

REPORT OF EXAMINATION
OF THE
FIRST AMERICAN SPECIALTY
INSURANCE COMPANY
AS OF
DECEMBER 31, 2023

Insurance Commissioner

A handwritten signature in blue ink, appearing to be "Debra", is positioned to the right of the "Insurance Commissioner" text.

Filed on May 7, 2025

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Los Angeles, California
March 31, 2025

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

FIRST AMERICAN SPECIALTY INSURANCE COMPANY

(hereinafter also referred to as the Company). The Company's home office is located at 4 First American Way, Santa Ana, California 92707.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2019. This examination covered the period from January 1, 2020 through December 31, 2023.

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 Nebraska as the lead state of the First American Title Insurance Company of the First American Title Group. It was conducted concurrently with other insurance entities in the holding company group, including First American Title Insurance Company, First American Title Insurance Company of Louisiana, First American Property and Casualty Insurance Company, First American Specialty Insurance Company, First American Title Guaranty Company, and Ohio Bar Title Insurance Company. The following states participated on the examination: California, Louisiana, Ohio, and Texas.

COMPANY HISTORY

The Company was incorporated in California on August 1, 1986, and commenced business on May 18, 1987, as Five Star Insurance Company. On January 29, 2001, the Company changed its name to First American Specialty Insurance Company.

The Company is wholly-owned by First American Financial Corporation (FAFC), a publicly traded company listed on the New York Stock Exchange under the ticker symbol "FAF". FAFC, through its subsidiaries, is engaged in the business of providing financial services

through its title insurance and services segment and its specialty insurance segment.

Effective February 1, 2021, the Company stopped issuing new or renewal insurance policies and sold its entire book of business to Liberty Mutual Insurance Company and Heritage Insurance Holdings, Inc. The Company is now in run-off, focusing on managing existing and future claims arising from the previously covered policies.

Capitalization

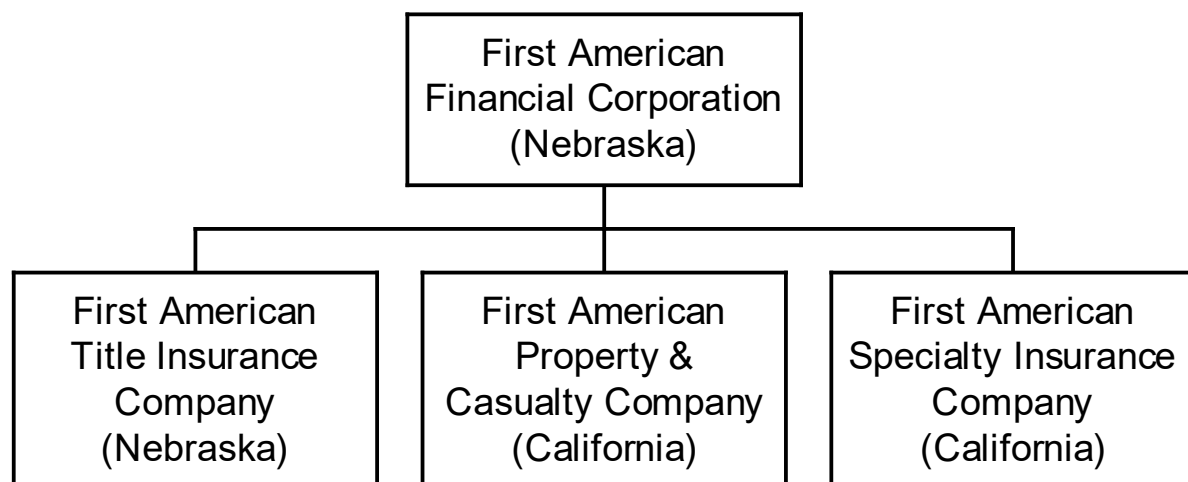
The Company is authorized to issue 1,000,000 shares of \$50 par value common stock, with 60,000 original shares issued and outstanding and wholly owned by FAFC.

