

REPORT OF EXAMINATION  
OF THE  
ALLIANCE UNITED INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2018

Filed on June 4, 2020

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY: .....	2
Capitalization .....	3
Dividends .....	3
MANAGEMENT AND CONTROL:.....	4
Management Agreements.....	6
TERRITORY AND PLAN OF OPERATION.....	7
LOSS EXPERIENCE.....	7
REINSURANCE .....	8
FINANCIAL STATEMENTS: .....	9
Statement of Financial Condition as of December 31, 2018.....	10
Underwriting and Investment Exhibit for the Year Ended December 31, 2018 .....	11
Reconciliation of Surplus as Regards to Policyholders from December 31, 2015 through December 31, 2018.....	12
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	13
Losses and Loss Adjustment Expenses .....	13
SUBSEQUENT EVENTS .....	13
SUMMARY OF COMMENTS AND RECOMMENDATIONS: .....	14
Current Report of Examination .....	14
Previous Report of Examination .....	14
ACKNOWLEDGMENT .....	15

Los Angeles, California  
May 27, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

### ALLIANCE UNITED INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 200 East Randolph Street, Suite 3300, Chicago, Illinois, 60601. The Company's statutory home office is located at 9121 Oakdale Avenue, Suite #201, Chatsworth, California 91311.

### SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The previous examination of the Company was as of December 31, 2015. This examination covered the period from January 1, 2016 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 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 of the Kemper Corporation and Illinois Department of Insurance served as the lead state. It was conducted concurrently with other insurance entities in the holding company group. In addition to Illinois and California, the following states participated on the examination: Louisiana, Missouri, New York, Ohio, Oklahoma, Oregon, Texas, Wisconsin, and Virginia.

## COMPANY HISTORY

Effective April 30, 2015, Alliance United Group (AUG) was acquired by Kemper Corporation (Kemper) through a reverse subsidiary merger transaction between Kemper, Kemper Acquisition Corporation, (a newly formed California corporation and subsidiary of Kemper), AUG, and Platinum Group of Companies. The transaction was a cash transaction for a total purchase price of \$71 million, subject to certain post-closing indemnifications. As a result of the transaction, Kemper became the owner of 100% of the issued and outstanding shares of AUG common stock, thereby becoming the indirect sole shareholder of the Company and Alliance United Insurance Services, LLC (AUIS).

The California Secretary of State approved the conversions of AUG and AUIS from California corporations to California limited liability companies, effective June 15, 2015, and June 22, 2015, respectively.

On June 3, 2015, the board of directors of AUG authorized a capital contribution of all the common stock of AUIS to the Company. The contribution was made on June 5, 2015, and as a result, AUIS became a wholly-owned subsidiary of the Company.

Effective January 31, 2018 the manager of AUG approved a distribution consisting of all of the common stock of the Company to Kemper; as a result, the Company became a wholly-owned direct subsidiary of Kemper.

### Capitalization

The Company is authorized to issue one hundred thousand shares of Class A voting common stock with a par value of \$1,000 per share. As of December 31, 2018, there were 2,600 shares issued and outstanding.

During the period under examination, the Company received cash capital contribution from Kemper a total of \$30 million in 2016, and \$20 million in 2018.

