

REPORT OF EXAMINATION
OF THE
QUALITAS INSURANCE COMPANY
AS OF
DECEMBER 31, 2014

Filed February 12, 2016

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION	1
COMPANY HISTORY:	2
Capitalization	3
Dividends	3
MANAGEMENT AND CONTROL:.....	4
Corporate Records.....	6
Management Agreements.....	6
Related Party Transactions.....	7
TERRITORY AND PLAN OF OPERATION.....	7
REINSURANCE:	8
Assumed.....	8
Ceded	8
ACCOUNTS AND RECORDS:.....	9
Deferred Tax Assets	9
Information Systems Controls.....	9
Vehicle Fraud Assessment	9
FINANCIAL STATEMENTS:	10
Statement of Financial Condition as of December 31, 2014.....	11
Underwriting and Investment Exhibit for the Year Ended December 31, 2014	12
Reconciliation of Surplus as Regards Policyholders from December 31, 2009 through December 31, 2014.....	13
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	14
Losses and Loss Adjustment Expenses	14
SUBSEQUENT EVENTS	14
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	15
Current Report of Examination	15
Previous Report of Examination	15
ACKNOWLEDGMENT	17

Los Angeles, California
November 3, 2015

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

QUALITAS INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 101 West Broadway, Suite 1270, San Diego, California 92101.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2009. This examination covered the period from January 1, 2010 through December 31, 2014.

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 included 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 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 is identified during the course of the examination, 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 incorporated on November 10, 1982 under the laws of the state of California, and commenced transacting property and casualty business on January 1, 1984.

On March 14, 2014, the Company became a wholly-owned subsidiary of Qualitas Financial Services, Inc., (QFSI), a Delaware company, following the sale of the Company by its former parent, Trinity Universal Insurance Company, a Texas company, to QFSI. QFSI is a wholly-owned subsidiary of Qualitas Controladora, S.A.B. de C.V. (QC), a financial holding company and ultimate controlling entity based in Mexico City, Mexico. QC is a publicly traded company on the Mexican Stock Exchange.

On March 25, 2014, the California Department of Insurance (CDI) approved the Company's name change from Valley Insurance Company to Qualitas Insurance Company.

Capitalization

The Company is authorized to issue 100,000 shares of its common stock with a par value of \$240 per share. As of December 31, 2014, there were 12,500 shares outstanding and issued to its parent, QFSI.

Prior to the acquisition of the Company by QFSI, and when the Company was named Valley Insurance Company, it transferred \$400,000 from its surplus account to its capital account in accordance with a resolution adopted by its board of directors on May 31, 2012. The CDI approved this transaction on October 11, 2012.

