REPORT OF EXAMINATION

OF THE

QUALITAS INSURANCE COMPANY

AS OF

DECEMBER 31, 2021

Filed on June 7th, 2023

TABLE OF CONTENTS

Los Angeles, California
May 19, 2023

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

QUALITAS INSURANCE COMPANY

(hereinafter also referred to as the Company). Its statutory home office and primary location of its books and records is located at 4545 Murphy Canyon Road, Suite 300, San Diego, California 92123.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2018. This examination covered the period from January 1, 2019 through December 31, 2021.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, 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 and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Company.

SUMMARY OF SIGNIFICANT FINDINGS

The Company's Risk Based Capital (RBC) total adjusted capital was less than 300% of its Authorized Control Level as of December 31, 2021. Its statutory accounting basis combined ratio was in excess of 120% for the year ended December 31, 2021. The RBC level coupled with the statutory accounting basis combined ratio triggered a Company Action Level Event, see "Loss Experience" section of the Examination Report.

The Company continues to experience significant adverse loss development as described in the "Subsequent Events" section.

COMPANY HISTORY

The Company was incorporated on November 10, 1982, under the laws of California, and commenced transacting property and casualty business on January 1, 1984. In June 1999, the Company was acquired by Trinity Universal Insurance Company. In March 2014, the Company was then acquired by Qualitas Financial Services, Inc. (QFS), a Delaware company, a wholly-owned subsidiary of Qualitas Controladors, S.A.B de C.V. (QC), a public-traded stock company on the Mexican Stock Exchange. On

March 25, 2014, the California Department of Insurance approved the Company's name change from Valley Insurance Company to Qualitas Insurance Company.

Capitalization

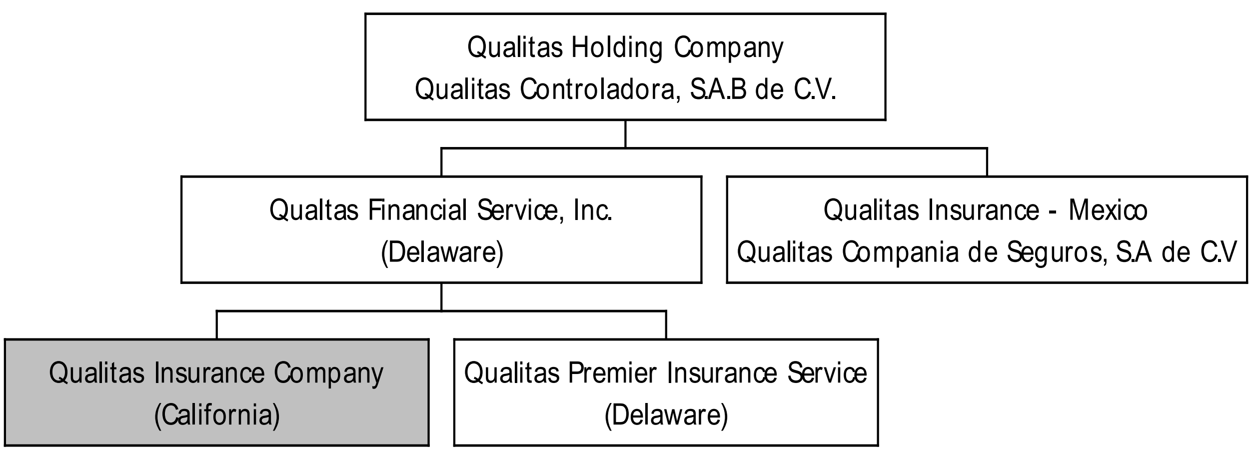
The parent company, QFS made the following capital contributions during the examination period:

Year	Type	Capital Contribution
2019	Cash	$ 5,000,000
2020	Cash	$13,000,000
2021	Cash	$35,000,000
2022*	Cash	$43,000,000

*subsequent period

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Qualitas Controladora, S.A.B. de C.V. is the ultimate controlling entity based in Mexico. The following organizational chart depicts the Company's relationship within the holding company system at December 31, 2021. All ownership is 100% unless otherwise indicated.



