

REPORT OF EXAMINATION
OF THE
INDEMNITY COMPANY OF CALIFORNIA
AS OF
DECEMBER 31, 2017

Filed on June 25, 2019

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Los Angeles, California
May 24, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

INDEMNITY COMPANY OF CALIFORNIA

(hereinafter also referred to as the Company) at its statutory home office located at 17771 Cowan, Suite 100, Irvine, California 92614.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2014. This examination covered the period from January 1, 2015 through December 31, 2017.

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 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 with California as the facilitating state of the Insko Insurance Services, Inc. subgroup of the AmTrust Financial Services, Inc. group. It was conducted concurrently with other insurance entities in the holding company group, including its immediate parent Developers Surety and Indemnity Company. The following states participated on the examination: Arizona, Delaware, Florida, Kansas, Nevada, New Jersey, New York, Oklahoma, Pennsylvania, and Texas.

COMPANY HISTORY

The Company is a property and casualty insurer incorporated under the laws of California on October 5, 1967. On January 2, 2014, the Company became part of the AmTrust NGH group when AmTrust Financial Services, Inc. purchased Insko Insurance Services, Inc., the Company's ultimate parent, and Developers Surety Indemnity Company, the Company's immediate parent.

Capitalization

On September 15, 2015, the Company added \$1,300,000 of common stock as a requirement for additional licenses in other states.

The Company is authorized to issue 2,500 shares of common stock with a par value of \$1,000 per share. As of December 31, 2017, all 2,500 shares are outstanding.

Dividends

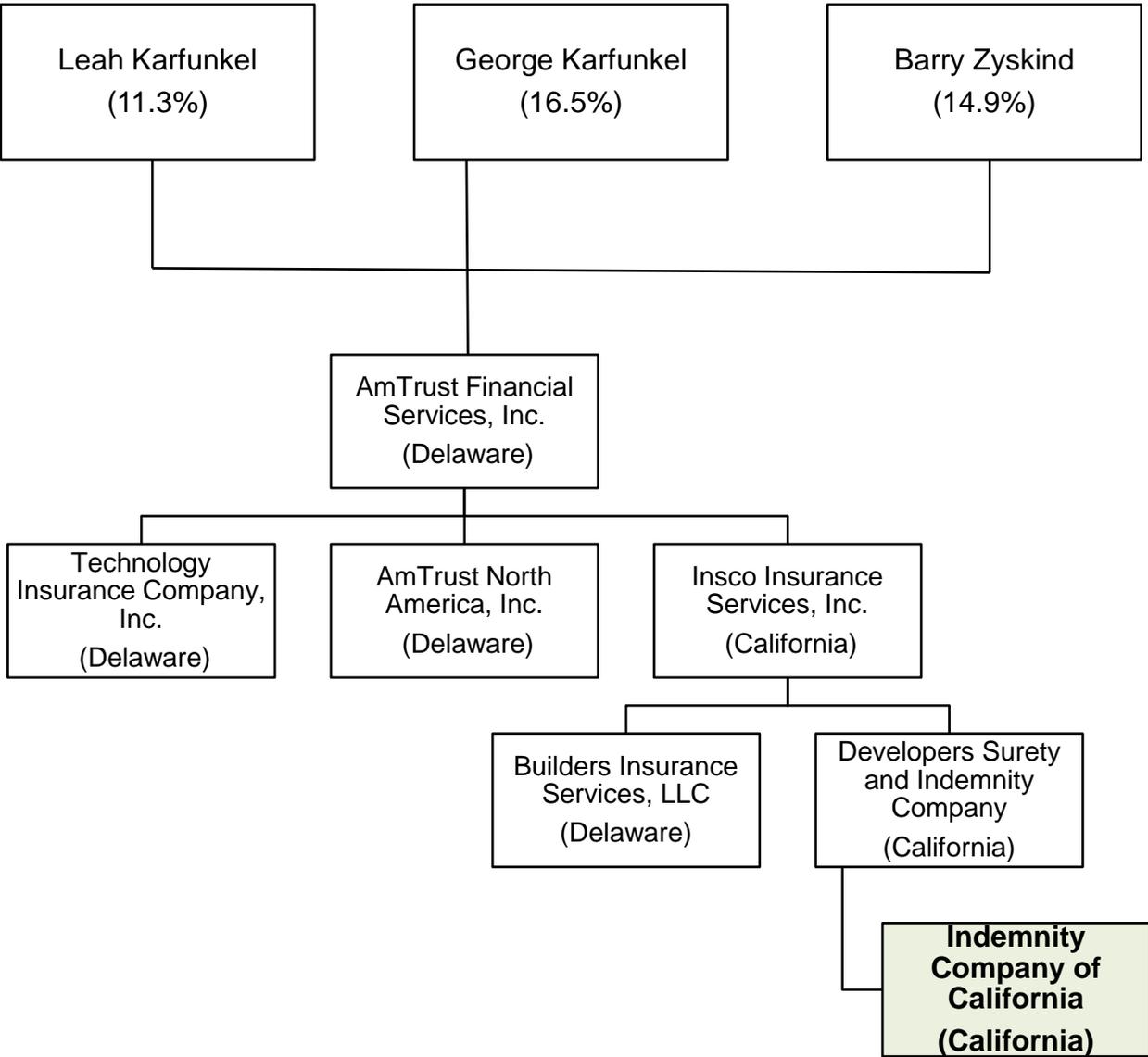
On September 30, 2015, the Company paid an ordinary cash dividend of \$1,300,000 to its parent company, Developers Surety and Indemnity Company (DSIC).

