REPORT OF EXAMINATION

OF THE

CALIFORNIA INSURANCE

GURANTEE ASSOCIATION

AS OF

JUNE 30, 2015

Dave Jones

Insurance Commissioner

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Los Angeles, California
September 16, 2016

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA INSURANCE GUARANTEE ASSOCIATION

(hereinafter also referred to as the Association) at its home office located at 101 North Brand Boulevard, Suite 600, Glendale, California 91203.

SCOPE OF EXAMINATION

The previous examination of the Association was as of June 30, 2011. This examination covered the period from July 1, 2011 through June 30, 2015.

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 Association'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 includes identifying and evaluating significant risks that could cause the insurer's surplus and funds to be materially misstated both currently and prospectively.

All accounts and activities of the Association were considered in accordance with the risk-focused examination process. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and an analysis of the Association's projected cash flows through 2021.

The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment was identified, the impact of such adjustment will be documented separately following the Association's financial statements.

This examination report includes findings of fact and general information about the Association 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 Association.

ASSOCIATION HISTORY

The Association was created by California legislation in 1969 to establish a fund from which insureds could obtain financial and legal assistance in the event their insurers became insolvent. The Association was organized pursuant to, and operates in accordance with California Insurance Code (CIC), Division 1, Part 2, Article 14.2, Section 1063. In addition, the Association functions pursuant to a Plan of Operation approved by the California Department of Insurance. The purpose of the Association is to provide against loss arising from the failure of an insolvent insurer to discharge its obligations under its insurance policies.

The Association is a statutory entity that depends on the Guarantee Act (CIC Sections 1063-1063.77) for its existence and for a definition of the scope of its powers, duties and protections. The Association issues no policies, collects no premiums, makes no profits, and assumes no contractual obligations from policyholders.

MANAGEMENT AND CONTROL

Management of the Association is vested in a thirteen-member Board of Governors (Board), eleven of which are appointed by the California Insurance Commissioner, and one member each is appointed by the Speaker of the California State Assembly and the President Pro Tempore of the California State Senate.

Nine members shall be member insurers and representative, as nearly as possible, of the classes of insurance and of the kinds of insurers covered by California Insurance Code Section 1063. At least five member insurers of the board must be from domestic insurers. At least three member insurers must be from stock insurers, and at least three must be from non-stock insurers.

A listing of the members of the board and principal officers serving at June 30, 2015 follows:

Governors

Name	Principal Business Affiliation
Lloyd Benedetti	Vice President, Controller Inter-Insurance Exchange of the Automobile Club of Southern California
Glenn S. Brown (1)	Chief Executive Officer Fu-Gen Inc. Research & Investigation
Gary Davis	President and Chief Executive Officer Lawyer's Mutual Insurance Company
Stephen Festa	Executive Vice President Employers Insurance Group

Name	Principal Business Affiliation
Peter Guastamachio	Chief Financial Officer and Chief Investment Officer State Compensation Insurance Fund
Jeffrey Huebner	Vice President, Cash, Investment, and Risk Management CSAA Insurance Exchange
Althea Jaderquist	Vice President, Financial Planning and Analysis Fireman's Fund Insurance Company
Paul Mattera	Senior Vice President and Chief of Public Affairs Liberty Mutual Insurance Company
William Vainisi	Vice President and Assistant General Counsel Allstate Insurance Company
Stephen Weinstein	General Counsel Mid-Century Insurance Company
Harry J. Wilson	Administrator CPF Health Benefits Trust
Thomas Wilson	Managing Director Monterey Peninsula Surgery Center, LLC
George Woolverton (2)	Co-President and Corporate Secretary Stockwell, Harris, Woolverton, and Muehl

Principal Officers

Name	Title
Wayne D. Wilson	Executive Director
John G. Horner	Deputy Executive Director
Anthony Kennedy	Director of Finance
Hal Fedora (3)	Director of Audit

(1) Appointed by the Speaker of the California State Assembly on May 14, 2009.
(2) Appointed by the President Pro Tempore of the California State Senate on April 5, 2012.
(3) Retired effective September 2, 2016.

