

Personal *Connections*



2010 Annual Report



Letter from the President

In the year after our centennial celebration I'm pleased to report that the journey we promised to take together into the next century of service is well on its way. In 2010 the journey continued in much the same way it began – by protecting farms and rural communities, demonstrating integrity through our actions, and valuing our personal relationships.

We take our professional relationships personally. Our commitment to developing and nurturing personal connections with our member mutuals, independent agents, and policyholders shows in everything we do. In a world where technology continually changes, we know that our personal touch is what sets us apart. The strong relationships we have built are the foundation of our success.

I remember my first years at Grinnell Mutual. In many ways, the business world looks very different today than it did those 30 years ago. Employees had typewriters rather than computers, phones were shared within departments, and the mailroom was the communications hub of the company. Today, everyone has access to the tools necessary to communicate quickly with all of our customers. Many of our customers have tools to easily conduct business with us without ever touching a piece of paper. Technology has changed, but the importance of personal relationships along with our policy of working together with customers, hasn't.

2010 success stories

The story of 2010 includes many outstanding examples of collaborating with our business partners. One of the stories you'll read is about the benefits realized by customers as a result of



restructuring Grinnell Mutual's marketing staff. The transition to a regional marketing structure facilitates meetings between mutuals, agents, and a Grinnell Mutual regional marketing manager. By bringing people and mutual interests together, our regional marketing managers help create a more powerful partnership.

We are always pleased to report new market opportunities. In 2010 we added three new members to the FarMutual® family, bringing our members to 294 – a 54 percent share of the farm mutual reinsurance market. Grinnell Mutual expanded into Pennsylvania, signing our first Pennsylvania mutuals to a 2011 reinsurance contract. We were also pleased to offer personal lines in Oklahoma for the first time in company history. Oklahoma agents have responded enthusiastically to Grinnell Mutual products, services, and ease-of-doing-business tools.

The 2010 financial summary provides news of improvements as well as losses due to severe storms. Increases in premiums, assets, and policyholder surplus added to the five-year trend of strengthening Grinnell Mutual's bottom line, good news in a challenging market environment. The 2010 storm season was tough on customers in Minnesota, northern Missouri, and parts of Iowa, with two storms alone exceeding \$15 million in losses. When times are difficult, that's when we're at our best. See how Claims Manager Stacey Dufoe exemplifies this as she set aside dealing with damage to her home to serve customers affected by a major hailstorm in Grinnell.

I'm extremely proud of the actions of the dedicated staff of Grinnell Mutual. Their accomplishments throughout the year are too numerous to mention here. Because of their efforts, we are able to keep a promise we made over 100 years ago. We promised the mutual companies we reinsured that we would be here in times of need. With the commitment of Grinnell Mutual employees, the loyalty of Grinnell Mutual agents, and with your help, I intend to keep that promise.

Thank you for what you do every day to bring meaning to the promises we make within the farm mutual insurance industry and the journey we take together. As you know, when it comes to your customers and you, our customer, it's personal. That's our policy of working together.

Personal
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Mission

To provide quality reinsurance and insurance products and services in a profitable manner through a partnership with member mutuals and agents.

Management decisions will be considered in light of their effect on the welfare of the membership.

Corporate Goals

1. Protect our financial strength and security.
2. Conduct business in a profitable and efficient manner, while respecting the rights, dignity and value of our employees.
3. Advise and support member mutuals, agents, and other customers.
4. Provide value to our customers, optimizing our use of financial, technological, and human resources.
5. Expand to support small mutual companies in additional states.
6. Be a responsible corporate citizen and encourage responsible corporate citizenship on the part of our employees.

Success built on personal connections

The farm mutual industry was built on personal relationships. The shared concern for all members and their families, along with an innovative spirit and Midwestern work ethic, formed the beginning of the farm mutual industry.

In the 21st century, personal relationships are still valued among Grinnell Mutual and its mutual members. We continue to discover innovative ways to work together. We know that nurturing long-lasting relationships is the best way to do business. It results in quality service and satisfied customers.

Equipment Breakdown

When you know your customers, you take their best interest to heart. That's what happened in northeast Iowa when Rod Lensing's submersible pump broke down, twice. That meant his 350-cow, family-owned dairy operation was without water. When the replacement failed less than a year after the first breakdown, the lack of water caused the pit pump to break as well. Luckily, his insurer, German Mutual Insurance Association in West Union, Iowa, had rolled Equipment Breakdown coverage onto all of its policies when Grinnell Mutual first introduced it in 2008, and Lensing had kept the coverage.

Lensing's agent and long-time friend, Bruce Gullickson of South Winn Insurance in Calmar, Iowa, recalled the conversation at his daughter's high school basketball game. "Rod hadn't thought to

submit the consequential pit pump claim, but I told him we could try it. A few days later, his wife called and said let's do it," said Gullickson.

"Rolling coverage onto policies has given agents opportunities to discuss this important protection with policyholders. Overall, I think the Equipment Breakdown coverage has been very well received. We've seen a 65 to 70 percent retention rate."

*Dick Hartkemeyer, manager
German Mutual Insurance Assn.*

While the replacement pump was still under warranty, Equipment Breakdown coverage paid for all labor costs to replace the second pump and all costs for the pit pump replacement. Lensing was pleased.

"The total covered loss for both claims was nearly \$10,000. Without Equipment Breakdown, he wouldn't have had coverage," explained Dick Hartkemeyer, manager of German Mutual. "Rolling coverage onto policies

has given agents opportunities to discuss this important protection with policyholders. Equipment Breakdown coverage has been very well received. We've seen a 65 to 70 percent retention rate of the coverage."

German Mutual is only one of several mutuals that have found innovative ways to improve customer service.

