

REPORT OF EXAMINATION
OF THE
SAN FRANCISCO REINSURANCE COMPANY
AS OF
DECEMBER 31, 2013

Filed June 8, 2015

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION	1
SUBSEQUENT EVENTS	2
COMPANY HISTORY:	5
Capitalization	5
MANAGEMENT AND CONTROL:.....	6
Management Agreements.....	8
TERRITORY AND PLAN OF OPERATION.....	8
REINSURANCE	8
ACCOUNTS AND RECORDS:.....	9
Information Systems Controls.....	9
FINANCIAL STATEMENTS:	9
Statement of Financial Condition as of December 31, 2013.....	10
Underwriting and Investment Exhibit for the Year Ended December 31, 2013	11
Reconciliation of Surplus as Regards Policyholders from December 31, 2010 through December 31, 2013.....	12
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	13
Losses	13
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	13
Current Report of Examination	13
Previous Report of Examination	13
ACKNOWLEDGMENT	14

San Francisco, California
March 26, 2015

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

SAN FRANCISCO REINSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 777 San Marin Drive, Novato, California 94998.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2010. This examination covers the period from January 1, 2011 through December 31, 2013. 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, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of

the Company were considered in accordance with the risk-focused examination process.

This was a coordinated examination with California as the lead state of the Fireman's Fund Subgroup of the Allianz Insurance Group. It was conducted concurrently with other insurance entities in the subgroup and included participation from the following states: Illinois (IL), Missouri (MO), New Jersey (NJ), Ohio (OH), and Texas (TX). The entities are:

- American Automobile Insurance Company (MO)
- The American Insurance Company (OH)
- Associated Indemnity Corporation (CA)
- Chicago Insurance Company (IL)
- Fireman's Fund County Mutual Insurance Company (TX)
- Fireman's Fund Indemnity Corporation (NJ)
- Fireman's Fund Insurance Company (CA)
- Fireman's Fund Insurance Company of Ohio (OH)
- Interstate Fire & Casualty Company (IL)
- National Surety Corporation (IL)

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company, loss experience; and statutory deposits.

SUBSEQUENT EVENTS

On September 17, 2014, the Company's ultimate parent, Allianz SE (AZSE), a European Company incorporated in the Federal Republic of Germany and the European Union, officially announced plans to reconfigure the Company's immediate parent, Fireman's Fund Insurance Company (FFIC) (Reorganization Plan). As part of the Reorganization Plan, FFIC's commercial property and casualty business will be integrated with Allianz Global Risks US Insurance Company, an Illinois corporation dba Allianz Global Corporate & Specialty North America (AGCS), which is one of several

global corporate insurance companies of AZSE. The legal ownership of FFIC and its direct subsidiaries will also be re-aligned through a transfer of ownership of FFIC and its direct subsidiaries from Allianz of America, Inc. (AZOA) to AGCS. Prior to the transfer of FFIC and its direct subsidiaries to AGCS, ownership of the Company will be transferred from FFIC to AZOA. After the transfer of ownership, FFIC's legacy asbestos and environmental, legacy worker's compensation, and legacy construction defect liabilities will be transferred to the Company.

The transfer of FFIC and its subsidiaries to AGCS, the transfer of ownership of the Company to AZOA, and the transfer of FFIC's legacy asbestos and environmental policy liabilities to the Company were filed as a series of transactions with the California Department of Insurance (CDI), with an effective date of January 1, 2015. The CDI issued non-disapproval letters for the filed transactions on December 15, 2014. The reorganization and transactions occurred in the following order:

- FFIC entered into a reinsurance agreement with the Company, by which FFIC ceded and the Company assumed and reinsured on an indemnity basis, 100% of FFIC's legacy asbestos and environmental liabilities for policies written prior to January 1, 1988, and all asbestos liabilities for policies written between January 1, 1988 and December 31, 2003. FFIC transferred outstanding reserves estimated at \$954 million as of December 31, 2014. The reinsurance premium equaled to the transferred reserves, with no surplus effect. The reinsurance agreement has a reinsuring limit of approximately \$1.6 billion.
- FFIC made a capital contribution to the Company in the amount of \$321 million in the form of cash and securities that constitute permitted investments under the California Insurance Code. After the infusion and the related reinsurance transactions with FFIC, the Company's policyholder's surplus was approximately \$394 million, with an estimated Risk-Based Capital (RBC) ratio of 275%.
- FFIC entered into an Intercompany Service Agreement with the Company, whereby the FFIC provides personnel and services necessary for the operation and administration of the Company's business, including claims handling and

adjusting, controllers and treasury, accounting and finance, legal and tax, and technological services.