Management Agreements

Authorization for the direct management of the Association's investment portfolio has been granted to two separate investment management firms, Payden & Rygel and Western Asset Management Company. Both agreements have been in effect for over 15 years. Each firm is responsible for the management of a designated segment of the Association's investment portfolio. Within the confines of the Association's codified guidelines, each investment management firm has authority to execute transactions without prior consultation with the Association's management.

Third Party Administrators

The majority of the Association's workers compensation claims are administered by third-party administrators (TPAs). As of June 30, 2015, there are four TPAs under contract: Broadspire; Intercare Holdings Insurance Services, Inc.; Sedgwick Claims Management Services, Inc.; and Patriot Risk Services, Inc. Under limited circumstances, the Association has the right to cancel the contracts. Fees paid to the TPAs are based on the number of claims filed. Some of the claims handling fees were paid at the inception of the agreements, whereas other contract fees are paid on a monthly or annual cycle based on the number of open claims. The TPAs have the authority to issue claim payments up to $25,000. Claim payments in excess of $25,000 require the approval of the Association's management.

TERRITORY AND PLAN OF OPERATION

The purpose of the Association is to provide insolvency insurance for each member insurer and to protect policyholders against loss arising from the failure of an insolvent, admitted insurer to discharge its obligations under its insurance policies. The

Association obtains funds to pay its covered claims through assessments of admitted insurers, release of special statutory security deposits previously placed with the state of the insolvent carriers, distributions from insolvent carriers' estates, and investment income.

Insurance companies writing property and casualty insurance business in California are required to participate in the California Insurance Guarantee Association. If an admitted property and casualty insurance company becomes insolvent, the Association administers unpaid claims and assesses each property and casualty insurance company up to 2% for all lines of written premium in the appropriate category. California Insurance Code (CIC) Section 1063.145 requires all property and casualty insurance companies to surcharge policies to recover these assessments.

The Association has the responsibility to pay and discharge covered claims of insurers as of the date a court of competent jurisdiction declares the property and casualty insurance company insolvent and a liquidator is appointed. Covered claims primarily include the policy obligations of insolvent insurers arising from property and liability coverages (exclusive of those lines not included per CIC Section 1063.1).

The Association allocates its claim payments and costs, incurred or estimated to be incurred, to one or more of the following categories: (a) workers' compensation claims; (b) homeowners' claims, and automobile claims, which include: automobile material damage, automobile liability (both personal injury and death and property damage), medical payments and uninsured motorist claims; and (c) claims other than workers' compensation, homeowners, or automobile. Separate premium charges (assessments) are required for each category. The assessments for each category are used to pay the claims and costs allocated to that category.

The CIC and labor laws establish the maximum claim settlement amounts for workers' compensation claims. Claims settlement amounts for covered claims other than workers' compensation are limited to $500,000 per claim or the policy limits, whichever is lower.

When a property and casualty insurance company becomes insolvent, the control of its assets transfers to the state insurance liquidator in its domiciliary state. The liquidator uses the assets of the insolvent insurance company to settle the outstanding liabilities of the company. Liquidators may advance funds to the Association prior to the settlement of all outstanding debts. The Association recognizes these advances as revenue when received. The advances are utilized to discharge claims against the insolvent insurance companies. The respective liquidator can recall these advances, in whole or in part. The Association recognizes any recall of advances when notified by the respective liquidator or receiver.

To the extent that assets, including advances from liquidators, are insufficient to discharge claim obligations, additional premium charges are assessed from member insurers when determined necessary by the Board of Governors (Board) of the Association. Conversely, to the extent that the assets exceed the ultimate cost of claim obligations for insolvent insurers, the excess fund balance, if any, will be applied to reduce future premium charges by the Association in the appropriate category.

