

REPORT OF EXAMINATION  
OF THE  
PREFERRED EMPLOYERS INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2018

Filed on May 15<sup>th</sup>, 2020

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Los Angeles, California  
April 6, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PREFERRED EMPLOYERS INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 9797 Aero Drive, 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, 2013. This examination covered the period from January 1, 2014 through December 31, 2018.

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 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 Berkley Insurance Company subgroup of W. R. Berkley Corporation. It was conducted concurrently with the examinations of the following insurance entities in the holding company group:

Company	NAIC CoCode	Domiciled State
Acadia Insurance Company	31325	Iowa
Admiral Indemnity Company	44318	Delaware
Admiral Insurance Company	24856	Delaware
American Mining Insurance Company	15911	Iowa
Berkley Assurance Company	39462	Iowa
Berkley Insurance Company	32603	Delaware
Berkley National Insurance Company	38911	Iowa
Berkley Regional Insurance Company	29580	Delaware
Berkley Specialty Insurance Company	31295	Delaware
Carolina Casualty Insurance Company	10510	Iowa
Clermont Insurance Company	33480	Iowa
Continental Western Insurance Company	10804	Iowa
Firemen's Insurance Company of Washington, D.C.	21784	Delaware
Gemini Insurance Company	10833	Delaware
Great Divide Insurance Company	25224	North Dakota
Intrepid Insurance Company	10749	Iowa
Key Risk Insurance Company	10885	Iowa
Midwest Employers Casualty Company	23612	Delaware
Nautilus Insurance Company	17370	Arizona
<b>Preferred Employers Insurance Company</b>	<b>10900</b>	<b>California</b>
Riverport Insurance Company	36684	Iowa
StarNet Insurance Company	40045	Delaware
Tri-State Insurance Company of Minnesota	31003	Iowa
Union Insurance Company	25844	Iowa
Union Standard Lloyds	43435	Texas

### COMPANY HISTORY

The Company was incorporated under the laws of California on December 11, 1997, and commenced business on June 1, 1998. The Company writes workers' compensation business for small employers in California. The Company is 100% owned by Berkley Insurance Company, a Delaware domiciled insurer, who writes commercial lines insurance.

The ultimate parent is W. R. Berkley Corporation, a publicly-traded entity on the New York Stock Exchange founded in 1967 and based in Greenwich, Connecticut, specializing in

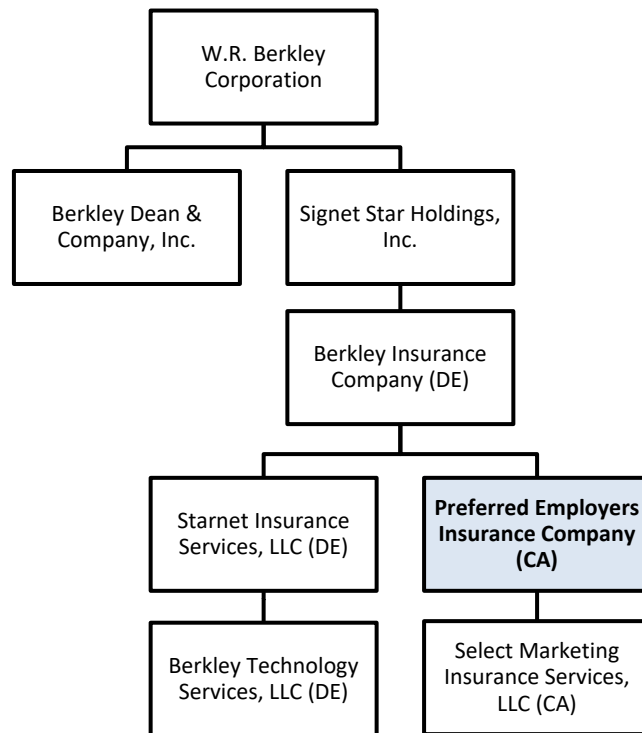
commercial lines insurance and reinsurance coverage throughout the United States and abroad.

