

REPORT OF EXAMINATION
OF THE
BUSINESS ALLIANCE INSURANCE COMPANY
AS OF
DECEMBER 31, 2020

A handwritten signature in blue ink, appearing to be 'P. DeLuca', is written over a horizontal line.

Filed on May 31, 2022

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Sacramento, California
April 28, 2022

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

BUSINESS ALLIANCE INSURANCE COMPANY

(hereinafter also referred to as the Company). The company's home office is located at 400 Oyster Point Blvd., Suite 327, South San Francisco, California 94080.

SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The previous examination of the Company was as of December 31, 2016. This examination covered the period of January 1, 2017 through December 31, 2020.

This 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. The examination also included identifying and evaluating significant risks that could cause the Company'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 includes 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 an adjustment was identified during the course of the

examination, the impact of such adjustments would 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 may 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 incorporated on November 12, 1996 under the laws of the State of California and commenced business on September 15, 1997. The Company has a paid-in capital of \$2.6 million which consists of a single class of \$100 par value common stock with 100,000 shares authorized, 26,000 shares issued and outstanding.

Effective January 1, 2020, all of the issued and outstanding stock of National Farm Financial Corporation (NFFC), the Company's immediate parent, was sold to the Steven J. Barsotti and Kandra U. Barsotti 2001 Living Trust (Barsotti Living Trust).

Dividends

In 2017, the Company paid an extraordinary cash dividend to its parent, NFFC in the amount of \$5 million. The California Department of Insurance (CDI) approved this transaction on June 5, 2017.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of National Farm Financial Corporation (NFFC), which is owned and controlled by the Steven J. Barsotti and Kandra U. Barsotti 2001 Living Trust (Barsotti Living Trust), which is controlled by Steven J. Barsotti and Kandra U. Barsotti. The following chart depicts the Company's relationship within the holding company system at December 31, 2020 (all ownership is 100%):

Steven J. Barsotti and Kandra U. Barsotti 2001 Living Trust
National Farm Financial Corporation (California)
Business Alliance Insurance Company (California)

The operations and affairs of the Company are subject to the supervision and control of a four-member Board of Directors. The following are members of the board and principal officers serving at December 31, 2020:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Steven J. Barsotti Fresno, California	Chief Financial Officer and Treasurer Business Alliance Insurance Company
Kandra U. Barsotti Fresno, California	Secretary Business Alliance Insurance Company
Robert T. Kingsley Carmel, California	Chief Executive Officer Business Alliance Insurance Company
Roger H. Platten ⁽¹⁾ Dyersville, Iowa	Director Business Alliance Insurance Company

⁽¹⁾Effective September 31, 2021, Roger Platten resigned from the Board of Directors.

Principal Officers

<u>Name</u>	<u>Title</u>
Steven J. Barsotti	Chief Financial Officer and Treasurer
Kandra U. Barsotti	Secretary
Robert T. Kingsley	Chief Executive Officer

Intercompany Agreement

Effective September 5, 1997, the Company entered into a broker agreement with Larry P. Chao Insurance Services. Under the terms of the agreement, Larry P. Chao Insurance Services is authorized to solicit and submit insurance applications and proposals for the classes and lines of business written by the Company. The Commissioner's Order Granting Exemption Letter dated September 10, 1997, exempted this agreement from the

prohibitions of California Insurance Code Section 1101(a). The agreement was terminated on September 1, 2019. The total fees incurred by the Company for services under the agreement were: \$23,588, \$19,799, \$13,855, and (\$94) for 2017, 2018, 2019, and 2020, respectively.

TERRITORY AND PLAN OF OPERATION

The company is licensed to transact property and casualty insurance in the state of California only. As a highly specialized niche underwriter of primarily small minority-owned businesses, the Company provides products that are specifically tailored to the needs of small businesses.

During 2020, the Company wrote commercial multiple peril and surety lines of business, which made up 78.2% and 21.8%, respectively, of the Company's total direct premiums written of \$6.4 million. The commercial multiple peril business is produced by independent brokers. The surety business consists of contractor license bonds produced by a single general agent, Greenwood General Insurance Agency.

