REPORT OF EXAMINATION

OF THE

PACIFIC COMPENSATION INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

Filed on March 9, 2018

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Los Angeles, California
December 5, 2017

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PACIFIC COMPENSATION INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 1 Baxter Way, Suite 170, Thousand Oaks, California 91362.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2012. This examination covered the period from January 1, 2013 through December 31, 2016.

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 riskfocused 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.

COMPANY HISTORY

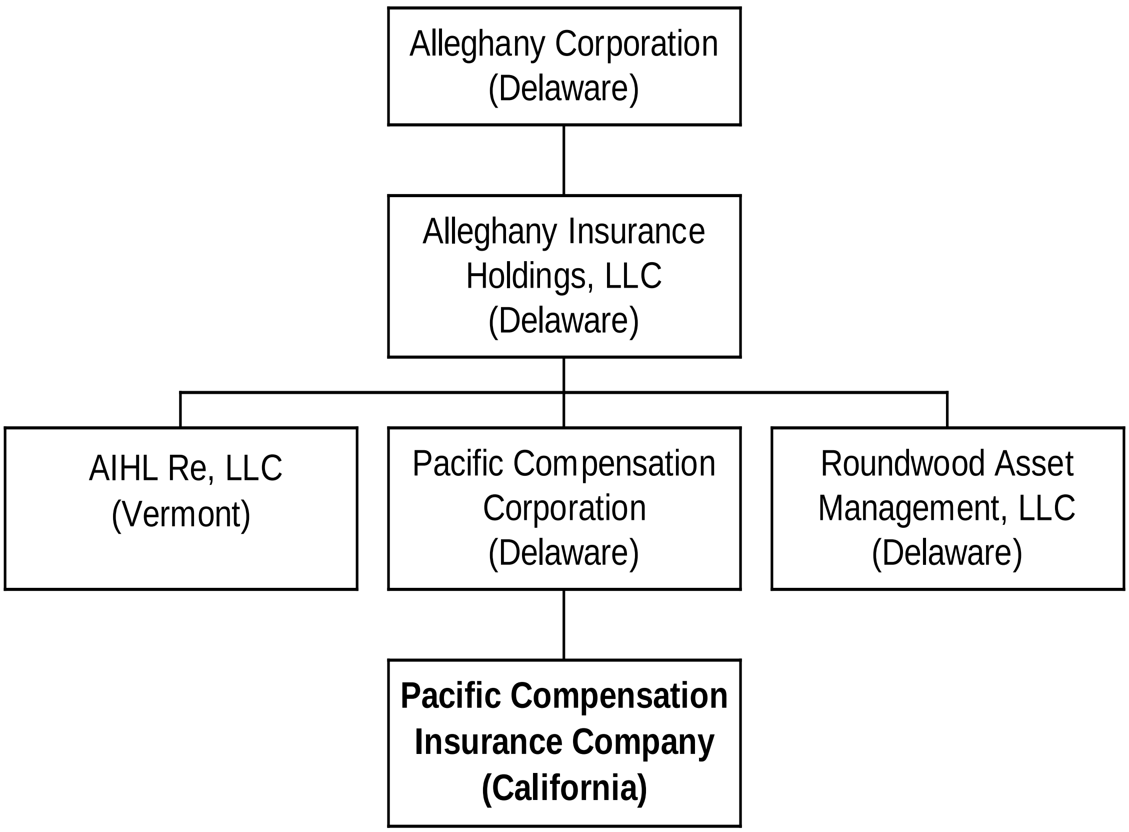
The Company was formerly Employers Direct Insurance Company (EDIC). EDIC was incorporated in the state of California on January 31, 2002 and commenced transacting property and casualty business on January 1, 2003. Effective April 12, 2010, the Company's name was changed to Pacific Compensation Insurance Company. Concurrently, on the same date its direct parent changed its name to Pacific Compensation Corporation.

