

REPORT OF EXAMINATION
OF THE
DEVELOPERS SURETY AND
INDEMNITY COMPANY
AS OF
DECEMBER 31, 2017

Filed on June 25, 2019

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION	1
COMPANY HISTORY:	2
Capitalization	3
Dividends	3
MANAGEMENT AND CONTROL:.....	3
Management Agreements.....	6
TERRITORY AND PLAN OF OPERATION.....	7
REINSURANCE:	8
Inter-Company Reinsurance Pooling Agreement.....	8
Assumed.....	9
Ceded	9
FINANCIAL STATEMENTS:	10
Statement of Financial Condition as of December 31, 2017	11
Underwriting and Investment Exhibit for the Year Ended December 31, 2017	12
Reconciliation of Surplus as Regards Policyholders from December 31, 2014 through December 31, 2017	13
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	14
Losses and Loss Adjustment Expenses	14
SUBSEQUENT EVENTS	14
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	15
Current Report of Examination	15
Previous Report of Examination	15
ACKNOWLEDGMENT	16

Los Angeles, California
May 24, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

DEVELOPERS SURETY AND INDEMNITY COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 17771 Cowan, Suite 100, Irvine, California 92614.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2014. This examination covered the period from January 1, 2015 through December 31, 2017.

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.

This was a coordinated examination with California as the facilitating state of the Insko Insurance Services, Inc. subgroup of the AmTrust Financial Services, Inc. group. It was conducted concurrently with other insurance entities in the holding company group, including Indemnity Company of California. The following states participated on the examination: Arizona, Delaware, Florida, Kansas, Nevada, New Jersey, New York, Oklahoma, Pennsylvania, and Texas.

COMPANY HISTORY

The Company is a property and casualty insurer and was incorporated under the laws of Iowa on October 10, 1936 and was licensed in California on August 30, 1999. On January 2, 2014, the Company and its subsidiary, Indemnity Company of California, became part of the AmTrust NGH Group when AmTrust Financial Services Inc. purchased Insko Insurance Services, Inc. (INSCO), its immediate parent. On November 29, 2016, the Company re-domesticated from Iowa to California.

Capitalization

The Company is authorized to issue five thousand shares of common stock with a par value of \$1,000 per share. As of December 31, 2017, there were three thousand and one hundred shares outstanding.