Premium charges are accrued as of the date declared by the Board of the Association and become due from the member insurers when billed. The rate of premium charges to each member is initially based on the written premium shown on the latest year's annual financial statement on file with the California Insurance Commissioner.

On July 9, 2012, the Governor of California signed Assembly Bill 2301 which amends the CIC Sections governing the operations of the Association, and revises the definition of "covered claims" with respect to the following requirement: Instead of the claim being presented as a claim to the liquidator in this state (California), the requirement is now for the claim to be presented as a claim to the liquidator in the state of domicile of the insolvent insurer, or to the Association.

On June 28, 2014, the Governor of California signed Assembly Bill 2230, which amended the applicable CIC Sections governing the operations of the Association. Effective January 1, 2015, the premium charged to a member insurer for a category of insurance would be 2% of the net direct written premium, unless there are outstanding bonds, in which case the premium would not exceed 1% of the net direct written premium for any category of insurance for which the bond proceeds are being used to pay claims and expenses.

In the event of a natural disaster, the Association, to the extent it determines necessary or desirable, may request the California Department of Insurance (CDI) to issue bonds pursuant to Article 14.25 (commencing with CIC Section 1063.50) to provide funds to pay covered claims of insolvent insurers. The Association may act as agent of the CDI to collect premium payments levied by the CDI on its member insurers.

Additionally, CIC Section 1063.70 authorizes the Association to request the issuance of bonds by the California Infrastructure and Economic Development Bank, to more expeditiously and effectively provide for the payment of covered claims that arise as a result of the insolvencies of insurance companies providing workers compensation insurance. Proceeds for the sale of bonds shall be deposited into a separate account, the Workers' Compensation Bond Fund. Notwithstanding any other limits on assessments, the Association shall have authority to levy upon member insurers special bond assessments in the amount necessary to pay the principal of and interest on the bonds. Any bonds issued to provide funds for covered claim obligations for workers' compensation claims shall be issued prior to January 1, 2023 in an aggregate principal amount outstanding at any one time not to exceed $1.5 billion. As of June 30, 2015, there were no outstanding bonds.

The Association was providing insolvency insurance for 138 insolvent companies, including both active and inactive insurers at June 30, 2015.

REINSURANCE

Reinsurance entered into by insurers prior to their insolvencies is administered by the California Department of Insurance, Conservation and Liquidation Office (CLO) or the domestic liquidator of a non-California domiciled company, and is therefore excluded from the Association's financial statements. Reinsurance recoveries made by the CLO or the domestic liquidator may be advanced to the Association subject to the priority needs of the estate in liquidation. Ancillary liquidations may also have a demand on assets recoverable including reinsurance recoverable.

ACCOUNTS AND RECORDS

The financial statements presented by the Association, which are regularly audited by independent certified public accountants, are prepared on a Generally Accepted Accounting Principles basis with the fiscal year ended June 30th. The Association's financial statements are prepared on a conservative basis (i.e., full value of estimated California-risk reserves are established with no deduction for inuring reinsurance recoverables, no anticipation of advances from estates in liquidation, and advances are recorded only when received).

Quarterly Report on Status of Statutory Deposit

California Insurance Code (CIC) Section 11698.3(c) requires that "the Association shall make a full report and accounting of the disposition of the deposit on or in the form and at the times as the Commissioner shall request, including a report of all interest income earned on the deposit." During the course of this examination, it was noted that the Association failed to comply with the requirements of CIC Section 11698.3(c). It is recommended that the Association comply with CIC Section 11698.3(c).

Based on the above noted finding and recommendation, and during the course of this examination, the Association implemented procedures to comply with the requirements of CIC Section 11698.3(c).

