REPORT OF EXAMINATION
OF THE
CYPRESS INSURANCE COMPANY
AS OF
DECEMBER 31, 2012

Filed June 5, 2014

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San Francisco, California
May 23, 2014

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CYPRESS INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records at 3333 Farnam Street, Suite 300, Omaha, Nebraska 68131. The Company's statutory home office and main administrative office is located at 525 Market Street, Suite 3110, San Francisco, California 94105.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2008. This examination covers the period from January 1, 2009 through December 31, 2012. The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting

Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination was a coordinated examination with Nebraska as the lead state of the Berkshire Hathaway Group. The examination was conducted concurrently with other insurance entities belonging to two separate subgroups of the Berkshire Hathaway holding company group - National Indemnity Companies Group (NICO) and Berkshire Hathaway Homestate Companies Group (BHHC).

The NICO Group is comprised of insurers as listed below:

- American Centennial Insurance Company (DE)
- Berkshire Hathaway Assurance Corporation (NY)
- Berkshire Hathaway Life Insurance Company of Nebraska (NE)
- Columbia Insurance Company (NE)
- Finial Reinsurance Company (CT)
- National Fire & Marine Insurance Company (NE)
- National Indemnity Company (NE)
- National Indemnity Company of Mid-America (IA)
- National Indemnity Company of the South (FL)
- National Liability and Fire Insurance Company (CT)
- Stonewall Insurance Company (NE)
- Unione Italiana Reinsurance Company of America (NY)
- Wesco-Financial Insurance Company (NE)

The BHHC Group consists of the following six insurers:

- Berkshire Hathaway Homestate Insurance Company (NE)
- Brookwood Insurance Company (IA)
- Continental Divide Insurance Company (CO)
- Cypress Insurance Company (CA)
- Oak River Insurance Company (NE)
- Redwood Fire and Casualty Insurance Company (NE)

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; and statutory deposits.

COMPANY HISTORY

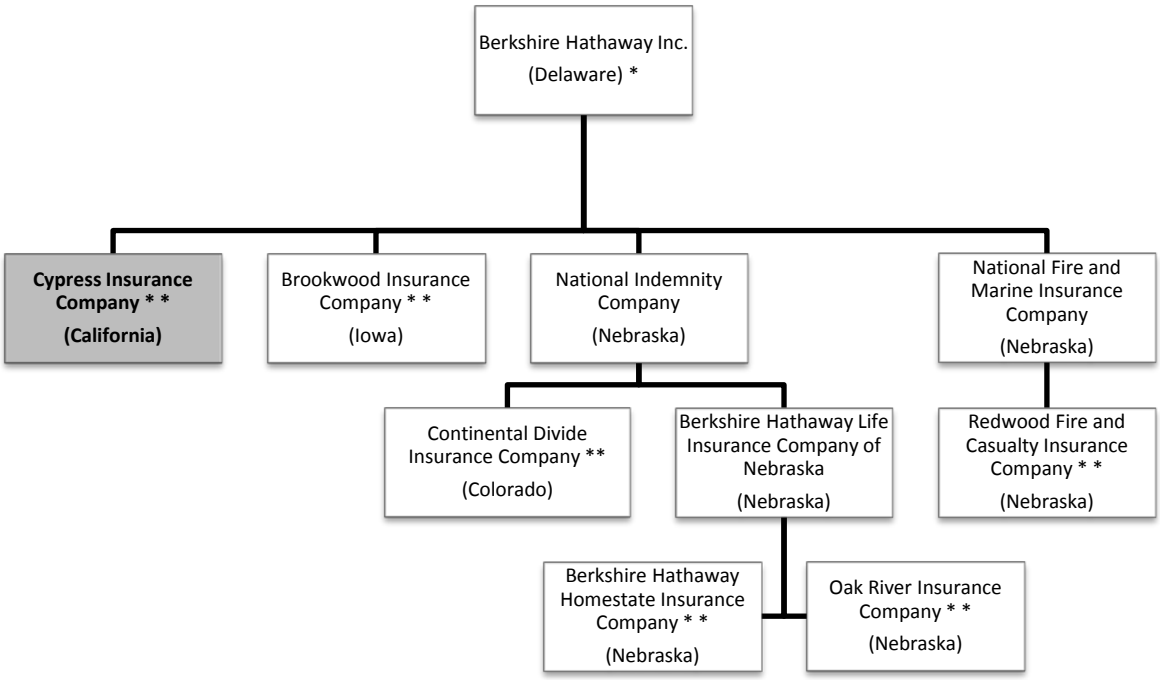
The Company was incorporated in California on October 17, 1962 under the laws of the State of California and commenced business on March 8, 1963. The Company has 104,000 authorized and outstanding shares of common stock with a par value of $50 per share. The Company was previously owned by OBH LLC (OBH) which was wholly-owned by Berkshire Hathaway Inc. ("BHI"), a publicly traded Delaware corporation. On January 1, 2012, OBH was merged with and into BHI. As a result, the Company became a direct subsidiary of BHI.

