

Examination Warrant Number 16-00000-17736-R1

**Report of Examination of
Saucon Mutual Insurance Company
Bethlehem, PA**

As of December 31, 2016

For Informational Purposes Only

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Harrisburg, Pennsylvania
August 31, 2017

Honorable Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 16-00000-17736-R1, dated June 8, 2016, an examination was made of

Saucon Mutual Insurance Company, NAIC Code: 17736

a Pennsylvania domiciled single-state, property mutual insurance company, hereinafter referred to as the "Company." The examination was conducted at the Company's home office, located at 74 West Broad Street, Suite 300, Bethlehem, PA 18018.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Pennsylvania Insurance Department ("Department") has performed an examination of the Company, which was last examined as of December 31, 2011. This examination covered the five-year period from January 1, 2012 through December 31, 2016.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Department and the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook* ("Handbook").

The Handbook requires that the Department plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, evaluate system controls and procedures used to mitigate those risks, and review subsequent events. 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, in accordance with

Saucon Mutual Insurance Company

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40 P.S. § 323.5(a), and general information about the Company 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.

For each year during the period under examination, the certified public accounting firm of Withum Smith & Brown, PC (“CPA”) provided an unmodified audit opinion on the Company’s year-end financial statements based on statutory accounting principles. Relevant work performed by the CPA, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

HISTORY

The Company was incorporated and licensed by the Department on May 3, 1832. It commenced business on September 14, 1832.

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382 (b)(1) property and allied lines, (b)(2) inland marine and physical damage, (c)(3) glass, (c)(4) other liability, (c)(5) boiler and machinery, (c)(6) burglary & theft, (c)(8) water damage, (c)(9) elevator, and (c)(13) personal property floater.

MANAGEMENT AND CONTROL

SURPLUS REQUIREMENTS

The Company’s minimum surplus requirement to conduct the business described above, pursuant to 40 P.S. § 386.1 is \$950,000 in minimum surplus. The Company has met all governing surplus requirements throughout the examination period.

INSURANCE HOLDING COMPANY SYSTEM

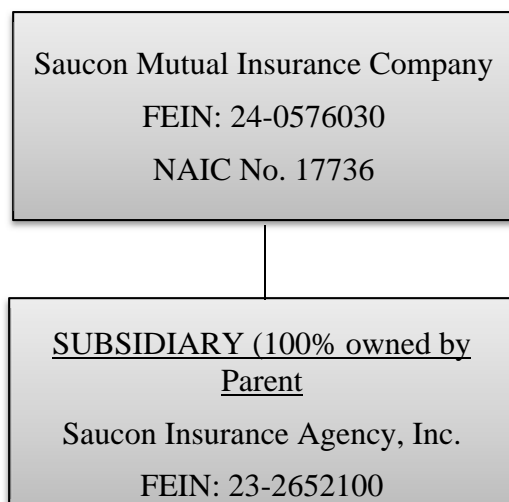
The Company meets the requirements for filing an insurance holding company system annual registration statement (“Annual Registration Statement”), in accordance with 40 P.S. § 991.1404.

Saucon Mutual Insurance Company is named as the ultimate controlling person in the holding company system and owns 100% of Saucon Insurance Agency, Inc. (“SIA”). SIA is an independent agency that represents a variety of insurance companies.

The following organizational chart depicts the Company’s holding company system as of December 31, 2016:

Saucon Mutual Insurance Company

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BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors (“Board”), which was comprised of the following members as of the examination date, December 31, 2016:

Name and Address	Principal Occupation
Brian Thomas Regan Bethlehem, PA	Shareholder Regan, Levin, Bloss, Brown & Co., PC
Susan Cooper Drabic Bethlehem, PA	President & Chief Executive Officer Morningstar Senior Living, Inc.
Phillip Jay Bell Orefield, PA	President & Chief Executive Officer Professional Claim Service, Inc.
Martin Charles Gilchrist Nazareth, PA	President Urban Research & Development Corp.
Richard Ellis Santee, Jr. Bethlehem, PA	Partner Shay, Santee & Kelhart
Bernard Joseph Story Emmaus, PA	President & Chief Executive Officer Lehigh Valley Community Foundation
Donna Jean Goss Bethlehem, PA	Consultant Northampton Community College
Michael Gerard Crofton Laverock, PA	President & Chief Executive Officer Philadelphia Trust Company