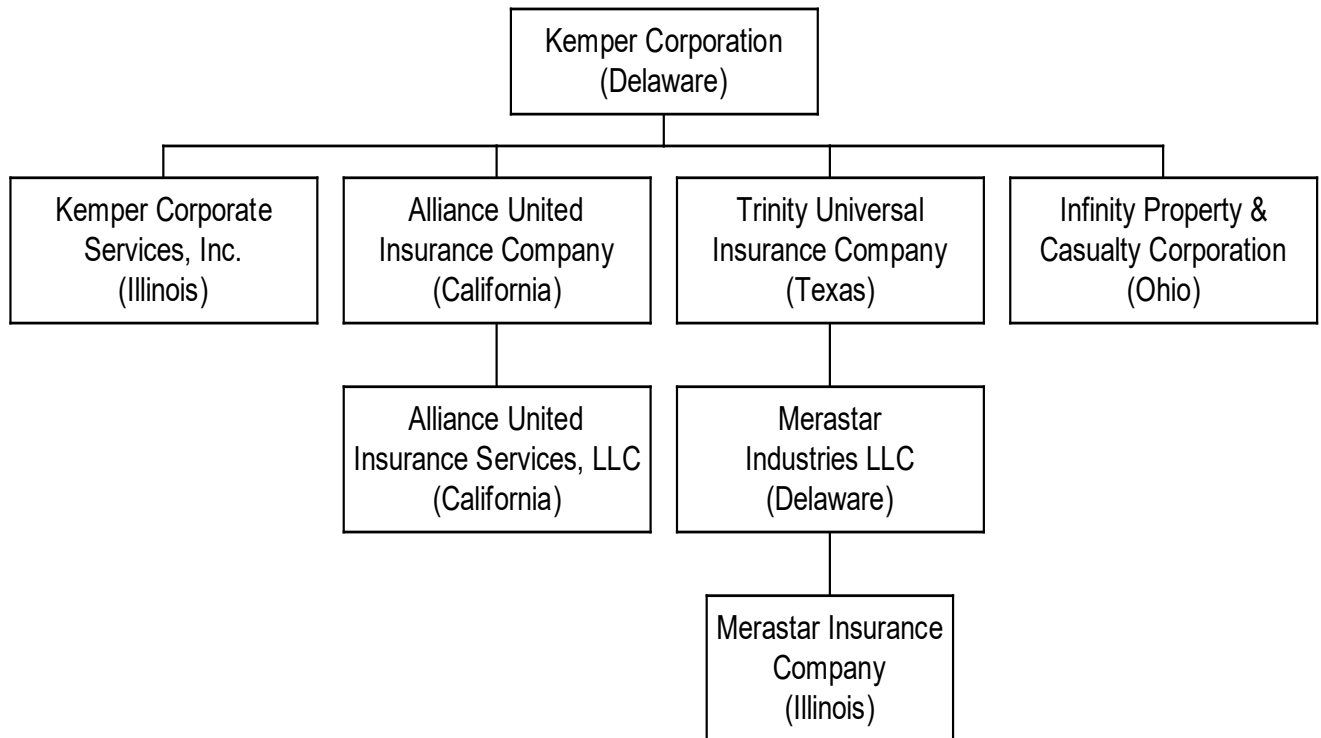
### Dividends

No dividends were paid by the Company during the examination period.

The Company received cash distributions from its subsidiary AUIS as follows: \$46 million, \$44.5 million, and \$51.2 million in 2016, 2017, and 2018, respectively.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Kemper Corporation (Kemper) is the ultimate controlling entity. Following is an abridged organizational chart showing the entities the Company had interrelationships with during the examination period. All ownership is 100%.



The seven 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, 2018:

## Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
John M. Boschelli Geneva, Illinois	Senior Vice President and Chief Executive Officer Kemper Corporation
Charles T. Brooks (a) Chicago, Illinois	Senior Vice President, Operations and Systems Information Technology Kemper Corporation
Timothy D. Bruns Ooltewah, Tennessee	President Alliance United Insurance Company
Troy J. McGill Cross Plains, Wisconsin	Vice President, Tax Kemper Corporation
Maxwell T. Mindak Elmhurst, Illinois	Vice President, Financial Planning and Analysis Kemper Corporation
Christopher L. Moses (a) Chicago, Illinois	Vice President and Treasurer Kemper Corporation
Richard Roeske Naperville, Illinois	Vice President and Chief Accounting Officer Kemper Corporation

## Principal Officers

<u>Name</u>	<u>Title</u>
Timothy D. Bruns	President
Clark H. Roberts(b)	Chief Financial Officer
Andrew D. MacDonald	Senior Vice President
Kim D. Leggette	Senior Vice President
Melissa V. Newville	Vice President
Judy L. Fuller	Secretary
Christiane L. Hall	Assistant Vice President

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

- (a) Effective March 5, 2019, Charles T. Brooks and Christopher L. Moses are no longer member of the board of directors. There was no replacement made.
- (b) Effective March 5, 2019, Clark H. Roberts is no longer the Chief Financial Officer. The position remains vacant.

## Management Agreements

**Service Agreement:** Effective May 1, 2015, the Company and Kemper Corporate Services, Inc. (KCSI), a wholly-owned subsidiary of Kemper are parties to a service agreement whereby KCSI provides certain general services to the Company, including, but not limited to, financial accounting and reporting, cash management and bank relations, corporate secretarial functions, financial planning and analysis of results of operations, administration of post-retirement life and medical benefits, investment accounting, legal support and advice, tax accounting and advice, and purchasing and accounts payable. Additionally, KCSI provides computer data processing and other information technology services to the Company. The California Department of Insurance (CDI) approved this agreement on June 25, 2015. The Company paid \$14.7 million, \$22.8 million, and \$32.5 million for services provided by KCSI in 2016, 2017, and 2018, respectively.

**General Service Agreement:** Effective May 1, 2015, the Company and Merastar Insurance Company (Merastar), an affiliate of the Company and an indirectly-owned subsidiary of Kemper, are parties to a general services agreement whereby Merastar administers the new and renewal property and casualty lines insurance business of the Company, as well as provides certain services and facilities to the Company. Services provided include marketing, underwriting, supervision of the adjustment of claims, payment of expenses, and staffing, among other services. Services between the Company and its affiliates are charged at rates that approximate cost. The CDI approved this agreement on June 25, 2015. The Company paid \$87.7 million, \$100.5 million, and \$108.5 million for services provided by Merastar in 2016, 2017, and 2018, respectively.

