

REPORT OF EXAMINATION
OF THE
CALIFORNIA CASUALTY INDEMNITY EXCHANGE
AS OF
DECEMBER 31, 2017

FILED: MARCH 12, 2019

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San Francisco, California
January 28, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA CASUALTY INDEMNITY EXCHANGE

(hereinafter referred to as the Exchange) at its home office located at 1875 South Grant Street, San Mateo, California 94402.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Exchange. The previous examination of the Exchange was from January 1, 2009 through December 31, 2013. This examination covers the period from January 1, 2014 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 Exchange's financial condition, to identify prospective risks, and to obtain information about the Exchange, including corporate governance, identification and assessment of inherent risks, and the evaluation of the 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 Exchange 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 Exchange's financial statements.

This examination report includes findings of fact and general information about the Exchange and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Exchange.

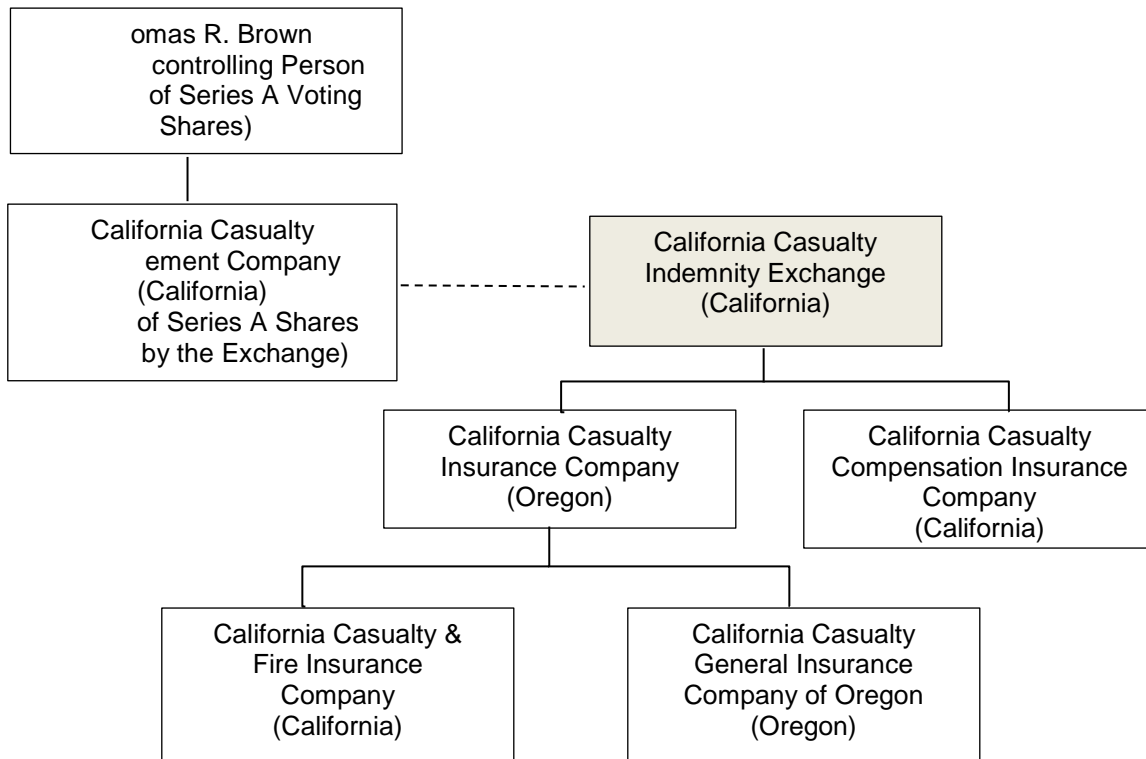
This was a coordinated examination with California as the lead state of the California Casualty Group. This examination was conducted concurrently with the Exchange's four subsidiaries: California Casualty & Fire Insurance Company (California), California Casualty Compensation Insurance Company (California), California Casualty Insurance Company (Oregon), and California Casualty General Insurance Company of Oregon (Oregon). The Oregon Department of Consumer and Business Services, Division of Financial Regulation participated in the examination.

MANAGEMENT AND CONTROL

The Exchange is a member of an insurance holding company system of which the California Casualty Management Company (CCMC) controls the Exchange as the attorney-in-fact. As of December 31, 2017, Thomas R. Brown owned or controlled 32.6% of the Class A voting common stock of CCMC.