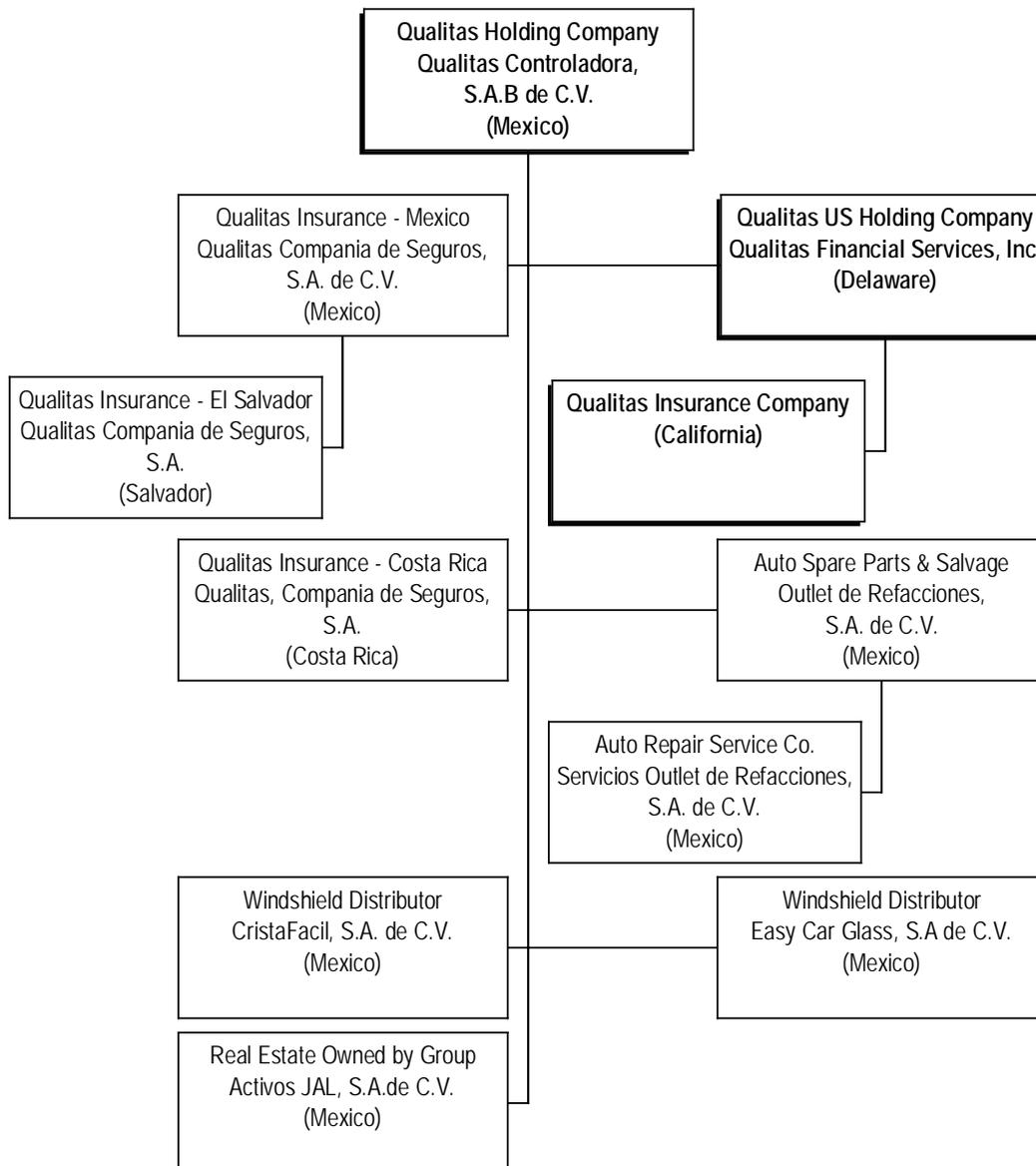
Dividends

The following dividend activity transpired prior to the acquisition of the Company by QFSI, when the Company was named Valley Insurance Company, and was a member of its former holding company system: The Company declared ordinary and extraordinary dividends during 2012 to be paid to its former parent, Trinity Universal Insurance Company (Trinity). The ordinary cash and real estate dividend was in the amount of \$1,968,477 and the distribution was made on July 2, 2012. The extraordinary dividends consisted of \$5,130,430 in cash, \$3,219,888 in securities, and \$1,345,000 in real estate for a total of \$11,663,796 and the distribution was made on July 10, 2012. The CDI approved the transactions on June 28, 2012.

It was later noted that the extraordinary dividend was incorrectly calculated and distributed. Therefore, on January 9, 2013, Trinity returned \$866,254 to the Company based on the corrected extraordinary dividend calculation. This resulted in a total extraordinary dividend distribution of \$10,797,541 as of December 31, 2012.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Qualitas Controladora, S.A.B. de C.V. (QC) is the ultimate controlling entity. QC is incorporated in the country of Mexico. The following organizational chart depicts the inter-relationship of the companies as of December 31, 2014: (All ownership is 100%).



The five 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, 2014:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Joaquin Brockman Mexico D.F., Mexico	Chairman and Chief Executive Officer Qualitas Compania de Seguros, S.A. de C.V.
Wilfrido Castillo Mexico D.F., Mexico	Vice-Chairman of the Board and Public Investors' Relations Director Qualitas Compania de Seguros, S.A. de C.V.
Noah Daniel Couttolenc Tiburon, California	Chief Technical Director and Chief Operation Officer Qualitas Compania de Seguros, S.A. de C.V.
Eduardo Pedrero San Diego, California	President and Chief Executive Officer Qualitas Insurance Company
Andres Ruiz-Hubard San Diego, California	Chief Financial Officer and Secretary Qualitas Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Eduardo Pedrero	President and Chief Executive Officer
Andres Ruiz-Hubard	Chief Financial Officer and Secretary
Noah Daniel Couttolenc	Chief Technical Director

Corporate Records

A review of the Company's policy concerning its board of director and shareholder meetings was performed subsequent to the acquisition by Qualitas Financial Services, Inc. (QFSI), and it was noted that the meetings were not formally conducted during this specific post acquisition examination period, even though the Company's Bylaws required them. This resulted in the Company failing to comply with the investment related requirements of California Insurance Code (CIC) Sections 1200 and 1201. Specifically, there were no minutes with any general statements pertaining to its investments, as required by CIC Section 1200, nor were there any minutes with references to amounts, facts, and the value of the securities as required under CIC Section 1201.

The lack of board of director and shareholder meetings can result in significant events and transactions not being disclosed, documented, and approved by the board. Therefore, it is recommended that the Company hold regular board and shareholder meetings as stated in their Bylaws in order to disclose, document, and approve significant events and transactions. It is also recommended that they comply with the investment related reporting requirements of CIC Sections 1200 and 1201.