- The Company entered into an Investment Management Agreement with its affiliate, Pacific Investment Management Company (PIMCO), whereby PIMCO provides investment management services for the Company's fixed income investment portfolio held in an account and other assets which may be transferred to PIMCO's control.
- The Company entered into an Investment Services Agreement with its affiliate, Allianz Investment Management (AIM), whereby AIM provides investment management and related advisory and operational support services with respect to the Company's assets and other assets that may be transferred to AIM's control.
- FFIC made an extraordinary dividend consisting of the transfer of ownership interest of all issued shares of common stock of the Company with an approximate value of \$395 million to AZOA. The Company became a direct subsidiary of AZOA and operates under the governance structure of AZSE. AZOA and the Company entered into a Capital Commitment Agreement on December 11, 2014. The Commitment began January 1, 2015 and remains in full force and effect as long as AZOA owns the Company. AZOA agreed to provide the Company with additional capital contributions in such amounts as may be required in order for the Company to maintain a minimum RBC ratio of 250%.
- The transfer of ownership of the Company's stock to AZOA did not result in any change of control or change in the ultimate shareholder of the Company. There were no changes to the articles of incorporation or bylaws of the Company, nor changes to the Company's name, state of organization or statutory home office. AZSE continues to hold the ultimate control of 100% of the voting securities of the Company.

COMPANY HISTORY

On January 2, 1991, Allianz of America, Inc. (AZOA), a U.S. subsidiary of Allianz SE (AZSE), purchased 100% of the capital stock of Fireman's Fund Insurance Company (FFIC), the Company's immediate parent as of the examination date. AZSE is the ultimate parent of the Fireman's Fund Group. AZSE operates on a worldwide basis through branch offices, subsidiaries and affiliated companies.

On November 1, 1997, FFIC and its subsidiaries became a wholly owned subsidiary of Allianz Insurance Company, a subsidiary of AZOA. Allianz Insurance Company, an Illinois company, changed its name to Allianz Global Risks US Insurance Company dba Allianz Global Corporate & Specialty US (AGCS) in 2003.

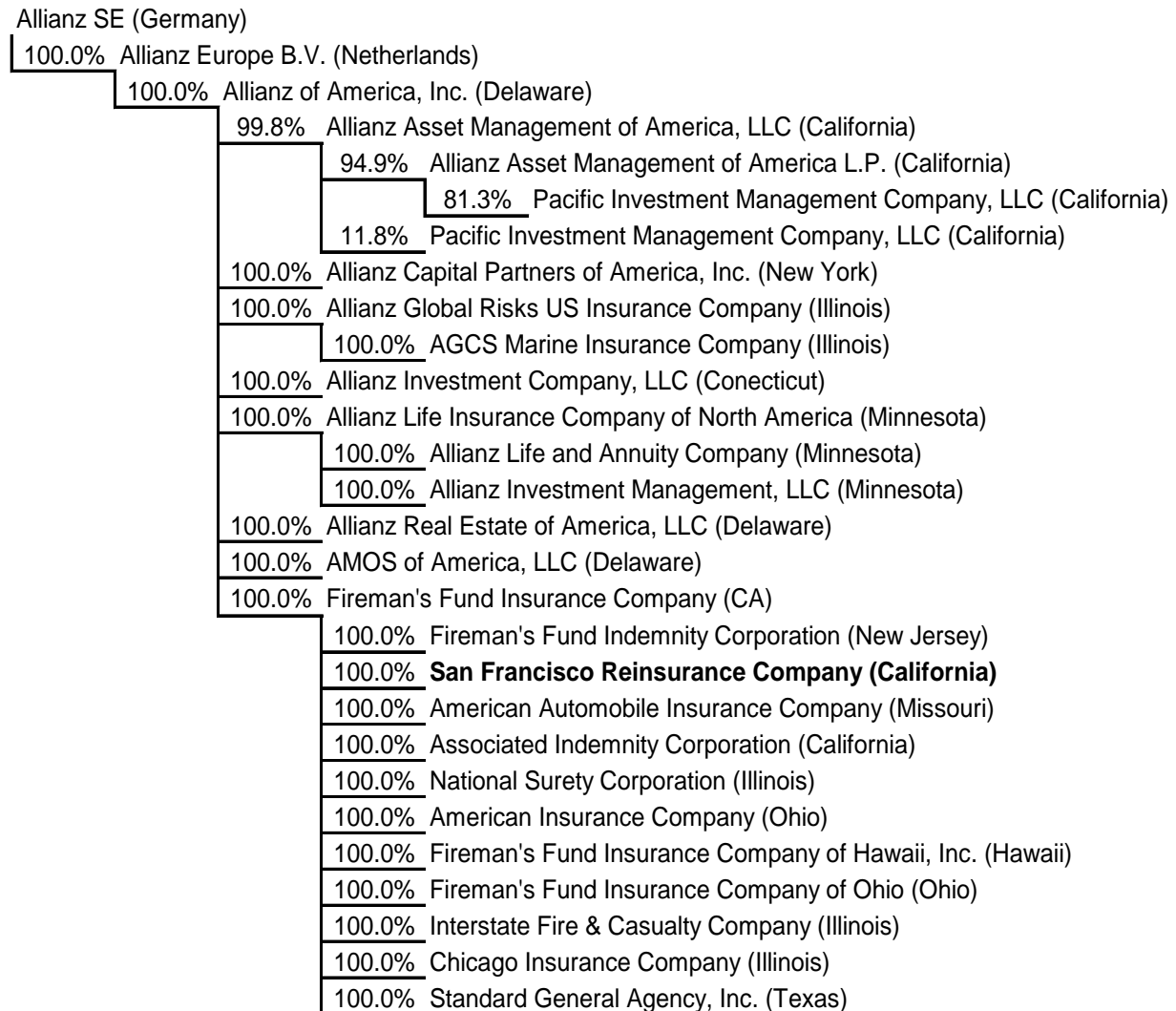
On December 31, 2012, AGCS distributed all outstanding shares of FFIC's stock to AZOA. FFIC and its subsidiaries were subsidiaries of AZOA until December 31, 2014, as described under Subsequent Events.

