


REPORT OF EXAMINATION
OF THE
PACIFIC SPECIALTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2020

A handwritten signature in blue ink, appearing to be 'P. DeLuca', is positioned above the filing date.

Filed on June 14, 2022

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Sacramento, California
May 12, 2022

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PACIFIC SPECIALTY INSURANCE COMPANY

(hereinafter also referred to as the Company). The company's home office is located at 5515 East La Palma Avenue, Suite 150, Anaheim, California 92807.

SCOPE OF EXAMINATION

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

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 significant 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 whereby California was the lead state of the Western Service Contract Group. It was conducted concurrently with the examination of the Pacific Specialty Property and Casualty Company with participation from Texas.

COMPANY HISTORY

The Company is a wholly-owned subsidiary of Western Service Contract Corporation (WSCC), a California corporation. The Company was incorporated under the laws of California in April 1988. It obtained its Certificate of Authority in December 1989 and commenced business in January 1990.

On July 30, 2020, the Company amended its bylaws to reflect the change of its principal office address to 5515 East La Palma Avenue, Suite 150, Anaheim, CA 92807.

Capitalization

The Company is authorized to issue 100,000 shares of common stock. As of December 31, 2020, it reported \$3,500,000 in common stock, which is comprised of 12,000 issued and outstanding shares with a par value of \$291.67 per share. The Company reported \$11,384,419 in gross paid-in and contributed surplus. There were no changes to the common

Dividends

The Company paid ordinary cash dividends to its parent, WSCC as shown in the schedule below:

Parent	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
WSCC	\$ 2,000,000	\$ 1,400,000	\$ 3,300,000	\$ 2,300,000	\$ 10,400,000	\$ 4,336,026

The Company has provided timely notification to the California Department of Insurance (CDI) in regard to the dividend payments in accordance with California Insurance Code (CIC) Section 1215.4(f).

MANAGEMENT AND CONTROL

The Company is wholly-owned by Western Service Contract Corporation (WSCC), a privately owned company and insurance holding company incorporated in California. The Company has one direct subsidiary, Pacific Specialty Property and Casualty Company (PSPCC). The holding company group is ultimately controlled and equally owned by two individuals, John M. McGraw and Michael J. McGraw. The following chart depicts the interrelationship of the entities within the holding company system at December 31, 2020. All ownership is 100% unless otherwise indicated.

John M. McGraw (50%)(Shareholder)
Michael J. McGraw (50%)(Shareholder)
 Western Service Contract Corporation (California)^(a)
 McGraw Insurance Services L.P. (Delaware)(0.1%)
 Pacific Specialty Insurance Company (California)
 Pacific Specialty Property and Casualty Company (Texas)
 McGraw Insurance Inc. (S. Corp)(Delaware)^(b)
 McGraw Insurance Services L.P. (Delaware)(99.9%)
 Western Service Leasing LLC (Florida)

(a) Western Service Contract Corporation owns 0.1% of McGraw Insurance Services L.P. (Delaware).

(b) McGraw Insurance Inc. (S. Corp) owns 99.9% of McGraw Insurance Services L.P. (Delaware).

The six members of the board of directors, who are elected annually, oversee the business and affairs of the Company. The following are members of the board and principal officers of the Company serving at December 31, 2020:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Michael F. Der Manouel Jr. Fresno, California	President Der Manouel Insurance Group
Ross C. Goodman Las Vegas, Nevada	Owner Goodman Criminal Defense Attorney
Kevin J. Kendrick San Francisco, California	Partner Kendrick Associates
John M. McGraw Anaheim, California	Shareholder Western Service Contract Corporation
John V. McGraw Anaheim, California	Founder (Retired)
Michael J. McGraw Anaheim, California	President Pacific Specialty Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Michael J. McGraw	President and Chief Executive Officer
Paul J. Cash	Chief Financial Officer and Treasurer
Kara L. Holzwarth	General Counsel and Secretary
Kevin J. Judice	Chief Operating Officer

Management Agreements

General Agency Agreement: The Company and its affiliate, The McGraw Company (TMC), a licensed agent, entered into a General Agency Agreement effective September 1, 1995. The Company filed a Second Amendment effective March 1, 2012. Both the Agreement and the Amendment were approved by the California Department of Insurance (CDI) on November 26, 2013 pursuant to California Insurance Code (CIC)