The following organizational chart depicts the Exchange's relationship within the holding company system at December 31, 2017 (all ownership is 100% unless otherwise

noted):



The operations and affairs of the Exchange are subject to the supervision and control of a sixteen-member Advisory Board in conformance with the Underwriters Agreement. A listing of the members of the Advisory Board and principal officers of the attorney-in-fact serving on December 31, 2017 follows:

Advisory Board

Name and Location

Principal Business Affiliation

Carl B. Brown
Palo Alto, California

Chief Executive Officer
California Casualty Management
Company

Jonathan A. Brown^(A)
Fair Oaks, California

Retired
Association of Independent Colleges &
Universities

Wayne S. Diviney

Retired

| | |
|--|--|
| Clifton, Virginia | National Education Association |
| Carolyn E. Doggett ^(B) Belmont, California | Retired California Teachers Association |
| Jose A. Gomez San Marino, California | Educator, University Administrator California State University, Los Angeles |
| Jon H. Hamm El Dorado Hills, California | Labor Union Executive California Association of Highway Patrolmen |
| Mitchell E. Hornecker Portland, Oregon | Business Consultant Modoc Consulting |
| Barbara E. Kerr Riverside, California | Retired California Teachers Association |
| Leona S. Lindner Washington, D.C. | Chief Marketing Officer National Education Association's Member Benefits Corporation |
| Michael G. McPherson Silver Spring, Maryland | Chief Financial Officer National Education Association |
| Karen M. Padovese Fairfield, California | Chief Executive Officer GeoVera Holdings, Inc. |
| Edward G. Phoebus III Silver Spring, Maryland | President and Chief Executive Officer National Education Association Member Benefits Corporation |
| Heather S. Schafer Millersville, Maryland | Executive Director National Volunteer Fire Council |
| Thomas M. Tongue Portland, Oregon | Attorney Scheabe, Williamson, & Wyatt |
| Joseph L. Volponi San Mateo, California | President California Casualty Management Company |
| Suzanne M. Zimmer ^(A) Golden, Colorado | Assistant Executive Director Colorado Education Association |

The following changes in the Advisory Board occurred subsequent to the examination date:

- (A) Jonathan A. Brown and Suzanne M. Zimmer became emeritus members, effective June 25, 2018, and October 12, 2018, respectively. The Exchange is in the process recruiting replacements.
- (B) Effective January 1, 2018, Karen B. Kyhn has been appointed as a member of the Advisory Board, replacing Carolyn E. Doggett.

Principal Officers of Attorney-In-Fact

The principal officers of the attorney-in fact (CCMC) at December 31, 2017 were as follows:

| <u>Name</u> | <u>Position</u> |
|-------------------|--|
| Carl B. Brown | Chief Executive Officer and Chairman of the Advisory Board |
| Joseph L. Volponi | President |
| Michael A. Ray | Executive Vice President and Chief Financial Officer |
| James R. Inglese | Secretary |
| Michael D. Bower | Executive Vice President |

Intercompany Agreements

Underwriters Agreement: The Exchange is managed by California Casualty Management Company (CCMC) under an Underwriters Agreement (Agreement). Under the terms of the Agreement, CCMC is paid a monthly fee of up to 125% of expenses incurred on the services performed by CCMC on behalf of the Exchange. An annual incentive fee of up to 10% of the California Casualty Group's calendar year pre-tax income, calculated after giving effect to such incentive, may also be paid to CCMC. The Agreement was revised on October 6, 1993 and approved by the California Department of Insurance (CDI) on November 12, 1993. There was no incentive fee paid during the examination period. The total fees paid by the Exchange under this Agreement were: \$81,951,689 in 2014, \$85,190,679 in 2015, \$82,197,913 in 2016, and \$81,299,850 in 2017.