Joint marketing visits

In July, Grinnell Mutual transitioned its marketing specialist positions so that regional marketing managers meet with both mutuals and agents. Since then, some mutual managers have taken the opportunity to join marketing managers on their calls to agents. Jim Buch, President of Benton Mutual Insurance Association of Benton, Iowa, recently joined Regional Marketing Manager Bill Gallagher for a day of visits.

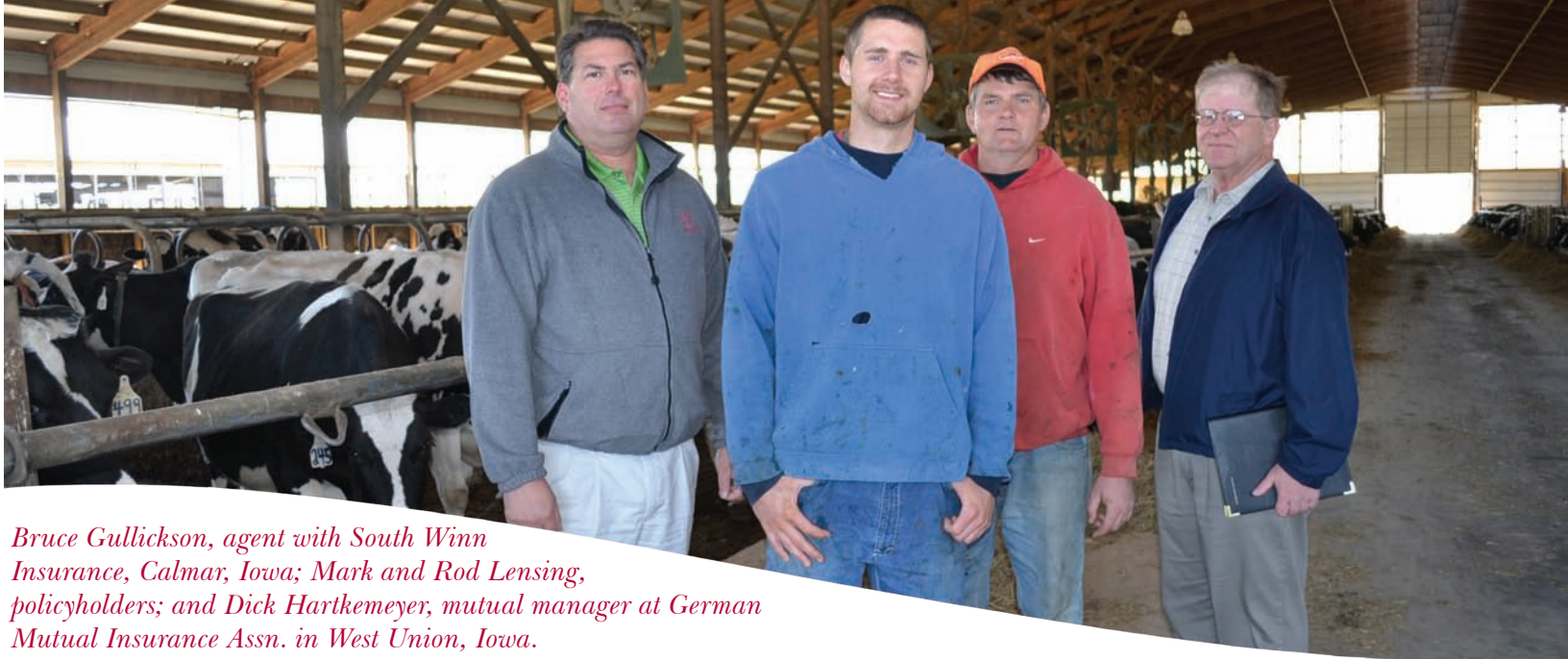
"It was a great opportunity to see agents face to face who, for one reason or another, I hadn't visited for a while. By reconnecting, we had the chance to remind agents of products and services our mutual and Grinnell Mutual offer and hear their feedback. It was a great experience," said Buch.

"By meeting agents with Jim, it helped reinforce the message of a policy of working together. There's something about going to an agent's office, to their turf, and meeting face to face that enhances relationships. It impresses upon the agents how important they are to our companies," said Gallagher.



Jim Buch, President of Benton Mutual Insurance Assn., and Regional Marketing Manager Bill Gallagher.

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Bruce Gullickson, agent with South Winn Insurance, Calmar, Iowa; Mark and Rod Lensing, policyholders; and Dick Hartkemeyer, mutual manager at German Mutual Insurance Assn. in West Union, Iowa.

Commercial field underwriters

Grinnell Mutual's commercial lines staff understands the value of working with agents in person. That's why a new commercial field underwriter program was launched in October. The program made three commercial field underwriters available to nearly 100 agents in parts of Illinois, Iowa, and Minnesota. By bringing specialized knowledge coupled with a personal touch to their work with commercial accounts, these underwriters provide value-added service to their agents and their agencies' insureds.

For example, when a good account didn't qualify for coverage with Grinnell Mutual because it handled ammonia, Commercial Field Underwriter Craig Hanson got involved.

"I was able to speak with the owner, coordinate a visit with a loss control specialist, make a pitch to Grinnell Mutual's Large Account Committee, and ultimately offer a quote on the agency's behalf," explained Hanson, who is based in North Mankato,



Grinnell Mutual commercial field underwriters Crystal Darling, Craig Hanson and John Shafer.

Minn. "We didn't get to write the business, but the agent saw the value of the commercial field underwriting program. I could do some of the legwork for him, especially regarding Grinnell Mutual's requirements."

"We're another point of contact for the agents. They feel like they have an advocate—someone who will help fight for the accounts. We also assist them with our online quoting system. It's a great help to our agents who write commercial business," said Commercial Field Underwriter Crystal Darling of Mechanicsville, Iowa.

