

CERTIFICATE

I, KEN SELZER, Commissioner of Insurance of Kansas, do hereby certify that the following and hereto attached is a true copy of

REPORT OF EXAMINATION
OF
FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE

11875 W. 85TH STREET
LENEXA, KANSAS 66214

AS OF
DECEMBER 31, 2016

the original of which is now on file and a matter of record in this office.

In Witness Whereof, I, KEN SELZER, Commissioner of Insurance of Kansas, have hereto affixed by signature and the seal of the Commissioner of Insurance, in the city of Topeka, Kansas this 25st day of August, 2017



Ken Selzer

Commissioner of Insurance

FILED
AUG 25 2017
KEN SELZER
Commissioner of Insurance

REPORT ON EXAMINATION
OF
FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
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Lenexa, Kansas
June 30, 2017

Honorable Ken Selzer
Commissioner of Insurance
Kansas Insurance Department
420 SW 9th Street
Topeka, Kansas 66612-1678

Dear Commissioner:

In accordance with your authorization and pursuant to K.S.A. 40-222 – *Examination of condition of company*, an examination has been conducted of the financial condition and business affairs of

**FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
11875 W. 85TH STREET
LENEXA, KANSAS 66214**

hereinafter referred to as the “Company” or “FREIE”. The following report on such examination is respectfully submitted.

SCOPE OF EXAMINATION

The examiners have performed a property and casualty multi-state financial examination of FREIE. The last examination covered the four-year period from January 1, 2008 through December 31, 2011. This examination covers the five-year period from January 1, 2012, through December 31, 2016.

The examination was conducted in accordance with the rules, regulations and directives of the Kansas Insurance Department (KID) and the observed guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* (Handbook). The Handbook requires the examiners to plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company

and evaluate system controls and procedures used to mitigate those risks. 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, as mentioned in K.S.A. 40-222, *Examination of Condition of Company*, and general information about the insurer 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.

Independent Audit Reports

Financial statements of the Company were audited by BKD, LLP for the years ending December 31, 2012, through December 31, 2016. In each of the years under examination, the auditors concluded that the financial statements of the Company present fairly, in all material respects, the admitted assets, liabilities and policyholders' surplus of the Company and the results of its operations and its cash flows for the years then ended in accordance with the accounting practices prescribed or permitted by the KID.

The independent auditor's work papers were reviewed and analyzed by the examiners. Significant reliance was placed on select work papers during the course of this examination.

SUMMARY OF SIGNIFICANT FINDINGS

No significant findings were noted during the course of the examination.

COMPANY HISTORY

FREIE was originally incorporated on May 14, 1957, as Federated Rural Electric Insurance Corporation (FREIC) under the laws of the state of Wisconsin and began business as a stock company on July 20, 1959. On September 27, 1999, FREIC's shareholders adopted a Plan of Re-domestication and Conversion whereby with the approval of both the Wisconsin Insurance Department and the Kansas Insurance Department, FREIC re-domesticated from Wisconsin on October 1, 1999 and converted to a reciprocal exchange under K.S.A. 40-1601 et seq. - *Reciprocal or Inter-insurance Contracts*. Federated Rural Electric Insurance Exchange was adopted as the present name.

CAPITAL STOCK

Prior to the conversion, FREIE was owned by both common and preferred stockholders. With the conversion, the stock of each shareholder converted into an allocation to each shareholder's "member's equity account" in the newly formed reciprocal. As of December 31, 2016, FREIE currently holds \$10,431,973 in a special surplus account for the purpose of paying off the holders of its common stock as consideration under the Plan of Re-domestication and Conversion.

SURPLUS NOTE

In 1992, FREIE issued a surplus note to the National Rural Utilities Cooperative Finance Corporation (CFC) in return for \$10,000,000 in cash and a CFC subordinated term certificate for \$1,111,111. In 2014, the surplus note and subordinated term certificate were amended into one surplus note with a maturity date of December 31, 2043, and an annual rate of 8.25%. The repayment of interest and principal may only be made upon the approval of the Kansas Insurance Commissioner.

As of December 31, 2016, the surplus note's principal was \$11,111,111. All requests for interest payments have been properly submitted to the Commissioner of Insurance and have been subsequently approved for payment.

MANAGEMENT AND CONTROL

The examiners reviewed the meeting minutes of the Board of Directors and its various committees. The review supports that FREIE'S transactions and events were adequately approved.