Section 1215.5(b)(4). As part of the restructuring in 2015, the Company, TMC, and McGraw Insurance Services L.P. (McGraw LP), a newly created entity, entered into a Joinder to General Agency Agreement to add McGraw LP as a party to the Agreement, so that TMC could transfer its operations to McGraw LP once it is fully licensed in all jurisdictions that TMC was licensed. TMC was subsequently terminated from the Agreement and McGraw LP has been the exclusive general agent for the Company. Pursuant to the Agency Agreement, McGraw LP acts as an insurance agent for the Company, which receives and accepts proposals for insurance, performs underwriting functions, issues and cancels policies, and collects and remits premiums. The CDI approved the Joinder on January 20, 2015 pursuant to CIC Section 1215.5(b)(4). On December 21, 2021, the Company made a Form D filing to amend (Third Amendment) the Agency Agreement. The purpose of the Third Amendment to the Agency Agreement is to update provisions to comply with changes in the California Holding Company Act and to update the maximum premium volume of \$300 million, up from the previously defined \$250 million, to match expected future premium volume. The Third Amendment was approved by the CDI on December 29, 2021. The commissions paid by the Company for services under this Agreement were \$69,129,381, \$72,675,557, \$77,902,999, and \$73,054,558 in 2017, 2018, 2019, and 2020, respectively.

Services and Expense Allocation Agreement: Effective January 1, 2019, Western Service Contract Corporation (WSCC), the Company, Pacific Specialty Property and Casualty Company (PSPCC), and McGraw LP entered into a Service and Expense Allocation Agreement (the "Service Agreement"). Pursuant to the Service Agreement, the Company shall provide to each affiliate the services including accounting and reporting, tax compliances, policy issuance and administration, underwriting and loss control, actuarial, claims administration, investment, treasury services, budget and cost accounting, the Company's personnel, electronic fund transfer, legal, office services, information technology, computer and communication services, policy records, sales, marketing, and other additional services. In addition, WSCC shall provide to the Company the software services consisting of use of the Duck Creek policy management and claims administration system. The parties agree that the compensation for providing the services and facilities is based on actual cost without a profit factor being built into that cost. The

actual costs are determined in accordance with appropriate time studies, activity counts, expense sharing, or other appropriate methods. Both the actual costs and the indirect and shared expenses are allocated in accordance with a method of cost allocation in conformity with Statements of Statutory Accounting Principles (SSAP) No. 70. The CDI issued a non-disapproval letter on December 6, 2018 pursuant to CIC Section 1215.5(b)(4). In 2019, the Company allocated \$1,020,142 in general expenses to McGraw LP and \$68,564 for software services to WSCC. In 2020, the Company allocated \$1,397,510 in general expenses to McGraw LP and \$681,571 for software services to WSCC.

Tax Allocation Agreement: Effective January 1, 2006, the Company entered into the Tax Allocation Agreement with its parent, WSCC, and affiliates. The allocation of the tax liability is based on each entity's taxable income as a percentage of the consolidated taxable income. Members are reimbursed for net operating losses and other tax credits upon the tax savings realized when the loss or credit is utilized. Tax liability is limited to the amount each party would pay as though a separate income tax return was filed. This Agreement was approved by the CDI on February 8, 2007, pursuant to CIC Section 1215.5(b)(4). Effective September 9, 2008, this Agreement was amended to add PSPCC as a party to the Agreement, and to add the provision required by Texas Administrative Code Section 7.204(a)(2)(E) concerning indemnification of the Texas insurer. On January 1, 2019, Amendment No. Two to the Agreement was added to acknowledge that Pacific Loan Administrators and Rockridge Finance Corporation are no longer parties to the Agreement. The CDI issued a non-disapproval letter on November 30, 2018 pursuant to CIC Section 1215.5(b)(4).

Related Party Transactions

Service Contract Reimbursement Policy: Effective October 14, 2008, the Company issued the Service Contract Reimbursement Policy to WSCC to provide contractual liability coverage for service contracts issued by WSCC in the event WSCC is unable to meet its obligations under the service contracts. WSCC issues service contracts for motorcycles, watercrafts, snowmobiles, and other mechanical breakdown coverages, and

pays \$5 per service contract to the Company for this coverage. Under this Policy, the Company received payments of \$108,230, \$108,880, \$117,515, and \$138,175 in 2017, 2018, 2019, and 2020, respectively.

