REPORT OF EXAMINATION

OF THE

EMPLOYERS COMPENSATION

INSURANCE COMPANY

AS OF

DECEMBER 31, 2018

Filed on March 9, 2020

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Los Angeles, California
January 24, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

EMPLOYERS COMPENSATION INSURANCE COMPANY

(hereinafter also referred to as the Company) at the corporate office located at 10375 Professional Circle, Reno, Nevada 89521. The Company's statutory home is located at 500 North Brand Boulevard, Glendale, California 91203.

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 Employers Insurance Group. It was conducted concurrently with other insurance entities in the holding company group, including Employers Insurance Company of Nevada (EICN), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC). The following states participated on the examination: Nevada and Florida.

COMPANY HISTORY

Capitalization

The Company is authorized to issue one million shares of common stock with a par value of $50 per share. On November 16, 2018, Employers Group, Inc. (EGI), the Company's parent, purchased an additional 8,000 shares of the Company for $400,000. As of December 31, 2018, there were 60,000 shares outstanding.

The Company is a member of the Federal Home Loan Bank of San Francisco (FHLB). On March 9, 2018, the Company entered into a standby Letter of Credit Reimbursement Agreement with the FHLB in the amount of $50,000,000. The Letter of Credit Reimbursement Agreement may only be used to satisfy, in whole or in part, insurance deposit requirements with the state of California, and are fully secured with eligible collateral at all times. As of the period under examination, the Company had not accessed these funds.

Dividends

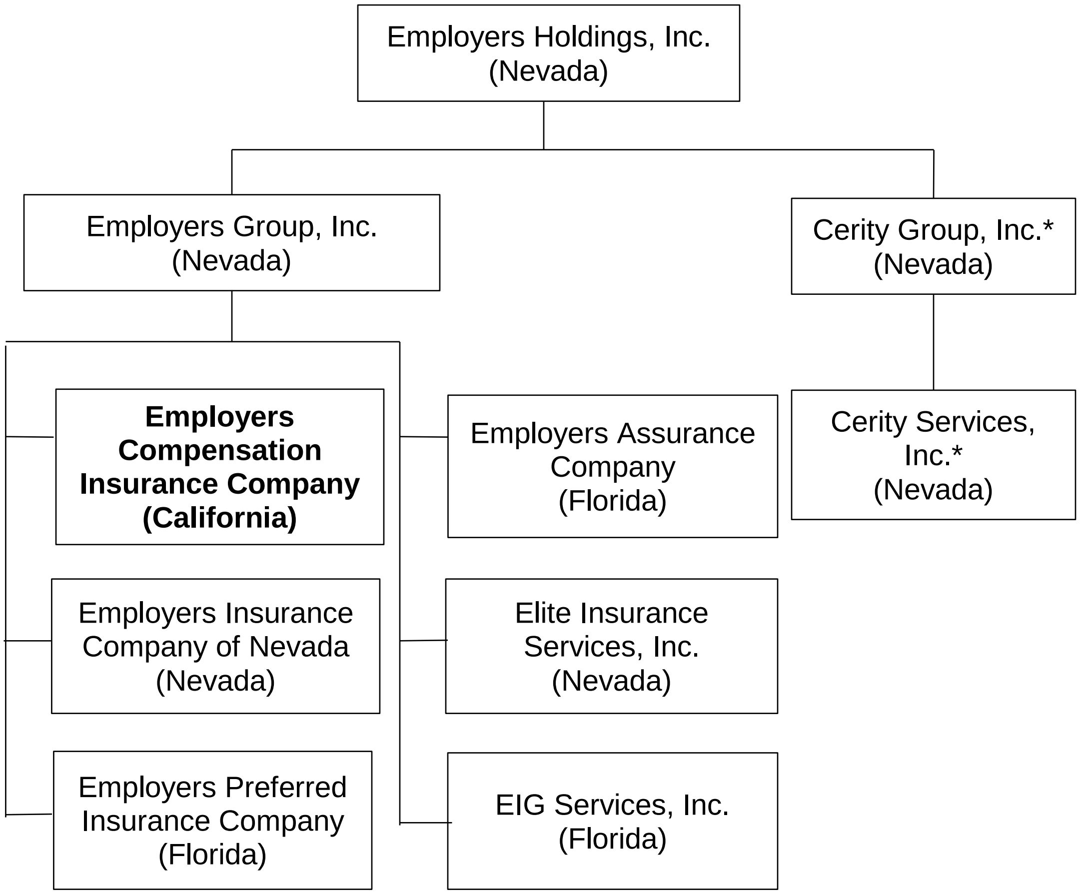
In June 2016, the Company paid an ordinary cash dividend in the amount of $33,500,000 to its parent at the time, Employers Insurance Company of Nevada.

