Minnesota FAIR Plan

Statutory Financial Statements
Together with
Independent Auditors' Report

December 31, 2013

MINNESOTA FAIR PLAN

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OLSEN THIELEN & CO., LTD.
Certified Public Accountants & Consultants

INDEPENDENT AUDITORS' REPORT

Governing Board of Directors
Minnesota FAIR Plan
Minneapolis, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of the Minnesota FAIR Plan (a nonprofit organization), which comprise the statutory statements of admitted assets, liabilities and members' equity as of December 31, 2013 and 2012, and the related statutory statements of operations, changes in members' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of the Department of Commerce of the State of Minnesota. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2, the financial statements were prepared on the basis of the financial reporting provisions of the Department of Commerce of the State of Minnesota, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the requirements of the Department of Commerce of the State of Minnesota. The effects on the financial statements of the variances between the regulatory basis of accounting described in Note 2 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

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Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to in the first paragraph do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Minnesota FAIR Plan as of December 31, 2013 and 2012, or the results of its operations or its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the admitted assets, liabilities, and members' equity of Minnesota FAIR Plan as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, on the basis of the financial reporting provisions of the Department of Commerce of the State of Minnesota as described in Note 2.

Olsen Thielen & Co., Ltd.

St. Paul, Minnesota
June 13, 2014

MINNESOTA FAIR PLAN

STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND MEMBERS' EQUITY DECEMBER 31, 2013 AND 2012

ADMITTED ASSETS

	2013	2012
Cash and Cash Equivalents	**$ 1,435,435**	$ 2,281,956
Bank Certificates of Deposit, at Cost, Maturing in 2014	**5,504,492**	5,500,000
Accrued Interest on Bank Certificates of Deposit	**7,567**	6,740
Computer Equipment, at Cost, Net of Accumulated Depreciation of $643,162 and $643,162	**–**	–
TOTAL ADMITTED ASSETS	**$ 6,947,494**	$ 7,788,696

LIABILITIES AND MEMBERS' EQUITY

	2013	2012
LIABILITIES:		
Unpaid Losses and Loss Adjustment Expenses	**$ 874,515**	$ 778,311
Unearned Premiums	**1,588,884**	1,555,383
Accounts Payable and Accrued Expenses	**278,580**	260,347
Total Liabilities	**2,741,979**	2,594,041
MEMBERS' EQUITY	**4,205,515**	5,194,655
TOTAL LIABILITIES AND MEMBERS' EQUITY	**$ 6,947,494**	$ 7,788,696

The accompanying notes are an integral part of the statutory financial statements.

MINNESOTA FAIR PLAN

STATUTORY STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
UNDERWRITING INCOME:		
Premiums Earned	**$ 4,259,659**	$ 4,494,734
UNDERWRITING LOSSES AND EXPENSES:		
Losses and Loss Adjustment Expenses	**2,317,243**	1,876,445
Commissions	**281,440**	275,247
Other Underwriting Expenses	**2,767,052**	2,717,504
Total Underwriting Losses and Expenses	**5,365,735**	4,869,196
UNDERWRITING LOSS	**(1,106,076)**	(374,462)
INVESTMENT INCOME	**9,336**	15,161
NET LOSS	**$ (1,096,740)**	$ (359,301)

The accompanying notes are an integral part of the statutory financial statements.

MINNESOTA FAIR PLAN

STATUTORY STATEMENTS OF CHANGES IN MEMBERS' EQUITY
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
BALANCE at Beginning of Year	**$ 5,194,655**	$ 5,468,009
Net Loss	**(1,096,740)**	(359,301)
Change in Non-Admitted Assets	**107,600**	85,947
BALANCE at End of Year	**$ 4,205,515**	$ 5,194,655

The accompanying notes are an integral part of the statutory financial statements.