Dividends Paid to Parent

On April 7, 2011, the Company paid an ordinary cash dividend totaling $22 million to its then parent, OBH LLC and properly notified the California Department of Insurance on March 21, 2011 in accordance with California Insurance Code Section 1215.4(f).

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, Berkshire Hathaway Inc. (BHI), an American multinational holding company headquartered in Omaha, Nebraska. The following abridged organizational chart is limited to the entities the Company had interrelationships with during the examination period within the holding company system (all ownership is 100% unless otherwise indicated):



* 34.8% owned by Warren E. Buffett at December 31, 2012

* * Collectively referred to as the Berkshire Hathaway Homestate Companies

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, 2012:

Directors

Name and Location	Principal Business Affiliation
Joseph G. Casaccio Stamford, Connecticut	Vice President National Indemnity Company
J. Michael Gottschalk Omaha, Nebraska	Vice President National Indemnity Company
Donald F. Wurster Omaha, Nebraska	President National Indemnity Company

Principal Officers

Name	Title
Robert N. Darby, Jr.	President
Andrew R. Linkhart	Chief Financial Officer
Jackie L. Perry	Secretary and Treasurer
Tracy L. Gulden	Senior Vice President
Mark Barba	Vice President
Brian P. Hall	Vice President
Margaret A. Hartmann	Vice President
Therissa E. McKelvey	Vice President
Richard O. Kirste	Vice President
William M. Lawrence	Vice President
Michael V. Campbell	Vice President
Reagan R. Pufall	Vice President

Intercompany Agreements

Consolidated Federal Income Tax Allocation Agreement: The Company has a Consolidated Federal Income Tax Allocation Agreement with its parent, Berkshire

Hathaway Inc., effective November 23, 1994. Pursuant to the agreement, the consolidated federal tax liability is allocated among the subsidiaries in the ratio that each subsidiary's separate tax return liability bears to the total consolidated federal tax liabilities of all subsidiaries that are members of the consolidated group. This agreement was in place before prior approval was required under California Insurance Code (CIC) Section 1215.5(b)(4).

Intercompany Service Agreement: The Company entered into a formal written Intercompany Service Agreement, effective November 23, 1994, with five affiliated insurers within the Berkshire Hathaway Homestate Companies Group. The agreement provides the following services: accounting; tax and auditing; underwriting; claims; investments; and other functional support services such as actuarial; telecommunications and electronic data processing; legal; and purchasing; payroll and employee relations services. Each member may provide to other members any of the services listed above. The costs of shared services are allocated based on actual costs. In 2013, the agreement was amended as a result of one affiliate's name changed from Cornhusker Casualty Company to Berkshire Hathaway Homestate Insurance Company (BHHIC) and an addition of a paragraph regarding appropriate licensing. The amendment was filed with the California Department of Insurance (CDI) in accordance with CIC Section 1215.5(b)(4). The CDI approved this amendment on September 6, 2013.

