of the statement date. The Company has complied with this recommendation.	17-18

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>Item</u>	<u>Page No.</u>
<u>A. Management</u>	
i. The Company should comply with the requirements of the Annual Statement Instructions and list all directors as of the date of the Annual Statement.	4
ii. The Company should comply with Section 312(b) of the New York Insurance Law and prepare a formal document, to be signed by each of the Board members acknowledging their receipt and review of report on examination and this review should be indicated in the respective minutes.	4
<u>B. Accounts and Records</u>	
i. <u>Investment Limitation</u>	8-9
It is recommended that the Company comply with Section 6623 (c) of the New York Insurance Law and limit its investment in Certificates of Deposit of any one institution to the amount of insurance provided by the Federal Deposit Insurance Corporation.	
ii. <u>Long-term Certificate of Deposit Misclassification</u>	9
It is recommended that the Company comply with the Statement of Statutory Accounting Principles No. 26 paragraph 2 as well as SSAP No. 2 paragraph 3 and classify certificates of deposit that have a maturity date in excess of one year from the date of acquisition as bonds.	
iii. <u>Cash-Checking Account Reconciliation</u>	10
It is again recommended that the Company prepare, or have prepared, a monthly bank reconciliation that will reconcile the balance per bank to the Company's books as required by Section 6611(a)(1) of the New York Insurance Law.	
iv. <u>Annual Statement Page 2 Reporting</u>	10
The Company should comply with the 2005 Annual Statement instructions when completing page 2 and include in the non-admitted asset column only those amounts for which the state does not allow the Company to take credit.	

v. Custodial Agreement 10-11

It is again recommended that the Company comply with Department guidelines, as set forth by NAIC guidelines, reinforced by Circular Letter No.2 of 1977 and obtain a custodial agreement that includes the suggestions specified by the NAIC and New York Insurance Department

vi. Rent and Travel Expenses 11

It is again recommended that all payments for rent and travel be broken down between these two accounts in the ledger, reconciled to the Annual Statement Expense Exhibit and that the rent payments be reasonably justified, as required by Section 6611(a)(1).

vii. Signatory Requirements 12

It is recommended that the Company management ensure that there are at least two officers listed as signatories on all current and future deposit accounts as this is a good internal control.

viii. Common Stocks 12

It is again recommended that the Company comply with Section 1409(a) of the New York Insurance Law by limiting investments in any one institution to ten percent of admitted assets.

Respectfully submitted,

WLS
Wayne Longmore,
Senior Insurance Examiner

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

Wayne Longmore, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

WLS
Wayne Longmore,
Senior Insurance Examiner

Subscribed and sworn to before me
this 16th day of JUNE, 2006.

DIANNE M. BURKE
Notary Public, State of New York
Qualified in Albany County
No. 01BU5076509
Commission Expires April 21, 2007

Appointment No 22497

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Howard Mills, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Wayne Longmore

as proper person to examine into the affairs of the

**Farmers Mutual Insurance Company of Milan
Pine Plains and Stanford**

and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of Albany,*

this 5th day of May 2006



A handwritten signature in cursive script, appearing to read "Howard Mills".

Howard Mills
Superintendent of Insurance