The business and affairs of the Company are managed by its Board, which consists of at least seven, but not more than eleven members. They are elected at the Annual Meeting of its policyholders to serve a term of three years. Directors of the Board are divided into three separate classes as nearly equal in number as possible. The election of each class is staggered so that no more than approximately one-third of the directors are elected each year.

The Company has a formal conflict of interest policy. The directors and officers must review and sign the policy annually which is monitored by the Company's Chief Executive Officer.

COMMITTEES

As of the examination date, December 31, 2016, the following committees were appointed by the Board and serving in accordance with the Company's by-laws:

Audit Committee

Bernard J. Story – Committee Chair
Susan C. Drabic
Richard E. Santee, Jr.

Nominating & Compensation Committee

Donna J. Goss – Committee Chair
Susan C. Drabic
Richard E. Santee, Jr.

Finance Committee

Martin C. Gilchrist - Committee Chair
Brian T. Regan
Bernard J. Story

Governance Committee

Richard E. Santee, Jr. - Committee Chair
Susan C. Drabic
Brian T. Regan
Phillip J. Bell
Michael G. Crofton

Contributions Committee

Phillip J. Bell - Committee Chair
Donna J. Goss
Bernard J. Story
Martin C. Gilchrist

OFFICERS

As of the examination date, December 31, 2016, the following officers were appointed and serving in accordance with the Company's by-laws:

Name

Brian Thomas Regan
Martin Charles Gilchrest
Phillip Jay Bell
Stephen Bajan

Title

Chairman of the Board/President
Treasurer
Secretary
Chief Executive Officer

CORPORATE RECORDS

MINUTES

A compliance review of corporate minutes revealed the following:

- The Annual Meetings of the Company's policyholders were held in compliance with its by-laws.

Saucon Mutual Insurance Company

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- The policyholders elected directors at such meetings in compliance with the by-laws.
- The policyholders ratified the prior year's actions of the officers and directors.
- Quorums were present at all directors' meetings.
- The Company's investment transactions are approved quarterly by the Board.
- All directors attend Board meetings regularly.
- The Company Board meeting's minutes approve the reinsurance contracts.

ARTICLES OF AGREEMENT

There were no changes made to the Company's Articles of Agreement during the examination period.

BY-LAWS

On April 8, 2013, the Company amended Article II, Section 3 of its by-laws to delineate that all members of the Board shall be policyholders of the Company.

On April 14, 2014, the Company amended Article I to update the provisions pertaining to the means of providing notice of meetings of policyholders, Article VI to provide for the indemnification of the Company's officers, directors and other persons, and Articles II and V to be consistent with the requirements of Pennsylvania insurance law regarding the independence of directors and the composition of the Board of Directors and Board committees.

These changes were properly filed with the Department.

SERVICE AND OPERATING AGREEMENTS

The Company entered into a management services agreement with SIA effective January 1, 2014 under which the Company provides accounting and clerical support to SIA. This agreement meets the fair and reasonable standards delineated in 40 P.S. § 991.1405(a)(1)(i).

REINSURANCE

CEDED

The Company is a party to two reinsurance contracts through its reinsurance intermediary, Guy Carpenter & Company, LLC ("Guy Carpenter"). The reinsurance contracts had effective dates of January 1, 2016, and are set to renew annually. The Company's total ceded premium for 2016 was \$96,145. The Company's net amount recoverable for 2016 was \$0. As of December 31, 2016, the Company had no outstanding amounts due from its reinsurers.