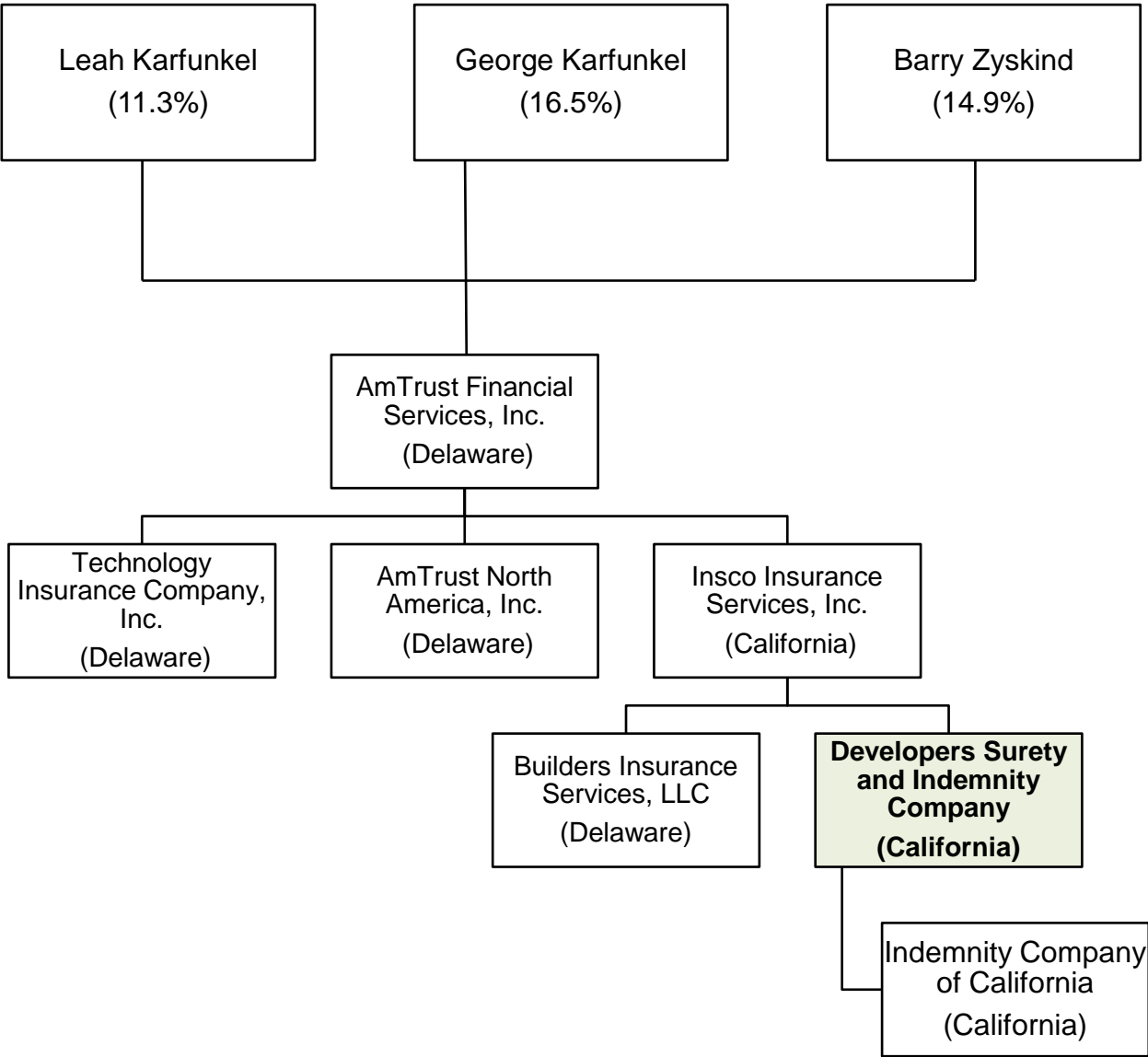
On December 31, 2017, the Company received a capital contribution in cash from INSCO, its immediate parent, in the amount of \$6,000,000.

Dividends

On January 30, 2015, the Company paid an ordinary cash dividend of \$2,000,000 to INSCO.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which AmTrust Financial Services, Inc., a Delaware corporation, is the ultimate controlling entity. The following is an abridged organizational chart. All ownership is 100%.



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, 2017:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Harry C. Crowell Newport Beach, California	President Crowell Industries
Donald T. DeCarlo Douglaston, New York	Attorney Self Employed
Susan C. Fisch San Francisco, California	Retired Insurance Executive
Harry Schlachter Lawrence, New York	Treasurer AmTrust Financial Services, Inc.
Stephen B. Ungar North Hills, New York	General Counsel and Secretary AmTrust Financial Services, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
Sam Zaza	President
Stephen B. Ungar	Secretary
Harry Schlachter	Treasurer
Kerry J. Heitz	Executive Vice President and Chief Financial Officer
Jeffery H. Mayer	Chief Actuary
Daniel Young	Senior Vice President, Chief Underwriting Officer
Barry W. Moses	Vice President, Regulatory & Compliance and Assistant Secretary
Blaine Williamson	Senior Vice President, Field Operations

Management Agreements

Insurance Services Management and Agency Agreement: Effective January 2, 2014, the Company entered into an Insurance Services Management and Agency Agreement with its affiliate, AmTrust North America, Inc., a Delaware licensed insurance agency, to market and administer covered commercial property and casualty risks and policies, including workers' compensation, employers' liability or other similar policies. Services include underwriting, billing and collections, reporting and record maintenance, claims management, and reserving support. The California Department of Insurance (CDI) approved the agreement in conjunction with the Company's re-domestication on November 29, 2016. This agreement is inactive. The Company paid service fees of \$0, \$0, and \$0 for 2015, 2016, and 2017, respectively.