In August 2017, the Company paid an ordinary cash dividend in the amount of $38,000,000 to its parent, EGI.

In September 2018, the Company paid an ordinary cash dividend in the amount of $48,400,000 to its parent, EGI.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Employers Group, Inc. (EGI), a Nevada corporation, and a member of an insurance holding company system of which Employers Holdings, Inc. (EHI) is the ultimate controlling entity. EHI is a publicly-traded insurance holding company and is incorporated in the state of Nevada. On June 3, 2016, EHI informed the California Department of Insurance (CDI) of its intention to "de-stack" its insurance subsidiaries. Whereas prior to the de-stacking, the Company was a subsidiary of Employers Insurance Company of Nevada (EICN) and Employers Assurance Company (EAC) was a subsidiary of Employers Preferred Insurance Company (EPIC); after the structural change, the Company and EAC became direct wholly-owned subsidiaries of EGI. Following is an abridged organizational chart as of December 31, 2018. All ownership is 100%.



* On May 22, 2018, EHI created Cerity Group, Inc. (CGI) and Cerity Services, Inc.(CSI), both Nevada corporations. CGI is wholly-owned by EHI. CSI is wholly-owned by CGI. EHI is the ultimate parent company of both CGI and CSI.

The five 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:

<u>Directors</u>

Name and Location	Principal Business Affiliation
Douglas D. Dirks Reno, Nevada	President and Chief Executive Officer Employers Holdings, Inc.
Stephen V. Festa Reno, Nevada	Executive Vice President, Chief Operations Officer Employers Holdings, Inc.
Lenard T. Ormsby Reno, Nevada	Executive Vice President, Chief Legal Officer and General Counsel, and Secretary Employers Holdings, Inc.
Michael S. Paquette Reno, Nevada	Executive Vice President, Chief Financial Officer, and Treasurer Employers Holdings, Inc.
Michael D. Rumbolz Las Vegas, Nevada	President and Chief Executive Officer Everi Holdings, Inc.

<u>Principal Officers</u>

Name and Location	Principal Business Affiliation
Douglas D. Dirks	Chief Executive Officer
Stephen V. Festa	President and Chief Operations Officer
Michael S. Paquette	Treasurer
Lori A. Brown	Senior Vice President, Deputy General Counsel, and Secretary
George (Chip) Carbonar	Vice President, Corporate Controller
Lawrence S. Rogers	Senior Vice President, Chief Underwriting Officer
Barry J. Vogt	Senior Vice President, Chief Claims Officer

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

- Lenard T. Ormsby resigned and was replaced with Lori A. Brown, General Counsel, EHI, effective January 1, 2019.
- On January 9, 2019, Gary Tongate was hired as Vice President, Enterprise Risk Management.
- On June 10, 2019, Marcus G. Bolinder was hired as Vice President, Deputy Legal Counsel.
- On August 5, 2019, Katherine H. Antonello was hired as Executive Vice President, Chief Actuary.
- On November 4, 2019, John M. Mutschink was hired as Senior Vice President, Chief Human Resource Officer.
- On December 2, 2019, Matthew S. Guilford was hired as Vice President, Corporate Marketing.