Credit Agreement: On June 26, 2014, WSCC and City National Bank (Lender) entered into a Credit Agreement for a \$40 million term loan, as amended (Credit Agreement). In connection with the Credit Agreement, WSCC, John McGraw, Michael McGraw, Lender and certain other parties entered into that certain Amended and Restated Stock Pledge Agreement dated June 26, 2014 (Pledge Agreement). The Pledge Agreement provides for, among other matters, the pledge of stock of the Company and WSCC for the benefit of Lender to secure WSCC's obligations under the Credit Agreement. In connection with such pledge, the Company filed with the CDI an application for exemption from Form A filing pursuant to CIC Section 1215.2(g), which exemption was granted by the CDI on May 7, 2014. On February 21, 2018, WSCC amended the Credit Agreement to add McGraw Insurance Inc. and McGraw LP as borrowers. The term loan bears variable interest at the bank's base rate plus a margin based on leverage thresholds defined within the agreement. The interest rate at December 31, 2020 was 3.75%. Payments are made in quarterly installments of principal and interest. The term loan matures on June 30, 2022. As of December 31, 2020, the unpaid principal and accrued interest balance of the credit agreement totaled \$10.4 million. On May 11, 2021, the loan agreement was amended, extending the maturity date to May 11, 2026, and increasing the loan balance to \$44.5 million.

TERRITORY AND PLAN OF OPERATION

The Company is a property and casualty insurance company licensed in 50 states and the District of Columbia. It is predominately a California personal lines writer. Personal line products consist of property (fire and homeowners multiple-peril), marine (watercraft/boats), private passenger automobile (primarily motorcycle), stand-alone earthquake, and personal liability. Commercial line products are offered to used car dealerships, landscape and janitorial operations, and business owners' package policies. The Company has three offices which are located in Anaheim, California (Underwriting,

Call Center, Accounting, Finance, Sales, Product Development, IT equipment, and Corporate Books and Records); Rancho Cordova, California (Claims); and Las Vegas, Nevada (IT infrastructure and executive management).

The Company's direct premiums written during 2020 totaled \$240.4 million, which consisted of homeowners multiple-peril (87.5%), earthquake (7%), other liability (2.7%), private passenger automobile liability (1.5%), and automobile physical damage (1.2%). The vast majority of the direct premiums were written in California (94.4%), followed by Connecticut (3.6%), New Jersey (1.1%), Oklahoma (0.4%), and Utah (0.2%).

The Company utilizes a multiple distribution platform to market its products. The majority of its business is produced through its affiliated general agency, McGraw Insurance Services L.P. The Company's motorcycle and personal watercraft policies are also offered through dealers possessing insurance licenses. Other distribution channels are direct, independent agents, and brokers. In 2020, approximately \$132.1 million (54.9%) of business was distributed by Ivantage Select Agency, Inc., an affiliate of Allstate Insurance Company; \$80.9 million (33.7%) was generated by independent agencies and brokers; \$22.0 million (9.2%) was produced by Farmers Insurance; \$2.8 million was generated by American Automobile Association (1.2%), and \$2.6 million (1.1%) was written by other distributors.

REINSURANCE

Assumed

The Company has a 90% quota share reinsurance agreement with its subsidiary, Pacific Specialty Property and Casualty Company (PSPCC), whereby it assumes 90% of premiums and liabilities underwritten by PSPCC.