All operations are conducted out of the Company's home office located in South San Francisco, California.

REINSURANCE

Assumed

The Company did not assume any reinsurance during the examination period.

Ceded

The following is a summary of principal reinsurance agreements in effect as of December 31, 2020:

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
<u>Property and Casualty:</u>			
Multi XOL Property	Hannover Re (50%, authorized) Odyssey Re (50%, authorized)	\$300,000 each loss, each risk	\$700,000 excess of \$300,000 each loss, each risk subject to a limit of \$2,800,000 million each loss
Multi XOL Casualty	Hannover Re (50%, authorized) Odyssey Re (50%, authorized)	\$300,000 each loss occurrence	\$700,000 excess of \$300,000 each loss occurrence
Property Catastrophe	Hannover Re (50%, authorized) Odyssey Re (50%, authorized)	\$1,000,000 each loss occurrence	\$1,500,000 excess of \$1,000,000 each loss occurrence

FINANCIAL STATEMENTS

The following 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, 2020. The accompanying comments to the amounts in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the statutory financial statements reported by the Company.

Statement of Financial Condition as of December 31, 2020

Summary of Operations and Capital and Surplus Account for the Year Ended
December 31, 2020

Reconciliation of Capital and Surplus from December 31, 2016 through
December 31, 2020

Statement of Financial Condition
as of December 31, 2020

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 8,150,870	\$	\$ 8,150,870	(1)
Common stocks	7,123,480		7,123,480	(1)
Cash and short-term investments	4,509,298		4,509,298	(1)
Investment income due and accrued	77,941		77,941	
Premiums and agents' balances in course of collection	(64,852)	3,500	(68,352)	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$0 earned but unbilled premiums)	1,735,192		1,735,192	
Amounts recoverable from reinsurers	310,814		310,814	(2)
Net deferred tax asset	142,000	142,000		
Aggregate write-ins for other than invested assets	77,836		77,836	
Total assets	\$ 22,062,579	\$ 145,500	\$ 21,917,079	
<u>Liabilities, Surplus, and Other Funds</u>				<u>Notes</u>
Losses			\$ 3,947,389	(3)
Loss adjustment expenses			1,076,518	(3)
Other expenses			161,307	
Taxes, licenses, and fees			16,204	
Current federal and foreign income taxes			55,857	
Unearned premiums			2,709,617	(4)
Advance premium			0	(5)
Ceded reinsurance premiums payable			319,160	
Aggregate write-ins for liabilities			38,863	
Total liabilities			8,324,915	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		5,490,240		
Unassigned funds (surplus)		5,501,924		
Surplus as regards policyholders			13,592,164	
Total liabilities, surplus, and other funds			\$ 21,917,079	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2020

Underwriting Income

Premiums earned	\$	5,489,640
Deductions:		
Losses incurred	\$	1,819,605
Losses adjustment expenses incurred		1,366,982
Other underwriting expenses incurred		<u>2,792,509</u>
Total underwriting deductions		<u>5,979,096</u>
Net underwriting loss		(489,456)

Investment Income

Net investment income earned	\$	346,436
Net realized capital losses		<u>146,436</u>
Net investment gain		492,872

Other Income

Finance and service charges not included in premiums	\$	77,082
Aggregate write-ins for miscellaneous income		<u>357,135</u>
Total other income		<u>434,217</u>
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		437,633
Federal and foreign income taxes incurred		<u>55,857</u>
Net income	\$	<u>381,776</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2019	\$	13,080,434
Net income	\$	381,776
Change in net unrealized capital gains		130,889
Change in net deferred income tax		(33,000)
Change in nonadmitted assets		<u>32,065</u>
Change in surplus as regards policyholders for the year		<u>511,730</u>
Surplus as regards policyholders, December 31, 2020	\$	<u>13,592,164</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2016 through December 31, 2020