Capitalization

The Company is authorized to issue 60,000 shares of common stock with a par value of \$100 per share. As of December 31, 2013, there were 39,215 shares outstanding. All outstanding shares of the Company's stock were directly owned by FFIC as of December 31, 2013.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, of which Allianz SE (AZSE) is the ultimate controlling entity. AZSE is incorporated in the Federal Republic of Germany and the European Union. The following is an abridged chart of the holding company system at December 31, 2013:



The five 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, 2013:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Jeffery F. Johnson San Anselmo, California	Vice President and Controller Fireman's Fund Insurance Company
Sally B. Narey ^(a) Larkspur, California	Senior Vice President, General Counsel, and Secretary Fireman's Fund Insurance Company
D. Andrew Torrance ^(b) Sausalito, California	President and Chief Executive Officer Fireman's Fund Insurance Company
Kevin E. Walker ^(c) Novato, California	Senior Vice President, Chief Financial Officer, and Treasurer Fireman's Fund Insurance Company
David M. Zona ^(d) Novato, California	Senior Vice President and Chief Underwriting Officer Fireman's Fund Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
D. Andrew Torrance ^(b)	Chairman of the Board, President, and Chief Executive Officer
Kevin E. Walker ^(c)	Senior Vice President, Chief Financial Officer, and Treasurer
Sally B. Narey ^(a)	Senior Vice President, General Counsel, and Secretary

The following changes in management occurred subsequent to the examination date:

- ^(a) Effective January 27, 2015, J. Terry Griffith was elected Vice President and Secretary, replacing Sally B. Narey.
- ^(b) Effective January 27, 2015, D. Andrew Torrance was replaced by Kevin E. Walker as President and Chief Executive Officer of the Company.
- ^(c) Effective January 1, 2015, Kevin E. Walker was named as the head of Allianz Runoff

Management US. He remains Senior Vice President, Chief Financial Officer, and Treasurer for the Company while reporting to Arthur E. Moossmann Jr. during the transition period.

^(d) Effective January 1, 2015, David M. Zona's role changed to Zone Lead Northeast of Fireman's Fund Insurance Company (FFIC).

Management Agreements

Tax Reimbursement Agreement: Effective December 17, 1999, between Allianz of America, Inc. (AZOA) and FFIC and its subsidiaries for the purpose of clarifying an Agreement that was in effect since 1991. Under the terms of this Agreement, the tax liability of FFIC and its subsidiaries are computed as if each member filed a separate stand-alone return. AZOA was the party primarily responsible for filing and making all tax payments on behalf of FFIC and its subsidiaries.

Service Agreement: Effective January 1, 1982, the Company entered into a Service Agreement for staff support and investment services with FFIC. This Agreement was last amended on September 30, 1994, in regard to the investment fees only.

TERRITORY AND PLAN OF OPERATION

The Company was a professional reinsurance company, which wrote pro-rata and excess reinsurance in both the domestic and foreign markets. Effective January 1, 1997, the Company ceased its underwriting operations, except for renewals, and is proceeding with the runoff of its existing business. Following the decision to place the Company into run-off, the renewal rights to the Company's book of business were sold to Hartford Fire Insurance Company.

REINSURANCE

The Company had no assumed or ceded premium written during the period covered by this examination. The reported liability for losses and loss adjustment expenses were for years prior to the examination period.