Providing peace of mind

The quality customer service you receive from working with people you know came close to home for several Grinnell Mutual employees last spring. In April, a severe hailstorm pounded both Grinnell and Cedar Falls, Iowa, affecting more than 600 direct lines policies. In the aftermath, a temporary adjusting site was set up in Grinnell Mutual's parking lot for area policyholders to get their vehicle claims settled quickly.

Claims staff members worked tirelessly to contact affected policyholders and assess damages, knowing they also had their own home and vehicle claims to submit. Nearly \$2.3 million was paid out in claims.

"I had just arrived home from the office when the wind picked up and the power went out, which was the start of a significant hailstorm," said Claims Manager Stacey Dufoe, whose own home suffered damage. "While I knew I was in the midst of my own property claim, my priority as an adjuster was to establish contact with our insureds, inspect

Success built on personal connections, *continued*

their property, assess the damages, and provide our customers with peace of mind in knowing that they come first.”

At a time when the value of personal service can easily be lost, Grinnell Mutual and its FarMutual® partners and agents continue to realize the benefits that come from strong personal connections. Our policyholders can trust that we'll be there for them when they need us most.

Whether it's prompt service in the aftermath of a storm, proactively offering insurance coverages that will benefit customers, or finding new ways to connect with business partners, the farm mutual industry values its working relationships.

Relationships click

Much has changed since the doors first opened at local county mutuals. The most telling changes are the tools used to conduct business. Ledger books and typewriters have been traded in for secured websites and online communications and rating systems.

Grinnell Mutual understands that effectively using technology allows us to maintain and enhance connections with our business partners and customers. Trusting relationships, along with easy-to-use, accurate technology, is a powerful combination that provides astounding results.

Grinnell Mutual enters Oklahoma direct lines market

Before 2010, most Oklahoma agencies had never



Van Simms of Watkins Insurance Agency and Al Hodgeman, Sr. Development Specialist visit at the first Grinnell Mutual continuing education class held in Oklahoma.

“Grinnell Mutual offers great products at competitive rates, excellent service and claims handling, and automation.”

Jimmy James, The Storehouse Services, Altus, Oklahoma

heard of Grinnell Mutual or Grinnell, Iowa, but the market was ready for a competitive auto carrier. By working with Farmers Mutual Fire Insurance Company in Okarche, Grinnell Mutual entered the personal lines market in Oklahoma last April. After one year, new connections with Oklahoma agents resulted in more than \$2 million of new business. The results exceeded everyone's expectations.

“The number one reason Grinnell Mutual has been successful in Oklahoma is service. You can call and get things taken care of, from underwriting to billing,” said Jimmy James, owner/agent for The Storehouse Services, Inc., of Altus, Okla. “Grinnell Mutual offers great products at competitive rates, excellent service and claims handling, and automation.”

With offices throughout the state, The Storehouse Services wrote more than \$330,000 in new business with Grinnell Mutual over the past year. Processing business online has played a key factor in their premium growth.

“In today's age, speed is of the essence. I have other companies similar in pricing to Grinnell Mutual, but the agents choose Grinnell because of the automation. When someone is sitting in front of you and they want a quote, you need to know within five minutes that the quote is completed accurately. We can pull the credit report and motor vehicle record (MVR) within seconds. There aren't surprises,” explained James. “Of all of our carriers, Grinnell Mutual is in the top three for its computer systems.”

Listening drives innovation

It's no coincidence that the online processing systems were a hit in Oklahoma. Grinnell Mutual's Technology Advisory Group (TAG), created five years ago and comprised of 17 to 20 agency representatives — mostly customer service representatives (CSRs), has shaped the development of the company's online processing and communications systems. From processing to billing, the group's insight has led to impressive results.

“To develop usable technology, the best people to give you input are the ones who work with it every day. TAG members have dedicated a great deal of

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Photo: Operations Manager Wanda Askelson and Principal Brian Petersburg of A&J Petersburg Insurance & Real Estate in Decorah, Iowa, pose by the corporate sign.

their time to educating Grinnell Mutual about ease of doing business from their perspective," said Senior Vice President of Direct Underwriting and Production Larry Jansen. "Over the past year, we made great strides in billing, personal lines, and the commercial processing system based on input from TAG, Agent Advisory, and President's Club meetings."

In 2010 Grinnell Mutual introduced several billing enhancements including invoices that are easier to read, easier to pay, and easier to access. Policyholders now have new options to pay online by credit card or e-check, plus they can make a payment before an invoice is generated.

"In the past year, we really began to see progress in the areas we've discussed with Grinnell Mutual," said charter TAG member Wanda Askelson, who serves as the operations manager of A&J Petersburg Agency in Decorah, Iowa. "With the billing improvements and introduction of insured e-check payment, our agency has made 66 percent fewer agency sweeps, saving time for our bookkeeper. That's good for our agency and it provides better service to our customers."

Significant progress was also made on the personal lines online (PLO) system and commercial processing system (CPS). The new PLO launched in early 2010 made continuous improvements throughout the year, which increased the speed of the system. Webinars introduced the changes to agency staff.

Much of the past year was also dedicated to completing the commercial processing system, one of Grinnell Mutual's most ambitious development

projects to date. When TAG returned for its 2011 meeting in April, the CSRs were pleased.

"I work mainly with commercial lines, so I am most excited that the new CPS is running. It makes it easier to quote and upload applications. It also allows my underwriter to see the quotes and change them if necessary. Plus, when I print out proposals, they look professional. Another important feature is allowing for backdating and cancellations on PLO," said Kathy Wahl of Omann Agency in St. Joesph, Minn.

In addition to improved technology, the annual TAG meetings also result in strengthened relationships between Grinnell Mutual and its direct lines agencies.

"I appreciate that Grinnell Mutual wants our input and listens to us," said Askelson. "The TAG meeting builds relationships. We meet Grinnell Mutual's hands-on staff as well as management. It's a good opportunity to get to know the people at Grinnell Mutual. There is mutual respect all around the room."

