REPORT OF EXAMINATION
OF THE
HERITAGE INDEMNITY COMPANY
AS OF
DECEMBER 31, 2017

Filed on June 25, 2019

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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

HERITAGE INDEMNITY COMPANY

(hereinafter also referred to as the Company) at both its statutory home office located at 17771 Cowan, Suite 100, Irvine, California 92614, and its main administrative office at 7125 W. Jefferson Avenue #100, Lakewood, Colorado 80235.

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 Delaware as the lead state of the AmTrust Financial Services, Inc. group. It was conducted concurrently with other insurance entities in the holding company group, including California affiliates Developers Surety and Indemnity Company, Indemnity Company of California, and Sequoia Insurance Company. The following states also participated on the examination: Arizona, Florida, Kansas, Nevada, New Jersey, New York, Oklahoma, Pennsylvania, and Texas.

SUMMARY OF SIGNIFICANT FINDINGS

The Company failed to file and seek prior approval from the California Department of Insurance (CDI) on related party transactions with its affiliate pursuant to California Insurance Code Section 1215.5(b)(4).

COMPANY HISTORY

Effective September 25, 2015, the Company became a wholly-owned subsidiary of AmTrust Financial Services, Inc. (AFSI), upon the completion of the sale by its former parent company, WDS Holdings, Inc. and former ultimate parent company, Wells Fargo & Company. AFSI is a multinational property and casualty insurer.

Capitalization

The Company has 100,000 shares of class A, $120 par value common stock authorized, and 25,000 shares issued and outstanding. The Company has no preferred stock issued and outstanding.

Dividends

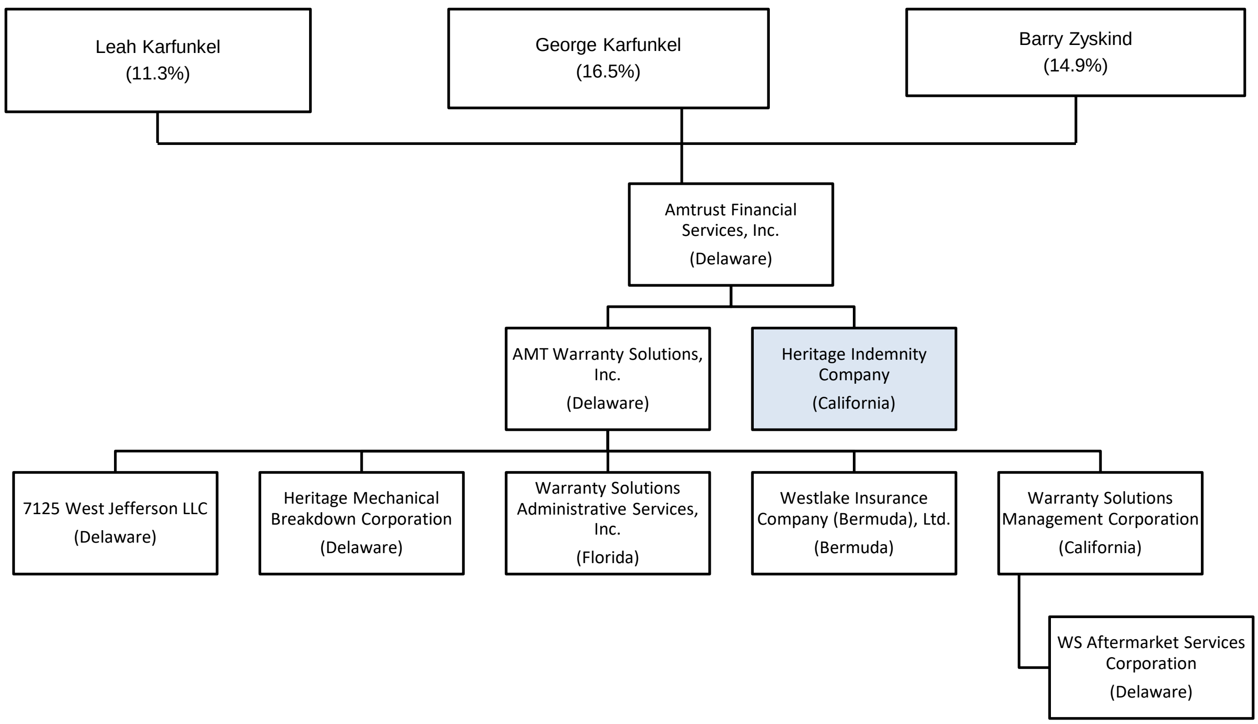
On June 30, 2015, the Company paid a $15,000,000 extraordinary dividend in cash and securities to its former parent WDS Holdings, Inc. The dividend was approved by the California Department of Insurance (CDI) on June 19, 2015.