Capitalization

The Company is authorized to issue 10,000 shares of common stock with a par value of \$1,000 per share. As of December 31, 2018, there were 3,500 shares issued and outstanding and held by Berkley Insurance Company.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which W. R. Berkley Corporation is the ultimate controlling entity. Following is an abridged organizational chart reflecting the ownership structure at December 31, 2018 (All ownership is 100%).



The six members of the board of directors, who are elected annually, oversee the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2018:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Richard M. Baio West Harrison, New York	Executive Vice President, Chief Financial Officer, and Treasurer W. R. Berkley Corporation
William R. Berkley, Jr. Greenwich, Connecticut	President and Chief Executive Officer W. R. Berkley Corporation
Paul J. Hancock Brookfield, Connecticut	Senior Vice President and Chief Actuary W. R. Berkley Corporation
Carol J. LaPunzina Demarest, New Jersey	Executive Vice President and Chief Human Resources Officer W. R. Berkley Corporation
Ira S. Lederman Bedford, New York	Executive Vice President and Secretary W. R. Berkley Corporation
James G. Shiel Pound Ridge, New York	Executive Vice President and Chief Investments Officer W. R. Berkley Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Richard M. Baio	Executive Vice President, Chief Financial Officer and Treasurer
William R. Berkley, Jr.	President and Chief Executive Officer
Ira S. Lederman	Executive Vice President and Secretary

## Management Agreements

**Administrative Service Agreement:** Effective February 1, 2006, the Company entered into an Administrative Service Agreement with its wholly-owned subsidiary, Select Marketing Insurance Services, LLC (SMI). Under the terms of this agreement, SMI markets and solicits workers' compensation insurance business on behalf of the Company. Similarly, the Company provides administrative services, offices, equipment and staff, for SMI to perform its business. Compensation for shared services and the use of facilities for both parties are based on the actual costs in accordance with California Insurance Code (CIC) Section 1215.5(a) and are settled on a monthly basis. This agreement was approved by the California Department of Insurance (CDI) on December 27, 2005, as required under CIC Section 1215.5(b)(4). Pursuant to the agreement the Company paid SMI \$462,660, \$816,338, \$659,918, \$774,473, and \$647,065 in 2014, 2015, 2016, 2017, and 2018, respectively.

**Computer Services Agreement:** Effective January 1, 2002, the Company entered into a Computer Services Agreement with Berkley Technology Services, LLC (BTS), an affiliate. Under the terms of this agreement, BTS provides computer and data processing services, including programming, operations, network management and consulting services. The actual cost for these services are charged to the Company on a quarterly basis. This agreement was approved by the CDI on February 15, 2002 as required under CIC Section 1215.5(b)(4). Pursuant to the agreement, the Company paid BTS \$1,884,689, \$2,162,531, \$2,981,499, \$2,465,362, and \$2,213,031 in 2014, 2015, 2016, 2017, and 2018, respectively.

**Investment Advisory Agreement:** The Company entered into an Investment Advisory Agreement dated April 23, 1998, and amended April 24, 1998, with Berkley Dean & Company, Inc. (BDC), an affiliate, to provide investment advisory and management services. BDC is compensated based on an annual fee equal to 0.25% of the first \$10 million and 0.20% thereafter of the net asset value of the portfolio at the end of each quarter. This agreement was approved by the CDI on April 27, 1998. Pursuant to the agreement, the following fees were paid: \$96,235, \$98,173, \$101,278, \$100,956, and



\$102,311 in 2014, 2015, 2016, 2017, and 2018, respectively.

Management Agreement: On January 1, 2013, the Company entered into a Management Agreement with its parent, Berkley Insurance Company (BIC). Services provided by BIC to the Company includes: underwriting, collection and settlement of premiums, claims adjustment and payment, appointment and termination of producers, advertising sales promotion and production, compute reinsurance ceded and assumed adjustments, preparing general ledger accounting and financial statements, and other administrative functions. The management fees for these services are calculated by the actual cost of services and settled with BIC on a daily basis. In order to determine actual costs in relation to indirect and shared expenses, the Company utilizes a cost method allocation in conformity with the statement of statutory accounting principles No. 70. This agreement was approved by the CDI on May 21, 2013, as required under CIC Section 1215.5(b)(4). Pursuant to the agreement, the Company paid BIC \$71,858,858, \$81,188,683, \$94,980,335, \$113,119,898, and \$115,172,182 in 2014, 2015, 2016, 2017, and 2018, respectively.