MINNESOTA FAIR PLAN

STATUTORY STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Insurance Premiums Collected	**$ 4,254,185**	$ 4,278,869
Interest Received	**8,509**	66,474
Insurance Claims Paid, Net of Recoveries of $65,029 and $70,807	**(2,052,209)**	(1,765,752)
Loss Adjustment Expenses Paid	**(168,830)**	(177,146)
Commissions Paid to Agents and Brokers	**(281,440)**	(275,247)
Cash Paid to Suppliers and Employees	**(2,709,844)**	(2,694,048)
Net Cash Used In Operating Activities	**(949,629)**	(566,850)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Bank Certificates of Deposit	**(5,504,492)**	(5,500,000)
Proceeds from Bank Certificates of Deposit	**5,500,000**	5,500,000
Change in Non-Admitted Assets	**107,600**	85,947
Net Cash Provided By Investing Activities	**103,108**	85,947
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(846,521)**	(480,903)
CASH AND CASH EQUIVALENTS at Beginning of Year	**2,281,956**	2,762,859
CASH AND CASH EQUIVALENTS at End of Year	**$ 1,435,435**	$ 2,281,956
CASH FLOWS FROM OPERATING ACTIVITIES:		
Reconciliation of Net Loss to Net Cash Used In Operating Activities:		
Net Loss	**$ (1,096,740)**	$ (359,301)
Adjustments to Reconcile Net Loss to Net Cash Used In Operating Activities:		
Change in:		
Accrued Interest on Bank Certificates of Deposit	**(827)**	51,313
Unpaid Losses and Loss Adjustment Expenses	**96,204**	(66,453)
Unearned Premiums	**33,501**	(193,936)
Accounts Payable and Accrued Expenses	**18,233**	1,527
Net Cash Used In Operating Activities	**$ (949,629)**	$ (566,850)

The accompanying notes are an integral part of the statutory financial statements.

NOTE 1 - NATURE OF OPERATIONS

The Minnesota FAIR Plan (the Plan) was established by the legislature of the State of Minnesota in accordance with the provisions of the Minnesota FAIR Plan Act of 1969. The purpose of the Plan is to provide limited property insurance coverage for eligible property owners when insurance is not available through voluntary markets. The membership of the Plan includes every property insurer authorized to write property insurance in the State of Minnesota. The Plan's Governing Board of Directors has the authority to assess all property insurance companies (hereinafter referred to as Members) that are licensed and write premiums in the state of Minnesota.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Plan prepares its financial statements in accordance with accounting practices prescribed or permitted by the Department of Commerce of the State of Minnesota. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners, as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed. Statutory practices vary in certain respects from accounting principles generally accepted in the United States of America. The effects of such variances on the accompanying financial statements have not been determined. However, these differences are presumed to be material. The most significant variances are the charging of acquisition costs (principally commissions and premium taxes) to operations as incurred rather than ratably as the related premiums are earned, and the designation of certain assets as non-admitted for financial statement purposes.

Accounting Estimates

The preparation of the financial statements in conformity with statutory practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The most significant area which requires the use of management's estimates is unpaid losses and loss adjustment expenses.

Subsequent Events

In preparing these financial statements, the Plan has evaluated for recognition or disclosure the events or transactions that occurred through June 13, 2014, the date the financial statements were available to be issued.

Cash and Cash Equivalents

All highly liquid debt instruments purchased with original maturities of three months or less are considered cash equivalents. The Plan's cash and cash equivalents are concentrated primarily within one financial institution.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Computer Equipment

Computer equipment is stated at the lower of cost less accumulated depreciation, or the amount allowable as admitted assets. Depreciation is computed using the straight-line method over the estimated useful lives of three to five years.

Unpaid Losses and Loss Adjustment Expenses

Insurance losses and related adjustment expense are charged to operations as incurred. The liability for unpaid losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. These liabilities are necessarily based on estimates and, while management believes that the amounts are adequate, the ultimate liabilities may exceed or be less than the amounts provided. The methods for making the estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in current operations.

Taxes

The Plan pays, on behalf of its Members, premium taxes to the state of Minnesota. The Plan is a nonprofit organization exempt from federal income taxes under Section 501(c)(6) of the Internal Revenue Code, and from state income taxes under Section 290.05 of the Minnesota statutes.

Non-Admitted Assets

Certain assets, primarily furniture and equipment, purchased computer hardware and software (exceeding 3% of admitted assets), prepaid expenses and prepaid pension costs are designated as “non-admitted assets”. The net change in these assets is reflected directly in members’ equity. The aggregate net book value of these non-admitted assets was $467,173 and $574,773 as of December 31, 2013 and 2012, respectively.

Assessments

When made, member assessments are reflected in the accompanying statutory statements of changes in members’ equity and represent amounts approved by the Governing Board of Directors and billed to the Members during the year. As defined by state statute, assessments are allocated to the Members based upon each Member’s pro rata share of total premiums written in the state of Minnesota for selected lines of business two years prior to the year of assessment. Assessments, when necessary, are used to fund the ongoing operations of the Plan. There were no member assessments in either 2013 or 2012.

