# REPORT OF EXAMINATION
# OF THE
# EXPLORER AMERICAN INSURANCE COMPANY
# AS OF
# DECEMBER 31, 2012

Filed June 20, 2014

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Los Angles, California
March 27, 2014

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

EXPLORER AMERICAN INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 11455 El Camino Real, San Diego, California 92130.

## SCOPE OF EXAMINATION

We have performed our examination of the Company. The previous examination of the Company was made as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2012. The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. 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 management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination was a coordinated examination and was conducted concurrently with the examinations of other insurance entities in the holding company group, including Insurance Company of the West (California), Explorer Insurance Company (California), and Independence Casualty and Surety Company (Texas). California served as the lead state.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; accounts and records; and statutory deposits.

## COMPANY HISTORY

On December 12, 2008, Explorer Holdings, Inc. purchased 100% of the common capital stock of Explorer American Insurance Company, formerly Westward Insurance Company, from Westward Life Insurance Company. Explorer Holdings, Inc. is a California holding company, wholly-owned by Western Insurance Holdings, Inc. (WIH). WIH is also the parent holding company of the Insurance Company of the West, and its pooled insurance subsidiaries, Explorer Insurance Company and Independence Casualty & Surety Company.

### Capitalization

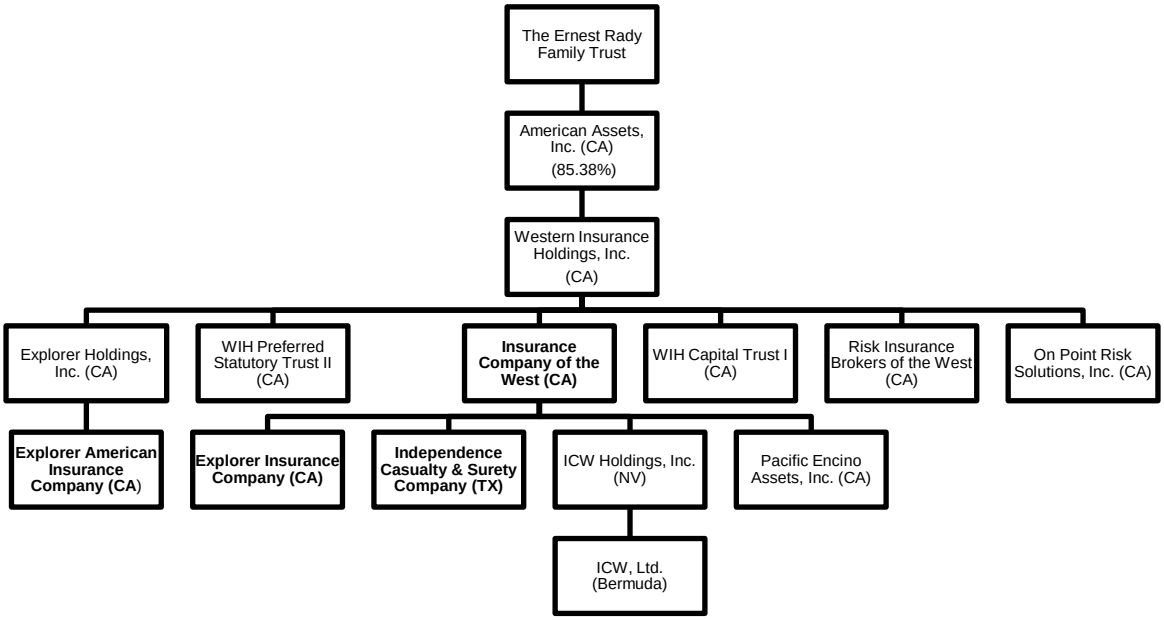
The Company is authorized to issue 50,000 shares of common capital stock with a par value of $50 per share. As of December 31, 2012, there were 20,000 shares outstanding.

Dividends Paid to Parent

In September 2008, the Company then named Westward Insurance Company paid, an extraordinary cash dividend to its parent, Westward Life Insurance Company, totaling $1,750,000. The California Department of Insurance approved this transaction on September 10, 2008.