<u>Management Agreements</u>

Amended and Restated Administrative Services Agreement: Effective January 1, 2016, the Company entered into an Amended and Restated Administrative Services Agreement (Agreement) with its ultimate parent, EHI, and affiliates. The Agreement replaced the previous agreement that was effective January 1, 2009. The purpose of the amendment was to remove affiliated parties that no longer existed (Pinnacle Benefits, Inc, AmSERV, Inc. and Employers Occupational Health, Inc., which all merged into EIG Services, Inc. (ESI) effective June 3, 2013, June 3, 2013, and January 1, 2014, respectively), and to add EHI and EGI as parties to the Agreement. Under the terms of the Agreement, the parties may furnish to each other various services such as: accounting, tax, auditing, functional support, claims, investment, and underwriting. As stipulated in the Agreement, the compensation for providing such services is based on actual cost. The Agreement was approved by the California Department of Insurance (CDI) on September 30, 2015. During the years 2015, 2016, 2017, and 2018, the expenses paid by the Company under the terms of the Agreement were $14,733,064, $7,942,002, $9,800,496, and $6,402,410, respectively.

Amended and Restated Tax Allocation Agreement: Effective January 1, 2016, the Company entered into an Amended and Restated Tax Allocation Agreement (Agreement) with its ultimate parent, EHI, and affiliates whereby the Company and its affiliates would file a consolidated federal income tax return. The Agreement replaced the previous agreement that was effective February 25, 2009. The purpose of the amendment was to remove affiliated parties that no longer existed and to add ESI and EGI as parties to the amended agreement. Under the terms of the Agreement, the consolidated federal tax liability is allocated to consolidating companies based on separate return calculations with credit given for any net operating losses or other items utilized in the consolidated tax return. Pursuant to this Agreement, the parties have the enforceable right to recoup the net losses carried forward as an offset to future net income subject to federal income taxes. The Agreement was approved by the CDI on September 30, 2015. During the years 2015, 2016, 2017, and 2018, federal income taxes paid by the Company totaled $10,219,986, $3,497,093, $11,492,191, and $4,795,776, respectively.

Network Carrier Agreement: Effective January 1, 2015, the Company entered into a Network Carrier Agreement (Agreement) with EPIC for business underwritten in the state of Texas. Under the terms of the Agreement, EPIC, which is a certified workers' compensation health care network in the state of Texas, will provide the Company access to its workers' compensation health care network and furnish various services, such as: contracting with providers, credentialing, quality improvement program, case management program and reporting, out-of-network referrals, and provide data required for reporting compliance, etc. The compensation for providing the services shall be based on actual cost without a profit factor built into the cost. The Agreement was approved by the CDI on March 25, 2015. The expenses associated with the Agreement are imbedded in the administrative services expenses. Refer to the Amended and Restated Administrative Service Agreement paragraph above for total expenses paid for each year of the examination.

On April 22, 2015, the Agreement was amended to include sections concerning the Company's ownership and control of the books and records of the Company in possession of EPIC. The Amended Network Carrier Agreement was approved by the CDI on May 21, 2015.

General Agency and Underwriting Manager Agreement: Effective October 14, 2014, the Company entered into a General Agency and Underwriting Manager Agreement

(Agreement) with its non-insurer affiliate, ESI, and its insurer affiliates. Under the terms of the Agreement, ESI may furnish various services, such as: claims payment or adjusting, underwriting, preparation of financial reports, reserving for claims and expenses, etc., to the insurer affiliates. The compensation to ESI for providing the services shall be based on actual cost without a profit factor built into the cost. Each party agrees that ESI shall not receive any commissions or profit sharing for any business transacted under the Agreement. The Agreement was approved by the CDI on October 10, 2014.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2018, the Company was licensed to transact the business of workers' compensation in 44 states and the District of Columbia. During the examination period, the Company expanded into Connecticut, Delaware, Louisiana, Maine, Nebraska, New Hampshire, North Carolina, Rhode Island, South Dakota, Vermont, and West Virginia. During 2018, the Company wrote $34.5 million in direct premiums. The majority of total direct premium written were from the states of California, New York, Pennsylvania, Nevada, Georgia, and Illinois at 50.8%, 9%, 6.1%, 4.8%, 3.6%, and 3.6%, respectively.