Intercompany Allocation Agreement: The Company entered into an allocation agreement with affiliated insurers who are participating cedents to a Property Excess Per Risk Reinsurance Contract, effective December 31, 2010. The agreement was established to formalize provisions for sharing amongst affiliates participating in the reinsurance contract. One affiliate, BHHIC, is appointed to be the agent for other cedents. The Company failed to file the agreement with the CDI for prior approval in compliance with CIC Section 1215.5(b)(4). It is recommended that the Company file this agreement with the CDI pursuant to CIC Section 1215.5(b)(4).

Intercompany Service Agreement: The Company entered into a service agreement with GUARD Insurance Group, Inc. (GUARD), effective November 1, 2013. Under the agreement, the Company will utilize the Guard Software for processing its workers' compensation business. The agreement provides for cost sharing and allocation of operating expenses among the parties. This agreement was filed with the CDI in accordance with CIC Section 1215.5(b)(4). The CDI approved this agreement on November 5, 2013.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes failed to provide any statements pertaining to the receipt of the examination report. It is recommended that the Company implement procedures to ensure compliance with CIC Section 735.

TERRITORY AND PLAN OF OPERATION

The Company operates as a specialty carrier, focusing on workers' compensation business primarily in California and four other southeastern states. During 2012, the Company wrote direct premiums of $338 million, of which 96% was written in California, 2.1% in Georgia, 1.6% in Arkansas, .12% in South Carolina, and .12% in Tennessee. Workers' compensation policies comprised 96.2% of the total direct premium written in 2012.

During the examination period, the Company obtained its Certificate of Authority from Hawaii and Virginia, as well as a surplus lines insurer license from Texas. As of December 31, 2012, the Company was licensed to write property and casualty

insurance in Alabama, Arkansas, California, Georgia, Hawaii, Idaho, Mississippi, New Mexico, Oklahoma, South Carolina, Tennessee, and Virginia. In addition to being licensed to write surplus lines in Texas, the Company was an accredited reinsurer in the states of Colorado, Delaware, Iowa, and Nebraska. The Company currently concentrates on writing workers' compensation business in California, even though the Company has put its effort into expanding into other states to diversify its business geographically.

Business is marketed through approximately 1,308 independent agents. The primary location of the Company's books and records is in Omaha, Nebraska. The workers' compensation line of business is mainly operated from the Company's statutory home office located in San Francisco, California. Other lines of business are conducted in Omaha, Nebraska. In addition, the Company maintains branch offices in San Diego, California, as well as Atlanta, Georgia.

REINSURANCE

Assumed

Previously, the Company assumed 100% of the non-California workers' compensation business written by affiliates in the Berkshire Hathaway Homestate Companies Group, and also assumed 90% of the California workers' compensation business written by its affiliate, Oak River Insurance Company (ORIC). On May 31, 2010, the Company stopped assuming the 90% of quota share agreement from ORIC, and on January 1, 2012, the Company stopped assuming all remaining workers' compensation business written by its affiliates. Effective December 31, 2012, the Company entered into intercompany commutation agreements with its affiliates whereby all outstanding liabilities with its affiliates were commuted. The Company recorded these commutations as an increase in paid loss and loss adjustment expenses and a reduction in reserves. The paid amount was calculated based on the reserves with the

expected payout pattern of the outstanding liabilities. The impact of the discount rate applied resulted in an underwriting gain of $12.0 million. The Company filed the commutation agreements with the California Department of Insurance (CDI) on November 9, 2012. They were approved by the CDI on December 10, 2012.

Other than the required state workers' compensation pools, the Company had no assumed reinsurance in-force as of December 31, 2012.

Ceded

Effective December 31, 2012, the Company entered into a 50% quota share reinsurance agreement with its affiliate, Redwood Fire and Casualty Insurance Company (Redwood) whereby the Company cedes 50% of its direct workers' compensation business to Redwood. The agreement was filed with the CDI for approval on November 9, 2012. The CDI approved the agreement on December 5, 2012.

