

REPORT OF EXAMINATION
OF THE
ASSOCIATED INDEMNITY CORPORATION
AS OF
DECEMBER 31, 2018

Filed on May 22, 2020

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Oakland, California
April 23, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

ASSOCIATED INDEMNITY CORPORATION

(hereinafter also referred to as the Company) at its home office located at 1465 N. McDowell Boulevard, Suite 100, Petaluma, California 94954.

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 covers the period from January 1, 2014 through December 31, 2018.

This 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. The examination also included 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 includes 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 an adjustment was identified during the course of the

examination, the impact of such adjustment would 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 the Company.

This was a coordinated examination whereby Minnesota is the lead state for the Allianz Insurance Group. Illinois was designated as the exam facilitator for the property and casualty subgroup of this coordinated examination. The examination of the Company was performed concurrently with the examination of the property and casualty insurers of this subgroup. The following states also participated in this coordinated exam: Missouri, New Jersey, and Ohio.

COMPANY HISTORY

Capitalization

The Company is authorized to issue 500,000 shares of common stock with a par value of \$40 per share. As of December 31, 2018, there were 87,500 shares issued and outstanding.

The Company is a direct subsidiary of Fireman's Fund Insurance Company (FFIC). On January 1, 2015, Allianz of America, Inc. contributed all of the issued and outstanding shares of common stock of FFIC to Allianz Global Risks US Insurance Company (AGR US), domiciled in Illinois. As a result, the Company became an indirect subsidiary of AGR US.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Allianz SE (AZSE), a Societas Europaea incorporated in the Federal Republic of Germany and organized under the laws of the European Union is the ultimate controlling entity. The following abridged organizational chart is limited to the Company's intercompany relationship within the holding company system and does not depict all entities under AZSE as of December 31, 2018 (all ownership is 100% unless otherwise noted):

Allianz SE (Germany)

- Allianz Europe B.V. (Netherlands)

 - Allianz of America, Inc. (Delaware)

 - Allianz Life Insurance Company of North America (Minnesota)

 - Allianz Life Insurance Company of New York (New York)

 - Allianz Investment Management, LLC (Minnesota)

 - Allianz Reinsurance America, Inc. (California)

 - Allianz Global Risks US Insurance Company (Illinois) (80% ownership)

 - Fireman's Fund Insurance Company (California)

 - American Automobile Insurance Company (Missouri)

 - Associated Indemnity Corporation (California)**

 - Chicago Insurance Company (Illinois)

 - Fireman's Fund Indemnity Corporation (New Jersey)

 - Interstate Fire & Casualty Company (Illinois)

 - National Surety Corporation (Illinois)

 - The American Insurance Company (Ohio)

 - Fireman's Fund Financial Services, LLC (Delaware)

 - Par Holdings, LTD (Bermuda) (14.3% ownership)

 - Allianz Global Corporate & Specialty SE (Germany)

 - ACGS International Holding B.V. (Delaware)

 - Allianz Global Risks US Insurance Company (Illinois) (20% ownership)

 - Allianz Underwriters Insurance Company (Illinois)

 - AGCS Marine Insurance Company (Illinois)

 - Allianz Partners S.A.S (France)

 - AWP P&C SA (France)

 - AWP USA Inc. (District of Columbia)

 - Jefferson Insurance Company (New York)

 - Allianz Argos 14 GmbH (Germany)

 - Allianz Holding France SAS (France)

 - Allianz France S.A. (France)

 - Euler Hermes Group (France) (98.6% ownership)

 - Euler Hermes North America Holding, Inc. (Delaware)

 - Euler Hermes North America Insurance Company (Maryland)

A four-member of the Board of Directors, elected annually, oversees the business and affairs of the Company. Following are members of the board and principal offices of the Company serving at December 31, 2018:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Julie A. Garrison Chicago, Illinois	Senior Vice President, General Counsel and Secretary Allianz Global Risks US Insurance Company
Vinko Markovina New York, New York	Senior Vice President, Regional Head Corporate and Global Head Midcorp Allianz Global Risks US Insurance Company
Katalin Noe Chicago, Illinois	Assistant Vice President Allianz Global Risks US Insurance Company
Douglas R. Renn Chicago, Illinois	Senior Vice President, Chief Financial Officer and Treasurer Allianz Global Risks US Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
William Scaldaferrri Julie Garrison	President and Chief Executive Officer Senior Vice President and General Counsel and Secretary
Douglas Renn	Senior Vice President, Chief Financial Officer and Treasurer
Peter Locy	Vice President, Controller and Assistant Treasurer

Management Agreements

Intercompany Service Agreement: This agreement was entered into by and between the Company, Fireman's Fund Insurance Company (FFIC), and FFIC's other wholly-owned subsidiaries effective January 1, 2012 and approved by the California Department of Insurance (CDI) on February 23, 2012. Under the terms of the agreement, FFIC agrees to provide services to each of its subsidiaries in the conduct of its operations and the administration of reinsured liabilities. The parties to the agreement agree to reimburse FFIC for the actual cost of services provided. Services provided include managerial, operational, strategic consulting, investment operations and support, treasury operations, accounting and finance, legal matters, risk management functions, facilities, fixtures, furniture and supplies, corporate audit functions, information technology, underwriting, claims handling, reinsurance operations and collections, and ad hoc consultation and support with non-recurring matters. No fees were paid as all costs were ceded under the pooling agreement.