Tax Allocation Agreement: Effective April 23, 1998, the Company entered into a Tax Allocation Agreement with its ultimate parent, W. R. Berkley Corporation (WRB), and its affiliates. Under the terms of this agreement, participants in the group file a consolidated federal income tax return. WRB is responsible for filing and making federal income tax estimates and final payments on behalf of the participants. Allocation of taxes is based upon separate return calculations with intercompany tax balance payable or receivable being settled in amounts as if separate returns were filed. Intercompany balances are settled quarterly within 45 days after the end of each quarter. This agreement was approved by the CDI on April 27, 1998 as required under CIC Section 1215.5(b)(4). The Company paid or (recovered) the following federal income taxes under this agreement for 2014, 2015, 2016, 2017, and 2018 was \$(81,746), \$114,000, \$93,000, \$129,000, and \$121,000, respectively.

## Corporate Records

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report, both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the Commissioner, and enter that fact in the board minutes. A review of the board minutes disclosed that the prior filed Report of Examination was not presented to the board of directors of the Company. It is recommended that the Company implement procedures in its board meeting to ensure adherence to the CIC Section 735.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact property and casualty insurance business in all states and the District of Columbia, except Florida, Idaho, Illinois, Indiana, Massachusetts, Minnesota, Nebraska, New York, and Washington. The Company solely writes workers' compensation business in California, and currently has not transacted in other states.

For the year ending December 31, 2018, the Company wrote \$174,651,292 of direct premiums, with more than sixteen thousand policy-holders. The business approach is to offer products tailored to the specific needs of smaller-sized businesses that employ fewer than fifty employees. The business is marketed and produced through a network of independent brokers located throughout California.

## REINSURANCE

### Assumed

The Company does not assume reinsurance.

## Ceded

The Company was a party to the Multiple Line Quota Share Reinsurance Contract (the Reinsurance Agreement) dated April 1, 2000, with Signet Star Reinsurance Company (SSRC), a Delaware corporation, whereby the Company ceded 90% of the net liability to the reinsurer. Effective January 1, 2013, the Reinsurance Agreement was amended to increase the cession rate from 90% to 100%, and it reflected that SSRC was renamed Berkley Insurance Company (BIC). The California Department of Insurance approved this amendment on March 8, 2013.

## 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, 2018. There were no adjustments made to the statutory financial statements filed by the Company.

Statement of Financial Condition as of December 31, 2018

Underwriting and Investment Exhibit for the Year Ended December 31, 2018

Reconciliation of Surplus as Regards Policyholders from December 31, 2013  
through December 31, 2018

Statement of Financial Condition  
as of December 31, 2018

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 44,680,908	\$	\$ 44,680,908	
Cash and short-term investments	3,678,862		3,678,862	(1)
Other invested assets	1,000	1,000		
Investment income due and accrued	457,778		457,778	
Uncollected premiums and agents' balances in the course of collection	4,165,586	376,615	3,788,971	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	40,919,085		40,919,085	
Current federal and foreign income tax recoverable and interest thereon	158,251		158,251	
Net deferred tax asset	93,889		93,889	
Guaranty funds receivable or on deposit	4,282,915		4,282,915	(2)
Aggregate write-ins for other than invested assets	<u>2,235,531</u>	<u>62,554</u>	<u>2,172,977</u>	
Total assets	<u>\$ 100,673,805</u>	<u>\$ 440,169</u>	<u>\$ 100,233,636</u>	
 <u>Liabilities, Surplus and Other Funds</u>				<u>Notes</u>
Losses			\$ 0	(3)
Reinsurance payable on paid loss and loss adjustment expenses			0	
Loss adjustment expenses			0	(3)
Commissions payable, contingent commissions and other similar charges			\$ 6,288,562	
Taxes, licenses and fees			6,184,667	
Ceded reinsurance premiums payable			39,766,999	
Payable to parent, subsidiaries and affiliates			<u>25,543</u>	
Total liabilities			52,265,771	
Common capital stock		\$ 3,500,000		
Gross paid in and contributed surplus		7,500,000		
Unassigned funds (surplus)		<u>36,967,865</u>		
Surplus as regards policyholders			<u>47,967,865</u>	
Total liabilities, surplus, and other funds			<u>\$ 100,233,636</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2018