Surplus as regards policyholders, December 31, 2016			\$ 17,655,730	<u>Notes</u>
	Gain in Surplus	Loss in Surplus		
Net income	\$ 669,372	\$		
Change in net unrealized capital gains		(255,937)		
Change in net deferred income tax	(77,921)			
Change in nonadmitted assets	89,046			
Dividends to stockholders		5,000,000		
Total gains and losses	<u>\$ 680,497</u>	<u>\$ 4,744,063</u>		
Surplus as regards policyholders, December 31, 2020			<u>\$ 13,592,164</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds, Common Stocks, Cash and Short-Term Investments

California Insurance Code (CIC) Section 1104.9(c) mandates that securities shall not be deposited in or with a qualified custodian, qualified depository, or qualified subcustodian except as authorized by an agreement between the insurer and the qualified custodian, if the agreement is satisfactory to and has been approved by the Commissioner. As of December 31, 2020, the Company had securities on deposit with Wells Fargo Advisors in the amount of \$12,204,665. It was observed that the Company is not in compliance with CIC Section 1104.9(c) because its securities on deposit with Wells Fargo Advisors is not in accordance to an approved custodial agreement pursuant to this insurance code section. It is recommended that the Company submit its custodial agreement with Wells Fargo Advisors to the Commissioner for approval pursuant to CIC Section 1104.9(c).

The Company was advised in August 2021 that US Bank assumed operational control of the custodial group at Union Bank, the Company's previous custodian. It was observed that the Company does not have an approved custodial agreement with its new custodian US Bank, pursuant to CIC Section 1104.9(c). It is recommended that the Company enter into a custodial agreement with US Bank and submit its custodial agreement with US Bank to the Commissioner for approval pursuant to CIC Section 1104.9(c).

The examination noted some errors in the Company's investment schedules within the statutory financial statements filed with the California Department of Insurance. It was observed that the Company misreported the par value of a US Treasury Note and a US Govt Mortgage Passthrough bond, and misreported the interest rate on two foreign bonds in its Schedule D. The Company also swapped the fair value, book value, and rate per share of two stocks and two mutual funds. The errors were not material, and no examination adjustment was made. It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule D, Part 1 and Part 2 reporting to ensure that the information in these schedules are accurate.

(2) Amounts Recoverable from Reinsurers

Statement of Statutory Account Principles (SSAP) No. 62R, paragraph 31 requires that reinsurance recoverable on paid losses be reported as an asset in the balance sheet and that reinsurance recoverable on unpaid case-basis and incurred but not reported losses and loss adjustment expenses (LAE) be netted against the liability for gross losses and LAE. It was observed that the Company's reporting of the reinsurance recoverable on paid losses and LAE is not correct because it includes some amounts that represent reinsurance recoverable on unpaid case-basis loss and LAE. The amount involved in this error was not material and no examination adjustment was made.

As of December 31, 2020, the Company had \$207,644 in reinsurance recoverable on paid loss and LAE due from Public Service Mutual Insurance Company (PSM) for claims through January 31, 2011. It was noted that the reinsurance recoverable from PSM were not reported on the Company's Schedule F Part 3. In addition, it was observed that the bulk of the reinsurance recoverable on loss and LAE due from PSM were over 90 days due because PSM has been placed in rehabilitation since 2017. SSAP No. 62R, paragraph 85 requires the establishment of a provision for overdue reinsurance liability to provide for a minimum reserve for uncollectible reinsurance with an additional reserve required if an entity's experience indicates that a higher amount should be provided. The examination noted that the Company did not setup a provision for overdue reinsurance in accordance with SSAP No. 62R, paragraph 85. The amount involved in this error was not material and no examination adjustment was made.

It was also observed that the amount of reinsurance recoverable on paid loss and LAE for Odyssey Reinsurance Company and Hannover Ruck Se as reported on the Company's Schedule F Part 3 were not supported by the records reviewed by the examination.

It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule F, Part 3 reporting to ensure that the schedule is accurate and complies with all provisions of SSAP No. 62R.

(3) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Actuarial Report as of December 31, 2020 prepared by the Company's independent actuary and concurred with the independent actuary's conclusion that the Company's loss and loss adjustment expense reserves as of December 31, 2020 are reasonable and have been accepted for purposes of this examination.