Tax Allocation Agreement: Effective January 1, 1992, the Exchange entered into a tax allocation agreement entitled “California Casualty Group Tax Allocation Agreement” (Tax Agreement) with its subsidiaries: California Casualty Insurance Company, California Casualty & Fire Insurance Company, California Casualty General Insurance Company of Oregon and California Casualty Compensation Insurance Company. On January 1, 1999, this Tax Agreement was restated as the “Tax Allocation Agreement California Casualty Indemnity Exchange and Subsidiaries” and was submitted to the CDI pursuant to California Insurance Code (CIC) Section 1215.5(b)(4) on March 26, 2008. The CDI did not disapprove the agreement as of March 24, 2009. The review and determination was made pursuant to CIC Section 1215.5(b) only. Under the terms of this restated Tax Agreement, the consolidated federal income tax liability of the Exchange and its subsidiaries is allocated to each company in proportion to each company’s share of taxable income, computed on a separate company basis. The Exchange is responsible for filing and making all tax payments on behalf of its subsidiaries.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Exchange is licensed to transact property and casualty insurance in all states except Michigan and New Jersey, as well as the District of Columbia. The Exchange’s business is focused on personal lines, which includes private passenger automobile and homeowners coverages. Effective January 1, 2017, workers’ compensation coverage for domestic workers is included under the homeowners multiple peril line of business.

Direct premiums written during 2017 totaled \$264.4 million. The majority of the business was written in California (66.4%), Colorado (6.2%), Pennsylvania (5.2%), and Maryland (2.4%), with the remaining 19.8% written in the other states and territories that the Exchange is licensed. The Exchange’s principal lines of business written during 2017 were private passenger auto liability (37.0%), auto physical damage (37.6%), and

homeowners multiple peril (24.6%). The remainder (less than 1%) was written in earthquake, inland marine, fire, and allied lines.

The Exchange has no employees. California Casualty Management Company (CCMC), the attorney-in-fact for the Exchange, has 670 employees, most of them perform services for the Exchange in accordance with the Underwriters Agreement. CCMC conducts operations from its home office in San Mateo, California. CCMC also has service centers at Colorado Springs, Colorado; Leawood, Kansas; and Glendale, Arizona. Those three service centers provide claims, corporate services, customer service, information technology, marketing, as well as sales and underwriting support. In addition, CCMC provides production and operating facilities pursuant to the provisions of the Underwriters Agreement.

The Exchange is a personal lines insurer that provides private passenger automobile and homeowners insurance to members of affinity groups involved in education, law enforcement, and public safety professions. Personal lines business is produced directly by CCMC's employees who are licensed insurance agents. The agents receive a salary and are eligible for varying levels of incentive compensation depending upon their position and their production.

REINSURANCE

Pooling

Effective January 1, 2011, a revised Intercompany Pooling Agreement (Agreement) was approved by the California Department of Insurance (CDI) on August 30, 2010 pursuant to California Insurance Code Section 1215.5(b)(3). This revised Agreement was amended to clarify that only the Exchange may purchase non-affiliate reinsurance contracts and each subsidiary's direct premiums and direct paid loss and loss adjustment expenses are ceded to the Exchange. Under the terms of this Agreement, each participating insurer cedes 100% of its direct and assumed business to the

Exchange. Personal lines of business are pooled separately from workers' compensation and miscellaneous commercial lines business, which are in run-off. Under this revised Agreement, personal lines business is retroceded to and assumed by California Casualty Insurance Company (CCIC), California Casualty & Fire Insurance Company (CCFIC) and California Casualty General Insurance Company of Oregon (CCGIC) according to their respective pooling percentages of 8%, 10%, and 12%. The Exchange retains 70% of the pooled personal lines business.

All workers' compensation and miscellaneous commercial lines direct and assumed business are retroceded 100% to California Casualty Compensation Insurance Company (CCCIC). California Casualty Group discontinued writing workers' compensation business in 1997, except for workers' compensation coverage for domestic workers under homeowners' policies, which are included in the personal lines of business described above.

Assumed

The Exchange is the only insurer in the pool that assumed business from non-affiliates. In 2017, the Exchange assumed an immaterial amount of premiums from Commercial Auto Insurance Procedure. The Exchange also had \$1.0 million assumed reserves in run-off from Lumberman's Mutual Casualty Company as of December 31, 2017.

Ceded

Effective January 1, 2000, CCIC, CCFIC, CCGIC, and the Exchange (Group) entered into a 15-year quota-share reinsurance agreement with Fireman's Fund Insurance Company (FFIC) covering the personal lines of business. Under the terms of this Agreement, for the first five years of the treaty, they ceded 20% of the personal lines written premiums and losses, and earned a ceding commission equal to 20% of the underwriting expenses. For the subsequent ten years of the treaty, the Group ceded 30% of the written premiums and losses and earned a ceding commission equal to 30%

of underwriting expenses. This Agreement was terminated, effective December 31, 2014.

