

REPORT OF EXAMINATION  
OF THE  
RESIDENCE MUTUAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2018

Filed on April 23<sup>rd</sup>, 2020

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Los Angeles, California  
April 10, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

### RESIDENCE MUTUAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 2172 Dupont Drive, Irvine, California 95612.

### 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, 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 California as the lead state of the Western Mutual Insurance Group. It was conducted concurrently with other insurance entities in the holding company group, including Western Mutual Insurance Company and Arizona Home Insurance Company. Arizona participated on the examination.

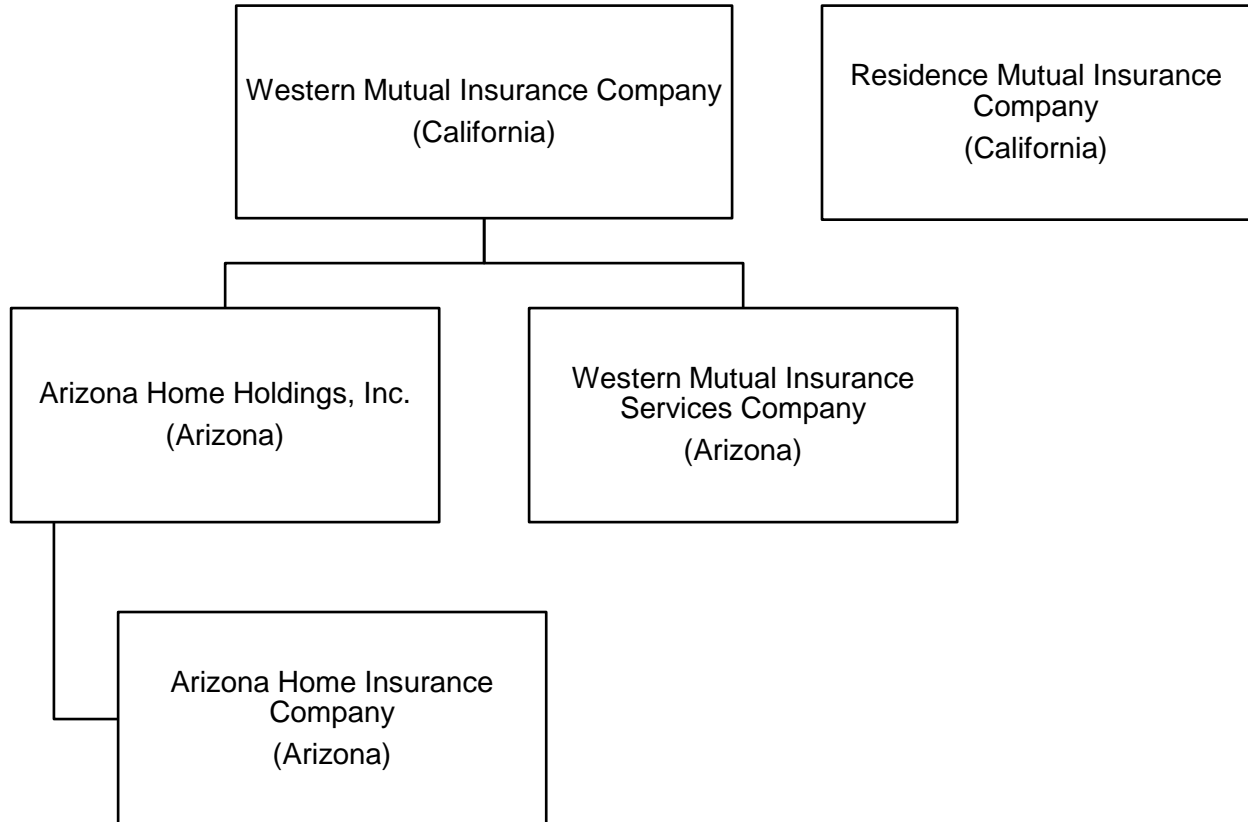
### COMPANY HISTORY

Western Mutual Insurance Group consists of three property and casualty insurance companies: The Company, Western Mutual Insurance Company (WMIC), and Arizona Home Insurance Company. The Company was incorporated in California on August 10, 1949 and commenced business on October 17, 1949.

The Company is a mutual insurance company and has no shareholders. On April 6, 2016, WMIC acquired the Company's 50% ownership of the Arizona Home Holdings, Inc. On October 26, 2018, WMIC acquired the Company's 50% ownership of Western Mutual Insurance Services Company.

MANAGEMENT AND CONTROL

The following organizational chart depicts the Company's relationship with its affiliates as of December 31, 2018 (All ownership is 100%):



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, 2018:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
James D. Anderson Newport Beach, California	Certified Public Accountant James D. Anderson, CPA
Michael D. Antonovich Glendale, California	Retired
John J. Barcal La Habra Heights, California	Attorney John J. Barcal, Inc.
Joe Crail Newport Coast, California	Chairman of the Board and President Western Mutual Insurance Group
Lucile Ann Crail Silverton, Oregon	Private Investor
Paul P. Rubincam <sup>(a)</sup> Palos Verdes Estates, California	Retired

Principal Officers

<u>Name</u>	<u>Title</u>
Joe Crail	President
Paul E. Calvet	Executive Vice President
Carmen Estrada	Secretary
Michael G. Hardy	Chief Financial Officer

<sup>(a)</sup> Kelly Ann Walker replaced Paul Rubincam as a director, effective February 15, 2019.