On April 13, 2017, the Company paid a $12,000,000 ordinary cash dividend to AFSI.

On December 27, 2017, an extraordinary dividend of $28,000,000 in securities was paid to AFSI. The dividend was approved by the CDI on December 19, 2017.

MANAGEMENT AND CONTROL

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



The three 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

Name and Location	Principal Business Affiliation
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

Name	Title
Adam S. Pope [a]	President
Harry Schlachter	Treasurer
Stephen B. Ungar	Secretary
Jeffrey H. Mayer	Chief Actuary
Melanie S. Garrison	Vice President
Barry W. Moses	Vice President, Regulatory & Compliance and Assistant Secretary

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

[a] Adam S. Pope was replaced by William K. Walton effective February 28, 2018. William K. Walton retired, effective March 8, 2019. Christopher H. Foy was named President, effective March 8, 2019.

Management Agreements

Intercompany Management Agreement: Effective September 25, 2015, the Company entered into an Intercompany Management Agreement with AFSI. Under the terms of the agreement, AFSI provides 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 California Department of Insurance (CDI) approved the agreement on April 16, 2016. The Company paid service fees of $0, $267,934, and $265,094 for 2015, 2016, and 2017, respectively.

Tax Allocation Agreement: Effective September 25, 2015, 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 to made within 30 days of the filing of the return. The CDI approved the agreement on December 31, 2015. The Company paid/(received) tax settlements of $0, $0, and $0 for 2015, 2016, and 2017, respectively. Taxes were not settled until September 2018 when AFSI paid the Company $3,244,610.

Related Party Transactions

A review of the Company's related party transactions disclosed various activities, such as premiums collection and claims handling services, were undertaken between the Company and its affiliate, Warranty Solutions Management Corporation, without any documented agreements. These transactions were also undertaken without the required filing and prior approval from the CDI as required by California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company file and seek prior approval for any related party transactions as required by CIC Sections 1215.5(b)(4) and 1215.5(c).

TERRITORY AND PLAN OF OPERATION

The Company primarily insures vehicle service contracts administered and marketed by affiliated companies, through automobile dealers and original equipment manufacturers throughout the United States. As of December 31, 2017, the Company was licensed in all 50 states and the District of Columbia. In 2017 the Company wrote $78.1 million of direct premiums. The top five states by premiums are listed below:

State	Amount	Percentage
Georgia	$10.9 million	14.0%
California	$10.1 million	13.0%
North Carolina	$7.1 million	9.1%
Florida	$4.8 million	6.1%
Virginia	$4.6 million	5.9%

REINSURANCE

Reinsurance Pooling Agreement

Effective October 1, 2017, the Company entered into a Reinsurance Pooling Agreement (Pooling Agreement) with sixteen of its U.S. property and casualty insurance affiliates. Under the Pooling Agreement, the Company cedes to Technology Insurance Company (TIC), and TIC assumes: (1) 100% of the Company's respective liabilities on all insurance policies and all assumed reinsurance contracts that were in force as of October 1, 2017, or that have expired or been terminated or non-renewed as of October 1, 2017; and (2) 100% of the Company's respective liabilities on all insurance policies and all assumed reinsurance contracts issued subsequent to October 1, 2017. The Company does not retain a proportional share of the profits and/or losses of the pooled business. The agreement was approved by the California Department of Insurance (CDI) on December 15, 2017. At year-end, December 31, 2017, the Company ceded $115,334,715.88 in premiums.

Assumed

The Company assumes an insignificant amount of business, only $4,000, as compared to its direct writings of $78,154,143. The assumed business is from Aria (Sac), Ltd., a Bermuda based insurance company.