Online connections

As more business is conducted online, several mutuals have realized the benefits of an online presence. In 2010, Farmers Pioneer Mutual Insurance Company of Onarga, Illinois, redesigned its website to make it more user-friendly. The website features a secured login for agents, online payment options for policyholders as well as useful links, a claim center, product information, an agent locator, and contact information for the mutual.

"We originally created the website to keep up with the times. We wanted to provide more information

Success built on personal connections, *concluded*

for our agents online, so we chose NAMIC Web Services to redesign our website after speaking with one of their customers,” explained Nancy Tavenner, manager of Farmers Pioneer Mutual.

With the redesign, Farmers Pioneer Mutual’s website became an easy way to pay bills for both agents and customers.

“Our agents can sweep a policyholder’s check online and it’s automatically marked paid. Our customers like to know their coverage is up to date as soon as they drop off the check. It’s convenient,” said Tavenner. “Policyholders can also log in to make payments and view their coverages online. So far, about five percent of our customers use this feature.”

Farmers Pioneer Mutual is not alone. At the close of 2010, 40 percent of Grinnell Mutual’s affiliated mutuals had a website. In 2011, with a 100 percent co-op program that promotes website development for mutual companies, this number is certain to increase. To make finding information easier for online insurance shoppers, Grinnell Mutual promotes linking farm mutual websites to Grinnell Mutual’s public site, grinnellmutual.com. In return, farm mutuals can also have their websites linked from Grinnell Mutual’s “Find a Mutual” feature.

“Insurance market research has shown that 70 percent of consumers of all ages shop online, but then prefer to buy in person from an agent,” said

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Susan Pickens, assistant vice president of Marketing Services

Susan Pickens, assistant vice president of Marketing Services. “By linking our websites, more web traffic is generated and online shoppers will be directed to an agent. It’s a powerful partnership.”

Relationships, a firm foundation

The value of personal service is the message in Grinnell Mutual’s latest television commercial.

“Our mutuals and agents embody Midwestern values and offer personal service from quoting policies to settling claims. This commercial presents a message that we believe will resonate with the communities we serve,” said Advertising

Manager Barb Baker. “By pre-producing a professional TV commercial, it’s easy and affordable for an agent or mutual to reach a broad audience through television advertising.”

The 30-second customizable TV commercial, titled “It’s Personal,” was filmed primarily in the Grinnell area and included some local policyholders. During 2011, agencies and mutuals can get 100 percent co-op reimbursement from their available co-op funds to air the commercial.

As Grinnell Mutual continues to explore new resources for connecting with customers and business partners, fostering long-term relationships continues to be at the forefront. From online communications and rating systems to modern advertising outlets, the success of Grinnell Mutual and its business partners continues to rest on the foundation of long-term, personal relationships.

As one of Grinnell Mutual’s President’s Club agents, Brian Petersburg, owner and agent of A & J Petersburg Agency in Decorah, Iowa, explains, “There is a trust factor between us and Grinnell Mutual because we have long-lasting business relationships. We’ve worked with our underwriter, Angie, for over 15 years. You can build relationships with a small regional company—that’s why we love working with Grinnell Mutual, from underwriting to claims,” he said.

Trusting relationships, paired with accurate, easy-to-use technology—that’s a powerful way to do business. It’s our policy of working together.



Policyholders Deloris and Eugene Lang of Grinnell, Iowa, from the Grinnell Mutual television commercial, “It’s Personal.”

Personal Connections

2010 Financial Summary & Commentary

To the policyholders of Grinnell Mutual Reinsurance Company:

Please review the financial information for your Company. Take note that the financial improvements made in 2009 were repeated in 2010. Premiums, assets, and policyholder surplus all improved. Over the last five years, your Company has made excellent progress to enhance its financial strength.

Underwriting

Premium growth continued to be challenging in 2010. However, your Company's expansion of personal business in Oklahoma, expansion in Ohio, growth in personal automobile business, and increased reinsurance assumed business provided for modest growth.

Expanding commercial production in the current environment continued to be difficult. Certain segments of our commercial business expanded, while other areas realized a decline in volume. Overall, your Company's written premium volume grew 2.8%.

The severe storm experience of 2008 and 2009 persisted in 2010. Two of the 2010 occurrences exceeded \$15.0 million and two others exceeded \$6.8 million. The storm events began in early April and lasted into late September.

In addition, several large fire losses occurred early in the year. For the third year in a row, property losses exceeded the 72.5% loss ratio retention for our main property ceded reinsurance program. Casualty business was generally favorable, providing some relief to the overall loss experience. The pure gross loss ratio was 66.1%.

In the aggregate, ceded reinsurance programs reduced net losses by \$41.0 million (compared to \$63.0 million in 2009), which decreased the net pure loss ratio to 64.2%. Underwriting expenses were controlled and decreased primarily due to reduced salaries, employee benefit costs, re-categorizing a class action lawsuit to loss reserves, and state tax items.

Expense increases were realized from claim adjustment services. Total expenses increased less than 1.0% and the expense ratio decreased one percentage point to 41.1%.

Investing

The low-yield investment environment of fixed-return investments continued to provide less than desirable results. However, an increased level of invested assets allowed the Company's investment income earned to improve. The favorable equity markets produced very good unrealized gains for a second year in a row. While higher yielding fixed-return investments are not expected to return soon, the economic outlook is generally favorable.

Other items of significance

Technology investment is essential in order to strengthen our relationships with you and to provide excellent service and products. During 2010, several improvements were made to our policy billing system and a new commercial policy processing system became a reality.

Results

The preceding results produced net income of \$7.1 million, increased surplus by 4.7% for the year, and improved the capacity ratio to 1.08. While not outstanding results, your Company continues to be financially strong to endure these challenging times and to be there for you.

The accompanying financial information displays the 2010 results in further detail. I would be happy to provide even greater detail and respond to any questions.