Through independent agents, brokers, and its strategic partnerships, the Company focuses on workers' compensation business principally in the state of California, targeting select small businesses engaged in low to medium hazard industries. The Company and its affiliates' top ten types of insureds were restaurants, automobile service or repair shops, hotels, motels and clubs, dentists, optometrists, and physicians, gasoline stations, wholesale stores, real estate management, apparel manufacturing, groceries and provisions, schools, colleges, and religious organizations.

REINSURANCE

Intercompany Reinsurance Agreement

Effective October 1, 2008, the Company and its former parent, Employers Insurance Company of Nevada (EICN), and other affiliates, Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), entered into an Intercompany Pooling Agreement (Pool) with EICN being the lead company of the Pool. Under the terms of the Pool, all business written by the four companies, net of inuring reinsurance, is pooled. Premiums, losses, and expenses incurred are then reapportioned to EICN, the Company, EPIC, and EAC in the proportions of 53%, 27%, 10%, and 10%, respectively.

On July 14, 2014, the Company filed an Amended and Restated Reinsurance Pooling Agreement (Amended Pool) with the California Department of Insurance (CDI) with an effective date of January 1, 2015. Under the Amended Pool, the lead company changed from EICN to EPIC, which resulted in all participating parties ceding all of their business, net of inuring reinsurance, to EPIC. EPIC retained 35% of the total business ceded to the Amended Pool and then retroceded to the Company, EICN, and EAC in the proportions of 35%, 18%, and 12%, respectively.

On September 14, 2017, the Company filed a new Amended Pool with the CDI with an effective date of January 1, 2018. Under the new Amended Pool, the lead company remained EPIC. However, the allocation proportions under the new Amended Pool were updated to EPIC – 40%, EAC – 30%, the Company – 20% and EICN – 10%.

Assumed

The Company did not assume any business during the examination period and does not currently assume any business other than the involuntary pools.

Ceded

The Company participates in an excess of loss reinsurance agreement with its affiliates, EICN, EPIC, and EAC. Excess of loss reinsurance provides $190 million excess of $10 million coverage for all businesses classified by the Company as workers' compensation and employers' liability. The reinsurance program includes coverage for terrorism losses excluding nuclear, chemical, biological, or radiological events. The following is a summary of the Company's reinsurance agreements in-force as of December 31, 2018:

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
First layer	Various domestic, foreign and alien companies led by Hannover Ruck Se and Partner Reinsurance Company of the U.S.	$10 million	$10 million excess $10 million, not to exceed $10 million per occurrence; limited to $20 million per term
Second layer	Various domestic, foreign and alien companies led by XL Reinsurance America, Inc., Hannover Ruck Se, and Market Global Reinsurance Company	$20 million	$30 million excess $20 million, not to exceed $30 million per occurrence; limited to $60 million per term
Third layer	Various domestic, foreign and alien companies led by Tokio Millennium Re AG (Bermuda Branch) and Endurance Specialty Insurance Ltd.	$50 million	$50 million excess $50 million, not to exceed $50 million per occurrence, limited to $100 million per term
Fourth Layer	Various domestic, foreign and alien companies led by Tokio Millennium Re AG (Bermuda Branch) and BGS Services (Bermuda) Limited	$100 million	$100 million excess $100 million, not to exceed $100 million per occurrence; limited to $200 million per term

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance (CDI) and present the financial condition of the Company for the period ending December 31, 2018. The accompanying comments on the financial statements reflect any examination adjustments to the amounts reported in the annual statement, and should be considered an integral part of the financial statements.