Premiums

Premiums are earned on a pro rata basis over the term of the policies. Premiums applicable to the unexpired terms of the policies in force are reported as “unearned premiums” at December 31, 2013 and 2012.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Policy Acquisition Costs

Commissions and other acquisition costs related to premiums written are charged to operations when the premiums are paid by the policyholder.

Research and Development

Research and development costs are charged to operations as incurred. Research and development costs consist of software development and were $596,008 and $599,489 in 2013 and 2012. Research and development costs are included in other underwriting expenses on the statutory statement of operations.

Credit Risk

Financial instruments which potentially subject the Plan to concentrations of credit risk consist principally of cash. The Company places its cash with high credit quality financial institutions. The Company had a credit risk concentration as a result of depositing $1,542,152 of funds in excess of Federal Deposit Insurance Corporation (FDIC) coverage of $250,000.

NOTE 3 - ACCOUNTING CHANGES

Effective January 1, 2013, the Plan adopted Statement of Statutory Accounting Principles ("SSAP") No. 92, *Accounting for Postretirement Benefits Other than Pensions*, ("SSAP92") *and* SSAP No. 102*, Accounting for Pensions, A Replacement of SSAP No. 89* ("SSAP 102"). SSAP 92 and SSAP 102 incorporates aspects of Financial Accounting Standards Board ("FASB") Statement 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefits Plans, An Amendment to FASB Statements No. 87, 88, 106* and FASB Staff Position 132(R) - 1 into statutory accounting, with modifications. These SSAPs change current statutory accounting by recognizing a liability for the full unfunded amount determined by comparing the projected benefit obligation for pension plans and the accumulated benefit obligation for postretirement benefit plans to the fair value of plan assets. The Plan has elected to recognize the transition impact on surplus over a period not exceeding ten years, in accordance with the guidelines. See Note 6 for further details.

NOTE 4 - UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The changes in unpaid losses and loss adjustment expenses for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
Balance at Beginning of Year	**$ 778,311**	$ 844,764
Incurred During the Year:		
Losses	**2,141,812**	1,730,977
Loss Adjustment Expenses	**175,431**	145,468
Total Incurred	**2,317,243**	1,876,445
Paid During the Year:		
Losses	**2,052,209**	1,765,752
Loss Adjustment Expenses	**168,830**	177,146
Total Paid	**2,221,039**	1,942,898
Balance at End of Year	**$ 874,515**	$ 778,311

NOTE 5 - MEMBERS' EQUITY

The members' equity represents the accumulated results from operations and assessments and the effects of changes in non-admitted assets through December 31, 2013. No distributions have been made to the members since the inception of the Plan.

NOTE 6 - RETIREMENT PLANS

The Plan is a participating employer of the Pension Plan of Insurance Organizations (PPIO), a multi-employer defined benefit pension plan which covers all eligible employees.

Information with respect to the Plan's participation in this plan for the years ended December 31, 2013 and 2012 is as follows:

Change in Plan Assets, Obligations and Funded Status

	2013	2012
Pension Benefits:		
Benefit Obligation at Beginning of Year	**$ 2,194,372**	$ 1,831,242
Service Cost	**69,472**	70,889
Interest Cost	**87,695**	86,338
Contributions by Plan Participants	**–**	–
Actuarial (Gain) Loss	**(213,325)**	218,205
Benefits Paid	**(12,302)**	(12,302)
Plan Amendments	**19,408**	–
Benefit Obligation at End of Year	**$ 2,145,320**	$ 2,194,372

	2013	2012
Change in Plan Assets:		
Fair Value of Plan Assets at Beginning of Year	**$ 2,105,115**	$ 1,868,086
Actual Return on Plan Assets	**268,014**	249,331
Employer Contributions	**–**	–
Contributions by Plan Participants	**–**	–
Benefits Paid	**(12,302)**	(12,302)
Fair Value of Plan Assets at End of Year	**$ 2,360,827**	$ 2,105,115

	2013	2012
Fund Status:		
Prepaid Benefit Costs	**$ 215,947**	$ 611,204
Overfunded Plan Assets	**215,507**	–
Liability for Pension Benefits	**–**	(89,257)
Total Assets (Nonadmitted)	**$ (431,454)**	$ (521,947)

NOTE 6 - RETIREMENT PLANS (Continued)

Change in Plan Assets, Obligations and Funded Status (Continued)

	2013	2012
Net Period Benefit Cost:		
Service Cost	**$ 69,472**	$ 70,889
Interest Cost	**87,695**	86,338
Expected Return on Plan Assets	**(130,793)**	(120,440)
Gains and Losses	**57,650**	52,839
Prior Service Cost or Credit	**6,469**	–
Professional Fees	**1,800**	1,800
Benefit Cost Recognized for the Year in the Statements of Operations - Statutory Basis	**$ 92,293**	$ 91,426