Hutch A. Kracht
Controller



Management's Discussion and Analysis of Financial

The following discussion and analysis, by management of Grinnell Mutual Reinsurance Company ("Grinnell Mutual" or "Company"), of Grinnell Mutual's financial condition and results of operations should be read in conjunction with its 2010 Annual Statement.

Company overview

Grinnell Mutual commenced operations in 1909 for the purpose of reinsuring property risks of small mutual insurers ("farm mutual business"). The Company reinsures 294 such insurers ("Member mutuals"), with the related premiums comprising 27% of gross premiums. Other gross premiums primarily consist of directly insured property and liability risks ("direct business") written through approximately 1,700 independent agents, who are also agents of the reinsured companies. Grinnell Mutual operates in eleven Midwest states. Commencing January 1, 2009, Grinnell Mutual assumed 100% of the premiums, and related losses and expenses, of its wholly-owned subsidiary Grinnell Select Insurance Company ("GSIC").

Management plans for controlled, moderate growth of premiums written and assumed. Premiums increased 2.8% in 2010 and 2.3% in 2009. Industry-wide information suggests that a more competitive environment with premium rate reductions began during 2004 and continued through 2010. Grinnell Mutual's premium growth is believed to exceed that of the industry.

The Company reinsures more than half of the small mutuals in its writing territory. This business can have volatile loss experience because the business is highly weather-related. From 2001 through 2007, the farm mutual business generally generated favorable experience. Thus, Grinnell Mutual has been able to maintain stable reinsurance rates during recent years. Less favorable loss experience in 2008 and 2009 generated an increase in 2009 and 2010 premiums due to rate increases. Such premiums increased 6.8% in 2010 and 4.8% in 2009.

Grinnell Mutual is a smaller competitor for direct business. The industry has experienced many premium rate changes. The Company desires to maintain stable premium rates, but must occasionally change rates based not only on its own experience, but the competitiveness of the industry. Consistent growth rates for direct business are more difficult to maintain. Premiums declined 1.0% in 2010 and 4.2% in 2009.

As previously stated, GSIC direct premium was assumed 100% by Grinnell Mutual in 2010 and 2009. GSIC direct premium written was \$76.3 million in 2010 and \$67.5 million in 2009.

The largest expense category for Grinnell Mutual relates to the benefits paid under the reinsurance contracts and direct insurance policies issued. The amount of losses and loss adjusting expenses incurred depends on, along with other factors, the volume of risks insured, the expertise of underwriters and claim adjusters, the weather, the legal environment, and how consistently future experience relates to past experience and other factors that are used to establish premium rates. The ratio of losses and loss adjusting expenses to premiums earned was 74.6% in 2010 and 66.9% in 2009.

Grinnell Mutual's farm mutual business had pure net loss ratios of 81.9% and 77.4% in 2010 and 2009, respectively. These results were primarily attributed to the adverse weather conditions in the Midwest — both in 2010 and in 2009. The direct business pure net loss ratios were 54.3% and 48.1% in 2010 and 2009, respectively. These results were consistent with reports of Midwest region-wide experience.

Underwriting and general expenses incurred by Grinnell Mutual include many of a variable nature that change as the premium volume changes, such as agent commissions and premium-based taxes. Other expenses are more fixed in nature, at least within a reasonable range of activity level, such as the cost of employees and facilities. Premium growth has not been sufficient during recent years to maintain a preferred percentage of such expenses to premiums of approximately 30%. The expense ratio increased in recent years to 30.5% in 2010 and 31.6% in 2009 due to limited premium growth and increases in certain expenses. It is anticipated that system automation costs (\$5.7 million in 2010 and \$6.4 million in 2009) will continue to be significant as additional processes are automated.

As is consistent with the cycles prevalent in the property and liability insurance industry, investment gains become less critical to overall profit as the underwriting results become more profitable, and more critical as underwriting results deteriorate. Net investment gains in 2010 were \$25.2 million compared to \$32.2 million in 2009. In 2009 and 2008, the deterioration of values in the investment markets required write downs of carrying values of certain investments in bonds of \$0.2 million and \$1.8 million, respectively, due to "other than temporary impairment". In 2009, \$14.6 million of net investment gains related to the sale of an equity ownership as part of an initial public offering. This investment had been carried with an unrealized gain of \$7.2 million.

Excluding realized gains and losses, net investment income in 2010 was greater than that of 2009 by 6.4%. Fixed-return investment income was limited the last two years by the lower yields available for reinvestment of maturing fixed-

Grinnell Mutual's farm mutual business had pure net loss ratios of 81.9% and 77.4% in 2010 and 2009, respectively. These results were primarily attributed to the adverse weather conditions in the Midwest — both in 2010 and in 2009.

Condition and Results of Operations

return investments. The relatively lower fixed-return yields are anticipated to continue in the coming year. However, the cash flow arising from the assumption of business from GSIC in 2009 has provided additional invested assets. Thus, the larger base of invested assets provided additional investment income.

Corporate structure and direction

As a mutual, Grinnell Mutual is controlled by its policyholders, including the member mutuals. The policyholders elect a Board of Directors that is comprised of managers of member mutuals, some of whom are also agents for the Company. The Board of Directors, among its other duties, approves premium and commission rates for farm mutual business and direct business.

Subsidiaries of Grinnell Mutual include GSIC, an insurance company; an insurance agency to provide additional insurance markets to Company agents; and providers of services to assist member mutuals.

As part of the highly-regulated and competitive insurance industry, the Company is subject to continuous monitoring by regulators and rating entities to ensure that policyholders and the public are adequately protected. The protections include financial stability and fairness of rates. In 2010, the Company was rated "A, Excellent" by the industry's principal rating entity — A.M. Best.

Critical accounting issues

The Company makes estimates and assumptions that have a significant effect on amounts and disclosures in the financial statements. The estimates and assumptions can be complex and require subjective judgment by management. The most significant estimates and assumptions relate to investment valuation, losses and loss adjustment expenses, income tax, and retirement benefits.