Capital Contribution

On February 26, 2021, the Company received \$12,000,000 in cash capital contributions from FAFC.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of First American Financial Corporation, FAFC, a Nebraska corporation. The following abridged organizational chart depicts the Company's relationship within the holding company system. All ownership is 100%:



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2023, are as follows:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
William J. Aulbert Santa Ana, California	Senior Corporate Counsel and Assistant Secretary First American Financial Corporation
Lisa W. Comehl Santa Ana, California	Senior Vice President, Chief Legal Officer, and Secretary First American Financial Corporation
Mark Edward Seaton Santa Ana, California	Executive Vice President and Chief Financial Officer First American Financial Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Ramon R. Machado	President
William J. Aulbert	Vice President and Secretary
Matthew F. Wajner	Vice President, Chief Financial Officer, and Treasurer

Management Agreements

Affiliated Companies Service Agreement: Effective December 31, 2012, and amended subsequently, the Company and its affiliates entered into the Affiliated Companies Service Agreement with First American Title Insurance Company (FATICO), an affiliate. Under the terms of the agreement, FATICO provides the following services to its affiliates: accounting and auditing, title plant and policy production, information technology, and other functional support services. FATICO also makes available its facilities upon request,

including but not limited to data processing, equipment, and business property. Compensation for services and use of facilities is based on actual cost without a profit factor being built into that cost and allocated to affiliates to be paid within thirty (30) days after the end of each calendar quarter. The allocation is in accordance with a method in conformity with Statement of Statutory Accounting Principles (SSAP) No. 70 of the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The California Department of Insurance (CDI) approved the original agreement on December 17, 2012. The agreement was later amended in 2014 due to the re-domestication of FATICO from California to Nebraska, and the amendment was approved by the CDI on March 6, 2015.

Throughout the examination period, the agreement was amended multiple times, all approved by the Nebraska Department of Insurance, the domiciled state of FATICO. The revisions included updating the list of affiliations due to the purchase-and-sale of affiliates, revisions to comply with specific states' requirements, settlement and termination provisions, and certain safeguard provisions to meet California requirements. The CDI approved these amendments on October 4, 2022. Under the terms of the agreement, the Company paid FATICO \$2,917,941, \$1,293,386, \$2,809,131, and \$695,429 for the services provided in 2020, 2021, 2022, and 2023, respectively.

Federal Tax Sharing Agreement: Effective June 1, 2015, the Company entered into a Federal Tax Sharing Agreement with its parent, First American Financial Corporation (FAFC). Under the terms of this agreement, the tax liability of the Company will be computed as if it was to file a separate stand-alone return. Any additional tax payable or refund due will be settled within thirty (30) days after IRS notification of the proper amount. The CDI approved this agreement on May 21, 2015. The Company recovered federal income tax of \$5,048,203, \$4,056,366, \$5,048,203, and \$1,456,389 in 2020, 2021, 2022, and 2023, respectively.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact multiple lines of property and casualty insurance business in Arizona, California, Nevada, New York, Oregon, Utah, and Washington and writes surplus line in Florida. However, the Company stopped issuing new or renewing insurance policies, effective February 1, 2021.

Effective January 18, 2021, the Company and its affiliates, First American Property and Casualty Insurance Company (FAPC), entered into separate Marketing Services and Renewal Rights Agreements with Liberty Mutual Insurance Company (Liberty) and with Heritage Insurance Holdings Inc. (Heritage). Under the terms of the agreements, the Company and FAPC will promote and facilitate the underwriting and renewal of the in-force policies for Liberty and Heritage. The California Department of Insurance (CDI) approved the agreements on March 9, 2021. The Company and its affiliate, FAPC, received a total of \$8,091,691 under the agreement from Liberty. No compensation was received from Heritage. The renewal transferring process was completed by year-end 2022.

On March 4, 2021, the Company filed an application with the CDI to amend its Certificate of Authority to withdraw its license from the private passenger automobile line of business. The application was approved on June 16, 2021. As of December 31, 2023, there are 120 outstanding claims in Arizona, California, and Nevada with an aggregate of \$9.1M in loss and loss adjustment expenses reserves. The Company anticipates closing all claims by the third quarter of 2026.

LOSS EXPERIENCE

A review of the Company's loss experience during the examination period disclosed a continued trend of net underwriting losses and net losses as follows:

Year	Premium Earned	Loss and Loss Expenses Incurred	Net Underwriting Loss	Net Loss	Surplus
2020	\$41,127,133	\$40,124,087	\$ (20,557,348)	\$ (6,987,135)	\$ 28,846,569
2021	33,409,515	35,098,391	(14,527,829)	(8,477,239)	21,259,532
2022	3,038,957	13,469,827	(13,738,302)	(7,106,025)	11,281,768
2023	112	1,740,325	(3,214,479)	(1,295,416)	10,472,895
2024	0	76,494	3,073,162	3,072,758	14,512,193

* Subsequent to the examination date

The Company experienced underwriting and net loss for all years under examination. The losses are anticipated due to the discontinuation of issuing new and nonrenewal insurance policies since 2021 and the continuation of the incurred loss payments on insurance policies written prior to February 1, 2021. However, it is also anticipated that the losses will decrease year over year, and the Company will run off the current reported claims by 2026.