Ceded

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

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
<u>Earthquake Quota Share Reinsurance Contract</u>	<u>Authorized</u> Palomar Specialty Insurance Company (100%)	50% of losses under the policies, loss adjustment expense, extra-contractual obligations, and loss in excess of policy limits covered under this contract	50% of losses under the policies, loss adjustment expense, extra-contractual obligations, and loss in excess of policy limits covered under this contract.
<u>Personal Umbrella Quota Share Reinsurance Contract</u>	<u>Authorized</u> General Reinsurance Corporation (100%)	5% of the first \$1 million each loss occurrence	95% of the first \$1 million each loss occurrence; and 100% excess of \$1 million each loss occurrence
<u>Multiple Lines Excess of Loss Reinsurance Contract</u> First Layer	<u>Authorized</u> Hannover Ruck SE (25%) Renaissance Reinsurance U.S. Inc. (20%) Allied World Insurance Company (13%) The Toa Reinsurance of America (13%) Odyssey Reinsurance Company (12.5%) Various reinsurers (13.5%) <u>Unauthorized</u> American Agricultural Insurance Company (3%)	\$1 million each loss, each risk, each loss occurrence	Coverage A (Property): \$1.5 million excess of \$1 million each loss, each risk. Aggregate limit of \$3 million each loss occurrence. Coverage B (Casualty): \$1.5 million excess of \$1 million each loss occurrence. Coverage C (Property and Casualty): \$1 million excess of \$1 million each loss occurrence.
Second Layer	<u>Authorized</u> Hannover Ruck SE (25%) Renaissance Reinsurance U.S. Inc. (20%) Allied World Insurance Company (13%) The Toa Reinsurance of America (13%) Odyssey Reinsurance Company (12.5%) Various reinsurers (13.5%) <u>Unauthorized</u> American Agricultural Insurance Company (3%)	\$2.5 million each loss, each risk, each loss occurrence	Coverage A (Property): \$1 million excess of \$2.5 million each loss, each risk. Aggregate limit of \$15 million for all losses. Coverage B (Casualty): \$1 million excess of \$2.5 million each occurrence, and further subject to a limit of \$3 million for all loss occurrences.
Third Layer	<u>Authorized</u> Hannover Ruck SE (25%) Renaissance Reinsurance U.S. Inc. (20%) Allied World Insurance Company (20%) Odyssey Reinsurance Company (18%) Various reinsurers (13.5%) <u>Unauthorized</u> American Agricultural Insurance Company (3.5%)	\$3.5 million each and every loss/risk	Coverage A (Property): \$5 million excess of \$3.5 million each loss, each risk. Aggregate limit of \$15 million for all losses. Coverage B (Casualty): \$5 million excess of \$3.5 million each occurrence, and further subject to a limit of \$15 million for all loss occurrences.

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
<u>Property Catastrophe Excess of Loss Reinsurance Contract</u> First Layer	<u>Authorized</u> Hannover Ruck SE (Pillar Capital) (40%) Lloyd's of London (18%) Various reinsurers (16.5%) <u>Unauthorized</u> R+V Versicherung AG (15.5%) Various reinsurers (10%)	\$5 million each loss occurrence	\$15 million excess of \$5 million each loss occurrence; limited to \$30 million for all loss occurrences.
Second Layer	<u>Authorized</u> Hannover Ruck SE (Pillar Capital) (26%) Lloyd's of London (16.5%) Various reinsurers (27.5%) <u>Unauthorized</u> R+V Versicherung AG (15%) Various reinsurers (15%)	\$20 million each loss occurrence	\$20 million excess \$20 million each loss occurrence; limited to \$40 million for all loss occurrences.
Third Layer	<u>Authorized</u> Lloyd's of London (26.5%) Various reinsurers (26.75%) <u>Unauthorized</u> R+V Versicherung AG (15%) Various reinsurers (31.75%)	\$40 million each loss occurrence	\$60 million excess \$40 million each loss occurrence; limited to \$120 million for all loss occurrences.
Fourth Layer	<u>Authorized</u> Lloyd's of London (21.5%) Various reinsurers (32%) <u>Unauthorized</u> Various reinsurers (46.5%)	\$100 million each loss occurrence	\$50 million excess \$100 million each loss occurrence; limited to \$100 million for all loss occurrences
Fifth Layer	<u>Authorized</u> Lloyd's of London (14.5%) Various reinsurers (35%) <u>Unauthorized</u> HCC International Insurance Company Plc (10%) Various reinsurers (40.5%)	\$150 million each loss occurrence	\$50 million excess \$150 million each loss occurrence; limited to \$100 million for all loss occurrences.
Sixth Layer	<u>Authorized</u> Arch Reinsurance Ltd (100%)	\$200 million each loss occurrence	\$25 million excess \$200 million each loss occurrence; limited to \$50 million for all loss occurrences.
Seventh Layer	<u>Unauthorized</u> HCC International Insurance Company Plc (100%)	\$225 million each loss occurrence	\$50 million excess \$225 million each loss occurrence; limited to \$100 million for all loss occurrences.
Home Cyber Protection, Home System Protection and Service Line Reinsurance Agreement	<u>Authorized</u> The Hartford Steam Boiler Inspection And Insurance Company (100%)	None	Home Cyber Protection: \$50,000 annual aggregate each policy. Home System Protection: \$100,000 for any one breakdown, any one policy Service Line: \$10,000 for any one service line failure, any one policy.