The six members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2021:

Directors

Name and Location	Principal Business Affiliation
Joaquin B. Dominguez Mexico D.F., Mexico	Director of Services to Foreign Offices Qualitas Compania de Seguros, S.A. de C.V.
Jose A.C. Etchegaray Mexico D.F., Mexico	President and Chairman of Board Qualitas Compania de Seguros S.A. de C.V.
Eduardo Pedrero San Diego, California	President and Chief Executive Officer Qualitas Insurance Company
Mary E. Queen San Diego, California	Chief Financial Officer Qualitas Insurance Company
Bernardo E. R. Salas Mexico D.F., Mexico	Chief Financial Officer and Vice Chairman of the Board Qualitas Compania de Seguros S.A. de C.V.
Eliane B.I.Sevilla Mexico D.F., Mexico	Chief Operations Officer Qualitas Compania de Seguros, S.A. de C.V.

Principal Officers

Name	Title
Eduardo Pedrero [a]	President and Chief Executive Officer
Mary E. Queen	Chief Financial Officer and Secretary
Arturo Agredano [b]	Chief Operating Officer
Michael Margarian	Vice President of Underwriting
Gustavo G. Guadalupe	Chief Information Officer
Lynne C. Soza [c]	Vice President of Claims

The following changes in directors and principal officers occurred subsequent to the examination date:

(a) Eduardo Pedrero, President and Chief Executive Officer retired and Roberto AB Galindo was elected, effective on January 1, 2023.
(b) Arturo Agredano, Chief Operating Officer, resigned, effective March 10, 2023, without a replacement.
(c) Effective January 24, 2022, Lynne C. Soza resigned as Vice President of Claims and was replaced by Jacob Moreno.

Management Agreements

Intercompany Affiliated Service Agreement: Effective September 2, 2016, the Company and Qualitas Compania de Seguros, S.A. de C.V. (Qualitas Mexico) entered into an Intercompany Affiliated Service Agreement. Under the terms of the Agreement, the Company agrees to make its facilities available and provide certain services to Qualitas Mexico, including but not limited to: data processing, equipment, business property, office space, communication equipment, and payroll. Compensation for providing services shall be limited to the actual cost incurred. This Agreement was approved by the California Department of Insurance (CDI) on January 24, 2017. On February 1, 2018, two amendments were made to the agreement. Amendment A added claims processing to the list of services the Company provides to QMX. Amendment B allows QMX to provide claims processing to the Company for claims that occur in Mexico. Amendment A and B were not filed nor approved by the CDI. It is recommended that the Company file Amendment A and B with the CDI to obtain approval, in accordance with California Insurance Code (CIC) Section 1215.5(b)(4). The Company received payments of $44,703, $38,591, and $17,633 from Qualitas Mexico under this agreement for the years 2019, 2020, and 2021, respectively.

General Agency Agreement: Effective May 25, 2017, the Company and Qualitas Premier Insurance Services (QPI) entered into a General Agency Agreement. The Company appointed QPI for lines of insurance listed within the product line authority, to countersign and deliver policies and binders of insurance, and to cancel insurance policies insured through the Company. QPI will collect all premiums due and will transmit premiums to the Company. QPI receives a commission of 18.0% of the net premium due on domestic commercial automobile liability business and 32.0% for cross-border business placed in Arizona, California, and Texas. The CDI approved this Agreement on July 2, 2018. The

Company paid commissions to QPI of $4,107,720, $5,804,105, and $7,326,068 for the years 2019, 2020, and 2021 respectively.

Intercompany Affiliated Service Agreement: Effective April 1, 2018, the Company and QPI entered into an intercompany affiliated service agreement. Under the terms of the Agreement, the Company agrees to make its facilities available and provide certain services to QPI, including but not limited to: data processing, equipment, business property, office space, and communication equipment. Compensation for providing services shall be limited to the actual cost incurred without a profit factor built-in. This Agreement was approved by the CDI on February 1, 2018. The Company received $42,659, $80,235, and $116,570 from QPI for the years 2019, 2020, and 2021, respectively.