REINSURANCE

Assumed

The Company does not assume reinsurance.

Ceded

The Company's principal ceded reinsurance treaties were terminated on May 31, 2022. As of December 31, 2023, the Company does not have any ceding reinsurance agreements.

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, 2023. 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, 2023

Underwriting and Investment Exhibit for the Year Ended December 31, 2023

Reconciliation of Surplus as Regards Policyholders from December 31, 2019
through December 31, 2023

Statement of Financial Condition
as of December 31, 2023

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 10,325,671	\$	\$ 10,325,671	
Cash and short-term investments	19,146,451		19,146,451	
Investment income due and accrued	33,413		33,413	
Current federal and foreign income tax recoverable and Interest thereon	1,007,287		1,007,287	
Net deferred tax asset	207,322	207,322	0	
Receivable from parent, subsidiaries and affiliates	776	776	0	
Aggregate write-ins for other than invested assets	<u>204,088</u>	<u>204,088</u>	<u>0</u>	
Total assets	<u>\$ 30,925,008</u>	<u>\$ 412,186</u>	<u>\$ 30,512,822</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 14,557,523	(1)
Other expenses			423,722	
Taxes, licenses and fees (excluding federal and foreign income taxes)			2,964	
Funds held by company under reinsurance treaties			3,970,601	
Payable to parent, subsidiaries and affiliates			<u>1,085,116</u>	
Total liabilities			20,039,926	
Common capital stock		\$ 3,000,000		
Gross paid-in and contributed surplus		29,345,000		
Unassigned funds (surplus)		<u>(21,872,104)</u>		
Surplus as regards policyholders			<u>10,472,896</u>	
Total liabilities, surplus and other funds			<u>\$ 30,512,822</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2023

Statement of Income

Underwriting Income

Premiums earned		\$ 112
Deductions:		
Losses and loss expenses incurred	\$ 1,740,327	
Other underwriting expenses incurred	<u>1,474,263</u>	
Total underwriting deductions		<u>3,214,590</u>
Net underwriting loss		(3,214,478)

Investment Income

Net investment income earned	\$ 848,060	
Net realized capital gain	<u>92,779</u>	
Net investment gain		940,839

Other Income

Net loss before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		<u>(2,273,639)</u>
Net loss after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(2,273,639)
Federal and foreign income taxes incurred		<u>(978,223)</u>
Net loss		<u>\$ (1,295,416)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2022		\$ 11,281,765
Net loss	\$ (1,295,416)	
Change in net deferred income tax	(18,261)	
Change in nonadmitted assets	(160,575)	
Aggregate write-ins for losses in surplus	<u>665,383</u>	
Change in surplus as regards policyholders for the year		<u>(808,869)</u>
Surplus as regards policyholders, December 31, 2023		<u>\$ 10,472,896</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2019 through December 31, 2023

Surplus as regards policyholders, December 31, 2019			\$ 30,041,348
	Gain in Surplus	Loss in Surplus	
Net loss	\$	\$ 23,865,814	
Net unrealized capital gains	1,040,498		
Change in net deferred income tax		2,947,059	
Change in nonadmitted assets	33,479,249		
Surplus adjustments: paid-in	12,000,000		
Aggregate write-ins for losses in surplus		<u>39,275,326</u>	
Total gains and losses	<u>\$ 46,519,747</u>	<u>\$ 66,088,199</u>	
Net decrease in surplus as regards policyholders			<u>(19,568,452)</u>
Surplus as regards policyholders, December 31, 2023			<u>\$ 10,472,896</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The California Department of Insurance actuary evaluated the Company's losses and loss adjustment expense reserves as of December 31, 2023, and concluded that they are reasonable and have been accepted for purposes of this examination.

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,

Shu Young, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Thomas Podsiadlo, CFE
Exam Supervisor
Department of Insurance
State of California