**Agency Agreement:** Effective February 18, 2004, the Company is a party to an agency agreement with its wholly-owned subsidiary, Alliance United Insurance, Services, LLC (AUIS). Under the provisions of the agreement, AUIS has the authority to process policies, collect premiums and perform responsibilities typical of a general servicing agent. Multiple amendments to this agency agreement were made and approved by the CDI, and the most recent amendment was approved on April 19, 2017. For services



provided, the Company paid AUIS commissions of \$61.6 million, \$75.9 million, and \$102 million in 2016, 2017, and 2018, respectively.

Federal Income Tax Agreement: The Company entered into a Federal Income Tax Agreement with Kemper on May 1, 2015. Under the terms of the Agreement, the Company will pay Kemper the amount of regular income tax it would pay the Internal Revenue Service as if filing separately. The Company's regular income tax liability shall not be greater nor less than the regular income tax liability would be if the Company had filed a separate tax return for all years in the consolidated period. This Agreement was approved by the CDI on June 3, 2015. During 2016, 2017, and 2018, the Company paid/(recovered) federal income taxes of \$(4.7) million, \$11.6 million, and \$9.2 million, respectively.

#### TERRITORY AND PLAN OF OPERATION

The Company is licensed to write Fire, Marine, Disability, Plate Glass, Liability, Common Carrier Liability, Boiler and Machinery, Burglary, Sprinkler, Team and Vehicle, Automobile, and Miscellaneous coverage solely in California.

Business is produced by a network of insurance agencies through its affiliated general agent Alliance United Insurance Service, LLC, its wholly-owned subsidiary. In 2018, the Company wrote \$861.16 million of direct premiums. Of the direct premiums, 65.80% was private passenger automobile liability, and 34.20% was automobile physical damage.

#### LOSS EXPERIENCE

The Company reported net underwriting loss of \$87 million, \$23 million, and \$33 million in 2016, 2017, and 2018, respectively. In 2016, the Company reported net loss of \$28 million. However; in 2017 and 2018, the Company reported net income of \$49 million and \$25 million, respectively.

The underwriting losses sustained by the Company during the examination period were primarily due to increase in loss and loss adjustment expense incurred. The investment income in 2017 and 2018 accounted for the overall net income for the same period.

The Company has maintained its Risk-Based Capital above company action levels and its surplus position primarily through cash capital contribution from its parent, Kemper Corporation of \$30 million in 2016, \$20 million in 2018, and \$15 million in 2020.

### REINSURANCE

At the acquisition of Kemper Corporation, all of the Company's quota share reinsurance program was terminated on a cut-off basis.

The Company maintain excess of loss reinsurance coverage that cede losses in the \$13 million excess of \$2 million layer to various authorized and unauthorized non-affiliated reinsurer. Effective January 1, 2019, this excess of loss reinsurance coverage was non-renewed.

As of December 31, 2018, the Company's exposure to catastrophes and other natural disasters is 100% reinsured to its affiliate, Trinity Universal Insurance Company. Other than the catastrophe coverage, the Company retained all business written and did not enter into any significant or unusual reinsurance program for the period under exam.

The Company does not assume any reinsurance business.

## 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, 2014. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and 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, 2018

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

Reconciliation of Surplus as Regards Policyholders from December 31, 2015  
through December 31, 2018