It was observed that the Schedule P, Part 2 for reporting years 2019, 2020, and 2021 were not prepared correctly because amounts shown for 2021 vs 2020 vs 2019 were inconsistent. It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule P reporting to ensure that the information in the schedule is correct.

(4) Unearned Premiums

It was observed that the methodology used by the Company for premium revenue recognition for its surety line of business does not comply with SSAP No. 60, paragraph 5. SSAP No. 60, paragraph 5 requires that when premiums are paid on an installment basis, premium revenue shall be recognized in the statement of operations using the monthly pro-rata method. Premiums not paid on the installment basis shall be recognized in the statement of operations in proportion with the amount and expected coverage period of the insured risk. The Company's methodology recognizes premium as earned when collected and any difference between written premium and collected premium is recorded as unearned premiums. It is recommended that the Company comply with SSAP No. 60, paragraph 5.

(5) Advance Premiums

SSAP No. 53, paragraph 15, requires insurers to report premiums received prior to the effective date of the policies as a liability (advance premiums) in the statutory financial statement. It was observed that the Company did not comply with SSAP No. 53, paragraph 15, because it included premiums received in 2020 in the amount of \$41,678

for 2021 surety policies in the written premiums for 2020 and failed to recognize liability for the advance premiums. It is recommended that the Company report advance premiums in accordance with SSAP No. 53, paragraph 15. This is a repeat finding.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Comments on Financial Statement Items – Bonds, Common Stocks, Cash and Short-Term Investments (Page 10): It is recommended that the Company submit its custodial agreement with Wells Fargo Advisors to the Commissioner for approval pursuant to California Insurance Code (CIC) Section 1104.9(c).

It is recommended that the Company enter into a custodial agreement with US Bank and submit its custodial agreement with US Bank to the Commissioner for approval pursuant to CIC Section 1104.9(c).

It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule D, Part 1 and Part 2 reporting to ensure that the information in these schedules are accurate.

Comments on Financial Statement Items – Amount Recoverable from Reinsurers (Page 11): It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule F, Part 3 reporting to ensure that the schedule is accurate and complies with all provisions of Statement of Statutory Accounting Principles (SSAP) No. 62R.

Comments on Financial Statement Items – Losses and Loss Adjustment Expense (Page 12): It is recommended that the Company implement procedures to strengthen its financial reporting and accounting controls over its Schedule P reporting to ensure that the information in the schedule is correct.

Comments on Financial Statement Items – Unearned Premiums (Page 12): It is recommended that the Company comply with SSAP No. 60, paragraph 5.

Comments on Financial Statement Items – Advance Premium (Page 13): It is recommended that the Company report advance premiums in accordance with SSAP No. 53, paragraph 15.

Previous Report of Examination

Comments on Financial Statement Items – Bonds, Preferred Stocks, Common Stocks, Cash and Short-Term Investments (Page 10): It was recommended that the Company implement procedures to ensure that bond designations are accurately reported. No issues were noted with the Company's reporting of bond designations.

It was also recommended that the Company implement appropriate procedures to comply with the Statement of Statutory Accounting Principles (SSAP) No. 26, paragraph 8. The Company is now in compliance.

It was also recommended that the Company comply with California Insurance Code Section 1104.9(c). The Company is not in compliance and a repeat finding and recommendation was issued for the current report of examination.

Comments on Financial Statement Items – Unearned Premiums (Page 11): It was recommended that the Company implement procedures to ensure compliance with SSAP No. 53, paragraph 8. The Company is not in compliance. A finding was made in the current report of examination addressing surety unearned premiums.

Comments on Financial Statement Items – Advance Premiums (Page 11): It was recommended that the Company report advance premiums in accordance with SSAP No. 53, paragraph 15. The Company is not in compliance and a repeat finding and recommendation was issued for the current report of examination.

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,

Christian Mitterholzer
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Ber Vang, CFE, AES, CISA
Supervising Insurance Examiner
Department of Insurance
State of California