## Management Agreements

Agency Agreement: Effective August 1, 1981, the Company and Western Mutual Insurance Company (WMIC) entered into an Agency Agreement with Cardinal Insurance Agency (Cardinal). Under the terms of the agreement, Cardinal provides insurance agency services for the Company and WMIC, which includes soliciting, selling, and servicing insurance products. The Company pays a commission to Cardinal based on a commission rate that ranges from 5% to 25%. From 2015 to 2018, the Company paid Cardinal \$72,621, \$39,690, \$71,314, and \$78,564, respectively, for the services provided under the agreement.

Agency Agreement: Effective October 6, 1994, the Company and WMIC entered into an Agency Agreement with Western Mutual Insurance Services Company (WMISC), formerly known as Inland Southern Insurance Services, Inc. The Company did not amend the agreement to reflect the name change to WMISC. Under the terms of the agreement, WMISC provides insurance agency services for the Company and WMIC, which includes soliciting, selling, and servicing insurance products. The Company pays a commission to WMISC based on a commission rate that ranges from 5% to 22.5%. From 2015 to 2018, the Company paid WMISC \$142,370, \$134,856, \$126,334, and \$40,157, respectively, for services provided under agreement. It is recommended that the Company amend the agreement to reflect the name change to WMISC.

Service Agreement: Effective January 1, 2006, the Company, WMIC, and Arizona Home Insurance Company (AHIC) entered into the Service Agreement (Agreement) whereby the participants cooperate in the performance of certain administrative and special services and share in the use of the day to day operations of certain property, equipment, and facilities. The California Department of Insurance approved this Agreement on February 8, 2008.

The shared functions provided include the following: accounting and auditing, premium collection, underwriting, claims, actuarial, data processing, legal, and payroll. Costs of the services are allocated at cost in accordance with the pooling percentages; 53% to the Company, 35% to WMIC, and 12% to AHIC. The Agreement requires that the charges

be settled within 45 days after each quarter. From 2015 through 2018, the Company's allocated shared costs were \$14.3 million, \$14.5 million, \$15.3 million, and \$15.9 million respectively, under the terms of this Agreement.

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2018, the Company was licensed to transact multiple lines of property and casualty insurance in the following six states: California, Colorado, Nevada, New Mexico, Texas, and Utah.

In 2018, the Company wrote \$53,209,996 of direct premiums. All of the direct premiums were written in California. The lines of business written were homeowners multiple peril (89.4%), fire (3.8%), earthquake (3.7%), and allied lines (3.1%).

Policies are issued exclusively on residential properties. Business is produced on a direct basis as well as through agencies and brokers.

## REINSURANCE

### Intercompany Reinsurance Agreement

Intercompany Quota Share Pooling Agreement: Effective January 1, 2006, the Company, Western Mutual Insurance Company (WMIC), and Arizona Home Insurance Company (AHIC) participate in the Intercompany Quota Share Pooling Agreement, whereby all business written by the pool participants is pooled and all premium, losses and expenses are reapportioned among the participants. Pool participation percentages are 53% for the Company, 35% for WMIC, and 12% for AHIC.



## Assumed Reinsurance

The Company does not assume any business except from the Intercompany Quota Share Pooling Agreement.

## Ceded Reinsurance

The following is a summary of the principal ceded reinsurance treaties as of December 31, 2018. All participating reinsurers are authorized.

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
<b><u>Property and Casualty</u></b>			
<b><u>Excess of Loss</u></b>			
First Layer	Transatlantic Reinsurance Company	\$ .4 million	\$ .6 million in excess of \$ .4 million of each and every loss occurrence with a maximum of \$1.8 million per loss occurrence
Second Layer	Transatlantic Reinsurance Company	\$1 million	\$2 million in excess of \$1 million of first layer of each and every loss occurrence with a maximum of \$6 million per occurrence
<b><u>Catastrophe:</u></b>			
First Layer	31.2% Various Lloyd's Syndicate 20.0% R+V Versicherung AG 8.0% American Agricultural Insurance Company 40.8% Various other reinsurers	\$2.5 million	\$5 million excess of \$2.5 million of each and every loss occurrence. Annual deductible \$2.5 million with a maximum of \$10 million for all loss occurrences during the term of the contract.