Federal and State Income Tax Sharing Agreement: Effective September 1, 2019, the Company entered into a Federal and State Income Tax Sharing Agreement with Qualitas Financial Services, Inc. (QFS), and QPI (QPI and the Company are collectively referred to as the Affiliates). The Agreement authorizes QFS to have the sole and exclusive responsibility for the preparation and filing of all consolidated Federal and State Income Tax returns. Company pays QFS the amount of regular income tax they would pay to the Taxing Authority (or receive from QFS any refund they would receive from the Tax Authority) as if they were separate companies filling separate FSIT returns. The CDI approved the Agreement on January 14, 2020. Under the terms of the Agreement, the Company paid (recovered) $0, $201,568, and ($109,807) to (from) QFS for the years 2019, 2020, and 2021, respectively.

Non-Affiliated Agreement

General Agency Agreement: Effective March 20, 2014, the Company and Macnafta Insurance Services, Inc. DBA: Quic Insurance Company (Macnafta) entered into a General Agency Agreement. The Company appointed Macnafta for lines of insurance listed within the product line authority, to countersign and deliver policies and binders of insurance, and to cancel insurance policies insured through the Company. Macnafta will collect all premiums due and will transmit premiums to the Company. Macnafta receives a commission of 20% of the net premium due on domestic commercial automobile liability business and 25% for cross-border business placed in California, and 19% for cross-border business placed in Taxes.

TERRITORY AND PLAN OF OPERATION

The Company's headquarter is located in San Diego, California. It is licensed in the following fourteen states; Arizona, California, Colorado, Idaho, Kansas, Maine, Montana, Nevada, Oklahoma, Oregon, Texas, Utah, Washington, and Wyoming.

The Company's primary focus is on the automobile market entering the United States from Mexico, writing both commercial automobile (cross-border and domestic) and personal automobile (cross-border and domestic). This business is referred to as "cross-border business" and "post-border business" under the rules and regulations mandated by the North American Free Trade Agreement.

As of December 31, 2021, the Company wrote $105.8 million in direct premiums written. Macnafta Insurance Services, Inc., an unaffiliated agency, produced $48.5 million (46.0%) of the direct premiums written, Qualitas Premier Insurance Services, Inc., an affiliate agency produced $34.5 million (32.6%) of the direct premiums written. Commercial automobile liability accounted for 88.5% and private passenger automobile liability accounted for 6.5% of the total direct written premiums. Of the total direct premiums written, $60.7 million (57.4%) was written in California, $32 million (30.3%) was written in Texas, and $6.3 million (6.0%) was written in Arizona.

LOSSES EXPERIENCE

The Company incurred loss and loss expense, net underwriting losses, and net income/(losses) under the examination are as follows:

Year	Incurred Loss and Loss Expense	Net Underwriting Loss	Net Income (Loss)
2019	$30,012,206	$(2,230,063)	$255,607
2020	43,031,602	(5,516,198)	(2,609,239)
2021	84,894,955	(26,952,122)	(20,124,043)
2022*	109,038,245	(48,281,480)	(42,955,996)

*subsequent period

The Company attributes the underwriting losses to lack of adequate pricing for its commercial lines. Lack of historical data used in calculating, the Company's estimates for the loss and loss adjustment expenses reserves have contributed to the continued adverse development. Loss and loss adjustment expenses increased by $41.9 million, which included $23.3 million in adverse development for accident years 2019 and prior. The majority of the adverse development was attributed to the commercial automobile line of business. Reserve strengthening to address prior period adverse developments also had a significant impact on 2021 underwriting income and surplus. All of the above resulted in the Company triggering the Risk Based Capital (RBC) Company Action Level.

As a property and casualty insurance company, the Company is subject to RBC requirements. RBC is a method developed by the National Association of Insurance Commissioners (NAIC) and adopted in the Insurance Code Section 739 to determine the minimum amount of statutory capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The Company's RBC total adjusted capital was 276.5% of its Authorized Control Level as of December 31, 2021. Its statutory accounting basis combined ratio was 127.7% for the year ended December 31, 2021. The RBC level coupled with the statutory accounting basis combined ratio triggered a Company Action Level Event.