Saucon Mutual Insurance Company

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The Company's reinsurance contracts are with a pool of reinsurers each assuming a certain percentage of risk through Guy Carpenter. All reinsurers are either licensed, qualified or certified in the Commonwealth of Pennsylvania ("Commonwealth") and hold at least an A-rating from A.M. Best. The listing of the participating reinsurers, their percentages in the pool, and a summary of each contract is provided below:

Hannover Rück SE	7.00%
Swiss Reinsurance America Corporation	20.00%
The Toa Reinsurance Company of America	16.50%
The following as part of the Regional Treaty Services Corporation:	
American Agricultural Insurance Company	18.50%
Berkley Insurance Company	14.00%
Employers Mutual Casualty Company	15.25%
Farmers Mutual Hail Insurance Company of Iowa	8.75%

The **General Multiline Excess of Loss Contract** makes the reinsurer liable in respect of each property and casualty loss, for the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$125,000 each loss, each risk, subject to a limit of liability to the Reinsurer of \$1,000,000 each loss, each risk, and further subject to a limit of liability to the Reinsurer of \$2,000,000 each Loss Occurrence for property business and \$1,000,000 each Loss Occurrence for casualty business.

The Reinsurer shall be liable in respect of the aggregate of losses for 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$600,000 that occur during the term of the contract.

The **Property Facultative Pro Rata** contract covers a maximum cession of \$2,000,000 on any one risk with a minimum net retention of \$30,000.

Guy Carpenter is licensed by the Department as required by 40 P.S. § 321.2(a). The Company's reinsurance program is operating pursuant to a properly executed written authorization with Guy Carpenter in accordance with 40 P.S. § 321.3.

All reinsurance contracts contain appropriate insolvency and arbitration clauses. Additionally, all contracts transfer risk as outlined in Statement of Statutory Accounting Principles No. 62.

ASSUMED

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

TERRITORY AND PLAN OF OPERATION

The Company is licensed and writing business solely in the Commonwealth, and its business is primarily concentrated in six eastern counties. The Company writes perpetual policies with its primary line of business being homeowners multiple peril. There has been no change in the Company's marketing philosophy since the last examination.

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
December 31, 2016				
Homeowners multiple peril	\$ 8,073	\$ 96,145	\$ (88,072)	\$ 1
Inland marine	578	0	578	(0)
Totals	\$ 8,651	\$ 96,145	\$ (87,494)	100 0%

SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are shown on an earned/incurred basis, and encompass the five-year period covered by this examination.

	Amount	Percentage
Premiums earned	\$ (413,016)	100.0 %
Losses incurred	\$ 706,989	(171 1)%
Loss expenses incurred	213,886	(51 8)%
Other underwriting expenses incurred	4,585,610	(1110 3)%
Net underwriting gain or (loss)	(5,919,501)	1433.2 %
Totals	\$ (413,016)	100 0 %

The Company reported the following net underwriting, investment, and other gains or losses during the period under examination:

	2016	2015	2014	2013	2012
Admitted assets	\$ 20,000,684	\$ 19,044,295	\$ 20,157,252	\$ 19,806,895	\$ 17,699,033
Liabilities	\$ 3,535,786	\$ 3,183,712	\$ 3,423,642	\$ 3,372,626	\$ 3,192,507
Surplus as regards policyholders	\$ 16,464,898	\$ 15,860,583	\$ 16,733,610	\$ 16,434,269	\$ 14,506,526
Gross premium written	\$ 8,651	\$ 9,853	\$ 11,010	\$ 11,480	\$ 16,347
Net premium written	\$ (87,494)	\$ (84,518)	\$ (84,437)	\$ (81,230)	\$ (80,047)
Underwriting gain/(loss)	\$ (1,372,073)	\$ (1,111,463)	\$ (1,511,535)	\$ (999,360)	\$ (925,070)
Investment gain/(loss)	\$ 1,289,424	\$ 1,247,970	\$ 1,597,855	\$ 1,263,835	\$ 1,160,366
Other gain/(loss)	\$ 31,409	\$ 72,585	\$ 82,138	\$ 30,751	\$ 18,720
Net income	\$ (51,240)	\$ 209,092	\$ 168,458	\$ 295,226	\$ 257,253

The Company experienced underwriting losses in all five years under examination with the greatest occurring in 2014. The Company's use of the single deposit perpetual model, which does not recognize direct premium writings, always results in an underwriting loss. However, somewhat larger underwriting losses were reported in recent years due to higher the normal other underwriting expenses.