On December 31, 2015, the Company paid an extraordinary cash dividend of \$5,000,000 to its parent company, DSIC. The dividend was approved by the California Department of Insurance on December 15, 2015.

On December 27, 2017, the Company paid an extraordinary dividend of \$12,000,000 in stocks and bonds to its parent company, DSIC, due to the reinsurance pooling agreement entered into by the Company. The dividend was approved by the California Department of Insurance on December 19, 2017.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which AmTrust Financial Services, Inc., a Delaware company, is the ultimate controlling entity. The following is an abridged organizational chart. 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, 2017:

Directors

| <u>Name and Location</u> | <u>Principal Business Affiliation</u> |
|---|---|
| Harry C. Crowell Newport Beach, California | President Crowell Industries |
| Donald T. DeCarlo Douglaston, New York | Attorney Self Employed |
| Susan C. Fisch San Francisco, California | Retired Insurance Executive |
| Harry Schlachter Lawrence, New York | Treasurer AmTrust Financial Services, Inc. |
| Stephen B. Ungar North Hills, New York | General Counsel and Secretary AmTrust Financial Services, Inc. |

Principal Officers

| <u>Name</u> | <u>Title</u> |
|-------------------|---|
| Sam Zaza | President |
| Stephen B. Ungar | Secretary |
| Harry Schlachter | Treasurer |
| Kerry J. Heitz | Executive Vice President and Chief Financial Officer |
| Jeffery H. Mayer | Chief Actuary |
| Daniel Young | Senior Vice President and Chief Underwriting Officer |
| Barry W. Moses | Vice President, Regulatory & Compliance, and Assistant Secretary |
| Blaine Williamson | Senior Vice President, Field Operations |

Management Agreements

Inter-Company Management Agreement: Effective January 2, 2014, the Company entered into an Inter-Company Management Agreement with AmTrust Financial Services, Inc. Services (AFSI). Under the terms of the agreement, AFSI is to provide investment fund management, statutory accounting and reporting, loss reserving and reinsurance placement, employee management and human resource services, corporate governance, and maintenance of fiduciary accounts services. The agreement was approved by the California Department of Insurance (CDI) on February 4, 2014. The agreement is inactive. No fees were paid to AFSI during years under the examination.

Tax Allocation Agreement: Effective January 2, 2014, the Company entered into a Tax Allocation Agreement with AFSI. The allocation is made on a separate return basis with current credit for any net operating losses or other items utilized in the consolidated tax return. Tax return settlement is made within 30 days of the filing of the return. The agreement was approved by the CDI on February 4, 2014. The Company paid/(received) tax settlements of \$253,190, \$(604,691), and \$369,596 for 2015, 2016, and 2017, respectively.

Underwriting Management Agreement – Effective August 1, 2010, the Company entered into an Underwriting Management Agreement with InSCO Insurance Services, Inc. (INSCO). Under the terms of the Agreement, INSCO is authorized to manage the insurance operations, including administration, production, distribution, and claims and adjusting functions. The compensation for providing the services is based on actual cost without a profit factor being built into the cost. The Company will reimburse INSCO monthly for all costs and expenses incurred in the performance of the duties under this Agreement. The Agreement was approved by the CDI on December 10, 2010.

The Agreement was subsequently amended and was approved by the CDI on July 8, 2012. The Company paid \$2,417,358, \$2,813,753, and \$3,099,565 for the years 2015, 2016, and 2017, respectively.