Management Agreements

Commercial Agency Agreement: Effective October 9, 2014, a Commercial Agency Agreement was executed between the Company and Qualitas Compania de Seguros, S.A. de C.V. (QCS), a Mexican affiliate. Under this agreement, the Company authorizes QCS to perform automobile liability and common carrier liability insurance operations in the United Mexican States, covering risks that may occur within the territory of the United States of America. This commercial agency agreement was not submitted to the California Department of Insurance (CDI) for approval, as required under CIC Section 1215.5(b)(4). It is recommended that the Company submit this agreement to the CDI for approval as required by CIC Section 1215.5(b)(4).

Related Party Transactions

During the acquisition of the Company, its immediate parent, QFSI made a commitment to the CDI that QFSI would ensure, commit, and maintain the total statutory capital and surplus of the Company at no less than \$15 million dollars for a period of five (5) years following the acquisition date of the Company. In 2014, the Company received a capital contribution of \$9,375,000 from QFSI in order to maintain its capital and surplus above the required \$15 million.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2014, the Company is licensed to transact business in the following fourteen states:

Arizona	Kansas	Oklahoma	Washington
California	Maine	Oregon	Wyoming
Colorado	Montana	Texas	
Idaho	Nevada	Utah	

Prior March 14, 2014 acquisition of the Company by Qualitas Financial Services, Inc., (QFSI), the Company had been in run-off since 2012. Upon acquisition by QFSI, the Company began writing commercial automobile liability policies for cross-border and post cross-border insurance under the new ownership in June, 2014. All business is written in three states: Arizona, California, and Texas. A large portion of the business is referred by its affiliate, Qualitas Compania de Seguros, S.A. de C.V. (QCS), as QCS is the largest automobile insurer in Mexico. For the year ended December 31, 2014, the direct premiums written by states were as follows:

<u>State</u>	<u>Direct Premiums Written</u>	<u>Percentage of Total</u>
Arizona	\$761,072	51.6%
California	438,380	29.6%
Texas	277,463	18.8%

REINSURANCE

Assumed

The Company has no assumed business.

Ceded

Commercial Automobile Liability Excess of Loss Reinsurance Agreement: Effective June 9, 2014, the Company entered into an Commercial Automobile Excess of Loss Reinsurance Agreement with Citadel Reinsurance Company Limited, Hamilton, Bermuda (Citadel). This agreement covers the commercial automobile cross-border business subject to the rules and regulations imposed by the North American Free Trade Agreement (NAFTA). Liabilities are insured up to \$750,000 ultimate net loss of each and every insured, and each and every loss occurrence in excess of the first \$250,000 retention. The maximum aggregate limit in respect of the first agreement year is \$3,750,000.

Motor Excess of Loss Reinsurance Agreement: Effective November 18, 2014, the Company entered into a Motor Excess of Loss Reinsurance Agreement with Transatlantic Reinsurance Company, Latin American & Caribbean Division. This agreement covers the commercial automobile post cross-border risks directly written in the state of Arizona. Liabilities are reinsured up to \$1,000,000 ultimate net loss of each and every loss occurrence in excess the first \$500,000 retention. The annual aggregate limit is \$4,000,000.

Effective immediately following the closing date of the transactions contemplated in the Stock Purchase Agreement between Trinity Universal Insurance Company (Trinity) and Qualitas Financial Services, Inc., Trinity assumed a 100% quota share participation in the Ultimate Net Loss of the Company in respect of all losses incurred relating to the Trinity business.

ACCOUNTS AND RECORDS

Deferred Tax Assets

Prior to the acquisition, the Company did not elect to admit deferred tax assets in the amount of \$14,334,566 pursuant to the National Association of Insurance Commissioners Statements of Statutory Accounting Principles Number 10R, paragraph 10.e. This amount is reflected as a cumulative effect of changes in accounting principles.

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, a finding was noted. This finding was presented to the Company along with a recommendation to strengthen this control. The Company should evaluate this recommendation, and make the appropriate change in order to strengthen its information system control.

Vehicle Fraud Assessment

The Company's vehicle count methodology in calculating the vehicle fraud assessment (VFA) did not comply with California Code of Regulation (CCR), Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62 (b). In its VFA calculation, the Company used the number of vehicles of the inforce policies at the end of each quarter as the number of insured vehicles per quarter as opposed to using the number of vehicles of the inforce policies as of the first day of the quarter, plus the number of vehicles newly insured during the quarter. Although it was determined that the current methodology did not result in variances during the current examination period, it is recommended that the Company correct its VFA procedures to ensure compliance with CCR, Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62 (b) for all future filing periods.