PENDING LITIGATION

The Company does not retain legal counsel on a continuous basis. As of December 31, 2016, and through the date of this examination report, management of the Company represents that they are not aware of any pending or threatened legal proceedings against the Company that would be considered outside the normal course of business or would have a material adverse effect on the Company's financial condition.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2016, and the results of its operations for the five-year period under examination, are reflected in the following statements*:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
Comparative Statement of Income;
Comparative Statement of Capital and Surplus; and
Comparative Statement of Cash Flow

*Note: Some financials shown in this report may contain immaterial differences to those reported in the Company's filed Annual Statements due to rounding errors.

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Saucon Mutual Insurance Company

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Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,

	2016	2015	2014	2013	2012
Bonds	\$ 605,314	\$ 555,521	\$ 656,544	\$ 902,219	\$ 1,477,101
Common stocks	18,358,628	17,032,252	17,877,864	17,595,603	15,668,039
Cash, cash equivalents and short term investments	982,207	1,344,144	1,461,644	1,073,632	399,276
Subtotals, cash and invested assets	19,946,149	18,931,917	19,996,052	19,571,454	17,444,416
Investment income due and accrued	40,064	42,486	44,423	40,437	42,845
Amounts recoverable from reinsurers	0	0	1,241	17,614	2,500
Electronic data processing equipment and software	643	2,689	9,058	15,630	22,204
Receivable from parent, subsidiaries and affiliates	7,865	61,260	100,517	155,797	181,105
Aggregate write-ins for other than invested assets	5,963	5,963	5,963	5,963	5,963
Total	\$ 20,000,684	\$ 19,044,295	\$ 20,157,252	\$ 19,808,895	\$ 17,699,033
Losses	\$ 293,000	\$ 41,500	\$ 86,401	\$ 55,401	\$ 120,000
Loss adjustment expenses	36,000	7,000	12,000	7,000	12,000
Other expenses	139,444	125,000	87,000	88,000	64,000
Current federal and foreign income taxes	5,000	5,000	5,000	5,000	5,000
Net deferred tax liability	872,017	762,863	983,905	819,630	634,108
Unearned premiums	4,037	4,404	5,590	5,367	6,024
Advance premium	772	737	715	689	2,294
Amounts withheld or retained by company for account of others	3,325	6,837	8,038	5,275	6,983
Aggregate write-ins for liabilities	2,182,191	2,230,571	2,234,893	2,288,284	2,343,088
Total liabilities	3,535,786	3,183,712	3,423,642	3,372,826	3,192,507
Unassigned funds (surplus)	16,464,898	15,860,583	16,733,610	16,434,269	14,506,526
Surplus as regards policyholders	16,464,898	15,860,583	16,733,610	16,434,269	14,506,526
Totals	\$ 20,000,684	\$ 19,044,295	\$ 20,157,252	\$ 19,808,895	\$ 17,699,033

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**Comparative Statement of Income
For the Year Ended December 31,**

	2016	2015	2014	2013	2012
Underwriting Income					
Premiums earned	\$ (87,127)	\$ (83,332)	\$ (84,660)	\$ (80,573)	\$ (77,324)
Deductions					
Losses incurred	336,976	36,606	144,001	88,475	92,931
Loss expenses incurred	69,418	25,524	37,757	52,155	29,032
Other underwriting expenses incurred	878,552	966,001	1,245,117	770,167	725,783
Total underwriting deductions	1,284,946	1,028,131	1,426,875	910,797	847,746
Net underwriting gain or (loss)	(1,372,073)	(1,111,463)	(1,511,535)	(999,360)	(925,070)
Investment Income					
Net investment income earned	322,034	330,990	317,082	274,602	374,287
Net realized capital gains or (losses)	967,390	916,980	1,280,773	989,233	786,079
Net investment gain or (loss)	1,289,424	1,247,970	1,597,855	1,263,835	1,160,366
Other Income					
Aggregate write-ins for miscellaneous income	31,409	72,585	82,138	30,751	18,720
Total other income	31,409	72,585	82,138	30,751	18,720
Net income before dividends to policyholders and before federal and foreign income taxes	(51,240)	209,092	168,458	295,228	254,017
Federal and foreign income taxes incurred	0	0	0	0	(3,236)
Net income	\$ (51,240)	\$ 209,092	\$ 168,458	\$ 295,228	\$ 257,253