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

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 868,810,213	$	$ 868,810,213	
Common stocks	9,834,550		9,834,550	
Cash and short-term investments	21,870,360		21,870,360	
Receivable for securities	58,372		58,372	
Investment income due and accrued	6,840,875		6,840,875	
Premiums and agents' balances in course of collection	4,292,997	1,218,479	3,074,518	
Premiums, agents' balances and installments booked but deferred and not yet due (including $2,161,100 earned but unbilled premiums)	15,219,008	599,187	14,619,821	
Amount recoverable from reinsurers	104,996		104,996	
Funds held by or deposited with reinsured companies	1,784,730		1,784,730	
Current federal and foreign income tax recoverable and interest thereon	5,943,325		5,943,325	
Net deferred tax asset	6,089,604		6,089,604	
Guaranty funds receivable or on deposit	832,230		832,230	
Receivables from parent, subsidiaries and affiliates	2,690,144		2,690,144	
Aggregate write-ins for other than invested assets	9,314,916	115,238	9,199,678	
Total assets	$ 953,686,320	$ 1,932,904	$ 951,753,416	

Liabilities, Surplus, and Other Funds

Losses		$ 284,474,080	(1)
Loss adjustment expenses		56,227,240	
Commissions payable, contingent commissions and other similar charges		2,830,444	
Other expenses		6,033,261	
Taxes, licenses, and fees		908,114	
Unearned premiums		62,786,073	
Advance premiums		759,884	
Ceded reinsurance premiums payable		181,770,158	(2)
Funds held by company under reinsurance treaties		67,908	
Remittances and items not allocated		492,412	
Provision for reinsurance		3,557	
Payable for parent, subsidiaries and affiliates		705,233	(2)
Payable for securities		11,149,640	
Aggregate write-ins for liabilities		980,462	
Total liabilities		609,188,466	
Common capital stock	$ 3,000,000		
Gross paid in and contributed surplus	214,000,000		
Unassigned funds (surplus)	125,564,950		
Surplus as regards policyholders		342,564,950	
Total liabilities, Surplus, and other funds		$ 951,753,416	

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

Statement of Income

Underwriting Income		
Premiums earned		$ 146,225,209
Deductions:		
Losses and loss expenses incurred	$ 78,259,125	
Other underwriting expenses incurred	45,661,051	
Total underwriting deductions		123,920,176
Net underwriting gain		22,305,033
Investment Income		
Net investment income earned	$ 30,290,525	
Net realized capital gain	882,152	
Net investment gain		31,172,677
Other Income		
Net loss from agents' or premium balances charged off (amount recovered $1,536,810 amount charged off $3,131,535)	$ (1,594,725)	
Finance and service charges not included in premiums	12,587	
Aggregate write-ins for miscellaneous income	123,793	
Total other loss		(1,458,345)
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		52,019,365
Dividends to policyholders		1,270,227
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		50,749,138
Federal and foreign income taxes incurred		(6,459,092)
Net income		$ 57,208,230

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		$345,344,595
Net income	$ 57,208,230	
Change in net unrealized capital gains	(2,733,473)	
Change in net deferred income tax	(16,304,721)	
Change in nonadmitted assets	7,411,989	
Change in provision for reinsurance	38,330	
Surplus adjustments:		
Paid-in Capital changes	400,000	
Paid in Surplus adjustments	(400,000)	
Dividends to stockholders	(48,400,000)	
Change in surplus as regards policyholders for the year		(2,779,645)
Surplus as regards policyholders, December 31, 2018		$ 342,564,950