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, 2014

Underwriting and Investment Exhibit for the Year Ended December 31, 2014

Reconciliation of Surplus as Regards Policyholders from December 31, 2009
through December 31, 2014

Statement of Financial Condition
as of December 31, 2014

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 13,042,980	\$	\$ 13,042,980	
Cash and short-term investments	3,030,738		3,030,738	
Investment income due and accrued	117,330		117,330	
Premiums and agents' balances in course of collection	183,676		183,676	
Guaranty funds receivable or on deposit	373		373	
Electronic data processing equipment and software	253,793		253,793	
Furniture and equipment	52,212	52,212	0	
Aggregate write-ins for other than invested assets	<u>74,224</u>	<u>11,241</u>	<u>62,983</u>	
 Total assets	 <u>\$ 16,755,326</u>	 <u>\$ 63,453</u>	 <u>\$ 16,691,873</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 157,900	(1)
Taxes, licenses and fees			63,889	
Unearned premiums			1,001,219	
Ceded reinsurance premiums payable			128,397	
Provision for reinsurance			100,869	
Payable to parent, subsidiaries and affiliates			<u>296,177</u>	
 Total liabilities			 1,748,451	
Common capital stock		\$ 3,000,000		
Gross paid-in and contributed surplus		21,789,581		
Unassigned funds (surplus)		<u>(9,846,159)</u>		
Surplus as regards policyholders			<u>14,943,422</u>	
 Total liabilities, surplus and other funds			 <u>\$ 16,691,873</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2014

Statement of Income

Underwriting Income

Premiums earned		\$ 260,744
Deductions:		
Losses incurred	\$ 145,627	
Loss expenses incurred	26,252	
Other underwriting expenses incurred	<u>1,495,336</u>	
Total underwriting deductions		<u>1,667,215</u>
Net underwriting loss		(1,406,471)
<u>Investment Income</u>		
Net investment income earned	<u>159,250</u>	
Net investment gain		159,250
<u>Other Income</u>		
Finance and service charges not included in premiums	<u>14,165</u>	
Total other income		<u>14,165</u>
Net loss		<u><u>\$ (1,233,056)</u></u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		\$ 6,894,812
Net loss	\$ (1,233,056)	
Change in nonadmitted assets	(63,454)	
Change in provision for reinsurance	(100,869)	
Surplus adjustments:		
Paid-in	9,375,000	
Aggregate write-ins for gain in surplus	<u>70,989</u>	
Change in surplus as regards policyholders for the year		<u>8,048,610</u>
Surplus as regards policyholders, December 31, 2014		<u><u>\$ 14,943,422</u></u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2009 through December 31, 2014

Surplus as regards policyholders, December 31, 2009			\$ 19,198,136
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net losses	\$	\$ 2,798,440	
Change in net deferred income tax		246,397	
Change in nonadmitted assets	14,301,165		
Change in provision for reinsurance	178,948		
Cumulative effect of changes in accounting principles		14,334,566	
Capital change: Paid-in	400,000		
Surplus adjustments: Paid-in	8,975,000		
Dividends to stockholders		10,797,541	
Aggregate write-ins for gains and losses in surplus	<u>67,117</u>	<u></u>	
Total gains and losses	<u>\$ 23,922,230</u>	<u>\$ 28,176,944</u>	
Net decrease in surplus as regards policyholders			<u>(4,254,714)</u>
Surplus as regards policyholders, December 31, 2014			<u>\$ 14,943,422</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Senior Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2014 were found to be reasonably stated and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

During 2015, Qualitas Financial Services, Inc. made four additional capital contributions totaling \$2,594,000 to the Company in order for them to remain above the required \$15 million in capital and surplus.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Corporate Records (Page 6): it is recommended that the Company hold regular board and shareholder meetings as stated in their Bylaws in order to disclose, document, and approve significant events and transactions. It is also recommended that they comply with the investment related reporting requirements of California Insurance Code Sections 1200 and 1201.

Management and Control – Management Agreements – Commercial Agency Agreement (Page 6): It is recommended that the Company submit the inter-company agreement to the California Department of Insurance (CDI) for approval in compliance with CIC Section 1215.5(b)(4).

Accounts and Records – Information Systems Control (Page 9): It is recommended that the Company make the appropriate change in order to strengthen its general information system control.

Accounts and Records – Vehicle Fraud Assessment (Page 9): It is recommended that the Company correct its vehicle fraud assessment procedures to ensure the compliance with California Code of Regulation, Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b).

Previous Report of Examination

Management and Control – Management Agreements – Federal Income Tax Agreement (Page 6): It was recommended that the Company submit any future amendments to the CDI for approval. This agreement was terminated.

Comments on Financial Statement Items – Bonds (Page 12): It was recommended that the Company draft a new custodial agreement to remedy the deficiencies and submit it to the CDI in accordance with CIC Section 1104.9. The Company is in compliance with CIC Section 1104.9.

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/_____

Victoria Wang, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

____/S/_____

Edward W. Aros, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California