Pursuant to Article III, Section II of FREIE's Subscriber's Agreement and Power of Attorney (subscriber's agreement), the United States is divided into ten regions. Two members of the Board of Directors (Board) are elected from each region. One director from each region shall be a manager of a rural electric cooperative and the other shall be an outside director of a rural electric cooperative. The two directors must be from different states within the region and must represent a cooperative currently insured by the Exchange. The article further states that a director's term shall be three years, with the election of directors to be such that the terms of service will be staggered to allow for one-third of the Board to be elected each year. The exhibit below contains a listing of directors, their principal occupations and term expiration as of December 31, 2016.

Name	Position, Employer and Region	Term
John W. Andrew	Manager/CEO, Delaware Elec. Co-op, Region I	2018
Timothy D. Burkett	Director, United Elec. Co-op, Region I	2019
Wendy H. Sellers	CEO, Washington EMC, Region II	2019
Marvin W. Sox	Director, Mid-Carolina Elec. Co-op, Inc., Region II	2019
Gregory H. Grissom	General Manager/CEO, Pennyrile RECC, Region III	2017
Robert Drinnen	Director, Appalachian Elec. Co-op, Region III	2017
David C. Lett	CEO, Harrison County REMC, Region IV	2018
Harold E. Cooper	Director, South Central Power Co., Region IV	2017
Shane L. Larson	CEO, Rock Energy Co-op, Region V	2019
Richard W. Liefer	Director, Monroe County Elec. Co-op, Region V	2019
Brian B. Krambeer	President/CEO, Tri-County Elec., Region VI	2017
Wendy R. Loucks	Director, Cass County Elec. Co-op, Region VI	2017
James C. Herron	General Manager/CEO, Mountain View Elec. Assn. Inc., Region VII	2019
Loren E. Dickens Jr.	Director, Radiant Elec. Co-op, Region VII	2019
James A. Ashworth	Manager/CEO, Southwest Elec. Co-op, Region VIII	2018
Frederick W. Herman	Director, Petit Jean Elec. Co-op, Region VIII	2018
Clay R. Fitch	Manager/CEO, Wells REC, Region IX	2018
Lori A. Anderson	Director, Columbia Basin Elec. Co-op, Region IX	2018
Chuck Moore	Manager/CEO, Navopache Elec. Co-op, Region X	2018
Arthur W. Connell	Director, Central NM Elec. Co-op, Region X	2018

The subscriber's agreement provides that the Board may designate three or more directors to constitute an executive committee. The executive committee shall have and exercise all the authority of the Board in the management of FREIE except for distributions to subscribers, vacancies on the Board, vacancies on committees and the election of officers. The Board may designate three or more directors to constitute other committees. The other committees may not exercise the authority of the Board in the management of FREIE, but may take actions deemed necessary to help promote and carry out the purpose of FREIE. As of December 31, 2016, the Board had established an executive committee, finance/audit committee, member relation committee, a policy,

bylaws & procedures committee, and a compensation committee. The members of these committees are as follows:

Name	Executive	Finance/Audit	Member	Policy	Compensation
Wendy R. Loucks	Chair				
Robert Drinnen		Member			
Harold E. Cooper				Member	
John W. Andrew		Member			
Arthur W. Connell		Member*			Member
Brian B. Krambeer	Member		Chair		
Lori A. Anderson			Member*		Member
Frederick W. Herman			Member		
Loren E. Dickens Jr.	Member	Chair			
James C. Herron	Member			Member*	Member
Shane L. Larson	Vice Chair				
Richard W. Liefer	Member			Member	
Gregory H. Grissom	Member		Member*		Chair
Timothy D. Burkett	Member			Chair	
James A. Ashworth			Member		
Clay R. Fitch				Member	
Chuck Moore				Member*	Member
Wendy H. Sellers		Member			
Marvin W. Sox			Member		
David C. Lett		Member			
Member* = Member attends meetings when compensation committee does not meet.					

The principal officers of FREIE shall be a President, two or more Vice Presidents, a Secretary, a Treasurer, a Chairman and a Vice Chairman of the Board of Directors. The Board shall elect each officer, with the Chairman and Vice Chairman being elected from the directors. Officers shall hold office until their successors have been duly elected, or until their death, resignation or removal. The officers listed below were duly elected as of December 31, 2016.