Capitalization

On December 1, 2016, the Company received a $23.9 million capital cash contribution from Alleghany Corporation, its ultimate parent, to increase surplus to above $100 million and to obtain an A.M. Best Financial Size Category rating of VIII, which the Company subsequently obtained on March 30, 2017. In accordance with California Insurance Code Section 1215.4(e), the Company notified the California Department of Insurance of the capital contribution on December 29, 2016.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Alleghany Corporation (Alleghany) is the ultimate controlling entity. Alleghany is incorporated in the state of Delaware. 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%):



The four 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, 2016:

Directors

Name and Location	Principal Business Affiliation
Joseph P. Brandon Fairfield, Connecticut	Executive Vice President Alleghany Corporation
Christopher K. Dalrymple Mount Kisco, New York	Senior Vice President, General Counsel, and Secretary Alleghany Corporation
Janet D. Frank Westlake Village, California	Chief Executive Officer and President Pacific Compensation Insurance Company
John L. Sennott, Jr. New York, New York	Senior Vice President and Chief Financial Officer Alleghany Corporation

Principal Officers

Name	Title
Janet D. Frank	Chief Executive Officer and President
Denise K. Richardson	Senior Vice President, Finance, Chief Financial Officer, Secretary, and Treasurer
Kristopher J. Mathis	Senior Vice President, Claims, Marketing and Policyholder Services
Teresa C. Smiley(a)	Senior Vice President, Human Resources
Christine E. Closser	Vice President, Chief Underwriting and Broker Relations Officer
Todd E. Hines	Vice President, Health and Safety and Facilities
John L. Sennott, Jr.	Vice President, Equities
Roger B. Gorham	Vice President, Fixed Income

Name	Title
David M. Skaggs	Vice President, Claims Legal, General Counsel and Chief Compliance Officer
Shawn A. Wright	Vice President, Chief Actuary and Chief Risk Officer

The following changes in management occurred:

(a) June E. Duxler, Vice President, Human Resources and Administration, retired July 11, 2014. Teresa C. Smiley replaced Ms. Duxler as Vice President, Human Resources, effective March 2, 2015. Ms. Smiley's title was changed to Senior Vice President, Human Resources, effective March 31, 2016. Ms. Smiley was separated effective January 3, 2017 and was not replaced.

Management Agreements

Tax Sharing Agreement: The Company entered into a tax sharing agreement with Pacific Compensation Corporation (PCC), its immediate parent, on January 1, 2003. Under the terms of the agreement, allocation of taxes is based on separate return calculations with current credit for net losses to the extent utilized by the consolidating entities. Intercompany tax balances are normally settled no later than thirty days following the filing of the consolidated tax return. The agreement was approved by the California Department of Insurance (CDI) on August 1, 2003. Effective August 14, 2007, an amendment to include eDirect Insurance Services, Inc. (eDirect), a wholly-owned direct subsidiary of PCC, was approved by the CDI. The agreement remains in effect with the exclusion of eDirect following its dissolution, effective July 21, 2016. The Company did not pay any federal income taxes during the examination period.

Term Loan Line of Credit Agreement: On March 23, 2007, the Company entered into a renewable term loan line of credit with its immediate parent, PCC, providing for loans in an aggregate amount up to $5 million. Effective August 26, 2009, the borrowing limit was increased to $6 million. No loans occurred during the examination period.

Administrative/Facilities Service Agreement: Effective June 14, 2007, the Company entered into an administrative/facilities service agreement with affiliate, eDirect. Under the terms of the agreement, the Company provided certain administrative support services and facilities to eDirect including, but not limited to, financial reporting, budget and cost accounting, personnel, legal, office services, policy records, information technology, computer, and communication services. Reimbursement for services provided was based on an actual cost basis. The CDI approved the agreement on June 13, 2007. The agreement remained in effect until the dissolution of eDirect, effective July 21, 2016. No expenses were incurred during the examination period.

Investment Management Agreements: The Company's investment portfolio is managed by two management firms; one of which is an affiliate, Roundwood Asset Management, LLC (formerly Alleghany Capital Partners, LLC) (Roundwood), and the non-affiliated firm is New England Asset Management (NEAM). Each firm is responsible for managing a designated segment of the Company's investment portfolio. Within the confines of the Company's codified guidelines, each investment management firm has the authority to execute transactions without prior consultation with the Company's management. The agreements are summarized as follows:

- Effective August 1, 2007, an existing investment management agreement between NEAM and the Alleghany Corporation (Alleghany) was amended to include the management of the Company's fixed income portfolio. Management fees for services provided under the agreement are calculated as follows: annual fee of 0.12% on the first $500 million of market value of assets managed; 0.10% on next $1 billion of market value of assets managed; and 0.05% on market value of remaining assets under management. The Company paid NEAM $210,258, $208,258, $220,800, and $267,649 in 2013, 2014, 2015, and 2016, respectively.
- On December 19, 2007, the CDI approved an investment management agreement between the Company and Roundwood. Effective January 1, 2008,

the agreement provides for the management of the Company's equity account consisting of cash, equity securities, and other assets. Management fees for services provided are calculated as follows: annual fee of 1.00% on the first $200 million of market value of assets managed; 0.25% on the next $200 million of market value of assets managed; and 0.25% of market value of remaining assets under management. Effective July 1, 2014, the agreement was amended and approved by the CDI on July 28, 2014, to reflect the name change. The Company paid Roundwood $0, $0, $24,823, and $100,178 in 2013, 2014, 2015, and 2016, respectively.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to write employers' liability and workers' compensation business in Arizona, California, Colorado, Idaho, Nevada, Oregon, and Utah. During the period under review, writings were limited to workers' compensation coverage in Arizona, California, and Nevada. At December 31, 2016, the Company wrote $139.6 million (99.9%) of direct business in the state of California.

The Company writes business through approximately 71 brokers, which have approximately 475 branch locations.

REINSURANCE

Stop Loss Agreement

Effective January 1, 2013, the Company entered into a Stop Loss Reinsurance Agreement (Stop Loss) with AIHL Re, LLC (AIHL Re), a Vermont captive insurer and affiliate. Under the terms of the agreement, AIHL Re provides the Company with non-cancelable reinsurance coverage with the following features: (1) coverage for adverse development on net losses and allocated loss adjustment expenses in excess of the Company's carried reserves at December 31, 2012, and (2) accident year stop loss coverage for any net loss and allocated loss adjustment expenses in excess of 75% of net earned premium for accident years 2013, 2014, and 2015. The agreement has an aggregate limit of $100 million, and was entered into by the Company as part of a plan to attain a rating of A- (Excellent) from rating agency A.M. Best, in order to better compete in the workers' compensation market. As a result of entering the agreement, A.M. Best upgraded the Company's financial strength rating from B++ (Good) to A- (Excellent) during the second quarter of 2013. The California Department of Insurance (CDI) approved this agreement on April 26, 2013. Effective September 30, 2013, the agreement was amended to establish a single beneficiary trust as the vehicle utilized by AIHL Re, an unauthorized reinsurer, to collateralize its obligations to the Company, thereby allowing the Company to take credit for the full amount of reinsurance provided by AIHL Re on its financial statements. This amendment was approved by the CDI on January 17, 2014. An additional amendment was made in 2015 to extend the stop loss coverage to include accident years 2016 and 2017. The amendment was approved by the CDI on February 18, 2015.

In conjunction with the Stop Loss, the Company's ultimate parent, Alleghany Corporation (Alleghany) entered into a Keep Well Agreement (Keep Well) with AIHL Re. The purpose of the Keep Well is to provide assurance to the Company of AIHL Re's ability to meet its obligations under the Stop Loss. Under the terms of the Keep Well, Alleghany would ensure that AIHL Re's surplus maintains at least $10 million at all times, subject to an aggregate cap of $100 million, until all obligations under the Stop Loss have been satisfied.

<u>Assumed</u>

With the exception of the Company's minor participation in the National Council on Workers' Compensation Insurance Pool, the Company did not assume reinsurance during the examination period.

Ceded

The Company's ceded reinsurance program provides protection for all businesses classified by the Company as workers' compensation and employers' liability. At year-end 2016, the Company maintained excess of loss reinsurance coverage for losses in excess of $5 million up to an aggregate of $60 million. Aside from the aforementioned Stop Loss, the Company is solely responsible for any losses above $60 million. As of December 31, 2016, the Company maintained the following reinsurance agreements:

Line of Business and Type of Contract	Reinsurer's Name (authorized unless noted)	Company's Retention	Reinsurer's Limit
Workers' Compensation/ Employers' Liability Excess of Loss			
First Layer	75.0% - Various Lloyd of London Syndicates 25.0% - Hannover Ruckversicherung SE – certified	$5 million	$5 million excess $5 million per occurrence; not to exceed $15 million aggregate
Second Layer	51.0% - Various Lloyd of London Syndicates 17.5% - Arch Reinsurance Company 15.0% - Hannover Ruckversicherung SE – certified 7.5% - XL Reinsurance America, Inc. 6.5% - Munich Reinsurance America, Inc. 2.5% - Markel Global Reinsurance Company	$10 million	$10 million excess $10 million each loss occurrence; not to exceed $20 million aggregate
Third Layer	40.0% - Various Lloyd of London Syndicates 15.0% - Munich Reinsurance America, Inc. 10.0% - Allied World Assurance Company, Ltd. - unauthorized 10.0% - Arch Reinsurance Company 10.0% - IOA Re o.b.o. The Cincinnati Insurance Company 7.5% - Partner Reinsurance Company of the U.S. 5.0% - Markel Global Reinsurance Company 2.5% - XL Reinsurance America, Inc.	$20 million	$40 million excess $20 million per occurrence; not to exceed $80 million aggregate
Workers Compensation Per Occurrence First Excess of Loss (For Accident Year 9/2008-8/2009)	100.0% - Allianz Risk Transfer – unauthorized	$1 million of Ultimate Net Loss per occurrence	$9 million excess $1 million of Ultimate Net Loss per occurrence,; limited to aggregate of $28 million

Facultative Reinsurance Agreement: The Company and Platte River Insurance Company (Platte River), an affiliate, entered into a Facultative Reinsurance Agreement on December 1, 2012. The purpose of the agreement was to provide a facility whereby the Company would be able to take advantage of Platte River's A.M. Best "A" rating in the California marketplace. The agreement allowed the Company the use of a cut-through endorsement ("Endorsement") to provide workers' compensation insurance to certain insureds that required at least an "A" rating or better from A.M. Best. Under the terms of the agreement, Platte River would make payments on workers' compensation claims covered under policies bearing the Endorsement in the unlikely event the Company was financially unable to make such payments. On July 18, 2013, the agreement was terminated when A.M. Best upgraded the Company's financial strength rating to "A-". All obligations by Platte River, the Company, and any applicable Endorsement issued prior to the termination date shall continue on a run-off basis until fully and finally exhausted or extinguished.

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, 2016. The accompanying comments to the amounts reported in the annual statement should be considered an integral part of the financial statements. There were no examination adjustments made to surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2016

Underwriting and Investment Exhibit for the Year Ended December 31, 2016

Reconciliation of Surplus as Regards Policyholders from December 31, 2012 through December 31, 2016

Statement of Financial Condition
as of December 31, 2016

Assets		Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds		$ 301,129,104	$	$ 301,129,104	(1)
Common stocks		10,095,141		10,095,141	
Cash and short-term investments		34,675,135		34,675,135	
Investment income due and accrued		2,333,072		2,333,072	
Premiums and agents' balances in course of collection		3,936,217	20,971	3,915,246	
Premiums, agents' balances and installments booked but deferred and not yet due (including $7,823,933 earned but unbilled premiums)		7,823,933	465,416	7,358,517	
Accrued retrospective premiums		89,992	15,407	74,585	
Amount recoverable from reinsurers		1,602		1,602	
Current federal and foreign income tax recoverable and interest thereon		1,528,222		1,528,222	
Electronic data processing equipment and software		987,901	987,901		
Furniture and equipment		66,871	66,871		
Aggregate write-ins for other than invested assets		1,221,830	1,074,801	147,029	
Total assets		$ 363,889,020	$ 2,631,367	$ 361,257,653	
Liabilities, Surplus and Other Funds					
Losses and loss adjustment expenses				$ 221,414,077	(2)
Commissions payable, contingent commissions and other similar charges				2,067,045	
Other expenses				4,982,529	
Taxes, licenses and fees				2,054,877	
Unearned premiums				15,771,894	
Advance premiums				585,402	
Ceded reinsurance premiums payable				33,978	
Funds held by company under reinsurance treaties				649,217	
Amounts withheld or retained by company for account of others				813,483	
Remittances and items not allocated				186,094	
Provision for reinsurance				17,889	
Aggregate write-ins for liabilities				932,330	
Total liabilities				249,508,815	
Common capital stock			$ 2,600,000		
Gross paid-in and contributed surplus			171,487,500		
Unassigned funds (surplus)			(62,338,662)		
Surplus as regards policyholders				111,748,838	
Total liabilities, surplus and other funds				$ 361,257,653	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2016