In addition to the above, the Company also had the following ceded reinsurance programs in effect as of December 31, 2012:

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
Workers' Compensation			
Excess of Loss (California business only)	National Indemnity Company (Authorized)	$2,000,000 Each loss occurrence	$3,000,000 Each loss occurrence
Excess of Loss (California and non-California business)	National Indemnity Company (Authorized)	$10,000,000 Each loss occurrence	$5,000,000 Each loss occurrence
Property or Commercial Auto			
Excess of Loss - Commercial Auto	Columbia Insurance Company (Authorized)	$1,000,000 Each loss occurrence	$4,000,000 Each loss occurrence
Excess of Loss - Property	7 reinsurers with varying participations: Authorized: Allied World Reinsurance Company, Employers Mutual Casualty Company, Odyssey Reinsurance Company, Aspen	$1,000,000 One risk, each loss	$4,000,000 One risk, each loss

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
	Insurance UK Limited, Hannover Rueckversicherung-AG, and Mapfre Re, Compania de Reaseguros, S.A. Unauthorized: Farm Bureau Mutual Insurance Company of Michigan		
Excess of Loss - Catastrophic Property Loss	National Indemnity Company (Authorized)	$2,000,000 Each loss occurrence	$10,000,000 Each loss occurrence

The Company is party to multiple cedent reinsurance contracts. Statement of Statutory Accounting Principles (SSAP) 62R, paragraph 9, requires allocation agreements: (1) the allocation must be in writing; and (2) the terms of the allocation agreement must be fair and equitable. It was noted that the agreements did not have proper cost allocation terms required by SSAP 62R, paragraph 9. For all outstanding multiple cedent agreements, it is recommended that the Company draft cost allocation agreements or amend the reinsurance contracts to ensure compliance with SSAP 62R, paragraph 9, and that the agreement which includes the cost allocation terms be filed with the CDI pursuant to CIC Section 1215.5(b)(4).

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review of the information systems general controls of the Berkshire Hathaway Homestate Companies, which includes the Company, was made. As a result of this review, several findings were noted in the following areas: information technology risks assessment, information technology governance, change management, patch management, business continuity planning, disaster recovery, and data security. These findings were presented to the Company along with recommendations to strengthen its controls. It is recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2012

Underwriting and Investment Exhibit for the Year Ended December 31, 2012

Reconciliation of Surplus as Regards Policyholders from December 31, 2008 through December 31, 2012

Reconciliation of Examination Changes as of December 31, 2012

Statement of Financial Condition
as of December 31, 2012

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 495,118,403	$	$ 495,118,403	
Preferred stocks	12,000,000		12,000,000	
Common stocks	227,140,880		227,140,880	
Cash and short-term investments	189,947,222		189,947,222	
Receivable for securities	250		250	
Investment income due and accrued	980,278		980,278	
Premiums and agents' balances in course of collection	136,082,526	992,281	135,090,245	
Premiums, agents' balances and installments booked but deferred and not yet due (including $1,718,447 earned but unbilled premiums)	1,790,650		1,790,650	
Amount recoverable from reinsurers	243,980		243,980	
Current federal and foreign income tax recoverable and interest thereon	364,685		364,685	
Guaranty funds receivable or on deposit	1,785,666	213,552	1,572,114	
Furniture and equipment, including health care delivery assets	318	318	0	
Receivables from parent subsidiaries and affiliates	334,384		334,384	
Aggregate write-ins for other than invested assets	583,671		583,671	
Total assets	$ 1,066,372,913	$ 1,206,151	$1,065,166,762	

Liabilities, Surplus and Other Funds			
Losses		$ 392,751,209	(1)
Reinsurance payable on paid loss and loss adjustment expenses		158,300,784	
Loss adjustment expenses		97,270,537	(1)
Commissions payable, contingent commissions and other similar charges		16,301,667	
Other expenses		2,905,607	
Taxes, licenses and fees		10,234,819	
Net deferred tax liability		30,007,711	
Unearned premiums		83,773,795	
Advance premium		0	(2)
Ceded reinsurance premiums payable		57,085,505	
Provision for reinsurance		136,000	
Drafts outstanding		80,054	
Payable to parent, subsidiaries and affiliates		6,049,468	
Aggregate write-ins for liabilities		3,088,374	
Total liabilities		857,985,530	
Common capital stock	$ 5,200,000		
Gross paid-in and contributed surplus	3,255,000		
Unassigned funds (surplus)	198,726,232		
Surplus as regards policyholders		207,181,232	
Total liabilities, surplus and other funds		$1,065,166,762	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2012