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

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2014			$ 318,546,240
Net income	$ 163,311,931	$	
Net unrealized capital gains		2,026,359	
Change in net deferred income tax		33,383,693	
Change in nonadmitted assets	16,010,618		
Change in provision for reinsurance	6,213		
Dividends to stockholders		119,900,000	
Capital changes: Paid-in	400,000		
Surplus adjustments: Paid-in		400,000	
Total gains and losses	$ 179,728,762	$ 155,710,052	
Net increase in surplus as regards policyholders			24,018,710
Surplus as regards policyholders, December 31, 2018			$ 342,564,950

Summary of Reclassifications as of December 31, 2018

As a result of the examination, the following reclassifications were made that have no impact on surplus. The Company misclassified certain premiums attributed to the Amended and Restated Reinsurance Pooling Agreement as payable to parent, subsidiaries, and affiliates as follows:

Annual Statement Line Item	Balance per Annual Statement	Increase	Decrease	Adjusted Balance
Ceded reinsurance premiums payable	$ 22,538	$181,747,620	$	$181,770,158
Payable to parent, subsidiaries, and affiliates	$182,452,853	$	$181,747,620	$ 705,233

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

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

(2) Ceded Reinsurance Premiums Payable and Payable to Parent, Subsidiaries, and Affiliates

As a result of the examination, a reclassification was made that had no impact on surplus. The Company reported certain premiums attributed to the Amended and Restated Reinsurance Pooling Agreement totaling $181,747,620 as Payable to parent, subsidiaries and affiliates. An examination reclassification was made to decrease Payable to parent, subsidiaries, and affiliates and increase Ceded reinsurance premiums payable. It is recommended that the Company implement controls to ensure compliance with the requirements of the Property/Casualty Annual Statement Instructions regarding items to include in or exclude from the Payable to parent, subsidiaries, and affliates balances, as well as accurate reporting of reinsurance amounts on the appropriate annual statement lines and on Schedule F, Part 3.

SUBSEQUENT EVENTS

On March 1, 2019, the Company and the Federal Home Loan Bank of San Francisco (FHLB) amended their Letter of Credit Reimbursement Agreement to increase the credit amount to $90,000,000.

On March 29, 2019, the Company filed a new Amended Pool with the California Department of Insurance (CDI) with an effective date of August 1, 2019. Under the new Amended Pool, Cerity Insurance Company (CIC) was added as a party. The allocation proportions under the new Amended Pool were updated to Employers Preferred Insurance Company (EPIC) – 40%, Employers Assurance Company (EAC) – 30%, the Company – 20%, Employers Insurance Company of Nevada (EICN) – 5% and CIC – 5%. The new Amended Pool was approved by the CDI on May 2, 2019.

On July 31, 2019, Cerity Group, Inc. (CGI) acquired all of the outstanding shares of capital stock of PartnerRe Insurance Company of New York (PICNY), a New York corporation, through a stock purchase agreement with Partner Reinsurance Company of the U.S. The purchase price paid at closing was equal to the sum of (a) the amount of statutory capital and surplus of PICNY at closing ($47,600,000), and (b) $5,800,000.

Effective August 1, 2019, the Company entered into an Amended and Restated Administrative Services Agreement with an effective date of August 1, 2019. Under the terms of the new agreement, CGI, CSI, and PICNY, now known as Cerity Insurance Company (CIC), were added as parties to the agreement. The agreement was approved by the CDI on July 31, 2019.

Effective September 30, 2019, the Company entered into an Amended and Restated Tax Allocation Agreement with an effective date of September 30, 2019. Under the terms of the new agreement, CGI, CSI, and PICNY, now CIC, were added as parties to the agreement. The agreement was deemed approved by the CDI on September 30, 2019, with a formal letter of approval dated and issued December 19, 2019.

In 2019, the Company received certificates of authority to write in Alaska and Hawaii.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

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/

Alea P. Talbert-Pence, CFE, CIA
Examiner-In-Charge
Risk & Regulatory Consulting
representing
Department of Insurance
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/S/

Edward Aros, CFE
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