Statement of Income

Investment Income

Net investment income earned	\$ 1,202,304	
Net realized capital losses	<u>(9,850)</u>	
Net investment gain		1,192,454
Net income before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		1,192,454
Net income after dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		1,192,454
Federal and foreign income taxes incurred		<u>124,362</u>
Net income		<u>\$ 1,068,092</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		\$ 46,924,002
Net income	\$ 1,068,092	
Change in net deferred income tax	1,643	
Change in nonadmitted assets	(34,018)	
Aggregate write-ins for gains in surplus	<u>8,146</u>	
Change in surplus as regards policyholders for the year		<u>1,043,863</u>
Surplus as regards policyholders, December 31, 2018		<u>\$ 47,967,865</u>

Reconciliation of Surplus as Regards to Policyholders  
from December 31, 2013 through December 31, 2018

Surplus as regards policyholders, December 31, 2013			\$ 41,872,753
	Gain in Surplus	Loss in Surplus	
Net income	\$ 5,851,916	\$	
Change in net deferred income tax	20,343		
Change in nonadmitted assets		201,840	
Aggregate write-ins for gains in surplus	<u>424,693</u>		
Total gains and losses	<u>\$ 6,296,952</u>	<u>\$ 201,840</u>	
Net increase in surplus as regards policyholders			<u>6,095,112</u>
Surplus as regards policyholders, December 31, 2018			<u>\$ 47,967,865</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Cash and Short-term Investments

The previous report of examination noted the Company's operating cash account was in the name of its parent company, Berkley Insurance Company (BIC). California Insurance Code (CIC) Section 1100 requires all deposits of the assets of an insurer to be made in its name. A recommendation was made in the previous report of examination to comply with CIC Section 1100.

The Company's operating cash account was reviewed and noted this account remains in the name of its parent company. The Company provided evidence that the funds in this account are not co-mingled with any other W. R. Berkley Corporation entities, and stated that this arrangement is structured in this manner, because BIC is authorized to act on behalf of the Company in accordance to the terms of its Management Agreement and Reinsurance Agreement. It is recommended that the Company's name also be added to the operating cash account to ensure adherence to CIC Section 1100.

### (2) Guaranty Funds Receivable or on Deposit

In 2000, the California Insurance Guaranty Association began assessing the Company for its share of policyholder obligations related to insolvencies of reporting entities that write workers' compensation business in California. The Company recoups the assessment through a two percent surcharge on its policyholder's premiums. As of December 31, 2018, the Company estimated an accrual of \$4.28 million for the guaranty funds receivable.

### (3) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance evaluated the Group's loss and loss adjustment expense reserves prepared by Delaware's independent actuary, INS Consultants, Inc., (INS). Based on the analyses performed by INS, the Company's

loss and loss adjustment expenses reserves as of December 31, 2018 were reasonable and have been accepted for the purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Corporate Records (Page 8): It is recommended that the Company implement procedures in its board meeting ensure adherence to the California Insurance Code (CIC) Section 735.

Comments on Financial Statement Items – Cash and Short-term Investments (Page 13): It is recommended that the Company includes the Company's name in the Company's operating cash account to ensure adherence to the CIC Section 1100.

### Previous Report of Examination

Comment on Financial Statement Items – Cash and Short-term Investments (Page 16): It was recommended the Company correct the deficiency noted within its cash holding account by complying with CIC Section 1100. The Company has not complied.



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/ \_\_\_\_\_

Shelly Liu  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California

/S/ \_\_\_\_\_

Edward Aros, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California