Second Amended and Restated Investment Management Agreement: The Company and Allianz Investment Management, LLC (AIM) entered into this agreement effective December 21, 2016. The CDI did not disapprove and authorized the companies to proceed with the transaction pursuant to California Insurance Code Section 1215.5(b)(4) on December 7, 2016. Under the terms of the agreement, AIM provides investment and cash management services for a fee for asset management services based on actual cost without profit. The fees incurred by the Company for services under this agreement were \$40,765, \$61,091, \$61,725, \$57,647, and \$47,507 in 2014, 2015, 2016, 2017, and 2018, respectively.

Tax Sharing Agreement: Effective January 1, 2018, the Company is a participant in a Tax Sharing Agreement entered into with Allianz of America, Inc. (AZOA) and other affiliates. Under the terms of the agreement, AZOA provides for computation of federal income taxes on a separate company basis and reimburses the Company for separate tax attributes, including credits and losses utilized in the consolidated federal income tax return. The amounts of federal income tax paid (recovered) by the Company during the

examination years were \$9,547,834, (\$9,300,246), (\$1,097,939), and (\$700,157) in 2015, 2016, 2017, and 2018, respectively. No amount was paid or recovered in 2014. The CDI approved the agreement on December 13, 2018.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2018, the Company is licensed to transact property and casualty insurance business in all fifty states and the District of Columbia. Direct premiums written during 2018 totaled \$42.0 million, of which 24.3% was written in California (24.3%), 14.7% was written in Hawaii, 9.4% was written in Washington, and the remaining 51.6% was written in all other states. The majority of the premium was written in commercial multiple peril line of business at \$31.1 million.

The Company's home office is located in Petaluma, California. Its parent, Allianz Global Risks US Insurance Company located in Chicago, Illinois, manages the day-to-day operations of the Company.

REINSURANCE

Second Amended and Restated Intercompany Reinsurance Agreement

Effective January 1, 2012, the Company and its affiliates entered into a Second Amended and Restated Intercompany Reinsurance Agreement. Under the terms of this agreement, each participating affiliates cedes to Fireman's Fund Insurance Company (FFIC) the liabilities of all policies and contracts of insurance issued, assumed, or otherwise reinsured by the affiliates. The liabilities of the affiliated insurers are pooled with the liabilities arising from policies and contracts of insurance issued directly by FFIC. FFIC retains 100 percent of the pool liabilities and the other participating affiliates do not assume any portion of the pool results. As of December 31, 2018, members in the pool were the Company, FFIC, The American Insurance Company, National Surety

Corporation, Interstate Fire and Casualty Company, American Automobile Insurance Company, and Chicago Insurance Company.

Assumed

The Company did not assume any reinsurance during the examination period.

Ceded

The Company did not cede any reinsurance during the examination period other than the business ceded under the Second Amended and Restated Intercompany Reinsurance described above.

ACCOUNTS AND RECORDS

Vehicle Assessment

Each insurer doing business in California is required to pay an annual special purpose assessment for each vehicle it insures in this state pursuant to Sections 1872.8, 1872.81, and 1874.8 of the California Insurance Code. In addition, according to the California Code of Regulations, Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62 (10 CCR § 2698.62), an insurer is required to maintain an Automobile Assessment File to identify the assessment due for each vehicle by its vehicle identification number for which a policy insurance was in force for each quarter or any part thereof.

In 2006, pursuant to 10 CCR § 2698.62, the California Department of Insurance (CDI) granted the Company's request for an exemption and approved the use of an alternative method for calculating the assessment. During the examination, it was observed that the Company did not consistently utilize the approved method for some years.