Name	Position
Wendy R. Loucks	Chairman of the Board
Shane L. Larson	Vice Chairman of the Board
Philip D. Irwin	Chief Executive Officer and President
Shelly N. Harvey	Vice President, Finance and Assistant Treasurer
Susan M. Olander	Vice President, General Counsel and Assistant Secretary
William C. West	Vice President, Underwriting
Chad C. Ogren	Vice President, Sales and Marketing
Richard D. Burns	Vice President, Claims
Robert C. Parr	Vice President, Safety and Loss Prevention
Jacob A. Bolan	Vice President, Information Technology
Claude M. Mattix	Vice President, Reinsurance

Insurance Company Holding System

K.S.A. 40-3301, et seq. - *Insurance Holding Companies*, requires a domestic insurer that is part of an insurance holding company system to file appropriate registration statements with the Commissioner of Insurance. The Company has submitted Form "B" and "C" registration statements to the KID for each of the years under examination. A review of the registration statements indicated that the Company is properly reporting items and events as required by statute.

The organizational chart below illustrates the identities and intercompany relationships among insurance and non-insurance companies and the controlling entities thereof, as of December 31, 2016.

Federated Rural Electric Insurance Exchange

Federated Rural Electric Management Corp. (Attorney-in-Fact)
 Lenexa Services, Inc. (KS Stock Company owned by Attorney-in-Fact)

FREIE is managed by its Attorney-in-Fact, Federated Rural Electric Management Corp (FREMC). FREMC was organized as a Kansas non-stock, membership corporation in May 1999, solely for the purpose of providing management and

insurance-related services to FREIE. The members of FREMC that serve on their board are the same individuals that serve on the Board of FREIE. Lenexa Services, Inc. (LSI) is wholly owned by FREMC. LSI provides insurance agency services to member insureds of Federated by placing coverage for risks not underwritten by FREIE.

Intercompany/Cost Sharing Agreements

Pursuant to the FREIE's subscriber's agreement, each subscriber agrees to its terms and has appointed FREMC, as its attorney-in-fact to carry out the purposes and objectives set forth in the agreement. The attorney-in-fact shall have the power for FREIE to insure electric and telephone cooperatives, other self-help cooperative or mutual organizations, associated organizations of the foregoing organizations, locally owned, for profit telephone companies, and other such entities, organizations or persons as may be authorized by the Board against loss or liability of every kind, nature or description, as may be authorized and permitted by law, and to issue contracts of indemnity or insurance on FREIE's behalf.

The management fee for the above services charged to FREIE cannot exceed 20% of the gross premiums written and other income in any year according to the subscriber agreement. FREIE reported the following management fees paid to FREMC:

Description	2012	2013	2014	2015	2016
Management Fee	\$12,653,000	\$12,081,000	\$12,518,000	\$13,350,000	\$13,317,000

TERRITORY AND PLAN OF OPERATION

As of December 31, 2016, the Company is authorized to transact business in all states except for Connecticut, the District of Columbia, Massachusetts, and Rhode

Island. The NAIC Schedule T Exceptions Report was reviewed for each of the states where the Company is licensed. No exceptions were noted.

As of December 31, 2016, the Company's largest lines of business were other liability at 36% of direct premiums written, workers' compensation at 27%, allied lines at 14%, commercial auto liability at 11% and fire at 8%. The remaining 4% represented inland marine, auto physical damage, fidelity and burglary and theft business.

The Company specializes in writing property and casualty policies for rural electric, generation and transmission cooperatives, as well as rural telephone and cable communication systems. All business is produced on a direct basis through an internal staff, and all underwriting, claims services and administrative functions are handled at their home office in Lenexa, Kansas.

GROWTH OF COMPANY

The exhibit below shows [REDACTED] the Company's financial growth (in thousands) for the period of December 31, 2012, through December 31, 2016. The financial growth amounts were obtained from annual statements filed by the Company.

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
[REDACTED]					
<i>(in thousands)</i>					
Admitted Assets	432,219	458,796	473,444	494,982	522,718
Liabilities	295,597	305,460	306,296	317,713	337,246
Capital and Surplus	136,622	153,336	167,148	177,269	185,472
Net Underwriting Gain/(Loss)	6,134	15,380	19,809	16,311	8,712
Net Income	19,355	31,449	34,144	32,639	23,488
Net Premiums Written	113,474	113,276	112,255	120,324	123,527

REINSURANCE

FREIE assumes auto liability, general liability, commercial liability, workers compensation, and directors, officers and managers business from Alaska Rural Electric Cooperative Association (ARECA) Insurance Exchange and uses its ceded reinsurance program listed below to reduce its exposure from losses.