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**Comparative Statement of Capital and Surplus
For the Year Ended December 31,**

	2016	2015	2014	2013	2012
Surplus as regards policyholders,					
December 31, previous year	\$ 15,860,583	\$ 16,733,810	\$ 16,434,289	\$ 14,506,528	\$ 13,804,648
Net income	(51,240)	209,092	168,458	295,228	257,253
Net unrealized capital gains or (losses)	758,650	(1,234,158)	185,578	1,806,945	383,209
Change in net deferred income tax	(109,154)	221,041	(84,275)	(285,522)	(72,875)
Change in nonadmitted assets	6,058	(99,002)	9,580	11,094	44,290
Change in provision for reinsurance	1	0	0	0	0
Dividends to stockholders	0	0	0	0	1
Change in surplus as regards policyholder for the year	804,315	(873,027)	299,341	1,927,743	611,878
Surplus as regards policyholders,					
December 31, current year	\$ 16,464,898	\$ 15,860,583	\$ 16,733,810	\$ 16,434,289	\$ 14,506,528

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**Comparative Statement of Cash Flow
For the Year Ended December 31,**

	2016	2015	2014	2013	2012
Cash from Operations					
Premiums collected net of reinsurance	\$ (87,459)	\$ (84,496)	\$ (84,411)	\$ (82,834)	\$ (78,390)
Net investment income	324,877	332,387	314,756	279,320	364,864
Miscellaneous income	31,409	72,585	82,138	30,751	18,718
Total income	268,827	320,476	312,483	227,237	305,192
Benefit and loss related payments	85,476	80,266	96,628	176,188	65,611
Commissions, expenses paid and aggregate write-ins for deductions	904,526	957,625	1,279,861	803,562	738,625
Federal and foreign income taxes paid (recovered)	0	0	0	0	(3,236)
Total deductions	990,002	1,037,891	1,376,489	979,750	791,000
Net cash from operations	(721,175)	(717,415)	(1,064,006)	(752,513)	(485,808)
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	298,943	200,318	245,000	592,144	203,609
Stocks	14,592,013	17,022,646	13,188,479	9,305,062	8,522,815
Net gain or (loss) on cash and short-term investments	16	0	0	2	16
Miscellaneous proceeds	0	1	612	607	559
Total investment proceeds	14,890,972	17,222,865	13,434,091	9,897,815	8,726,999
Cost of investments acquired (long-term only):					
Bonds	351,510	99,289	0	0	3,073
Stocks	14,190,031	16,494,460	12,004,999	8,456,356	8,514,095
Miscellaneous applications	0	0	0	4	0
Total investments acquired	14,541,541	16,593,749	12,004,999	8,456,360	8,517,168
Net cash from investments	349,431	629,116	1,429,092	1,441,455	209,831
Cash from Financing and Miscellaneous Services					
Other cash provided (applied):					
Other cash provided or (applied)	9,807	(29,201)	22,926	(14,586)	13,800
Net cash from financing and miscellaneous sources	9,807	(29,201)	22,926	(14,586)	13,800
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	(361,937)	(117,500)	388,012	674,356	(262,177)
Cash and short-term investments:					
Beginning of the year	1,344,144	1,461,644	1,073,632	399,276	661,453
End of the year	\$ 982,207	\$ 1,344,144	\$ 1,461,644	\$ 1,073,632	\$ 399,276