It is recommended that the Company use the method for counting vehicles that was approved by the CDI to comply with the requirements of 10 CCR § 2698.62. It is also recommended that the Company notify the CDI of any deviation from the method previously granted and to request for approval of any new method used to produce the

number of vehicle count. The Company agrees with the recommendations to comply with 10 CCR § 2698.62.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance for the period ending December 31, 2018. The accompanying comments to the amounts reported in the financial statements should be considered an integral part of the financial statements. No adjustments were 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, 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	\$ 88,063,725	\$	\$ 88,063,725	
Cash and short-term investments	1,420,363		1,420,363	
Receivable for securities	129,226		129,226	
Investment income due and accrued	460,125		460,125	
Amount recoverable from reinsurers	11,077,420		11,077,420	
Current federal and foreign income tax recoverable and interest thereon	74,004		74,004	
Receivables from parent, subsidiaries, and affiliates	486		486	
Aggregate write-ins for other than invested assets	<u>1,949,606</u>		<u>1,949,606</u>	
Total assets	<u>\$ 103,174,955</u>	<u>\$</u>	<u>\$ 103,174,955</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 0	(1)
Other expenses			7,767	
Net deferred tax liability			232,371	
Ceded reinsurance premiums payable			10,832,484	
Payable for parent, subsidiaries and affiliates			<u>229,470</u>	
Total liabilities			11,302,092	
Common capital stock		\$ 3,500,000		
Gross paid-in and contributed surplus		13,005,856		
Unassigned funds (surplus)		<u>75,367,007</u>		
Surplus as regards policyholders			<u>\$ 91,872,863</u>	
Total liabilities, surplus and other funds			<u>\$ 103,174,955</u>	

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

Underwriting Income

Premiums earned		\$	0
Deductions:			
Losses and loss adjustment expenses incurred	\$	0	
Other underwriting expenses incurred	0		
	<u>0</u>		
Total underwriting deductions			<u>0</u>
Net underwriting gain or loss			0

Investment Income

Net investment income earned	\$	2,086,734	
Net realized capital losses	(81,158)		
	<u>2,005,576</u>		
Net investment gain			<u>2,005,576</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes			2,005,576
Federal and foreign income taxes incurred			<u>589,635</u>
Net income			<u>\$ 1,415,941</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		\$	90,018,427
Net income	\$	1,415,941	
Change in net unrealized capital gains	287,547		
Change in net deferred income tax	150,948		
	<u>1,854,436</u>		
Change in surplus as regards policyholders for the year			<u>1,854,436</u>
Surplus as regards policyholders, December 31, 2018			<u>\$ 91,872,863</u>

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

Surplus as regards policyholders, December 31, 2013			\$ 82,310,227
	Gain in Surplus	Loss in Surplus	
Net income	\$ 7,711,935	\$	
Change in net unrealized capital gains	922,295		
Change in net deferred income tax	928,406		
	\$ 9,562,636	\$	
Total gains and losses			
Net increase in surplus as regards policyholders			9,562,636
Surplus as regards policyholders, December 31, 2018			\$ 91,872,863

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the actuarial work prepared by the lead state's consulting actuary, Merlinos & Associates and concurred that Allianz's group losses and loss adjustment expense reserves as of December 31, 2018 were reasonable and have been accepted for purpose of this examination. As of December 31, 2018, the Company reported zero net loss and loss adjustment expense reserves (LAE) because one hundred percent of its losses and LAE expenses were ceded to Fireman's Fund Insurance Company.

SUSEQUENT EVENTS

Coronavirus Disease 2019 (COVID-19)

On January 30, 2020, the World Health Organization (WHO) declared the outbreak of COVID-19, a Public Health Emergency of International Concern. The pandemic has triggered unprecedented government mandates and health and safety measures, which have significantly impacted the U.S. and global financial markets, in particular, U.S. publicly traded equity securities, and impacts on yields and interest rates in the U.S. bond market. As the pandemic still unfolds, it is too early to draw any definite conclusions as to its overall impact to the Company at this time.

U.S. Agribusiness

Pursuant to a strategic decision to exit the U.S. Agribusiness (agriculture and farm) sector, effective February 24, 2020, an agreement was reached to sell the renewal rights to the U.S. Agribusiness book of business of the Company, Fireman's Fund Insurance Company, The American Insurance Company National Surety Corporation and American Automobile Insurance Company to ACE American Insurance Company. With a transition process beginning immediately and anticipated through August 2021.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Vehicle Assessment – Vehicle Assessment (Page 7): It is recommended that the Company use the method for counting vehicles that was approved by the California Department of Insurance (CDI) to comply with the requirements of California Code of Regulations, Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62 (10 CCR § 2698.62). It is also recommended that the Company notify the CDI of any deviation from the method previously granted and to request for approval of any new method used to produce the number of vehicle count. The Company agrees with the recommendations to comply with 10 CCR § 2698.62.

Previous Report of Examination

Accounts and Records – Information Systems Controls (Page 23): 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 has taken steps to address the recommendations.

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/_____

Li Lim, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California

_____/S/_____

Ber Vang, CFE, AES, CISA
Supervising Insurance Examiner
Department of Insurance
State of California