FREIE has entered into nine (9) reinsurance agreements to cede the property and liability risks associated with the policies directly written and assumed by them. Annually, the reinsurance program is reviewed by management and their reinsurance intermediary, Holborn Corporation, as well as their lead reinsurer. The review ensures that the reinsurance treaties are updated to reflect changing retentions, language and coverage. Currently, FREIE has entered into the multiple layer liability excess agreement, property per risk excess of loss agreement, workers' compensation catastrophe excess agreement, commercial umbrella liability quota share agreement, directors, officers and management (DOM) quota share agreement, property catastrophe quota share agreement, facultative agreement, cyber liability quota share, and terrorism excess agreement.

Effective January 1, 2014, and thereafter, FREIE added an annual aggregate deductible provision to retain the first \$5,000,000 in the aggregate of losses, otherwise recoverable, under the multiple layer liability excess, property per risk excess of loss, commercial umbrella liability and workers' compensation catastrophe excess.

The reinsurers retaining the most outstanding liabilities are Transatlantic Reinsurance Company, Swiss Reinsurance America Corporation and Endurance Reinsurance Corporation of America. All of the above named reinsurers are credit rated

by AM Best as A or better. The below schedule indicates the reinsurance coverage by line of business.

Line of Business	Reinsurance Coverage	Agreement
Workers Compensation	Layer 1: \$1.75M excess (xs) \$1.25M Layer 2: \$7M xs \$3M Layer 3: \$10M xs 10M	Multiple Layer Liability Excess
Workers Compensation	\$10M xs \$20M	Workers Compensation Catastrophe Excess
Directors, Officers and Management	Layer 1: 85% quota share of \$5M Layer 2: 85% quota share of \$5M Layer 3: 97.5% quota share of \$10M	DOM Quota Share
All Other Liability	Layer 1: \$.75M xs \$1.25M Layer 2: \$5M xs \$2M	Multiple Layer Liability Excess
Umbrella Liability	Layer 1: 97.5% of first \$10M Layer 2: 100% of \$10M xs \$10M	Commercial Umbrella Liability Quota Share
Property	Layer 1: \$4M xs \$1M Layer 2: \$5M xs \$5M Layer 3: \$6M xs \$10M	Property Per Risk Excess of Loss
Liability and Property	Excess of reinsurance limits up to policy limits	Facultative
Property	Layer 1: 95% of \$7.5M xs \$5M Layer 2: 95% of \$7.5M xs \$12.5M	Property Catastrophe Quota Share
Cyber Security	100% of all risks not to exceed \$1M	Cyber Liability Quota Share
Property, Liability and Workers Compensation (Excludes Auto and Reinsurance Assumed)	\$30M xs \$5M	Terrorism Excess

All reinsurance agreements reviewed during the course of the examination contained insolvency and cancellation clauses as required by paragraph (c) of K.S.A. 40-221a—*Reinsurance of Risks of and by Kansas Companies*. All reinsurance agreements reviewed provided for the transfer of risk.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Kansas Insurance Department and present the financial condition of the Company for the period ending December 31, 2016. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

**FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
ANALYSIS OF ASSETS
AS OF DECEMBER 31, 2016**

	Assets	Assets Nonadmitted	Net Admitted Assets
Bonds	\$ 470,522,780		\$ 470,522,780
Preferred stocks	7,288,526		7,288,526
Common stocks	3,263		3,263
Properties occupied by the company	7,096,520		7,096,520
Properties held for sale	404,727		404,727
Cash and short-term investments	16,693,490		16,693,490
Other invested assets	9,902,583	\$ 9,560,156	342,427
Investment income due & accrued	3,625,462		3,625,462
Uncollected premiums and agents' balances in the course of collection	666,320		666,320
Deferred premiums and agents' balances deferred and not yet due	8,478,492		8,478,492
Amounts recoverable from reinsurers	1,242,903		1,242,903
Net deferred tax asset	23,056,024	16,766,024	6,290,000
EDP equipment and software	62,706		62,706
Aggregate write-ins for other than invested assets	56,067	56,067	
Totals	\$ 549,099,863	\$ 26,382,247	\$ 522,717,616

**FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2016**

Losses	\$ 207,436,313
Loss adjustment expense	60,666,091
Other expenses	20,241,529
Taxes, licenses and fees	1,054,374
Current federal and foreign income tax payable	28,064
Unearned premiums	35,692,042
Advance premiums	9,427,546
Ceded reinsurance premiums payable	1,990,393
Payable to parent, subsidiaries and affiliates	485,833
Payable for securities	223,658
Total liabilities	<u>337,245,843</u>
Aggregate write-ins for other than special surplus funds	10,431,973
Surplus notes	11,111,111
Unassigned funds	<u>163,928,689</u>
Surplus as regards policyholders	<u>185,471,773</u>
Totals	<u><u>\$ 522,717,616</u></u>

**FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
STATEMENT OF INCOME
CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2016**

<u>Underwriting Income:</u>	
Premiums earned	\$ 124,729,148
<u>Deduct:</u>	
Losses incurred	84,702,211
Loss expenses incurred	13,446,085
Other underwriting expenses incurred	17,868,440
Total underwriting deductions	<u>116,016,736</u>
Net underwriting gain or (loss)	8,712,412
<u>Investment Income:</u>	
Net investment income earned	12,707,392
Net realized capital gains or (losses)	2,145,150
Net investment gain or (loss)	<u>14,852,543</u>
<u>Other Income:</u>	
Net gain (loss) from agents' or premium balances charged off	(30,237)
Finance and service charges not included in premiums	
Aggregate write-ins for miscellaneous income	(46,794)
Total other income	<u>(77,031)</u>
Net income after dividends to policyholders and before federal income taxes	23,487,924
Federal income taxes incurred	
Net income	<u>\$ 23,487,924</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2015	\$ 177,269,163
Net income	23,487,924
Change in net unrealized capital gains (losses)	875,327
Change in net deferred income tax	2,089,125
Change in nonadmitted assets	(5,621,468)
Change in provision for reinsurance	
Aggregate write-ins for gains and losses in surplus	<u>(12,628,298)</u>
Change in surplus as regards policyholders for the year	<u>8,202,610</u>
Surplus as regards policyholders, December 31, 2016	<u>\$ 185,471,773</u>

**FEDERATED RURAL ELECTRIC INSURANCE EXCHANGE
CAPITAL AND SURPLUS ACCOUNT
RECONCILIATION OF CAPITAL AND SURPLUS SINCE LAST EXAMINATION**

Surplus as regards policyholders, December 31, 2011			<u>\$ 122,135,165</u>
Net income	2012	19,355,144	
	2013	31,448,832	
	2014	34,144,205	
	2015	32,639,118	
	2016	<u>23,487,924</u>	141,075,223
Change in net unrealized capital gains or (losses)	2012	241,630	
	2013	71,528	
	2014	(161,746)	
	2015	(947,722)	
	2016	<u>875,327</u>	79,017
Change in net deferred income tax	2012	1,579,755	
	2013	(494,675)	
	2014	2,544,596	
	2015	4,497,997	
	2016	<u>2,089,125</u>	10,216,798
Change in nonadmitted assets	2012	2,164,479	
	2013	(475,229)	
	2014	(6,208,431)	
	2015	(8,482,509)	
	2016	<u>(5,621,468)</u>	(18,623,158)
Aggregate write-ins for gains and losses in surplus	2012	(8,853,869)	
	2013	(13,837,226)	
	2014	(16,505,806)	
	2015	(17,586,073)	
	2016	<u>(12,628,298)</u>	<u>(69,411,272)</u>
Surplus as regards policyholders, December 31, 2016			<u>\$ 185,471,773</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

No adjustments were made to surplus as a result of this examination. The capital and surplus of the Company, as of December 31, 2016, was \$185,471,773, which was the same amount, reported by the Company in its 2016 filed Annual Statement.

COMMENTS ON FINANCIAL STATEMENTS

There were no significant or material findings resulting from the examination that warranted inclusion in the report on examination.

SUMMARY OF RECOMMENDATIONS

There were no findings or recommendations identified as a result of this examination that warranted inclusion in the report on examination.

CONCLUSION

The assistance and cooperation by the officers of the Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Ms. Tamara House, CFE, a senior financial examiner and Mr. Shane Mead, CISA, CRISC, an information systems examiner representing the Kansas Insurance Department, participated in this examination.

Respectfully submitted,



Christopher W. Buchanan, CPA, CFE
Senior Financial Examiner
Examiner-In-Charge

EXHIBIT S
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION


State of Kansas

County of Shawnee

Christopher W. Buchanan being duly sworn, states as follows:

1. I have authority to represent the Kansas Insurance Department in the examination of Federated Rural Electric Insurance Exchange
2. The Kansas Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report, and the examination of Federated Rural Electric Insurance Exchange performed in a manner consistent with the standards and procedures required by K.S.A. 40-222.

The affiant says nothing further.



Examiner's Signature

Subscribed and sworn before me by Christopher W. Buchanan on this
14 day of July, 2017.

(SEAL)



Dale Hubbell

Notary Public

My commission expires 3/19/2019

(date)