Intercompany Management Agreement: Effective January 2, 2014, the Company entered into an Intercompany Management Agreement with AmTrust Financial Services, Inc. Services (AFSI). Under the terms of the agreement, AFSI is to provide investment fund management, statutory accounting and reporting, loss reserving and reinsurance placement, employee management and human resource services, corporate governance and maintenance of fiduciary accounts services. The CDI approved the agreement in conjunction with the Company's re-domestication on November 29, 2016. This agreement is inactive. The Company paid service fees of \$0, \$0, and \$0 for 2015, 2016, and 2017, respectively.

Tax Allocation Agreement: Effective January 2, 2014, the Company entered into a Tax Allocation Agreement with AFSI. The allocation is made on a separate return basis with current credit for any net operating losses or other items utilized in the consolidated tax return. Tax return settlement is made within 30 days of the filing of the return. The CDI approved the agreement in conjunction with the Company's re-domestication on November 29, 2016. The Company paid/(received) tax settlements of \$3,878,342, \$(236,717), and \$2,814,730 for 2015, 2016, and 2017, respectively.

Underwriting Management Agreement – Effective August 1, 2010, the Company entered into an Underwriting Management Agreement with Insko Insurance Services, Inc. (INSCO). Under the terms of the agreement, INSCO is authorized to manage the insurance operations, including administration, production, distribution and claims, and adjusting functions. The compensation for providing the services is based on actual cost. The Company will reimburse INSCO monthly for all costs and expenses incurred in the performance of duties under this agreement. The agreement was approved by the Iowa Insurance Division. The agreement was in effect prior to re-domestication from Iowa and no material change was made. The Company paid service fees of \$12,843,826, \$14,553,445, \$16,062,619 for 2015, 2016, and 2017, respectively.

Underwriting Management Agreement – Effective June 1, 2012, the Company entered into an Underwriting Management Agreement with Builders Insurance Services, LLC (Builders), an affiliate. Under the terms of the agreement, Builders manages the property and casualty insurance operations of the Company. The compensation for providing the services is based on actual cost. The Company will reimburse Builders monthly for all costs and expenses incurred in the performance of duties under this agreement. The agreement was approved by the Iowa Insurance Division. The agreement was in effect prior to re-domestication from Iowa and no material change was made. The Company paid service fees of \$1,642,293, \$1,636,332, and \$1,923,935 for 2015, 2016, and 2017, respectively.

TERRITORY AND PLAN OF OPERATION

The Company provides surety bonds for construction contractors and land and housing developers, contractors liability and miscellaneous other property and casualty insurance to developers and contractors, and licenses & permit bonds to businesses of all sizes to meet federal, state, and local regulatory requirements for business licensure. Surety applicants which meet the basic standards are written through the Company.

As of December 31, 2017, the Company was licensed to transact aircraft, automobile, boiler and machinery, burglary, common carrier liability, credit, disability, fire, legal

insurance, liability marine, miscellaneous, plate glass, sprinkler, surety, team and vehicle, and workers' compensation insurance in California. The Company was licensed in all fifty (50) states, including the District of Columbia, and the U.S. Virgin Islands.

At December 31, 2017, the Company had direct written premiums of \$71,938,499 of which 67.1% is surety and 32.2% is other liability-occurrence. The top three states in direct written premiums and percentages are: California \$23,918,325 (33.2%), Washington \$10,662,830 (14.8%), and Oregon \$7,722,923 (10.7%).

The Company had a distribution network of approximately 4,700 independent producers. As of December 31, 2017, there were 15 branch offices that worked with the agency force and to perform marketing and underwriting functions.