The Exchange and its subsidiaries entered into reinsurance agreements with Munich Reinsurance America Inc. (Munich Re), primarily covering workers' compensation claims from 1935 through 2001. A Commutation and Release Agreement was entered on March 28, 2017 with Munich Re to release Munich Re from assumed risks and liabilities on workers' compensation business in exchange for \$22.0 million. In accordance with the Intercompany Pooling Agreement, all workers' compensation direct and assumed business are retroceded 100% to CCCIC. As a result, CCCIC's loss and loss expense reserves increased by \$21.2 million, assets increased by \$21.7 million, and income and surplus increased by \$0.5 million.

The following is a summary of principal reinsurance agreement in-force as of December 31, 2017:

| Type of Contract Property Catastrophe Excess of Loss | Reinsurer(s) and Participation | Company's Retention | Reinsurer's Limits |
|--|--|-----------------------------|--|
| 1 st Layer | <u>Authorized:</u> General Reinsurance Company (42.5%) Munich Re America (20%) Swiss Re America Corporation (7.5%) Renaissance Reinsurance LTD. (5.0%) Underwriters at Lloyd's, London (5.0%) <i>Note: The Exchange retained the remaining 20%.</i> | \$20 million per occurrence | \$20 million excess of \$20 million per occurrence, subject to \$40 million maximum annual limit |
| 2 nd Layer | <u>Authorized:</u> General Reinsurance Company (45.5%) Munich Re America (20%) Swiss Re America Corporation (7.5%) Renaissance Reinsurance LTD. (12.0%) Underwriters at Lloyd's, London (5.0%) <i>Note: The Exchange retained the remaining 10%.</i> | \$40 million per occurrence | \$35 million excess of \$40 million per occurrence, subject to \$70 million maximum annual limit |

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Exchange with the California Department of Insurance for the period ending December 31, 2017. The accompanying comments to the amounts reported in the financial 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, 2017

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

Reconciliation of Surplus as Regards Policyholders from December 31, 2013
through December 31, 2017

Statement of Financial Condition
as of December 31, 2017

| <u>Assets</u> | <u>Ledger and Nonledger Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|---|--|--------------------------------|--------------------------------|--------------|
| Bonds | \$ 212,350,668 | \$ | \$ 212,350,668 | |
| Common stocks | 177,762,088 | | 177,762,088 | |
| Cash, cash equivalents and short-term investments | 1,605,853 | | 1,605,853 | |
| Receivables for securities | 103,161 | | 103,161 | |
| Investment income due & accrued | 1,255,314 | | 1,255,314 | |
| Uncollected premiums and agents' balances in course of collection | 1,111,213 | 85,413 | 1,025,800 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 148,649,055 | | 148,649,055 | |
| Amount recoverable from reinsurers | 11,052,799 | | 11,052,799 | |
| Amount recoverable relating to uninsured plans | 291 | | 291 | |
| Current federal and foreign income tax recoverable and Interest thereon | 17,389 | | 17,389 | |
| Furniture and equipment, including health care delivery assets | 34,400 | 34,400 | | |
| Receivables from parent, subsidiaries and affiliates | 21,018,810 | | 21,018,810 | |
| Aggregate write-ins for other than invested assets | <u>1,524,027</u> | <u>482,352</u> | <u>1,041,675</u> | |
| Total assets | <u>\$ 576,485,068</u> | <u>\$ 602,165</u> | <u>\$ 575,882,903</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | | |
| Losses | | | \$ 89,448,535 | (1) |
| Reinsurance payable on paid losses and loss adjustment expenses | | | 7,018,107 | |
| Loss adjustment expenses | | | 23,763,046 | (1) |
| Other expenses (excluding taxes, licenses and fees) | | | 411,524 | |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | | | 1,111,631 | |
| Current federal and foreign income taxes | | | 48,083 | |
| Unearned premiums | | | 127,442,478 | |
| Advance premium | | | 1,142,871 | |
| Ceded reinsurance premiums payable | | | 51,684,970 | |
| Amounts withheld or retained by company for account of others | | | 3,770,728 | |
| Payable to parent, subsidiaries and affiliates | | | 25,934,272 | |
| Payable for securities | | | 1,994,225 | |
| Aggregate write-ins for liabilities | | | <u>523,558</u> | |
| Total liabilities | | | 334,294,057 | |
| Unassigned funds (surplus) | | <u>\$ 241,588,846</u> | | |
| Surplus as regards policyholders | | | <u>241,588,846</u> | |
| Total liabilities, surplus and other funds | | | <u>\$ 575,882,903</u> | |