FINANCIAL STATEMENTS

The following financial statements prepared for this examination period include:

Statement of Financial Condition as of June 30, 2015

Statement of Income and Changes in Surplus Funds
for the Fiscal Year Ended June 30, 2015

Statement of Cash Flow
for the Fiscal Year Ended June 30, 2015

Statement of Financial Condition
as of June 30, 2015

Assets		Per Examination	Notes
Cash and short-term investments:			
Unrestricted		$ 373,845,947	
Restricted for workers' compensation claims and debt service		9,372,691	
Investments in debt securities available-for-sale, at fair value:			
Unrestricted		2,659,538,906	
Restricted for workers' compensation claims		137,967,641	
Investments in equity securities available-for-sale, at fair value:			
Unrestricted		204,537,815	
Accrued investment income		8,352,962	
Accrued but not received statutory deposits		44,100,693	
Premium charges available:			
Unrestricted, net of provision for uncollectible premium charges of $2,773,400		20,025,927	
Fixed assets, net		5,016,216	
Deposits and other assets		775,035	
Total assets		$ 3,463,533,833	
Liabilities and Fund Deficit			
Reserve for claims		$ 3,092,536,023	(1)
Reserve for claim adjustment and administrative expenses		466,597,116	(1)
Unpresented checks outstanding one year and greater		14,177,258	
Premium charge credits due to members		43,785,410	
Pre-liquidation recoveries due to liquidators		527,829	
Accounts payable		5,510,225	
Total liabilities		3,623,133,861	
Fund deficit:			
Fund deficit	$ (226,984,887)		(2)
Accumulated other comprehensive income	67,384,859		
Total fund deficit		(159,600,028)	
Total liabilities and fund deficit		$ 3,463,533,833	

Statements of Income and Changes in Surplus Funds
for the Fiscal Year Ended June 30, 2015

		Per Examination
Assessments and investment activity:		
Premiums charges declared		$ 295,967,075
Uncollectible premium charges		(2,773,400)
Net investment income		33,902,940
Net realized investment gain		7,858,444
Liquidator activity:		
Advances from liquidators		128,064,026
Statutory deposits		3,233,968
Total income		466,253,053
Claims activity:		
Claims paid	$ (202,255,489)	
Claim adjustment expenses paid	(57,379,437)	
Decrease in reserve for claims	300,952,526	
Decrease in reserve for claims adjustment and administrative expenses	208,331	
		41,525,931
Unearned premiums activity:		
Unearned premiums paid		(955,357)
Administrative expense activity:		
Administrative expenses paid	(23,088,630)	
Interest expense	(385,785)	
		(23,474,415)
Total expenses		17,096,159
Net income		483,349, 212
Accumulated other comprehensive income		67,384,859
Fund deficit at beginning of period		(710,334,099)
Fund deficit at end of period		$ (159,600,028)

Statements of Cash Flow
for the Fiscal Year Ended June 30, 2015

		Per Examination
Cash flow from operating activities:		
Net income		$ 483,349,212
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of bond	323,147	
Depreciation of fixed assets	1,456,483	
Realized gain on investments	(7,858,444)	
Amortization of debt securities available for sale	5,882,998	
Decrease (increase) in:		
Premium charges due from members	65,714,633	
Provision for uncollectible premium charges	455,239	
Accrued investment income	271,214	
Accrued but not received statutory deposits	(3,233,968)	
Deposits and other assets	392,819	
Total		63,404,121
Increase (decrease) in:		
Reserve for claim, claim adjustment and administrative expenses	(301,160,857)	
Book overdraft	(2,814,328)	
Premium charges credits due to members	(2,961,995)	
Pre-liquidation recoveries due to liquidators	(18,161,707)	
Accrued interest expense	(6,883)	
Deposits and other assets	(6,225,553)	
Total		(331,331,323)
Net cash provided by operating activities		215,422,010
Cash flows from investing activities:		
Debt securities available for sale:		
Purchases, unrestricted	(2,272,891,069)	
Proceeds from sales, unrestricted	1,989,083,874	
Proceeds from calls or maturities, unrestricted	154,295,585	
Purchases restricted for workers' compensation claims, debt services and leases	(241,531,452)	
Proceeds from sales, restricted for workers' compensation claims and debt service	229,807,688	
Proceeds from calls or maturities, restricted for workers' compensation claims and debt service	141,533,126	
Equity securities available-for-sale:		
Purchases, unrestricted	(8,879,129)	
Proceeds from sales, unrestricted	6,649,836	
Purchases of fixed assets	(2,779,224)	
Net cash used in investing activities		(4,710,765)
Cash flows from financing activities:		
Redemption of bonds		(118,000,000)
Increase (decrease) in cash and short-term activities		92,711,245
Cash and short-term investments at beginning of period		290,507,393
Cash and short-term investments at end of period		$ 383,218,638