On April 14, 2022, a comprehensive RBC Corrective Action Plan (RBC Plan) was submitted to address the actions taken by the Company to increase its RBC total adjusted capital above 300%. Corrective actions taken included but were not limited to; $35 million immediate cash contribution by the parent, reserve strengthening, claims department realignment, filing rate increases, and strengthening of talent in various departments to improve loss and operating performance. The CDI requested additional information on

May 26, 2022 and June 16, 2022.

REINSURANCE

Assumed

The Company has no assumed reinsurance.

Ceded

The Company had the following ceded reinsurance agreements in place as of December 31, 2021.

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
Excess of Loss (1/1/21-12/31/21)	Everest Reinsurance Company 75% (Authorized) Eureka Re SCC 20% (Unauthorized) Citadel Reinsurance Company Limited 5% (Unauthorized)	$500,000	The contract insures up to $500,000 with a retention of $500,000 for a total of $1,000,000. The maximum aggregate limit under this agreement is equal to $20, 000,000.
Excess of Loss Bus (3/1/21-5/31/22)	Various Lloyds' Syndicates 90% (Authorized) MS Amlin AG 10% (Unauthorized)	$1,000,000	The contract insures up to $4,000,000 with a retention of $1,000,000 for a total of $5,000,000. The maximum aggregate limit under this agreement is equal to $20,000,000

Effective January 1, 2023, the Company terminated all its reinsurance programs.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2021. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no examination adjustments made to the financial statements as a result of the examination.

Statement of Financial Condition as of December 31, 2021

Underwriting and Investment Exhibit for the Year Ended December 31, 2021

Reconciliation of Capital and Surplus as Regards Policyholders from December 31, 2018 through December 31, 2021

Statement of Financial Condition
as of December 31, 2021

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 148,362,058	$	$ 148,362,058	
Common stocks	10,106,829		10,106,829	
Cash and short-term investments	21,259,073		21,259,073	
Receivable for securities	19,350,000		19,350,000	
Investment income due and accrued	427,673		427,673	
Uncollected premiums and agents' balances in course of collection	6,582,042		6,582,042	
Amount recoverable from reinsurers	487,692		487,692	
Current federal and foreign income tax recoverable and interest thereon	695,862		695,862	
Net deferred tax asset	5,863,554	5,863,554	0	
Guaranty funds receivable or on deposit	73,380	73,380	0	
Electronic data processing equipment and software	956,034	956,034	0	
Furniture and equipment	288,820	288,820	0	
Receivables from parent, subsidiaries and affiliates	12,423		12,423	
Aggregate write-ins for other than invested assets	150,033	150,033	0	
Total assets	$ 214,615,474	$ 7,331,821	$ 207,283,653	

Liabilities, Surplus and Other Funds			Notes
Losses		$ 91,948,065	(1)
Loss adjustment expenses		11,821,739	(1)
Commissions payable, contingent commissions and other similar charges		2,003,770	
Other expenses		1,507,970	
Taxes, licenses and fees		822,432	
Unearned premiums		47,429,566	
Ceded reinsurance premiums payable		(1,168,774)	
Funds held by company under reinsurance treaties		71,275	
Payable to parent, subsidiaries and affiliates		4,045,947	
Payable for securities		80,547	
Total liabilities		158,562,537	
Common capital stock	$ 3,000,000		
Surplus notes	6,000,000		
Gross paid-in and contributed surplus	82,433,549		
Unassigned funds (surplus)	(42,712,409)		
Surplus as regards policyholders		$ 48,721,140	
Total liabilities, surplus and other funds		$ 207,283,677	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2021

Statement of Income

Underwriting Income			
Premiums earned		$ 87,983,538	
Losses incurred	$ 70,998,060		(1)
Loss adjustment expenses incurred	13,896,895		(1)
Other underwriting expenses incurred	30,040,705		
Total underwriting deductions		114,935,660	
Net underwriting loss		(26,952,122)	
Investment Income			
Net investment income earned	$ 1,825,957		
Net realized capital gain	4,122,939		
Net investment gain		5,948,896	
Other income			
Finance and service charges not included in premiums	187,519		
Aggregate write-ins for miscellaneous income	(5,107)		
Total other income		182,412	
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(20,820,814)	
Federal and foreign income taxes incurred		(696,771)	
Net loss		$ (20,124,043)	