## MANAGEMENT AND CONTROL

Ultimate control of the Company is maintained by Ernest S. Rady Family Trust. The following organizational chart depicts the Company's relationship within the holding company system (all ownership is 100%, unless otherwise noted):




*Remaining ownership of Western Insurance Holdings, Inc. is held by the Ernest S. Rady Family Trust (10.82%), Company Officers (2.1%), and Stock Purchase and Savings Plan (1.7%).

The four 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, 2012:

Directors

| Name and Location | Principal Business Affiliation |
|---|---|
| Bernard M. Feldman<br>Del Mar, California | Director<br>Explorer American Insurance Company |
| Kevin M. Prior<br>San Diego, California | President and Chief Executive Officer<br>Explorer American Insurance company |
| Ernest S. Rady<br>La Jolla, California | Chairman of Board<br>Explorer American Insurance Company |
| Fariborz Rostamian<br>Solana Beach, California | Vice President, Controller, and Treasurer<br>Insurance Company of the West |

Principal Officers

| Name | Title |
|---|---|
| Kevin M. Prior | President and Chief Executive Officer |
| Richard J. Manship | Senior Vice President |
| Fariborz Rostamian | Vice President, Controller, and Treasurer |
| Mary E. Cannon | Secretary |
| Sheryl M. Hadlen | Vice President |

Management Agreements

Tax Allocation Agreement: In accordance with a Tax Allocation Agreement executed on December 31, 1996, the Company and its affiliates have been filing their federal income taxes in a consolidated return with its ultimate parent, American Assets, Inc. Allocation of taxes is based upon separate return calculations with current credit for net losses. The Company paid the following taxes during the examination period:

| Year | Amount |
|---|---|
| 2008 | $ 8,999 |
| 2009 | $ 0 |
| 2010 | $ 20,610 |
| 2011 | $ 20,369 |
| 2012 | $ 21,739 |
| Total | $ 71,717 |

A review of the Tax Allocation Agreement noted that the agreement was not amended to include the Company as a party to the agreement. It is recommended that a formal amendment be executed to include the Company as a legal party to the Tax Allocation Agreement. Furthermore, it is recommended that the Company submit the agreement to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code Section (CICS) 1215.5(b)(4).

Investment Management Agreement: Effective January 1, 2007, Western Insurance Holdings, Inc. (WIHI) entered into an Investment Management Agreement with American Assets Investment Management, LLC. Under the terms of the agreement, WIHI appointed non-insurance affiliate American Assets Investment Management, LLC as its Investment Manager to provide investment advisory services for WIHI's investment portfolio, including its insurance subsidiaries. The services performed by American Investment Management, LLC are subject to the direction and control of the Company's board of directors and/or appointed investment committee. Investment management fees incurred were $1,506,000; $1,684,000; $1,962,000; and $1,831,000; for 2009; 2010; 2011; and 2012, respectively. All investment management fees were paid by WIHI to American Assets Investment Management, LLC under the terms of this agreement.

The Investment Management Agreement was not disclosed in the Company's Annual Holding Company Registration Statement and the CDI has no record of approval. It is recommended that the Company disclose this agreement in its Annual Holding Company Registration Statement Form B in accordance with CICS 1215.4(b), and

submit the agreement to the California Department of Insurance for approval in accordance with CICS 1215.5(b)(4).

## TERRITORY AND PLAN OF OPERATION

The Company is licensed in California to write automobile insurance. The Company was inactive during the examination period, and there are no open claim reserves. The Company is dormant and not seeking to write any new business, nor is it developing a marketing plan for the future.

