

REPORT OF EXAMINATION  
OF THE  
INTERINSURANCE EXCHANGE  
OF THE AUTOMOBILE CLUB  
AS OF  
DECEMBER 31, 2012

Filed June 4, 2014

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Los Angeles, California  
February 24, 2014

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

INTERINSURANCE EXCHANGE OF THE AUTOMOBILE CLUB

(hereinafter also referred to as the Exchange) at its home office located at 3333 Fairview Road, Costa Mesa, California 92626.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Exchange. The previous examination of the Exchange was made as of December 31, 2009. This examination covers the period from January 1, 2010 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 Exchange's financial condition, to identify prospective risks, and to obtain information about the Exchange, 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 Exchange were considered in accordance with the risk-focused examination process.

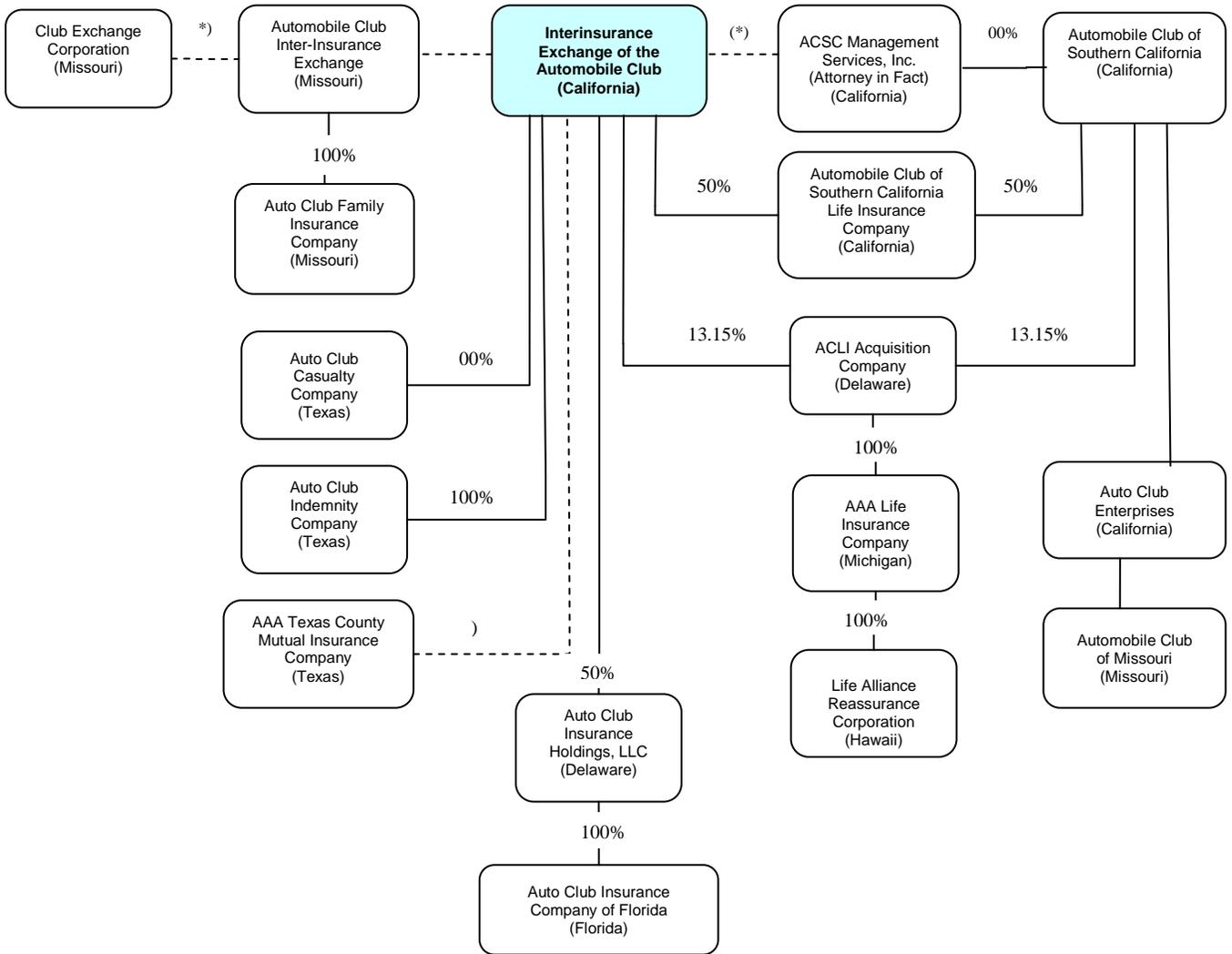
The examination was a coordinated examination, with California serving as the lead state and was conducted concurrently with the following insurance entities in the holding company group:

<u>Company</u>	<u>State of Domicile</u>
Automobile Club of Southern California Life Insurance Company	CA
Automobile Club Inter-Insurance Exchange	MO
Auto Club Family Insurance Company	MO
Auto Club Casualty Company	TX
Auto Club Indemnity Company	TX
AAA Texas County Mutual Insurance Company	TX

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

### MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Exchange's parent along with its affiliated insurance companies, depicts the Exchange's relationship within the holding company system at December 31, 2012:



(\*) Contractual or other relationship to operate the Exchange

The Exchange is managed and controlled by a seven-member Board of Governors which is composed of persons who are members of, and appointed by, the Board of Directors of the Automobile Club of Southern California. Following are members of the board and principal officers of the Exchange serving at December 31, 2012:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Peter K. Barker Santa Barbara, California	Retired Chairman California JPMorgan Chase & Co.
David R. Carpenter Santa Barbara, California	Chairman of the Board and Chief Executive Officer UniHealth Foundation
Richard S. Hamilton Pittsburgh, Pennsylvania	Chairman and Governing Director AAA East Central
Antonia Hernandez Pasadena, California	President and Chief Executive Officer California Community Foundation
Lawrence M. Higby Newport Beach, California	Retired Vice Chairman, President, and Chief Executive Officer Apria Healthcare
Thomas E. Larkin, Jr. Los Angeles, California	Vice Chairman and Director The TCW Group, Inc.
Thomas V. McKernan Arcadia, California	Chairman and Retired Chief Executive Officer Automobile Club of Southern California

Principal Officers

<u>Name</u>	<u>Title</u>
Gail C. Louis	Corporate Secretary
Avery R. Brown	Assistant Secretary

Principal Officers of ACSC Management Services, Inc. (\*)

<u>Name</u>	<u>Title</u>
Robert T. Bouttier	President and Chief Executive Officer
John F. Boyle	Executive Vice President
David M. Mattingly <sup>(a)</sup>	Senior Vice President, Chief Financial Officer, and Treasurer

<u>Name</u>	<u>Title</u>
Gail C. Louis	Corporate Secretary
Avery R. Brown	Senior Vice President, General Counsel, and Assistant Secretary
Christopher M. Baggaley	Senior Vice President
Alice C. Bisno	Senior Vice President
Michael A. Johnson	Senior Vice President
Rosemary W. Sabins	Senior Vice President

(\*) Attorney-in-Fact of the Interinsurance Exchange of the Automobile Club.

<sup>(a)</sup> David M. Mattingly retired on May 1, 2013 and was replaced by Raju T. Varma, effective May 16, 2013.

### Management Agreements

Management Agreement: Pursuant to a Management Agreement, Automobile Club of Southern California (ACSC) and its affiliates, including ACSC Management Services, Inc. (Management Services), the Attorney-in-Fact for the Exchange, employ all personnel of the Exchange. The Exchange reimburses Management Services for salaries and other employee-related costs through the management service fee. A portion of the employee benefit costs is allocated directly to the Exchange.

Pursuant to the Management Agreement, Management Services performs all of the operations of the Exchange. Management Services provides services related to the acquisition and issuance of insurance and the administrative activities associated with the business of the Exchange. In consideration for services rendered, the Exchange pays Management Services the following:

- (1) A sum equal to 1% of the premiums earned, less the tax computed according to the provisions of California Insurance Code (CIC) Section 1530; and
- (2) A sum equal to the amount of the operating expenses incurred (i.e. cost reimbursement) by Management Services for the performance of the above-indicated services. Cost allocation studies are performed each quarter to determine the cost to be allocated to the Exchange.

The following fees were paid under the terms of the agreement: \$436,151,322 in 2010, \$440,833,023 in 2011, and \$457,750,418 in 2012. This agreement went into effect December 19, 1996, before the prior approval provisions of CIC Section 1215.5 (b)(4) became effective and has never been amended.

Administrative Service Agreement: Effective February 1, 2000, the Exchange entered into an Administrative Service Agreement with Auto Club Indemnity Company. Under the terms of the agreement, the Exchange provides the following services: personnel services, financial services, management information systems support, facilities support, procurement support, insurance support services, marketing, advertising and promotional activities, and legal services. The services are provided on a cost allocation/reimbursement basis in accordance with insurance accounting principles. The following fees were paid under the terms of the agreement: \$16,901,104 in 2010, \$19,507,548 in 2011, and \$22,504,583 in 2012. This agreement was reviewed by the California Department of Insurance (CDI), which issued its letter of consent dated November 2, 1999.