Ceded

Other than the aforementioned “Reinsurance Pooling Agreement”, the Company is also a party to a 100% quota-share Service Contract Liability Reinsurance Contract, effective March 1, 1984, and subsequently amended on October 25, 2004, with its affiliate, Westlake Insurance Company (Bermuda), Ltd. (Westlake). Per the agreement, ceding commission was amended from 10% to 0% for service contract liability insurance policies written on or after January 1, 2004. During 2017, the Company ceded $40,919,000 in premiums to Westlake, or approximately 52.3% of the Company’s direct business of $78,154,143. The agreement was approved by the CDI on June 18, 1996, in accordance with California Insurance Code Section 1215.5(c).

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 on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements.

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

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 54,710,954	$	$ 54,710,954	
Cash and short-term investments	2,707,074		2,707,074	
Receivable for securities	194,856		194,856	
Investment income due and accrued	424,615		424,615	
Current federal and foreign income tax recoverable and interest thereon	3,166,293		3,166,293	
Net deferred tax asset	1,000,626	310,975	689,651	
Receivables receivable parent, subsidiaries, and affiliates	6,689,709		6,689,709	
Aggregate write-ins for other than invested assets	235,491	235,491	0	
Total assets	$ 69,129,618	$ 546,466	$ 68,583,152	

Liabilities and Surplus and Other Funds

Losses and loss adjustment expenses			$ 0	(1)
Funds held by company under reinsurance treaties			1,836,552	
Payable to parent, subsidiaries and affiliates			49,090,733	
Total liabilities			50,927,325	
Common capital stock		$ 3,000,000		
Gross paid-in and contributed surplus		25,784,907		
Unassigned funds (surplus)		(11,129,080)		
Surplus as regards policyholders			17,655,827	
Total assets			$ 68,583,152	

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

Statement of Income

Underwriting Income		
Premiums earned		$ 16,735,092
Deductions:		
Losses and loss expenses incurred	$ 15,145,353	
Other underwriting expenses incurred	(6,427,129)	
Total underwriting deductions		8,718,224
Net underwriting loss		8,016,868
Investment Income		
Net investment income earned	$ 2,838,374	
Net realized capital gain	371,196	
Net investment gain		3,209,570
Other Income		
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		11,226,438
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		11,226,438
Federal and foreign income taxes incurred		(2,318,951)
Net income		$ 13,545,389

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		$ 50,500,135
Net income	$ 13,545,390	
Change in net deferred income tax	(5,427,805)	
Change in nonadmitted assets	1,444,536	
Dividends to stockholder	(40,000,000)	
Aggregate write-ins for losses in surplus	(2,406,433)	
Change in surplus as regards policyholders for the year		(32,844,312)
Surplus as regards policyholders, December 31, 2017		$ 17,655,823

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

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2014			$ 51,635,403
Net income	$ 27,612,938	$	
Change in net deferred income tax		6,155,537	
Change in nonadmitted assets	96,310		
Surplus adjustments: Paid-in		15,000,000	
Dividends		40,000,000	
Aggregate write-ins for gains and losses in surplus		533,291	
Total gains and losses	$ 27,709,248	$ 61,688,828	
Net decrease in surplus as regards policyholders			(33,979,580)
Surplus as regards policyholders, December 31, 2017			$ 17,655,823

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Delaware, the lead state, retained INS Consultants, Inc. (INS) for the purpose of 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.

SIGNIFICANT SUBSEQUENT EVENTS

On February 28, 2018, AmTrust Financial Services, Inc. (AFSI) sold 50.4% of its United States Fee Businesses (Warranty Solutions) including Warranty Solutions Management Corporation to Amynta Holdings LLC (Amynta), a subsidiary of Madison Dearborn Partners. Amynta has operations in warranty and services contracts for the automotive, consumer products and specialty equipment industries, among others, and administration of workers' compensation and contractor liability coverage in the United States.

The Form A application in connection to the privatization of 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.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Related Party Transactions (Page 6): A review of the Company's related party transactions disclosed various activities, such as premiums collection and claims handling services, were undertaken between the Company and its affiliate, Warranty Solutions Management Corporation (WSMC), without any documented agreements. It is recommended the Company enter into an agreement with WSMC pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Previous Report of Examination

Management and Control – Management Agreements – Tax-Sharing Agreement (Page 6): It was recommended that the Company amend its Tax-Sharing Agreement to reflect its current ultimate parent, Wells Fargo and Company. The Company has entered into a new tax allocation agreement with its parent AmTrust Financial Services, Inc.

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