Statement of Income

Underwriting Income		
Premiums earned		$ 138,816,185
Deductions:		
Losses and loss expenses incurred	$ 104,363,714	
Other underwriting expenses incurred	40,140,560	
Total underwriting deductions		144,504,274
Net underwriting loss		(5,688,089)
Investment Income		
Net investment income earned	$ 5,682,500	
Net realized capital gain	243,567	
Net investment gain		5,926,067
Other Income		
Net loss from agents' or premium balances charged off (amount recovered $0 amount charged off $728,432)	$ (728,432)	
Finance and service charges not included in premiums	1,531	
Aggregate write-ins for miscellaneous income	139,135	
Total other loss		(587,766)
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(349,788)
Federal and foreign income taxes incurred		(1,652,608)
Net income		$ 1,302,820

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2015		$ 87,066,971
Net income	$ 1,302,820	
Change in net unrealized capital gains	(99,837)	
Change in net deferred income tax	(53,759)	
Change in nonadmitted assets	(349,468)	
Change in provision for reinsurance	(17,889)	
Surplus adjustments:		
Paid-in	23,900,000	
Change in surplus as regards policyholders for the year		24,681,867
Surplus as regards policyholders, December 31, 2016		$ 111,748,838

Reconciliation of Surplus as Regards Policyholders
from December 31, 2012 through December 31, 2016

Surplus as regards policyholders, December 31, 2012			$ 108,920,766
	Gain in Surplus	Loss in Surplus	
Net losses	$	$ 22,732,406	
Net unrealized capital gains	260,405		
Change in net deferred income tax	140,218		
Change in nonadmitted assets	1,263,739		
Change in provision for reinsurance		3,884	
Surplus adjustments: Paid-in	23,900,000		
Total gains and losses	$ 25,564,362	$ 22,736,290	
Net increase in surplus as regards policyholders			2,828,072
Surplus as regards policyholders, December 31, 2016			$ 111,748,838

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Workers' Compensation Deposit

California Insurance Code (CIC) Section 11691 states, in part, that an insurer writing workers' compensation business in the state of California must maintain a deposit with the State Treasurer to provide protection for the workers of the state in the event that it is unable to pay compensable workers' compensation claims when due.

During the review of the Company's loss and loss adjustment expense reserves as of December 31, 2016 performed by a California Department of Insurance (CDI) Actuary, it was determined that the Company had a $10.8 million gross reserve deficiency. It is recommended that the Company consider this deficiency when calculating its workers' compensation deposit requirements for carried gross reserves as of December 31, 2017.

(2) Loss and Loss Adjustment Expenses

A senior casualty actuary of the CDI reviewed both the 2016 appointed actuary report and analysis performed by CDI staff of the loss and LAE reserves carried by the Company as of December 31, 2016. Although the CDI analysis estimated that the carried gross reserves were deficient by $10.8 million, the carried net reserves were estimated to be redundant by $3.2 million and are therefore reasonably stated as of December 31, 2016.

SUBSEQUENT EVENTS

On September 13, 2017, Alleghany Corporation (Alleghany) announced that its wholly-owned subsidiary Alleghany Insurance Holdings LLC, signed a definitive agreement to sell the Company to CopperPoint Mutual Insurance Company (CopperPoint), an Arizona domiciled company, for $150 million of total cash consideration. In connection with the transaction, AIHL Re, LLC (AIHL Re) will continue to provide coverage for adverse development on net losses and allocated loss adjustment expenses in excess of the Company's carried reserves at December 31, 2017. On September 13, 2017, CopperPoint filed a Form A with the California Department of Insurance (CDI). Additionally, the Company submitted two From D filings with the CDI on September 18, 2017; (1) to commute the current Stop Loss Reinsurance Agreement between the Company and its former affiliate, AIHL Re and (2) to file the new Stop Loss Reinsurance Agreement between the Company and AIHL Re. Notwithstanding, the Keep Well Agreement between Alleghany and AIHL Re will remain in effect with the aggregate guarantee being increased to $150 million. The Form A is still pending review by the CDI.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Comments on Financial Statement Items – Worker's Compensation Deposit (Page 14): It is recommended that the Company consider the $10.8 million gross reserve deficiency when calculating its workers' compensation deposit requirements for carried gross reserves as of December 31, 2017.

Previous Report of Examination

Comments on Financial Statement Items – Workers' Compensation Deposit (Page 17): It was again recommended that the Company recalculate its workers' compensation deposit requirements. The Company complied with the previous examination recommendation; however, based on the current actuarial reserve review performed by the California Department of Insurance Actuary the workers' compensation deposit should be reviewed for adequacy.

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/_________________________

Anjanette Briggs, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

___/S/_________________________

Edward Aros, CFE
Senior Insurance Examiner, Supervisor
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