Administrative Service Agreement: Effective February 1, 2000, the Exchange entered into an Administrative Service Agreement with Auto Club Casualty Company. Under the terms of the agreement, the Exchange provides the following services: personnel services, financial services, management information systems support, facilities support, procurement support, insurance support services, marketing, advertising and promotional activities, and legal services. The services are provided on a cost allocation/reimbursement basis in accordance with insurance accounting principles. The following fees were paid under the terms of the agreement: \$3,209 in 2010, \$1,132 in 2011, and \$3,904 in 2012. This agreement was reviewed by the CDI, which issued its letter of consent dated November 2, 1999.

Managerial Service Agreement: On September 30, 2002, the Exchange purchased a management agreement to operate AAA Texas County Mutual Insurance Company, a Texas mutual insurer formerly known as Industrial County Mutual Insurance

Company. The following fees were paid to the Exchange under the terms of the agreement: \$54,054,193 in 2010, \$55,818,454 in 2011, and \$62,625,793 in 2012. This agreement was reviewed by the CDI, which issued its Notice of Non-objection to Implementation on November 13, 2002. Effective December 31, 2009, the Exchange entered into an Amendment No. 1 to add new language to promote the timely settlement of amounts owed between the parties in accordance with Statement of Statutory Accounting Principles No. 96 and to provide a right of setoff clause between the parties under the agreement. The amendment was approved by the CDI on January 8, 2010.

**Tax Sharing Agreement:** The Exchange's federal income tax return is consolidated with its wholly-owned subsidiaries, Auto Club Casualty Company and Auto Club Indemnity Company. Allocation is based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually when tax payments are remitted to the Internal Revenue Service. The Exchange paid the following taxes during the examination period: \$69,697,243 in 2010, \$38,824,208 in 2011, and \$36,678,033 in 2012. The CDI approved this agreement on August 27, 1999.

**Affiliation Agreement:** The Exchange assumed operational control of the Automobile Club Inter-Insurance Exchange (Missouri Exchange), an affiliate of Automobile Club of Missouri (Missouri Club), and its subsidiary, Auto Club Family Insurance Company (ACFIC), through an Affiliation Agreement that was executed on March 1, 2006. The agreement is between the Exchange, ACSC, Auto Club Enterprises, Missouri Club, Missouri Exchange, Management Services, and Club Exchange Corporation, the Attorney-in-Fact appointed by its subscribers.

Pursuant to the Affiliation Agreement on June 30, 2006, the Exchange purchased a \$50 million surplus note from the Missouri Exchange. The surplus note has a stated interest rate of prime plus 1% per annum on the unpaid balance until the scheduled maturity date of June 30, 2026. Any payment of principal and interest shall be paid only with the prior approval of the Director of Insurance of the Missouri Department of Insurance.

The Affiliation Agreement also provides for a pooling agreement. Through the pooling agreement, the Exchange assumes all of Missouri Exchange's and ACFIC's business and cedes back 4% and 1% to each of them, respectively. The CDI approved the Affiliation Agreement and the above related transactions on June 27, 2006.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2012, the Exchange was licensed to write various lines of property and casualty business in the following ten states:

California	New Mexico	Texas
Hawaii	Ohio	Vermont
Maine	Pennsylvania	Virginia
New Hampshire		

In 2012, the Exchange wrote \$2.2 billion in direct premiums. Of the direct premiums written, \$2.1 billion (95.5%) was written in California and \$100 million (4.5%) was written in eight other states. The Exchange is licensed in Ohio, but does not write policies on a direct basis. The Exchange is also an accredited reinsurer in Florida, Michigan, and Missouri.

During 2012, \$2.1 billion (98.4%) of the Exchange's direct business written was automobile and homeowners insurance. The Exchange offers insurance to members of the Automobile Club of Southern California (ACSC) and its affiliated motor clubs as well as non-members in some states. Business is predominantly acquired through the agents of ACSC, affiliated through ACSC's ownership of its Attorney-in-Fact, ACSC Management Services, Inc., which manages the Exchange. The Exchange and its affiliates currently offer insurance to approximately 27% of the American Automobile Association national membership.