Investments in fixed-return securities are generally reported at amortized cost. Investments in equities are reported at fair value, although value adjustments are reported as a change in surplus rather than as a component of net income. Each investment with a fair value less than cost (or amortized cost) must be evaluated to determine if the value impairment is other than temporary. If the impairment is judged to be other than temporary, a realized loss must be recognized and reported. In making this judgment, management considers factors such as historic operating trends, business prospects, industry status, analyst ratings, size of impairment, time period of impairment, and the Company's intent and ability to hold the investment.

Losses and loss adjustment expenses represent the estimated ultimate cost of all reported and unreported claims incurred, net of salvage and subrogation recoveries. The liabilities for unpaid losses and loss adjustment expenses are estimated using individual case valuations and statistical analyses. The estimates are based on assessments of known facts and circumstances, historic development patterns, estimated trends in claims frequency and severity, legal theories, and other factors. Ultimate amounts can vary based on new information, changes in trends,

and other events. The estimates are continually reviewed and adjusted as necessary in current operations.

Deferred income tax assets are recognized to the extent that future taxable income is judged to be sufficient to realize those benefits. Judgments are made regarding the timing of the reversal of the separate components of the assets. The actual timing of the reversals may vary from the estimates based on new information and changes in trends. Statutory accounting practices also limit the recognition of deferred income tax assets. Such assets deemed to not be recoverable under the accounting practices are "nonadmitted" and not included as part of policyholder surplus.

A defined benefit retirement plan is provided for certain Company employees. The retirement plan benefit obligations are estimated by a consulting actuarial firm. Because the benefits are ultimately settled in the future, the determination of current annual expenses and liabilities is subject to estimates and assumptions. Management and the consulting actuarial firm review the assumptions annually and modify them as necessary based on historic experience and expected future trends. Key assumptions include the discount rate and the expected long-term rate of return. Changes in the Company's pension obligations may occur in the future due to variances in actual results from the key assumptions made.

Results of operations summary

	2010	2009	2008
Premiums earned	\$366,072	\$353,914	\$306,822
Losses and loss adjustment expenses	(272,938)	(236,776)	(240,217)
Underwriting gain (loss)	(19,141)	534	(34,752)
Net investment gain	25,194	32,179	23,881
Net income (loss)	5,250	25,030	(1,993)
Surplus change	15,530	42,047	(34,896)
Combined ratio	1.05	0.99	1.12
Surplus change percentage	4.7	14.7	(10.9)
Capacity ratio	1.08	1.13	1.06

The preceding information summarizes certain key operations results for the most recent three years.

Comparison of 2010 to 2009

Premiums earned increased by 3.4%. Growth came from increased reinsurance rates (primarily from member mutuals) and expansion in the states of Ohio and Oklahoma. Gross premiums written and assumed increased by 2.8%. Premiums ceded to reinsurers reduced premiums by \$50.9 million due to increased volume and increased reinsurance rates.

Losses and loss adjustment expenses incurred increased from 66.9% to 74.6% of premiums earned. This deterioration was the result of poorer performance of the member mutual business primarily due to unfavorable weather. There were

Management's Discussion and Analysis of Financial

significant windstorm and fire losses. The direct division also had less favorable results due to weather.

An underwriting loss resulted in 2010 of \$19.1 million compared to a gain of \$0.5 million in 2009. Most of the decline in results came from the loss experience previously discussed. There was a decrease in expenses in 2010. The underwriting losses resulted in no performance compensation expense and no expense for contributions to the defined contribution retirement plan. The combined ratio (losses and expenses divided by premiums) worsened to 1.05 from 0.99.

Net investment gain declined by 21.7%. A primary reason for the decline was the sale of zero-basis stock in an initial public offering that created \$9.2 million of after-tax realized gains in 2009. Net investment income earned grew by 6.4%. Rates of return on new investments available in the market were less than those of investments maturing from the portfolio. However, a larger base of earning assets from the assumption of business (including related assets) from GSIC provided more earning assets for Grinnell Mutual.

Net operating results declined by \$19.8 million due to the reduced underwriting results and net investment gain.

Unrealized gains on investments provided \$7.3 million of surplus gains; these gains were a significant contributor to the reduction in nonadmitted deferred tax assets, which provided \$3.7 million of surplus increase. Total net surplus increases were \$15.5 million or an annual increase of 4.7%. This surplus increase combined with the moderate premium growth improved the capacity ratio (net premiums written divided by surplus) from 1.13 to 1.08.

Comparison of 2009 to 2008

Premiums earned increased by 15.3%. Excluding the premiums assumed from GSIC, premiums earned declined by 5.6%. Growth was more difficult due to increased competition in the industry. Gross premiums written and assumed increased by 18.4% (declined 1.2% before the GSIC assumption). Premiums ceded to reinsurers reduced premiums by \$52.0 million due to increased rates and the required accrual of \$7.0 million for recognition of the proportional share of premiums under a multi-year ceded agreement with large first-year losses.

Losses and loss adjustment expenses incurred decreased from 78.3% to 66.9% of premiums earned. This improvement was the result of additional reinsurance recoveries on property business and much improved results on casualty business from the above-average experience in 2008.

An underwriting gain resulted in 2009 of \$0.5 million compared to a loss of \$34.8 million in 2008. Most of the

improvement in results came from the loss experience previously discussed. There was also an improvement in expenses in 2009. A class action law suit against the Company was evaluated to have expense exposure of \$1.5 million and was accrued for in 2008 (with no change in status reflected in 2009). The combined ratio (losses and expenses divided by premiums) improved to 0.99 from 1.12.