Effect on Members Equity

	2013	2012
Amounts in Members' Equity Recognized as Components of Net Periodic Benefit Cost:		
Items Not Yet Recognized as a Component of Net Periodic Cost - Prior Year	**$ 611,204**	$ 574,729
Net Prior Service Cost Arising During the Period	**19,408**	–
Net Prior Service Cost Recognized	**(6,469)**	–
Net Gain and Loss Arising During the Period	**(350,546)**	89,314
Net Gain and Loss Recognized	**(57,650)**	(52,839)
Items Not Yet Recognized as a Component of Net Periodic Cost - Current Year	**$ 215,947**	$ 611,204
Amounts in Members' Equity that Have Not Yet Been Recognized as Components of Net Periodic Benefit Cost:		
Net Prior Service Cost	**$ 12,939**	$ –
Net Recognized Gains and Losses	**203,008**	611,204
	$ 215,947	$ 611,204

Assumptions

	2013	2012
Weighted-Average Assumptions Used to Determine Benefit Obligations at End of Year:		
Discount Rate	**4.75%**	4.00%
Rate of Compensation Increase	**3.00%**	3.00%
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Costs at Beginning of Year:		
Discount Rate	**4.00%**	4.75%
Average Rate of Compensation Increase	**3.00%**	3.00%
Expected Return on Plan Assets	**6.25%**	6.50%

NOTE 6 - RETIREMENT PLANS (Continued)

Transition Impact

	12/31/2012	1/1/2013
Accumulated Benefit Obligation	$ (1,985,083)	$ (1,995,568)
Profected Benefit Obligation	(2,194,372)	(2,194,968)
Plus: Non-Vested Liability	(7,420)	(19,408)
Total Projected Benefit Obligation	(2,201,792)	(2,214,376)
Plan Assets at Fair Value	2,105,115	2,114,698
Funded Status	(96,677)	(99,678)
Prior Service Cost:		
Prior Service Cost (Non-Vested)	7,420	–
Unrecognized Losses (Gains)	611,204	–
Total Unrecognized Items	618,624	–
Net Overfunded Plan Assets / (Liability for Benefits)	$ 521,947	$ (99,678)
Surplus Impact Deferred:		
Net Overfunded Plan Asset / (Liablity for Benefits) - Transition Impact		$ (99,678)
Current Year Transition Impact at December 31, 2013:		
Transition Surplus Impact		(99,678)
Minimum Transition Liablity:		
10% of Calculated Surplus Impact		(9,968)
Anticipated Annual Amortization of Unrecognized Items		(64,119)
Difference Between Unfunded ABO and Accrued benefit Surplus Impact/Amortization of Remaining Surplus		–
Greater of Minimum Transition Liability Amounts: 2013 Surplus Impact		$ (64,119)
2013 Gains Used To Offset Transition Surplus Losses		(35,559)
2013 Transition Surplus Impact		$ (99,678)

Plan Assets

The Plan assets by asset category at December 31 are as follow:

	2013	2012
Equity Securities	**59.90%**	51.40%
Debt Securities	**37.50**	45.40
Cash	**2.60**	3.20
	100.00%	100.00%

The target asset allocations are 60% for equity securities and 40% for debt securities.

NOTE 6 - RETIREMENT PLANS (Continued)

Cash Flows

Expected future benefit payments are as follows:

2014	$ 55,036
2015	65,909
2016	100,729
2017	112,310
2018	121,790
2019 - 2023	777,749
	$ 1,233,523

The Plan also participates in a multi-employer 401(k) savings plan which is available to all eligible employees. Employees may make before-tax and/or after-tax contributions of not less than 1% and not more than 75% of their annual compensation, as permitted by law. The Plan matches 100% of the first 1% of employees' contributions and 70% of the next 5% of employees' contributions. The Plan's contribution is made each pay period. The Plan recognized $36,494 and $33,590 in expense relating to this plan during the years ended December 31, 2013 and 2012, respectively.

NOTE 7 - COMMITMENTS

The Plan has a lease for office space expiring August 2014. Rent expense was $73,975 and $73,683 during 2013 and 2012, respectively. In addition to rent, the Plan pays maintenance and operating costs on the leased office space. Aggregate rent payments due on the non-cancelable operating lease over the remaining lease term are as follows:

2014	$ 27,942