## REINSURANCE

### Intercompany Pooling Agreement

Effective July 1, 2006, the Exchange is party to a pooling agreement with Automobile Club Inter-Insurance Exchange and Auto Club Family Insurance Company. This pooling agreement was a part of the previously noted Affiliation Agreement (see Management and Control section), which was approved on June 27, 2006. The following are the pooling agreement participation percentages under the terms of this agreement:

<u>Company</u>	<u>State of Domicile</u>	<u>Pooling Share</u>
Interinsurance Exchange of the Automobile Club	CA	95%
Automobile Club Inter-Insurance Exchange	MO	4%
Auto Club Family Insurance Company	MO	<u>1%</u>
Pool Total		<u>100%</u>

### Assumed

The Exchange assumes 100% of the private passenger automobile business written by its subsidiary, Auto Club Casualty Company, and 100% of the homeowners, inland marine, other liability, and private passenger automobile business written by its subsidiary, Auto Club Indemnity Company, through two quota-share reinsurance agreements. The California Department of Insurance (CDI) allowed the Exchange to proceed with these agreements in a letter dated November 2, 1999.

The Exchange also assumes 100% of the private passenger automobile business written by AAA Texas County Mutual Insurance Company through a quota-share reinsurance agreement. The CDI issued a Notice of Non-objection to Implementation of this agreement in a letter dated November 13, 2002.

Effective November 1, 2006, the Exchange entered into a 40% Quota Share Reinsurance Agreement where the Exchange assumes 40% of the private passenger automobile business written in Georgia by the Auto Club South Insurance Company, a non-affiliated company, domiciled in Florida. The Exchange is an accredited reinsurer in the state of Florida. The agreement was amended January 1, 2012 to increase the assumed business to 50%.

Effective January 1, 2007, the Exchange entered into a 50% Quota Share Reinsurance Agreement where the Exchange assumes 50% of the business written in the State of Ohio from Member Select Insurance Company (MSIC), a non-affiliated insurance entity, domiciled in Michigan.

As an expansion of the above 50% Quota Share Reinsurance Agreement, effective June 1, 2007, the Exchange assumes 50% of the business written in West Virginia and Kentucky by Auto Club Property-Casualty Insurance Company (ACPC), a non-affiliated insurance entity, domiciled in Iowa.

Effective March 1, 2012, the quota share agreements with MSIC and ACPC were amended, whereby, MSIC and ACPC now cede to the Auto Club Insurance Association, a non-affiliated insurance entity, domiciled in Michigan, then retrocede to the Exchange. The Exchange is an accredited reinsurer in the State of Michigan.

In total for 2012, the Exchange assumed \$618.4 million in premiums written, which represented 13.4% of its surplus as regards policyholders.

## Ceded

The following is a summary of the ceded reinsurance treaties inforce as of December 31, 2012 (In thousands):

Type of Contracts	Reinsurer(s) Name	Exchange's Retention	Reinsurer's Maximum Limits
Property Catastrophe Excess of Loss (*)			
2 <sup>nd</sup> Layer (**)	Various Authorized and Unauthorized	(A) \$100,000 per Risk (B) \$200,000 per Risk	\$150,000 per Risk
3 <sup>rd</sup> Layer (**)	Various Authorized and Unauthorized	(A) \$250,000 per Risk (B) \$350,000 per Risk	\$200,000 per Risk
4 <sup>th</sup> Layer (**)	Various Authorized and Unauthorized	(A) \$450,000 per Risk (B) \$550,000 per Risk	\$350,000 per Risk
5 <sup>th</sup> Layer	Various Authorized and Unauthorized	(A) \$800,000 per Risk (B) \$900,000 per Risk	\$50,000 per Risk
6 <sup>th</sup> Layer	Various Authorized and Unauthorized	(A) \$850,000 per Risk (B) \$950,000 per Risk	\$25,000 per Risk

(\*) The Exchange did not renew the 1<sup>st</sup> Layer in 2012

(\*\*) The Exchange participates at a rate of 5% in the 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> Layer

(A) All other markets except California

(B) California market

Effective January 1, 2007, the Exchange entered into a 50% Quota Share Reinsurance Agreement where the Exchange cedes 50% of the business written in the state of Pennsylvania to Auto Club Insurance Association (ACIA), a non-affiliated insurance entity, domiciled in Michigan. ACIA is an accredited reinsurer in the state of California.

Effective January 1, 2008, the Exchange entered into a Multiple Cedant Allocation Agreement with its affiliate, Automobile Club Inter-Insurance Exchange to allocate reinsurance premiums, reinstatement premiums, and reinsurance recoveries under their single reinsurance program. The allocation method for reinsurance premiums is based on the average annual losses and the reinsurance recoveries are based on the actual

claim payments. This agreement was reviewed by the CDI, which issued its letter of consent dated March 28, 2008.