Statement of Income

Underwriting Income		
Premiums earned		$ 326,178,851
Deductions:		
Losses	$ 217,028,372	
Loss expenses incurred	62,463,455	
Other underwriting expenses incurred	46,770,531	
Total underwriting deductions		326,262,358
Net underwriting loss		(83,507)
Investment Income		
Net investment income earned	$ 11,420,884	
Net realized capital gain	(2,037,500)	
Net investment gain		9,383,384
Other Income		
Net gain from agents' or premium balances charged off (amount recovered $254,642, amount charged off $185,316)	$ 69,326	
Finance and service charges not included in premiums	18,957	
Aggregate write-ins for miscellaneous income	50,866	
Total other income		139,149
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		9,439,026
Federal and foreign income taxes incurred		(3,220,553)
Net income		$ 12,659,579

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2011		$ 187,401,550
Net income	$ 12,659,579	
Change in net unrealized capital gains	12,529,502	
Change in net deferred income tax	(4,712,433)	
Change in nonadmitted assets	(711,966)	
Change in provision for reinsurance	15,000	
Change in surplus as regards policyholders for the year		19,779,682
Surplus as regards policyholders, December 31, 2012		$ 207,181,232

Reconciliation of Surplus as Regards Policyholders from December 31, 2008 through December 31, 2012

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2008 per Examination			$ 239,054,571
Net loss	$	$ 56,695,759	
Net unrealized capital gains	33,897,771		
Change in net deferred income tax	17,715,079		
Change in nonadmitted assets		230,374	
Change in provision for reinsurance	63,000		
Cumulative effect of changes in accounting principles		4,623,056	
Dividends to stockholders		22,000,000	
Total gains and losses	$ 51,675,850	$ 83,549,189	
Net decrease in surplus as regards policyholders			(31,873,339)
Surplus as regards policyholders, December 31, 2012, per Examination			$ 207,181,232

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the Nebraska Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2012 were found to be reasonably stated and have been accepted for the purposes of this examination. A Casualty Actuary from the California Department of Insurance concurs with this conclusion.

(2) Advance Premium

The Company did not report premiums received prior to the effective date of the policies as advanced premiums. Instead, the Company recorded the advance deposits as a negative premium receivable when the cash is received. The Company's accounting methodology for premiums received prior to the effective date of the policies is not in compliance with the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, nor with Statement of Statutory Accounting Principles (SSAP) 53, paragraph 13. It is recommended that the Company comply with the NAIC Annual Statement Instructions and SSAP 53, paragraph 13, for the reporting of advance premiums.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Intercompany Agreements (Page 5): It is recommended that the Company file the Intercompany Allocation Agreement with the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5.(b)(4).

Corporate Records (Page 7): It is recommended that the Company implement procedures to ensure compliance with CIC Section 735.

Reinsurance – Ceded (Page 9): It is recommended that the Company draft cost allocation agreements or amend the reinsurance contracts to ensure compliance with the Statement of Statutory Accounting Principles (SSAP) 62R, paragraph 9, and that the agreement which includes the cost allocation terms be filed with the CDI pursuant to CIC Section 1215.5(b)(4).

Accounts and Records – Information Systems Controls (Page 10): It is recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its controls over its information systems.

Comments on Financial Statement Items – Advance Premium (Page 15): It is recommended that the Company comply with the National Association of Insurance Commissioners Annual Statement Instructions and SSAP 53, paragraph 13, for the reporting of advance premiums.

Previous Report of Examination

Comments on Financial Statement Items – Uncollected Premiums and Agents' Balances in the Course of Collection (Page 12): It was recommended that earned but unbilled (EBUB) premium be estimated and recorded in the Annual Statement in accordance with Statements of Statutory Accounting Principles (SSAP) No. 53. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

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Mei Gu, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California