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
Second Layer	26.0% Various Lloyd's Syndicate 20.0% R+V Versicherung AG 8.0% American Agricultural Insurance Company 46.0% Various other reinsurers	\$7.5 million	\$12.5 million in excess of \$7.5 million of each and every loss occurrence with a maximum of \$25 million for all loss occurrences during the term of the contract.
Third Layer	25.3% Various Lloyd's Syndicate 20.0% R+V Versicherung AG 8.0% American Agricultural Insurance Company 8.0% Mapfre Re, Compania De Reasegueros S.A. 38.7% Various other insurers	\$20 million	\$35 million in excess of 20 million of each and every loss occurrence with a maximum of \$70 million for all loss occurrences during the term of the contract.

As of the examination date, and under the terms of its external reinsurance agreements, the Company reported total net reinsurance recoverables of \$314 thousand.

### 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. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no adjustments made to the financial statements as a result of the examination.

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, 2014 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	\$ 103,890,413	\$	\$ 103,890,413	
Common stocks	15,287,699		15,287,699	
Properties occupied by the company	3,410,922		3,410,922	
Cash and short-term investments	9,305,407		9,305,407	
Investment income due and accrued	439,962		439,962	
Premiums and agents' balances in course of collection	1,361,748	4,945	1,356,803	
Amount recoverable from reinsurers	3,497,163		3,497,163	
Aggregate write-ins for other than invested assets	<u>113,545</u>	<u>6,200</u>	<u>107,345</u>	
 Total assets	 <u>\$ 137,306,859</u>	 <u>\$ 11,145</u>	 <u>\$ 137,295,714</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 12,816,206	(1)
Reinsurance payable on paid loss and loss adjustment expenses			3,273,623	
Commissions payable, contingent commissions and other similar charges			384,467	
Other expenses			1,460,448	
Taxes, licenses and fees			(30,839)	
Current federal and foreign income taxes			142,369	
Net deferred tax liability			1,146,000	
Unearned premiums			22,497,183	
Advance premiums			785,617	
Ceded reinsurance premiums payable			114,304	
Payable to parent, subsidiaries and affiliates			1,093,139	
Aggregate write-ins for liabilities			<u>189,403</u>	
 Total liabilities			 43,871,920	
Unassigned funds (surplus)		<u>\$ 93,423,794</u>		
Gross paid-in and contributed surplus				
Surplus as regards policyholders			<u>93,423,794</u>	
 Total liabilities, surplus and other funds			 <u>\$ 137,295,714</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 41,299,218
Deductions:		
Losses and loss expenses incurred	\$ 28,765,971	
Other underwriting expenses incurred	<u>9,607,562</u>	
Total underwriting deductions		<u>38,373,533</u>
Net underwriting gain		2,925,685

Investment Income

Net investment income earned	\$ 1,698,157	
Net realized capital gain	<u>768,379</u>	
Net investment gain		2,466,536

Other Income

Finance and service charges not included in premiums	\$ <u>116,019</u>	
Total other income		<u>116,019</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		5,508,240
Federal and foreign income taxes incurred		<u>1,042,349</u>
Net income		<u>\$ 4,465,891</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		\$ 89,245,492
Net income	\$ 4,465,891	
Change in net unrealized capital gains less capital gains tax	(1,188,863)	
Change in net deferred income tax	905,000	
Change in nonadmitted assets	<u>(3,726)</u>	
Change in surplus as regards policyholders for the year		<u>4,178,302</u>
Surplus as regards policyholders, December 31, 2018		<u>\$ 93,423,794</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2014 through December 31, 2018

Surplus as regards policyholders, December 31, 2014			\$ 77,246,573
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 16,668,660	\$	
Change in net foreign exchange capital losses		226,245	
Change in net deferred income tax		346,000	
Change in nonadmitted assets	<u>80,806</u>	<u>                    </u>	
Total gains and losses	<u>\$ 16,749,466</u>	<u>\$ 572,245</u>	
Net increase in surplus as regards policyholders			<u>16,177,221</u>
Surplus as regards policyholders, December 31, 2018			<u>\$ 93,426,794</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expense

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2018, were found to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Agency Agreement (Page 5): The Agency Agreement between the Company and Western Mutual Insurance Services Company (WMISC) still reflects WMISC's its former name, Inland Southern Insurance Services, Inc. It is recommended that the Company amend the agreement to reflect the name change to WMISC.

### Previous Report of Examination

Accounts and Records – Information Systems Controls (Page 9): It was recommended that the Company should evaluate improving its information systems controls and make appropriate changes to strengthen these controls. The Company has implemented additional information system controls.

Accounts and Records – Related Party (Page 9): It was recommended that the Company comply with the Statements of Statutory Accounting Principles (SSAP) No. 25, paragraph 19 to disclose all related parties and relevant transactions. The Company acknowledged this recommendation and had included all related parties and transactions in its December 2015 Annual Statement, Schedule Y, Parts 1 and 2.

Accounts and Records – Reinsurance (Page 9): It was recommended that the Company comply with SSAP No. 63, paragraph 8, in regards to the recording and accounting of premiums, losses and expenses as a result of the Pooling Agreement. The Company acknowledged this recommendation and had reported in its December 31, 2015 Annual Statement gross of the Pooling Agreement.

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 Asuncion, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California