Net investment gain increased by 34.7%. One reason for the improvement was the sale of zero-basis stock in an initial public offering that created \$9.2 million of after-tax realized gains. Another reason was the \$1.8 million realized loss related to other than temporary impairment of certain bonds in 2008. Net investment income earned declined by 8.0%. Rates of return on new investments available in the market were less than those of investments maturing from the portfolio. In addition, a smaller base of earning assets from 2008 year losses was a significant factor.

Net operating results improved by \$27.0 million due to the improved underwriting results and net investment gain.

Surplus for the protection of policyholders increased 14.7%. Improvement in the investment markets provided net unrealized gains of \$5.3 million and contributed to a reduction in nonadmitted deferred income tax. Also, the additional liability for pension plan was eliminated as the pension plan assets recovered in value, which provided additional surplus of \$4.1 million. This surplus improvement was offset by the assumption of premiums from GSIC, such that the capacity ratio (net premiums written divided by surplus) declined from 1.06 to 1.13. However, the capacity ratio improved on a combined (with GSIC) basis.

Liquidity and capital resources

Liquidity is a measure of an entity's ability to secure enough cash to meet its obligations. Primary sources of cash are from collection of premiums, investment income, and investment maturities. Primary uses of cash are for claim payments, agent commissions, general expenses, taxes, property and equipment additions, and investment purchases. Ordinarily, premium collections and investment income are sufficient to cover claim payments and the various operating expenses, leaving funds available for investment.

The most unpredictable cash flow component is the payment of claims. The timing of claim payments can vary significantly and large losses may occur. Cash needs for claim payments are mitigated by scheduled maturities of investments, reinsurance programs, and lines of credit.

Fixed-return investment maturities are scheduled to provide recurring cash flow should unexpected cash needs arise. Under ordinary circumstances, the maturing investments

The Company's relatively conservative investment policy is expected to limit investment portfolio deterioration. The Company generally limits its investment portfolio to highly rated fixed-return securities and no more than 10% in equities.

Condition and Results of Operations, *continued*

are reinvested. Should cash needs exceed the ordinary, the maturing investment proceeds can be used to satisfy operating needs. The Company also maintains a portion of its investments in highly-liquid, relatively short-term investments to provide a secondary source of liquidity.

Grinnell Mutual has established reinsurance programs to cede catastrophic and larger-than-desired losses to other reinsurance companies. When such losses occur, claims are made by the Company against the reinsurers, which reimburse the Company. While there is a short delay as the cash reimbursement inflow trails the claim payment outflow, the reinsurance program does limit the volatility of the losses and provides for the timely recovery of negative cash flow.

Grinnell Mutual also maintains lines of credit for operating funds. One line is for \$15 million with a commercial bank. A second line is with the Federal Home Loan Bank of Des Moines with the amount based on the availability of mortgage-based investments to provide collateral. These lines are established to reduce the possibility of having to liquidate a portion of the Company's investment portfolio to meet large cash flow needs should the investment market be in a low-value period. The Company has made no borrowings under these credit arrangements.

During 2010, Grinnell Mutual produced positive cash flow from operations of \$28.2 million and made additional net investments of \$27.2 million. During 2009, Grinnell Mutual produced positive cash flow from operations of \$28.4 million and made additional net investment purchases of \$30.0 million. The availability of maturing investments and reinsurance recoveries were sufficient to not require any borrowing under the credit arrangements.

Surplus grew 4.7% in 2010 and 14.7% in 2009. The Company has significant capacity and has no plans to seek additional capitalization from sources other than operations.

Factors that may impact future results

Inflation generally has an impact on operations through increased losses and expenses. Management considers inflation when establishing the liabilities for unpaid claims and loss adjustment expenses. Premiums are also affected by inflation, but increases in premiums may be restricted or delayed by competition and the regulatory rate-setting environment.

Grinnell Mutual conducts business in the Midwest, which is exposed to damaging storms and the potential for earthquake near the New Madrid Fault. Thus, significant storm or quake experience could materially adversely affect the Company's results of operations and surplus. Catastrophic exposure is monitored by management and by the Company's reinsurance broker. The ceded reinsurance program is developed annually based on the exposure to such losses. Additional property reinsurance protection has been added periodically to provide for increased exposure.

The Company's relatively conservative investment policy is expected to limit investment portfolio deterioration. The Company generally limits its investment portfolio to highly rated fixed-return securities and no more than 10% in equities.

As a regulated company, Grinnell Mutual is subject to changes that may be applied to the insurance industry in general. The Company is responsible for complying with laws, rules, and regulations in each of the states in which it operates. These states may also be influenced by regulation in other states through the operations of the National Association of Insurance Commissioners, the organization that, among other things, attempts to standardize insurance company regulation in the United States. Certain of the laws, rules, and regulations impact how insurance may be written, how claims are settled, how rates are established, and how information is to be reported. Such impacts can affect the competitive environment, the cost of administration, interpretation of the underlying insurance contracts, and perceptions of the public. Certain factions favor Federal rather than state regulation and have attempted to further involve the United States government. The effects of any future Federal regulation are unknown.

Terrorism

The Federal Terrorism Risk Insurance Act established a program for commercial property and liability losses resulting from foreign acts of terrorism. The Act required insurance companies to make terrorism coverage available and provided for limited Federal protection above individual company retention levels through 2005.

Grinnell Mutual implemented the Act's requirements. Although the Company is exposed to terrorism losses, it provided for premium charges to insureds, obtained reinsurance coverage in addition to the Federal protection, and evaluated risks such that it expected to limit its losses in the event of insured losses from acts of terrorism. In December 2005, the Terrorism Risk Insurance Extension Act extended the expiration of the Federal program through 2007. The Terrorism Risk Insurance Program Reauthorization and Extension Act of 2007 extended the program through 2014. The Company continues to manage its terrorism risk under the program's requirements.