ACCOUNTS AND RECORDS

Unclaimed Property

California Code of Civil Procedure (CCP) Part 3, Title 10, Chapter 7, Article 3, Sections 1530 and 1532 – Unclaimed Property Law requires that all tangible personal property located in the State of California that is held or owing in the ordinary course of business and has remained unclaimed by the owner for more than three years after it became payable or distributable, is escheated to the California State Controller's Office (SCO).

The Company was unable to provide documentation to evidence that unclaimed property for the 2017 property report cycle was reported and/or remitted to the SCO. In addition, the Company was late to file the unclaimed property remittance report to the SCO for the 2019 property report cycle. It is recommended that the Company escheat unclaimed property to the SCO timely and implement procedures to ensure future compliance with CCP Sections 1530 and 1532.

Annual Statement Instructions

Pursuant to the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, the Appointed Actuary must report to the Board of Directors each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors and identify the manner of presentation (e.g., webinar, in-person presentation, written). During the course of the examination, it was noted that the Appointed Actuary did not report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. This is a repeat finding from the Previous Report of Examination. It is again recommended that the Company implement appropriate procedures to ensure that its Appointed Actuary report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion; and that such reporting is documented in the minutes of the Board of Directors or Audit Committee.

Premium Taxes

During the review of the Company's California premium tax filings for the examination period, it was noted that the Company misreported its premium taxes by overstating its California FAIR Plan premiums by \$780,408 in 2017; and not reporting its California FAIR Plan premiums of \$729, \$787, and \$892 in 2018, 2019 and 2020, respectively. It is recommended that the Company report and pay the California premium taxes properly and accurately, and implement procedures to ensure future compliance with California Revenue and Taxation Code (RTC) Sections 12301 and 12302.

Vehicle Fraud Assessment

California Insurance Code (CIC) Section 1872.8(a) requires each insurer doing business in California to pay an annual vehicle fraud assessment fee for each vehicle insured under an insurance policy issued in California. California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b) states that the vehicle fraud assessment shall be due on each vehicle, identified by its vehicle identification number for each quarter that a policy is in force on such vehicle and when a vehicle is added to or replaced one under an existing policy. During the course of the examination, the data provided by the Company did not reconcile to the quarterly filings during the examination period to evidence that it was in compliance with CIC Section 1872.8(a) and CCR Section 2698.62(b). It is recommended that the Company implement procedures to ensure its vehicle count data is accurate and comply with CIC Section 1872.8(a) and CCR Section 2698.62(b).

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance for the period ending December 31, 2020. The accompanying comments to the amounts in the annual statements should be considered an integral part of the financial statements. No adjustments were made to the financial statements as a result of the examination.

Statement of Financial Condition as of December 31, 2020

Underwriting and Investment Exhibit for the Year Ended December 31, 2020

Reconciliation Surplus as Regards Policyholders 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	\$ 246,828,600	\$	\$ 246,828,600	(1)
Common stocks	35,045,165		35,045,165	(1)
Cash, cash equivalents, and short-term investments	(4,232,274)		(4,232,274)	(1)
Other invested assets	10,371,767		10,371,767	
Receivables for securities	556,419		556,419	
Investment income due and accrued	2,665,653		2,665,653	
Uncollected premiums and agents' balances in the course of collection	3,663,021		3,663,021	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,788,772		3,788,772	
Amounts recoverable from reinsurers	1,090,997		1,090,997	
Current federal and foreign income tax recoverable and interest thereon	1,870,441		1,870,441	
Net deferred tax asset	6,491,854	590,071	5,901,783	
Electronic data processing equipment and software	236,065	236,065		
Furniture and equipment	216,375	216,375		
Receivables from parent, subsidiaries and affiliates	1,191,349		1,191,349	
Aggregate write-ins for other than invested assets	4,563,289	4,563,289		
Total assets	\$ 314,347,493	\$ 5,605,800	\$ 308,741,693	