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Reserves for Claims and Claims Adjustment Expenses and Administrative Expenses

The Association's reserves for claims and claims adjustment expenses are primarily comprised of workers' compensation reserves associated with insolvencies of workers compensation carriers. The Association's workers' compensation reserves are 90% of its total stated reserves.

The Association provided the examiners with an actuarial report issued by Daniel Murphy of Trinostics LLC prepared as of June 30, 2015.

For each year covered by this examination, the Association's external auditors issued a qualified opinion on the financial statements. The opinion stated in part that "the underlying claims information related to certain insolvencies was not sufficiently reliable or complete to enable the Association to estimate on a reasonable basis the reserve for claims, claim adjustment expenses and administrative expenses and the reserve for unearned premium."

A Casualty Actuary from the California Department of Insurance (Casualty Actuary) has opined that since the Association is an insolvency fund, the amount of claims and claims adjustment expense reserves are impractical to calculate with any degree of precision. Claims data emanating from different insurers with differing levels of data integrity create practical limits on producing claims estimates. With consideration given to the ability of the Association to issue additional bonds for funding as well as ongoing premium charges, the Casualty Actuary concluded that the Association does not require precise reserve requirements to function properly.

(2) Fund Deficit

As of June 30, 2015, the surplus funds balance (deficit) by line of business is as follows:

	Fund balance (deficit)
Workers' compensation	$ (1,525,815,364)
Automobile and homeowners	439,820,357
All other	859,010,120
Total fund deficit	$ (226,984,887)

As depicted above, the fund deficit was primarily from insolvencies of several workers' compensation insurers. The Association intends to fund the deficit in the workers' compensation category through annual assessments of premium charges to member companies, distributions from the estates of the insolvent insurers, and investment income. Surplus from each line of business can only be used to pay claims for that particular category. To meet short-term liquidity needs, the Association may borrow from the other lines of business. However, the Association's Plan of Operation requires these borrowings from the other lines of business to be in the form of loans which are the irrevocable obligation of the workers' compensation fund to repay, together with interest and any such borrowings must be approved by the California Insurance Commissioner.

(3) Cash Flow Projections

The Casualty Actuary from the California Department of Insurance has concluded that the cash flow forecasts reviewed by the Association's Board of Governors are adequate to assess the potential funding short-falls over the ten-year time horizon under which the Association evaluates its financial position.

SUBSEQUENT EVENTS

The Association reported surplus funds of $1.06 billion on its June 30, 2016 balance sheets, an increase of $1.22 billion from the reported fund deficit of $159 million on its balance sheets as of June 30, 2015. In addition, net income increased from $483 million to $1.21 billion from June 30, 2015 to June 30, 2016, respectively.

The increase in surplus and the increase in net income were largely due to the favorable adjustments in reserves for claims and claim adjustment and administrative expenses. The adjustments were positively impacted by the updated industry loss emergence patterns in the workers' compensation line of business that allowed the Association to reduce its carried claims and claims adjustment expense reserves and the decrease in pure premium rates as filed by the Workers' Compensation Insurance Rating Bureau of California, driven by favorable medical loss development.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

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,

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

Vivien Fan, CFE
Senior Insurance Examiner, Supervisor
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