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SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2016, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 605,314	3.0 %
Common stocks	18,358,628	92.0 %
Cash	93,116	0.5 %
Short-term investments	889,091	4.5 %
Totals	<u>\$ 19,946,149</u>	<u>100.0 %</u>

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1 - highest quality	\$ 1,238,551	82.9 %
2 - high quality	255,854	17.1 %
Totals	<u>\$ 1,494,405</u>	<u>100.0 %</u>

Years to Maturity	Amount	Percentage
1 year or less	\$ 939,017	62.8 %
2 to 5 years	249,534	16.7 %
6 to 10 years	305,854	20.5 %
Totals	<u>\$ 1,494,405</u>	<u>100.0 %</u>

Since the last examination, common stocks have increased as a percentage of admitted assets from 88% to 92% while bonds have decreased from 8.4% to 3.0%. Approximately 80% of the bond portfolio has maturity dates of 5 years or less and the remaining 20% has maturity dates of 5 to 10 years. Approximately 74% of the Company's bond holdings are U.S. Government bonds which all have NAIC designations of 1.

The Company's investment portfolio is held under a custodial agreement with Philadelphia Trust Company. This custodial agreement meets the standards required by 31 Pa. Code § 148a.3.

The Company has a written investment policy as required by 40 P.S. § 653b(b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company was following its investment policy at December 31, 2016.

LIABILITIES

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported reserves in the amount of \$293,000 for losses and \$36,000 for loss adjustment expenses ("LAE") on its December 31, 2016 Annual Statement.

For each year during the examination period, the Company was exempt from the requirement to file a Statement of Actuarial Opinion on the adequacy of its loss reserves as provided in the NAIC *Annual Statement Instructions – Property Casualty*. This exemption was granted annually to the Company in correspondence received from the Department.

Due to the small size of the Company, the examination staff limited its testing to a high-level review of the Company's loss reserve estimates. Based on the information reviewed, the examination staff obtained sufficient evidence to determine that the Company's loss and LAE reserve estimates at December 31, 2016 appear to be reasonable.

SUBSEQUENT EVENTS

The following events transpired subsequent to December 31, 2016.

At its March 22, 2017, meeting, the Board decided not to re-elect Martin Gilchrist who had reached the maximum age prescribed in the Company's by-laws. The Board voted to set the number of directors at seven.

Effective August 23, 2017, an Order was issued by the Insurance Commissioner of the Commonwealth granting approval of a series of transactions allowing for the conversion of Saucon Mutual Insurance Company to a stock insurance company. The acquisition of control of the converted company, to be renamed Saucon Insurance Company, was made by Saucon Holding Company and the acquisition of control of Saucon Holding Company by Brian Regan and Michael Crofton.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained no recommendations.

CURRENT EXAMINATION

There are no recommendations as a result of the current examination.

CONCLUSION

As a result of this examination, the financial condition of Saucon Mutual Insurance Company, as of December 31, 2016, was determined to be as follows:

	Amount	Percentage
Admitted assets	\$ 20,000,684	100.0 %
Liabilities	\$ 3,535,786	17.7 %
Surplus as regards policyholders	16,464,898	82.3 %
Total liabilities and surplus	\$ 20,000,684	100.0 %

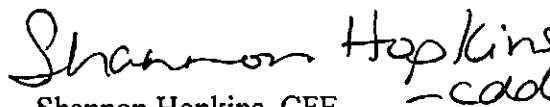
Since the previous examination, made as of December 31, 2011, the Company's assets increased by \$3,007,476, its liabilities increased by \$437,226, and its surplus increased by \$2,570,250.

This examination was conducted by Dennis Williams.

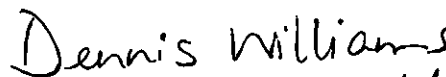
Respectfully,



Melissa L. Greiner
Director
Bureau of Financial Examinations



Shannon Hopkins, CFE
Examination Manager



Dennis Williams
Examiner-in-Charge