Liabilities, Surplus, and Other Funds

Notes

Losses		\$ 24,704,361	(2)
Reinsurance payable on paid loss and loss adjustment expenses		34,657	
Loss adjustment expenses		21,646,102	(2)
Other expenses		3,444,059	
Taxes, licenses and fees		(1,042,247)	
Borrowed money		1,787,412	
Unearned premiums		109,711,314	
Advance premiums		6,774,627	
Ceded reinsurance premiums payable		(531,484)	
Funds held by company under reinsurance treaties		103,266	
Aggregate write-ins for liabilities		544,795	
Total liabilities		167,176,862	
Common capital stock	\$ 3,500,000		
Gross paid-in and contributed surplus	11,384,419		
Unassigned funds (surplus)	126,680,412		
Surplus as regards policyholders		141,564,831	
Total liabilities, surplus, and other funds		\$ 308,741,693	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2020

Underwriting Income

Premiums earned		\$ 213,279,582
Deductions:		
Losses incurred	\$ 94,376,929	
Loss adjustment expenses incurred	24,700,989	
Other underwriting expenses incurred	93,958,110	
Total underwriting deductions		210,036,028
Net underwriting gain		243,554

Investment Income

Net investment income earned	\$ 8,370,509	
Net realized capital losses	6,471,325	
Net investment gain		14,841,834

Other Income

Finance and service charges not included in premiums	\$ 1,069,429	
Aggregate write-ins for miscellaneous income	(4,500,395)	
Total other income		(3,430,996)
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		11,654,422
Federal and foreign income taxes incurred		(105,194)
Net income		<u>\$ 11,759,616</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2019		\$ 134,510,641
Net income	\$ 11,759,616	
Change in net unrealized capital losses	(3,133,811)	
Change in net deferred income tax	(469,297)	
Change in nonadmitted assets	1,197,682	
Dividends to stockholders	(2,300,000)	
Change in surplus as regards policyholders for the year		7,054,190
Surplus as regards policyholders, December 31, 2020		<u>\$ 141,564,831</u>

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

Surplus as regards policyholders, December 31, 2016			\$ 132,026,110	<u>Notes</u>
	Gain in Surplus	Loss in Surplus		
Net income	\$ 10,216,126	\$		
Change in net unrealized capital losses		866,991		
Change in net deferred income tax		8,028,005		
Change in nonadmitted assets	17,214,020			
Change in provision in reinsurance	3,130			
Dividend to stockholders		9,000,000		
Aggregate write-ins for gains and losses in surplus	441			
Total gains and losses in surplus	\$ 27,443,717	\$ 17,894,996		
Surplus as regards policyholders, December 31, 2020			<u>\$ 141,564,831</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

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

California Insurance Code (CIC) Section 1104.9(d) states that no agreement between the qualified custodian and the insurer shall be approved by the Commissioner unless the qualified custodian agrees therein to comply with this section. This section requires that the custodian agreement be submitted for approval with the California Department of Insurance (CDI). The Company's investments, consisting of bonds, common stocks, cash and short-term investments, are held with Northern Trust Company of California as of December 31, 2020. It is noted that the Company did not submit its custodian agreement with Northern Trust Company of California with the CDI for review and approval in accordance with CIC Section 1104.9(d). It is recommended that the Company submit its custodian agreement with the CDI for approval in accordance with CIC Section 1104.9(d).

(2) 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 actuary's conclusion that the Company's loss and loss adjustment expense reserves as of December 31, 2020 were reasonable and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

A novel strain of coronavirus (COVID-19) was detected and reported to World Health Organization (WHO) in December 2019. Since then, it has spread around the world, resulting in business and social disruption. The outbreak was declared a Public Health Emergency of International Concern by the WHO on January 30, 2020. The pandemic has triggered unprecedented government mandates and health and safety measures which have significantly impacted the U.S. and global financial markets, in particular, U.S. publically traded equity securities, and impacts on yields and interest rates in the U.S.

bond market. As the pandemic still unfolds, it is too early to draw any definite conclusions as to its overall impact to the Company at this time.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Unclaimed Property (Page 11): It is recommended that the Company escheat unclaimed property to the California State Controller’s Office (SCO) timely and implement procedures to ensure future compliance with California Code of Civil Procedure (CCP) Sections 1530 and 1532.