TERRITORY AND PLAN OF OPERATION

The Company provides surety bonds for construction contractors and land and housing developers, and licenses & permit bonds to businesses of all sizes to meet federal, state, and local regulatory requirements for business licensure. Surety applicants which meet the basic standards are written through the Company.

As of December 31, 2017, the Company was licensed to transact marine, surety, liability, and automobile insurance in its domicile state of California. The Company was licensed in 42 states and the District of Columbia.

At December 31, 2017, the Company had direct written premiums of \$9,310,566 of which 100% was surety. The top three states in direct written premiums and percentages are California with \$6,497,068 (69.8%), Washington with \$1,357,451 (14.6%), and Hawaii with \$654,991 (7.0%).

The Company had a distribution network of approximately 4,700 independent producers. As of December 31, 2017, there were 15 branch offices that worked with the agency force and to perform marketing and underwriting functions.

REINSURANCE

Inter-Company Reinsurance Pooling Agreement

Effective October 1, 2017, the Company entered into an Inter-Company Reinsurance Pooling Agreement (Pooling Agreement) with sixteen of its U.S. property and casualty insurance affiliates. Under the Pooling Agreement, the Company agreed to cede and transfer to Technology Insurance Company (TIC), and TIC agreed to assume and accept as its own obligation: (1) 100% of the Company's respective liabilities on all insurance policies and all assumed reinsurance contracts that were in force as of October 1, 2017, or that have expired or been terminated or non-renewed as of October 1, 2017; and (2) 100% of the Company's respective liabilities on all insurance policies and all assumed

reinsurance contracts issued subsequent to October 1, 2017. The Company does not obtain a proportional share of the profits and/or losses of the pooled business. The agreement was approved by the California Department of Insurance on December 15, 2017.

Assumed

Company does not assume reinsurance.

Ceded

Other than the Inter-Company Reinsurance Pooling Agreement, the following is a summary of the Company's reinsurance agreements in force as of December 31, 2017:

| Line of Business and Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Limit |
|---------------------------------------|--|--|--|
| <u>Surety</u> | Authorized | | |
| Quota Share | Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd. | 40% | 60% of the Company's net liability |
| <u>Surety</u> | | | |
| Excess of Loss | | | |
| First layer | Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd. | 40% of \$7.0 million in excess of \$500 thousand | 60% of \$7.0 million in excess of \$500 thousand, maximum limit of \$28 million Aggregate Ultimate Loss per year |
| Second Layer | Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd, Odyssey Reinsurance Company | 0% | 100% of \$7.5 million in excess of \$7.5 million, maximum limit of \$15 million Aggregate Ultimate Loss per year |
| Third Layer | Munich Reinsurance America, Inc., Swiss Reinsurance Company Ltd, Odyssey Reinsurance Company | 0% | 100% of \$15 million in excess of \$15 million, maximum limit of \$30 million Aggregate Ultimate Loss per year |

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, 2017. The accompanying comments to the amounts reported in the annual statements 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, 2017

Underwriting and Investment Exhibit for the Year Ended December 31, 2017

Reconciliation of Surplus as Regards Policyholders from December 31, 2014
through December 31, 2017

Statement of Financial Condition

as of December 31, 2017

| <u>Assets</u> | <u>Ledger and Nonledger Assets</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|---|--|--------------------------------|--------------|
| Bonds | \$ 6,401,819 | \$ 6,401,819 | |
| Common stocks | 402 | 402 | |
| Cash and short-term investments | 4,313,952 | 4,313,952 | |
| Investment income due and accrued | 60,923 | 60,923 | |
| Amount recoverable from reinsurers | (26,599) | (26,599) | |
| Receivables from parent | <u>72,338</u> | <u>72,338</u> | |
| Total assets | <u>\$ 10,822,835</u> | <u>\$ 10,822,835</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | |
| Losses and loss adjustment expenses | | \$ 0 | (1) |
| Current federal and foreign income taxes | | 654,606 | |
| Net deferred tax liability | | 1,463 | |
| Ceded reinsurance premiums payable | | (84,737) | |
| Amounts withheld or retained by company for account of others | | 3,389,381 | |
| Payable to parent, subsidiaries and affiliates | | <u>1,118,377</u> | |
| Total liabilities | | 5,079,090 | |
| Common capital stock | \$ 2,500,000 | | |
| Gross paid-in and contributed surplus | 2,451,009 | | |
| Unassigned funds (surplus) | <u>792,736</u> | | |
| Surplus as regards policyholders | | <u>5,743,745</u> | |
| Total liabilities, surplus and other funds | | <u>\$ 10,822,835</u> | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2017