Statement of Financial Condition  
as of December 31, 2018

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 572,863,521	\$	\$ 572,863,521	
Preferred stocks	15,344,206		15,344,206	
Common stocks	137,352,014		137,352,014	
Cash, cash equivalents, and short-term investments	(4,406,587)		(4,406,587)	
Other invested assets	4,765,577	4,609,308	156,269	
Aggregate write-ins for invested assets	(19,161)		(19,161)	
Investment income due and accrued	5,642,442		5,642,442	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	90,181,003		90,181,003	
Amounts recoverable from reinsurers	75,510		75,510	
Current federal and foreign income tax recoverable and interest thereon	9,029,016		9,029,016	
Net deferred tax asset	11,471,088	2,134,336	9,336,752	
Electronic data processing equipment and software	159,307	35,000	124,307	
Furniture and equipment	489,819	489,819	0	
Receivables from parent, subsidiaries and affiliates	664,828		664,828	
Aggregate write-ins for other than invested assets	708,811	708,811	0	
Total assets	<u>\$ 844,321,394</u>	<u>\$ 7,977,274</u>	<u>\$ 836,344,120</u>	
 <u>Liabilities, Surplus, and Other Funds</u>				<u>Notes</u>
Losses			\$ 355,672,365	(1)
Loss adjustment expenses			68,213,122	(1)
Other expenses			3,132,711	
Taxes, licenses, and fees			6,615,913	
Unearned premiums			153,273,635	
Ceded reinsurance premiums payable			288,657	
Remittances and items not allocated			207,540	
Provision for Reinsurance			5,043	
Payable for parent, subsidiaries and affiliates			13,079,221	
Payable for securities			282,957	
Aggregate write-ins for liabilities			<u>2,171,699</u>	
Total liabilities			602,942,865	
Common capital stock		\$ 2,600,000		
Gross paid in and contributed surplus		228,255,776		
Unassigned funds (surplus)		<u>2,545,479</u>		
Surplus as regards policyholders			<u>233,401,255</u>	
Total liabilities, surplus, and other funds			<u>\$ 836,344,120</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 833,490,490
Deductions:		
Losses incurred	\$ 574,833,392	
Loss adjustment expenses incurred	105,783,004	
Other underwriting expenses incurred	<u>186,261,890</u>	
Total underwriting deductions		<u>866,878,286</u>
Net underwriting loss		(33,387,796)

Investment Income

Net investment income earned	\$ 68,642,234	
Net realized capital gain	<u>445,289</u>	
Net investment gain		<u>69,087,523</u>
Net income before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		35,699,727
Net income after dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		35,699,727
Federal and foreign income taxes incurred		<u>10,079,252</u>
Net income		<u>\$ 25,620,475</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2017		\$ 198,619,352
Net income	\$ 25,620,475	
Change in net unrealized capital gains or (losses) less capital gains tax	(9,479,759)	
Change in net deferred income tax	3,705,685	
Change in nonadmitted assets	(5,036,890)	
Change in provision for reinsurance	(5,043)	
Surplus adjustments: Paid in	20,000,000	
Aggregate write-ins for gains and losses in surplus	<u>(22,564)</u>	
Change in surplus as regards policyholders for the year		<u>34,781,903</u>
Surplus as regards policyholders, December 31, 2018		<u>\$ 233,401,255</u>

Reconciliation of Surplus as Regards to Policyholders  
from December 31, 2015 through December 31, 2018

Surplus as regards policyholders, December 31, 2015			\$ 135,234,957
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 46,996,147	\$	
Change in net unrealized capital losses		5,461,462	
Change in net deferred income tax		3,930,325	
Change in nonadmitted assets	10,589,545		
Change in provision for reinsurance		5,043	
Surplus adjustment: Paid-in	50,000,000		
Aggregate write-ins for gains and losses in surplus		<u>22,564</u>	
Total gains and losses	<u>\$ 107,585,692</u>	<u>\$ 9,419,394</u>	
Net increase in surplus as regards policyholders			<u>98,166,298</u>
Surplus as regards policyholders, December 31, 2018			<u>\$ 233,401,255</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Illinois, the lead state, retained Milliman, Inc. (Milliman) for the purpose of determining the reasonableness of the Group's loss and loss adjustment expense reserves. Based on the analysis by Milliman and the review of their work by a Casualty Actuary from the California Department of Insurance, the Company's December 31, 2018 reserves for losses and loss adjustment expenses were found to be reasonably stated and have been accepted for the purpose of this examination.

### SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared the outbreak of a coronavirus (COVID-19) pandemic. The extent of the impact of COVID-19 on the Company's operational and financial performance will depend on certain developments, including the duration and spread of the outbreak, regulatory decisions, and the impact on the financial markets, all of which are uncertain and cannot be predicted. Due to the timing of the examination and field work, the effects of the pandemic on this entity are not fully addressed within this examination report.

On March 31, 2020, the Company received \$15 million cash capital contribution from Kemper Corporation to support its investment portfolio losses due to the recent market volatility as a result of the COVID-19 pandemic. The capital contribution will guarantee the premium to policyholder surplus ratio at the appropriate level.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None.

### Previous Report of Examination

Corporate Records (Page 9): It was recommended that the Company implement procedures to ensure future compliance with California Insurance Code Section 735. The Company has complied with this recommendation.

Accounts and Records – Information System Controls (Page 11): As the result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems. The Company has complied with this recommendation.

Accounts and Records – Taxes, Licenses, and Fees (Page 13): It was recommended that the Company establish and implement procedures to ensure that adequate documentation is maintained to support its filings with the California Department of Insurance. The Company has complied with this recommendation.



ACKNOWLEDGMENT

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

Respectfully submitted,

/S/

Ferdinand Ison  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California

/S/

Grace Asuncion, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California