Accounts and Records – Annual Statement Instructions (Page 11): It is recommended that the Company implement appropriate procedures to ensure that its Appointed Actuary report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion; and that such reporting is documented in the minutes of the Board of Directors or Audit Committee.

Accounts and Records – Premium Taxes (Page 12): It is recommended that the Company report and pay the California premium taxes properly and accurately, and implement procedures to ensure future compliance with California Revenue and Taxation Code (RTC) Sections 12301 and 12302.

Accounts and Records – Vehicle Fraud Assessment (Page 12): It is recommended that the Company implement procedures to ensure its vehicle count data is accurate and comply with California Insurance Code (CIC) Section 1872.8(a) and California Code of Regulations (CCR) Section 2698.62(b).

Comments on Financial Statement Items – Bonds, Common Stocks, Cash and Short-Term Investments (Page 18): It is recommended that the Company submit its custodian agreement with the California Department of Insurance (CDI) for approval in accordance with CIC Section 1104.9(d).

Previous Report of Examination

Company History – Dividends Paid to Parent (Page 3): It was recommended that the Company timely report and pay all future ordinary dividends and other distributions to its shareholders in accordance with CIC Section 1215.4(f). The Company is now in compliance.

Management and Control – Management Agreements (Page 7):

Allocation of Overhead Charges Agreement: It was recommended the Company timely file future assignments, modifications, amendments to its management agreements with the CDI in accordance with CIC Section 1215.5(b)(4). This is no longer applicable since this Agreement has been terminated and replaced by the Services and Expense Allocation Agreement effective January 1, 2019.

Tax Allocation Agreement: It was recommended that the Company properly notify the CDI of the modification, effective September 9, 2008, in accordance with CIC Section 1215.5(b)(4). The Company is now in compliance.

Service and Expense Allocation Agreement: It was recommended that the Company implement policies and procedures to ensure future compliance with CIC Section 1215.5(b)(4). The Company is now in compliance.

Accounts and Records – Information System Controls (Page 12): It was recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its information system controls. The Company has implemented changes to strengthen its controls over information systems. In addition, it was recommended that the Company inform its officers, directors, employees, and agents to provide the requested information and documents for IT controls review timely in compliance with CIC Section 734. The Company has strengthened its information system controls. Moreover, the Company is now in compliance with CIC Section 734.

Accounts and Records – Annual Statement Statements (Page 12): It was recommended that the Company implement procedures to ensure that its Appointed Actuary report to

the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion; and that such reporting is documented in the minutes of the Board of Directors or Audit Committee. The Company has not complied with this recommendation.

Accounts and Records – Notice to the Board of Prior Examination Report (Page 13): It was recommended that the Company inform the Board of Directors of the receipt of the examination report; both in the form first formally prepared by the examiners, and in the form officially filed by the Commissioner and document these facts within the Board minutes in compliance with CIC Section 735. The Company is now in compliance.

Accounts and Records – Board Review and Approval of Investments (Page 13): It was recommended the Company document the Board's authorization or approval of its investments in accordance with CIC Sections 1200 and 1201. The Company is now in compliance.

Accounts and Records – Annual Information Statement (Page 13): It was recommended that the Company provide updated and accurate information in the Annual Information Statement filings with the California Department of Insurance, such as the amendments of its Bylaws. The Company is now in compliance.

Accounts and Records – Unclaimed Property (Page 14): It was recommended that the Company adopt formal procedures to identify, report and/or remit escheatable items with the State Controller's Office in accordance with the California Unclaimed Property Law and Regulations. The Company has partially complied with the recommendation.

Accounts and Records – Conflict of Interest (Page 14): It was recommended that the Company establish policies and procedures to ensure that all the directors and officers complete annual conflict of interest statements and properly file them for review in accordance with the Company's Policy Guide Conflict of Interest. The Company is now in compliance.

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,

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