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|------------------|------------------|
| Premiums earned | | \$ 3,037,435 |
| Deductions: | | |
| Losses and loss expenses incurred | \$ 83,520 | |
| Other underwriting expenses incurred | <u>1,401,101</u> | |
| Total underwriting deductions | | <u>1,484,621</u> |
| Net underwriting gain | | 1,552,814 |

Investment Income

| | | |
|------------------------------|----------------|-----------|
| Net investment income earned | \$ 455,295 | |
| Net realized capital gain | <u>581,002</u> | |
| Net investment gain | | 1,036,297 |

Other Income

| | | |
|--|---------------|---------------------|
| Aggregate write-ins for miscellaneous income | <u>\$ 901</u> | |
| Total other income | | <u>901</u> |
| Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes | | 2,590,012 |
| Federal and foreign income taxes incurred | | <u>497,466</u> |
| Net income | | <u>\$ 2,092,546</u> |

Capital and Surplus Account

| | | |
|---|------------------|---------------------|
| Surplus as regards policyholders, December 31, 2016 | | \$ 16,305,009 |
| Net income | \$ 2,092,546 | |
| Change in net unrealized capital losses | (476,193) | |
| Change in net deferred income tax | (193,642) | |
| Change in nonadmitted assets | 464,759 | |
| Dividends to stockholders | (12,000,000) | |
| Aggregate write-ins for losses in surplus | <u>(448,734)</u> | |
| Change in surplus as regards policyholders for the year | | <u>10,561,264</u> |
| Surplus as regards policyholders, December 31, 2017 | | <u>\$ 5,743,745</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2014 through December 31, 2017

| | | | |
|--|-----------------------------|----------------------------|---------------------|
| Surplus as regards policyholders, December 31, 2014 | | | \$ 20,699,474 |
| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> | |
| Net income | \$ 2,132,950 | \$ | |
| Net unrealized capital gains | | 170,963 | |
| Change in net deferred income tax | 73,604 | | |
| Change in nonadmitted assets | 457,414 | | |
| Changes in Capital – Paid in | 1,300,000 | | |
| Dividends to stockholders | | 18,300,000 | |
| Aggregate write-ins for gains and losses in surplus | <u> </u> | <u>448,734</u> | |
| Total gains and losses | <u>\$ 3,963,968</u> | <u>\$ 18,919,697</u> | |
| Net decrease in surplus as regards policyholders | | | <u>(14,955,729)</u> |
| Surplus as regards policyholders, December 31, 2017 | | | <u>\$ 5,743,745</u> |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Delaware, the lead state, retained INS Consultants, Inc. (INS) for the purpose of assisting this examination in determining the reasonableness of the Group's loss and loss adjustment expense reserves. Since the business of the Company was pooled, it was necessary to evaluate the losses on a group-wide basis. Based on the analysis by INS and the review of their work by a Casualty Actuary from the California Department of Insurance, the Company's December 31, 2017 reserves for losses and loss adjustment expenses were found to be reasonably stated and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

On April 25, 2018, the Company received a \$2,000,000 Paid-in contribution in cash from its immediate parent, Developers Surety and Indemnity Company.

The Form A, in connection to the privatization of AmTrust Financial Services, Inc. (AFSI) by Evergreen Parent GP, LLC was approved by the California Department of Insurance on November 27, 2018. The completion of the transaction closed on November 29, 2018.

On April 19, 2019, AFSI and Liberty Mutual Insurance entered into an agreement to acquire the global surety and credit reinsurance operations of AFSI. Upon closing, Liberty Mutual will acquire AmTrust Surety, previously managed by Insko Insurance Services, Inc., which provides contract, commercial, and subdivision bonds primarily in the western United States. The majority of the surety business is written through the Company and its parent, Developers Surety and Indemnity Company. The AmTrust Surety portion of the acquisition is expected to close in the second quarter of 2019.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Summary of Comments and Recommendations – Current Report of Examination (Page 16): It was recommended that the Company amend the Commencement and Termination article of the Subdivision Bond Quota Share Agreement with Munich Reinsurance America, Inc. to comply with California Code of Regulation Title 10, Chapter 5, Subchapter 3, Article 3, Sections 2303.14(b)(l)(A) and 2303.14(b)(l)(B). The agreement has been terminated.

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/_____

Thomas Podsiadlo, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

/S/_____

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