In total for 2012, the Exchange ceded \$190.4 million in premiums written, which represented 4.1% of its surplus as regards policyholders.

### 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, 2009  
through December 31, 2012

Statement of Financial Condition  
as of December 31, 2012

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 4,290,401,919	\$	\$ 4,290,401,919	
Common stocks	2,083,436,087		2,083,436,087	
Real estate	98,582,622		98,582,622	
Cash and short-term investments	(2,013,320)		(2,013,320)	
Other invested assets	106,215,678		106,215,678	
Receivable for securities	3,286,085		3,286,085	
Investment income due and accrued	56,767,513		56,767,513	
Premiums and agents' balances in course of collection	198,742,214	898,024	197,844,190	
Premiums, agents' balances and installments booked but deferred and not yet due	382,858,646		382,858,646	
Reinsurance: Amounts recoverable from reinsurers	26,546,228	191,249	26,354,979	
Guaranty funds receivable or on deposit	97,015		97,015	
Electronic data processing equipment and software	36,047,210	29,306,442	6,740,768	
Furniture and equipment, including health care delivery assets	11,500,940	11,500,940	0	
Receivable from parent, subsidiaries and affiliates	1,276,409		1,276,409	
Aggregate write-ins for other than invested assets	<u>19,345,648</u>	<u>17,198,472</u>	<u>2,147,176</u>	
<b>Total assets</b>	<b><u>\$ 7,313,090,894</u></b>	<b><u>\$ 59,095,127</u></b>	<b><u>\$ 7,253,995,767</u></b>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 905,098,641	(1)
Reinsurance payable on paid loss and loss adjustment expenses			86,215,705	
Other expenses			6,949,261	
Taxes, licenses and fees			11,191,587	
Current federal income taxes			7,077,723	
Net deferred tax liability			164,512,000	
Unearned premiums			1,252,602,720	
Advance premiums			24,298,448	
Dividends declared and unpaid: Policyholders			42,275,000	
Ceded reinsurance premiums payable			71,763,793	
Amounts withheld or retained by company for account of others			5,384,052	
Remittances and items not allocated			1,178,302	
Provision for reinsurance			666	
Payable to parent, subsidiaries and affiliates			39,441,670	
Payable for securities			15,795,334	
Aggregate write-ins for liabilities			<u>10,540,681</u>	
<b>Total liabilities</b>			<b>2,644,325,583</b>	
Unassigned funds (surplus)		<u>4,609,670,184</u>		
Surplus as regards policyholders			<u>4,609,670,184</u>	
<b>Total liabilities, surplus and other funds</b>			<b><u>\$ 7,253,995,767</u></b>	

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

Statement of Income

Underwriting Income

Premiums earned		\$2,569,837,988
Deductions:		
Losses and loss expenses incurred	\$ 1,861,478,698	
Other underwriting expenses incurred	<u>623,514,495</u>	
Total underwriting deductions		<u>2,484,993,193</u>
Net underwriting gain		84,844,795

Investment Income

Net investment income earned	\$ 204,148,951	
Net realized capital gains	<u>62,344,668</u>	
Net investment gain		266,493,619

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$416,624, amount charged off \$5,619,189)	\$ (5,202,565)	
Finance and service charges not included in premiums	54,296,510	
Aggregate write-ins for miscellaneous losses	<u>(100,987)</u>	
Total other income		<u>48,992,958</u>
Net income before dividends to policyholders, after capital gains tax and before federal income taxes		400,331,372
Dividends to policyholders		<u>160,566,105</u>
Net income after dividends to policyholders, after capital gains tax and before federal income taxes		239,765,267
Federal income taxes incurred		<u>19,812,639</u>
Net income		<u>\$ 219,952,628</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2011		\$4,265,318,037
Net income	\$ 219,952,628	
Change in net unrealized capital gains	127,854,367	
Change in net deferred income tax	(3,893,000)	
Change in nonadmitted assets	208,285	
Change in provision for reinsurance	<u>229,867</u>	
Change in surplus as regards policyholders for the year		<u>344,352,147</u>
Surplus as regards policyholders, December 31, 2012		<u>\$4,609,670,184</u>



## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

The December 31, 2012 loss and loss adjustment expense reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Exchange's reserves for losses and loss adjustment expenses were deemed reasonable and have been accepted for purposes of this examination.

## 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 Attorney-in-Fact's officers and employees during the course of this examination.

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Deanna Lo, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California