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2020		$ 41,424,540
Net loss	$ (20,124,043)	
Change in net unrealized capital losses	(835,671)	
Change in net deferred income tax	3,879,854	
Change in nonadmitted assets	(6,745,948)	
Change in provision for reinsurance	(3,877,599)	
Surplus adjustment:		
Paid-in	35,000,000	
Change in surplus as regards policyholders for the year		7,296,592
Surplus as regards policyholders, December 31, 2021		$ 48,721,132

Reconciliation of Capital and Surplus
from December 31, 2018 through December 31, 2021

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2018			$ 23,670,285
Net Loss	$	$ 22,477,675	
Change in net realized capital gains	583,397		
Change in net deferred income tax	4,271,898		
Change in nonadmitted assets		6,280,823	
Change in provision for reinsurance in unauthorized companies		4,045,950	
Surplus adjustments – Paid-in	53,000,000		
Total gains and losses	$ 57,855,295	$ 32,804,448	
Net increase in surplus as regards policyholders			25,050,847
Surplus as regards policyholders, December 31, 2021			$ 48,721,132

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The December 31, 2021 reserves and related actuarial loss and loss adjustment expense reserves were evaluated by a Senior Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Company's loss and loss adjustment expense reserves were found to be reasonably stated given what was known as of year-end 2021, and have been accepted for purposes of this examination. However, it was noted the carried reserves were on the lower-end of the actuarial range. Given the Company reported adverse development from 2021 to 2022, it is recommended that the Company increase its carried reserves to be more aligned to the actuarial mid-point estimate to allow for additional development.

SUBSEQUENT EVENTS

Continued adverse development in the Company's reserve estimates and material reserve strengthening led to underwriting loss of $48 million and net loss of $43.0 million in 2022, as described in the "Loss Experience" section. Policyholders' surplus fell only 11.2% to $43.2 million as a result of a parental capital infusion of $43.0 million made in 2022. The Company again reported a Risk-Based Capital (RBC) Company Action Level Event as the Company's RBC total adjusted capital was less than 300% of its Authorized Control Level and the Company reported a combined ratio of 154.6% as of December 31, 2022.

On April 21, 2023, the Company submitted its 2022 RBC Corrective Action Plan (RBC Plan). Proposed corrective actions include but are not limited to; additional capital contributions by the parent, continued reserve strengthening, and obtaining adequate rates. The California Department of Insurance is currently reviewing the RBC Plan.

A Senior Casualty Actuary from the California Department of Insurance (CDI) reviewed the 2021 and 2022 Annual Statements along with the 2021 and 2022 Actuarial Opinions and supporting Actuarial Reports prepared by the Company's opining actuary. Based on the review, it was determined that there was additional loss and loss adjustment expense (LAE) development during 2022 of $35.1 million for the accident year 2021 which the Company recognized.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management Agreements – Intercompany Affiliated Service Agreement (Page 5): It is recommended that the Company file Amendment A and B with the CDI to obtain approval, in accordance with California Insurance Code (CIC) Section 1215.5(b)(4) for all management agreements.

Comments on Financial Statement – Loss and Loss Adjustment Expense (Page 14): It is recommended that the Company increase its carried reserves to be more aligned to the actuarial mid-point estimate to allow for additional development.

Previous Report of Examination

Account and Record – Financial Statements (Page 9): The Company inaccurately reported closed claim counts in its 2018 and 2019 annual statements, Schedule P, Part 5B and 5C, Section 1 and 3. It was recommended that the Company implement procedures to strengthen its financial reporting and accounting controls to ensure that all accounts and schedules are fairly and accurately reported within its filed financial statements. The Company is now in compliance.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

Voong, Amy

Digitally signed by Voong, Amy
Date: 2023.06.07 07:39:36 -07'00'

Amy Voong, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Briggs, Anjanette

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Anjanette Briggs, CFE
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