REINSURANCE

Inter-Company Reinsurance Pooling Agreement

Technology Insurance Company, Inc., a Delaware company, is the lead in a quota share Inter-Company Reinsurance Pooling Agreement (Agreement) under which the Company and the insurers listed below pool their risks and obtain a proportional share of the profits and/or losses of the pooled business. The Agreement became effective October 1, 2017. Under the Agreement, business is allocated among the pool participants as follows:

<u>Pool Participants</u>	<u>State of Domicile</u>	<u>Pooling Share</u>
Technology Insurance Company, Inc.	DE	55.0%
Wesco Insurance Company	DE	25.0%
Developers Surety and Indemnity Company	CA	10.0%
Security National Insurance Company	DE	10.0%
Total		<u>100.0%</u>

The Agreement was approved by the California Department of Insurance on December 15, 2017.

Assumed

Other than its participation in the Inter-Company Reinsurance Pooling Agreement, the Company has \$40,000 reinsurance assumed.

Ceded

Other than Inter-Company Reinsurance Pooling Agreement, the following is a summary of the Company's reinsurance agreements in force as of December 31, 2017):

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
<u>Surety</u>	Authorized		
Quota Share	Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd.	40%	60% of Company's net liability
<u>Surety</u>			
Excess of Loss First Layer	Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd	40% of \$7.0 million in excess of \$500 thousand	60% of \$7.0 million in excess of \$500 thousand, maximum limit of \$28 million Aggregate Ultimate Loss per Year
Second Layer	Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd, Odyssey Reinsurance Company	0%	100% of \$7.5 million in excess of \$7.5 million, maximum limit of \$15 million Aggregate Ultimate Loss per year
Third Layer	Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd, Odyssey Reinsurance Company	0%	100% of \$15 million in excess of \$15 million, maximum limit of \$30 million Aggregate Ultimate Loss per year

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, 2017. 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 surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2017

Underwriting and Investment Exhibit for the Year Ended December 31, 2017

Reconciliation of Surplus as Regards Policyholders from December 31, 2014
through December 31, 2017

Statement of Financial Condition
as of December 31, 2017

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 100,192,195	\$	\$ 100,192,195	
Common stocks	36,334,046		36,334,046	
Cash and short-term investments	15,715,703		15,715,703	
Receivable for securities	12,565		12,565	
Investment income due and accrued	981,160		981,160	
Premiums and agents' balances in course of collection	74,807,859	21,647,916	53,159,943	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$0 earned but unbilled premiums)	129,431,544		129,431,544	
Accrued retrospective premiums	125,005		125,005	
Amount recoverable from reinsurers	633,048		633,048	
Net deferred tax asset	14,795,509		14,795,509	
Guaranty funds receivable or on deposit	58,928		58,928	
Electronic data processing equipment and software	58,888		58,888	
Receivables from parent	248,728,948		248,728,948	
Aggregate write-ins for other than invested assets	<u>20,439,189</u>		<u>20,439,189</u>	
 Total assets	 <u>\$ 642,314,587</u>	 <u>\$21,647,916</u>	 <u>\$ 620,666,671</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 335,675,140	(1)
Commissions payable, contingent commissions and other similar charges			5,660,725	
Other expenses			3,104,706	
Taxes, licenses and fees			7,088,031	
Current federal and foreign income taxes			11,832,604	
Unearned premiums			134,740,320	
Advance premiums			2,212,453	
Dividends declared and unpaid: Policyholders			13,671	
Ceded reinsurance premiums payable			213,399	
Funds held by company under reinsurance treaties			97,236	
Amounts withheld or retained by company for account of others			11,182,012	
Payable to parent, subsidiaries and affiliates			927,384	
Aggregate write-ins for liabilities			<u>5,834,519</u>	
 Total liabilities			 518,582,200	
Aggregate write-ins for special surplus funds		\$ 17,308,515		
Common stock		3,100,000		
Gross paid in and contributed surplus		28,235,885		
Unassigned funds (surplus)		<u>53,440,071</u>		
 Surplus as regards policyholders			 <u>102,084,471</u>	
 Total liabilities and surplus			 <u>\$ 620,666,671</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2017