## REINSURANCE

The Company had no reinsurance during the period under examination.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2012

Underwriting and Investment Exhibit for the Year Ended December 31, 2012

Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2012

## Statement of Financial Condition
## as of December 31, 2012

| Assets | Ledger and Nonledger Assets | | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 1,726,184 | | $ 1,726,184 | |
| Preferred stocks | 102,080 | | 102,080 | |
| Cash and short-term investments | 775,664 | | 775,664 | |
| Investment income due and accrued | 23,296 | | 23,296 | |
| Total assets | $ 2,627,224 | | $ 2,627,224 | |
| **Liabilities, Surplus and Other Funds** | | | | |
| Losses and loss adjustment expenses | | | $ 0 | (1) |
| Taxes, licenses and fees | | | 2,000 | |
| Current federal income taxes (including $0 on realized capital gains (losses)) | | | 43,507 | |
| Net deferred tax liability | | | 728 | |
| Payable to parent, subsidiaries and affiliates | | | 28,199 | |
| Total liabilities | | | 74,434 | |
| Common capital stock | | $ 1,000,000 | | |
| Gross paid-in and contributed surplus | | 1,200,000 | | |
| Unassigned funds (surplus) | | 352,790 | | |
| Surplus as regards policyholders | | | 2,552,790 | |
| Total liabilities, surplus and other funds | | | $ 2,627,224 | |

## Underwriting and Investment Exhibit
## for the Year Ended December 31, 2012

### Statement of Income

| | | |
|---|---|---|
| **Underwriting Income** | | |
| Premiums earned | | $ 0 |
| Deductions: | | |
| Losses and loss expenses incurred | $ 0 | |
| Other underwriting expenses incurred | 4,585 | |
| Total underwriting deductions | | 4,585 |
| Net underwriting loss | | (4,585) |
| **Investment Income** | | |
| Net investment income earned | $ 74,669 | |
| Net realized capital loss | (2,001) | |
| Net investment gain | | 72,668 |
| Net income after capital gains tax and before federal income taxes | | 68,083 |
| Federal and foreign income taxes incurred | | 26,728 |
| Net income | | $ 41,355 |

### Capital and Surplus Account

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31, 2009 | | $ 2,491,533 |
| Net income | $ 41,355 | |
| Change in net unrealized capital gains | 20,630 | |
| Change in nonadmitted assets | 6,492 | |
| Aggregate write-ins for losses in surplus | (7,220) | |
| Change in surplus as regards policyholders for the year | | 61,257 |
| Surplus as regards policyholders, December 31, 2012 | | $ 2,552,790 |

## Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2012

| | Gain in Surplus | Loss in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 2007 per Examination | | | $ 4,070,623 |
| Net income | $ 214,677 | $ | |
| Net unrealized capital gains | 18,330 | | |
| Change in net deferred income tax | | 5,119 | |
| Change in nonadmitted assets | 5,758 | | |
| Dividends to stockholders | | 1,750,000 | |
| Aggregate write-ins for gains and losses in surplus | | 1,479 | |
| Total gains and losses | $ 238,765 | $ 1,756,598 | |
| Net decrease in surplus as regards policyholders | | | (1,517,833) |
| Surplus as regards policyholders, December 31, 2012, per Examination | | | $ 2,552,790 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company was inactive during the examination period and did not report a reserve liability for loss and loss adjustment expenses.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management Agreement – Tax Allocation Agreement (Page 5): It is recommended that a formal amendment be executed to include the Company as a legal party to the Tax Allocation Agreement. Furthermore, it is recommended that the Company submit the agreement to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code Section (CICS) 1215.5(b)(4).

Management Agreements – Investment Management Agreement (Page 5): It is recommended that the Company report said agreement in its Annual Holding Company Registration Statement Form B in accordance with CICS 1215.4(b), and submit the agreement to the CDI for approval in accordance with CICS 1215.5(b)(4).

### Previous Report of Examination

Corporate Records (Page 4): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CICS 735. The Company has complied with this recommendation.

Bonds, Stocks and Investment (Page 9): It was recommended that the Company execute a custodial agreement with a qualified custodian and file the agreement with the CDI for approval. The Company has complied with this recommendation.

## ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and its parent's employees, during the course of this examination.

Respectfully submitted,

_____/S/_____
Joshua J. Johnson, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California