Effective January 1, 2015, as noted in the Subsequent Events section of this report, the Company entered into a reinsurance agreement with Fireman's Fund Insurance Company (FFIC) by which FFIC ceded and the Company agreed to assume certain legacy asbestos and environmental liabilities for policies written prior to January 1, 1988 and asbestos liabilities for policies written between January 1, 1988 and December 31, 2003 by FFIC and its subsidiaries, excluding the Company, up to a reinsuring limit of \$1.7 billion. On December 15, 2014, the California Department of Insurance (CDI) notified the Company that the CDI does not disapprove the agreement.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was conducted of the Company's general controls over its information systems. As a result of this review, several findings were noted in controls over logical security. These findings were presented to the Company, along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2013

Underwriting and Investment Exhibit for the Year Ended December 31, 2013

Reconciliation of Surplus as Regards Policyholders from December 31, 2010 through December 31, 2013

Statement of Financial Condition
as of December 31, 2013

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 90,570,368	\$	\$ 90,570,368	
Cash and short-term investments	1,932,854		1,932,854	
Other invested assets	121,013		121,013	
Investment income due and accrued	715,396		715,396	
Reinsurance:				
Amount recoverable from reinsurers	553,995		553,995	
Funds held by or deposited with reinsured companies	62,564		62,564	
Current federal and foreign income taxes recoverable	742,362		742,362	
Net deferred tax asset	<u>1,957,407</u>	<u>119,950</u>	<u>1,837,457</u>	
 Total assets	 <u>\$ 96,655,959</u>	 <u>\$ 119,950</u>	 <u>\$ 96,536,009</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 22,963,068	(1)
Reinsurance payable on paid loss and loss adjustment expenses			(14,907)	
Other expenses			(131,197)	
Taxes, licenses and fees			40,711	
Funds held by company under reinsurance treaties			254,885	
Provision for reinsurance			364,651	
Payable to parent, subsidiaries and affiliates			49,451	
Payable for securities			<u>203</u>	
 Total liabilities			 23,526,865	
 Common capital stocks	 \$ 3,921,500			
Gross paid-in and contributed surplus	10,633,647			
Unassigned funds (surplus)	<u>58,453,997</u>			
 Surplus as regards policyholders			 <u>73,009,144</u>	
 Total liabilities, surplus and other funds			 <u>\$ 96,536,009</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2013

Statement of Income

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses incurred	\$ 2,229,762	
Other underwriting expenses incurred	<u>1,823</u>	
Total underwriting deductions		<u>2,231,585</u>
Net underwriting loss		(2,231,585)

Investment Income

Net investment income earned	\$ 2,704,158	
Net realized capital loss	<u>177,165</u>	
Net investment gain		<u>2,881,323</u>
Net income before federal and foreign income taxes		649,738
Federal and foreign income taxes incurred		<u>(35,758)</u>
Net income		<u>\$ 685,496</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2012		\$ 72,113,272
Net income	\$ 685,496	
Change in net unrealized capital gains	47,584	
Change in net unrealized foreign exchange capital gains	22,631	
Change in net deferred income tax	(99,887)	
Change in nonadmitted assets	(5,306)	
Change in provision for reinsurance	<u>245,354</u>	
Change in surplus as regards policyholders for the year		<u>895,872</u>
Surplus as regards policyholders, December 31, 2013		<u>\$ 73,009,144</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2010 through December 31, 2013

Surplus as regards policyholders, December 31, 2010 per Examination			\$ 75,219,292
	Gain in Surplus	Loss in Surplus	
Net loss	\$	\$	4,881,724
Net unrealized capital gains	47,584		
Change in net foreign exchange capital losses		27,984	
Change in net deferred income tax	1,354,124		
Change in nonadmitted assets	184,451		
Change in provision for reinsurance	1,016,843		
Cumulative effect of changes in accounting principle	96,558		
Total gains and losses	\$ 2,699,560	\$ 4,909,708	
Net decrease in surplus as regards policyholders			(2,210,148)
Surplus as regards policyholders, December 31, 2013, per Examination			\$ 73,009,144

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses

The California Department of Insurance (CDI) retained an independent Consulting Actuary pursuant to authority granted in California Insurance Code Section 733, to evaluate the Company's loss reserves as of December 31, 2013. In addition, a Senior Casualty Actuary with the CDI reviewed the work of the Consulting Actuary. Based on the analyses performed by the Consulting Actuary and CDI Senior Casualty Actuary, the CDI has determined that the loss reserves as reported by the Company are reasonable and have been accepted for the purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information Systems Controls (Page 9): As the result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Previous Report of Examination

Accounts and Records – Information Systems Controls (Page 6): As the result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems. The Company had implemented changes to strengthen some of its controls; however, as noted in the Accounts and Records section, improvements are still needed.

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,

_____/s/_____

Shawn Towchik, CFE
Examiner-In-Charge
Contract Examiner
Department of Insurance
State of California