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

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|-------------------|--------------------|
| Premiums earned | | \$ 246,604,009 |
| Deductions: | | |
| Losses incurred | \$ 180,338,156 | |
| Loss expenses incurred | 37,706,231 | |
| Other underwriting expenses incurred | <u>65,469,196</u> | |
| Total underwriting deductions | | <u>283,513,583</u> |
| Net underwriting loss | | (36,909,573) |

Investment Income

| | | |
|------------------------------|------------------|------------|
| Net investment income earned | \$ 6,094,141 | |
| Net realized capital gains | <u>4,733,514</u> | |
| Net investment gain | | 10,827,655 |

Other Income

| | | |
|---|------------------|------------------------|
| Net loss from agents' or premium balances charged off | \$ (707,123) | |
| Finance and service charges not included in premiums | <u>1,301,019</u> | |
| Total other income | | <u>593,896</u> |
| Net income before federal and foreign income taxes incurred | | (25,488,023) |
| Federal and foreign income taxes incurred | | <u>(2,693,289)</u> |
| Net income | | <u>\$ (22,794,733)</u> |

Capital and Surplus Account

| | | |
|---|------------------|-----------------------|
| Surplus as regards policyholders, December 31, 2016 | | \$ 273,027,912 |
| Net income | \$ (22,794,733) | |
| Change in net unrealized capital Losses | (9,281,957) | |
| Change in net deferred income tax | 755,709 | |
| Change in non-admitted assets | <u>(118,085)</u> | |
| Change in surplus as regards policyholders for the year | | <u>(31,439,066)</u> |
| Surplus as regards policyholders, December 31, 2017 | | <u>\$ 241,588,846</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2013 through December 31, 2017

| | | | |
|---|----------------------------|----------------------------|-----------------------|
| Surplus as regards policyholders, December 31, 2013, per Examination | | | \$ 336,456,315 |
| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> | |
| Net income | \$ | \$ 62,697,066 | |
| Change in net unrealized capital gains | | 31,080,887 | |
| Change in net deferred income tax | | 1,397,486 | |
| Change in non-admitted assets | <u>307,970</u> | | |
| Total gains and losses | <u>\$ 307,970</u> | <u>\$ 95,175,439</u> | |
| Net decrease in surplus as regards policyholders | | | <u>94,867,469</u> |
| Surplus as regards policyholders, December 31, 2017, per Examination | | | <u>\$ 241,588,846</u> |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Actuarial Report as of December 31, 2017 prepared by the Exchange's actuary and concurred with the actuary's conclusion that the Exchange's loss and loss adjustment expense reserves as of December 31, 2017 are reasonable and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

Effective May 24, 2018, the Exchange's attorney-in-fact, California Casualty Management Company (CCMC) sold the property located at 1650 Telstar Drive, Colorado Springs, CO, 80920 and leased it back from the buyer, Oak Street Real Estate Capital, for 12 years. The Exchange is a guarantor on the lease between CCMC (lessee) and Oak Street Real Estate Capital (lessor) for that property. If CCMC is unable to honor its future lease payments, the Exchange would be liable to pay these obligations. CCMC management believes there is no scenario that would trigger this event for the Exchange.

In November 2018, Camp and Woolsey fires had a major impact on California Casualty Group (Group). The Camp Fire is the deadliest and most destructive fire in California history. As of December 31, 2018, the Group reported a gross loss of \$41,868,000 and a net loss of \$20,018,000 from the Camp and Woolsey fires. Under the Intercompany Pooling Agreement, the Exchange retains 70% of the pooled personal lines business. As such, the Exchange's share of the net loss was \$14,012,600.

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 Exchange's officers and California Casualty Management Company's employees during the course of this examination.

Respectfully submitted,

Mei Gu, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

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