Internal control over financial reporting

The Company has established controls to protect the Company and to ensure that regulatory requirements are met related to internal accounting controls documentation, testing, and representations by management. The Company expects that any future regulatory requirements should not become effective until sufficiently far in the future that the Company can meet the requirements without significant negative impact on its results of operations.

Balance Sheets

Grinnell Mutual Reinsurance Company

December 31

2010 2009
(000s)

Assets

Bonds	\$ 496,071	\$ 468,218
Stocks	63,536	56,760
Subsidiaries	32,633	30,767
Other investments	88	165
Real estate (occupied by Company)	4,451	4,924
Cash and short-term investments	<u>50,396</u>	<u>47,622</u>
Total investments	647,175	608,456
Accrued investment income	5,448	5,298
Premiums and agents' balances receivable	63,738	64,635
Reinsurance balances	18,985	42,519
Current and deferred income tax	15,670	14,022
Data processing equipment	2,007	1,204
Other	<u>1,469</u>	<u>1,428</u>
Total assets	<u>\$ 754,492</u>	<u>\$ 737,562</u>

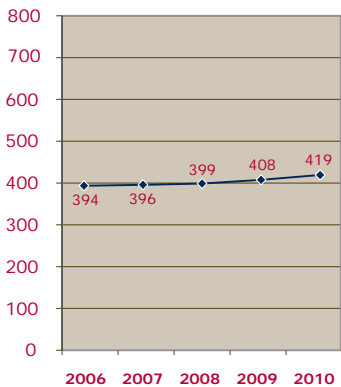
Liabilities

Unpaid losses and loss adjustment expenses	\$ 244,137	\$ 240,360
Unearned premiums	121,377	118,781
Accrued expenses and accounts payable	33,341	39,194
Current income tax	-	524
Reinsurance balances	10,168	9,524
Drafts outstanding	1,412	601
Statutory reserve	<u>1,171</u>	<u>1,222</u>
Total liabilities	411,606	410,206

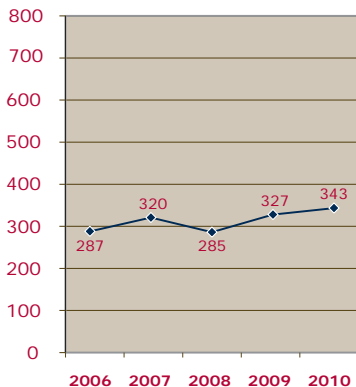
Surplus

	<u>342,886</u>	<u>327,356</u>
Total liabilities and surplus	<u>\$ 754,492</u>	<u>\$ 737,562</u>

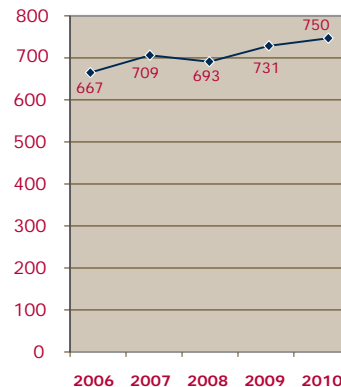
Gross Premiums
(in millions of \$)



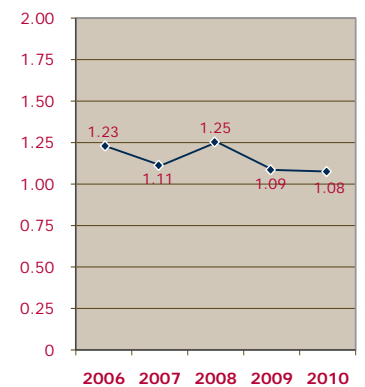
Policyholders' Surplus
(in millions of \$)



Assets
(in millions of \$)



Capacity Ratio
(smaller is better)



Statements of Operations and Surplus

Grinnell Mutual Reinsurance Company

		Year Ended December 31	
		<u>2010</u>	<u>2009</u>
		(000s)	
Underwriting			
Premiums earned		\$ 366,072	\$ 353,914
Losses incurred		(234,818)	(204,207)
Loss adjustment expenses incurred		(38,120)	(32,569)
Underwriting and general expenses incurred		<u>(112,275)</u>	<u>(116,604)</u>
	Underwriting gain (loss)	(19,141)	534
Investment			
Net investment income		25,051	23,534
Net realized gains (losses)		<u>143</u>	<u>8,645</u>
	Net investment gains	25,194	32,179
Other			
		<u>(135)</u>	<u>1,150</u>
	Income before tax	5,918	33,863
Federal income tax expense			
		<u>668</u>	<u>8,833</u>
	Net income	5,250	25,030
Other surplus changes			
Net unrealized investment gains		7,343	5,333
Change in nonadmitted assets		3,762	6,086
Change in deferred income tax		(877)	1,261
Change in additional liability for pension plan		-	4,133
Change in statutory reserve		<u>52</u>	<u>204</u>
	Total surplus changes	15,530	42,047
Surplus at beginning of year		<u>327,356</u>	<u>285,309</u>
	Surplus at end of year	<u>\$ 342,886</u>	<u>\$ 327,356</u>
Expenses by classification			
Claim adjustment services		\$ 12,938	\$ 5,439
Commissions		59,641	58,947
Advertising		2,507	2,586
Boards, bureaus, and associations		2,050	1,913
Salaries and payroll taxes		35,491	37,612
Employee relations and welfare		8,872	10,112
Travel		1,808	1,714
Equipment and depreciation		9,821	10,389
Postage, telephone, and express		2,138	2,067
Taxes, licenses, and fees		4,983	6,294
Outside services		4,480	4,653
Other		<u>6,907</u>	<u>8,603</u>
	Total expenses	<u>\$ 151,636</u>	<u>\$ 150,329</u>
Expenses by function			
Loss adjustment		\$ 38,120	\$ 32,569
Underwriting and general		112,275	116,604
Investment		<u>1,241</u>	<u>1,156</u>
	Total expenses	<u>\$ 151,636</u>	<u>\$ 150,329</u>



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