Statement of Income

Underwriting Income

Premiums earned		\$ 90,035,574
Deductions:		
Losses and loss expenses incurred	\$ 54,786,732	
Other underwriting expenses incurred	<u>68,302,918</u>	
Total underwriting deductions		<u>123,089,650</u>
Net underwriting loss		(33,054,076)

Investment Income

Net investment income earned	\$ 3,032,253	
Net realized capital gain	<u>2,427,384</u>	
Net investment gain		5,459,637

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$0 amount charged off \$4,371,750)	\$ (4,371,750)	
Finance chargers	134,752	
Aggregate write-ins for miscellaneous income	<u>26,699,081</u>	
Total other income		<u>22,462,083</u>
Net loss before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(5,132,356)
Dividends to policyholders		<u>(198,583)</u>
Net loss after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(4,933,773)
Federal and foreign income taxes incurred		<u>13,817,602</u>
Net loss		<u>\$ (18,751,375)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		\$ 98,147,007
Net income	\$ (18,751,375)	
Change in net unrealized capital gains	4,094,123	
Change in net deferred income tax	12,642,719	
Change in nonadmitted assets	(17,943,576)	
Capital Changes		
Paid-in	100,000	
Surplus adjustments:		
Paid-in	6,000,000	
Aggregate write-ins for losses in surplus	<u>17,795,573</u>	
Change in surplus as regards policyholders for the year		<u>3,937,464</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 102,084,471</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2014 through December 31, 2017

Surplus as regards policyholders, December 31, 2014			\$ 82,243,187
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 3,294,695	\$	
Net unrealized capital gains	785,176		
Change in net deferred income tax	13,109,640		
Change in nonadmitted assets		19,243,798	
Changes in Capital – Paid in	100,000		
Changes in Surplus – Paid in	6,000,000		
Dividends to stockholders		2,000,000	
Aggregate write-ins for gains and losses in surplus	<u>17,795,572</u>	<u> </u>	
Total gains and losses	<u>\$ 41,085,082</u>	<u>\$ 21,243,798</u>	
Net increase in surplus as regards policyholders			<u>19,841,284</u>
Surplus as regards policyholders, December 31, 2017			<u>\$ 102,084,471</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Delaware, the lead state, retained INS Consultants, Inc. (INS) for the purpose of assisting this examination in determining the reasonableness of the Group's loss and loss adjustment expense reserves. Since the business of the Company was pooled, it was necessary to evaluate the losses on a group-wide basis. Based on the analysis by INS and the review of their work by a Casualty Actuary from the California Department of Insurance, the Company's December 31, 2017 reserves for losses and loss adjustment expenses were found to be reasonably stated and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

On April 25, 2018, the Company paid a \$2,000,000 Paid-in contribution in cash to its subsidiary, Indemnity Company of California.

The Form A application in connection to the privatization of AmTrust Financial Services, Inc. (AFSI) by Evergreen Parent GP, LLC was approved by the California Department of Insurance on November 27, 2018. The transaction was completed on November 29, 2018.

On December 31, 2018, the board of directors of the Company took corporate action to authorize receipt of a capital contribution of \$20,000,000 from its parent, AFSI. On February 15, 2019, the Company received \$20,000,000 in cash and securities from AFSI.

On April 19, 2019, AFSI and Liberty Mutual Insurance entered into an agreement to acquire the global surety and credit reinsurance operations of AFSI. Upon closing, Liberty Mutual will acquire AmTrust Surety, previously managed by Insko Insurance Services, Inc., which provides contract, commercial, and subdivision bonds primarily in the western United States. The majority of the surety business is written through the Company and

its affiliate, Indemnity Company of California. The AmTrust Surety portion of the acquisition is expected to close in the second quarter of 2019.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

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/_____

Thomas Podsiadlo, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

/S/_____

Grace F. Asuncion, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California