

REPORT OF EXAMINATION
OF THE
HERITAGE INDEMNITY COMPANY
AS OF
DECEMBER 31, 2021

Insurance Commissioner

A handwritten signature in blue ink, appearing to read "P. DeLo" or similar, written over a light blue rectangular background.

Filed on June 23, 2023

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Los Angeles, California
May 25, 2023

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HERITAGE INDEMNITY COMPANY

(hereinafter also referred to as the Company). The Company's statutory home office and main administrative office is 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, 2017. This examination covered the period from January 1, 2018 through December 31, 2021.

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 of the AmTrust Financial Services, Inc. group with Delaware as the lead state. It was conducted concurrently with other insurance entities in the holding company group, including California affiliates Developers Surety and Indemnity Company and Sequoia Insurance Company. The following states also participated in the examination: Arizona, Florida, New York, Oklahoma, Pennsylvania, and Texas.

COMPANY HISTORY

Effective September 25, 2015, the Company became a wholly-owned subsidiary of AmTrust Financial Services, Inc. (AFSI) upon the completion of the sale by its former parent company, WDS Holdings, Inc., and former ultimate parent company, Wells Fargo & Company. AFSI is a multinational property and casualty insurer.

The Form A application in connection to the privatization of AFSI by Evergreen Parent GP, LLC was approved by the California Department of Insurance (CDI) on November 27, 2018 and the transaction was completed on November 29, 2018. The approval included a provision restricting the Company from paying dividends without prior approval from the CDI until November 29, 2023.

Effective December 31, 2019, the Company became a wholly-owned subsidiary of Developers Surety and Indemnity Company upon the completion of the transfer of

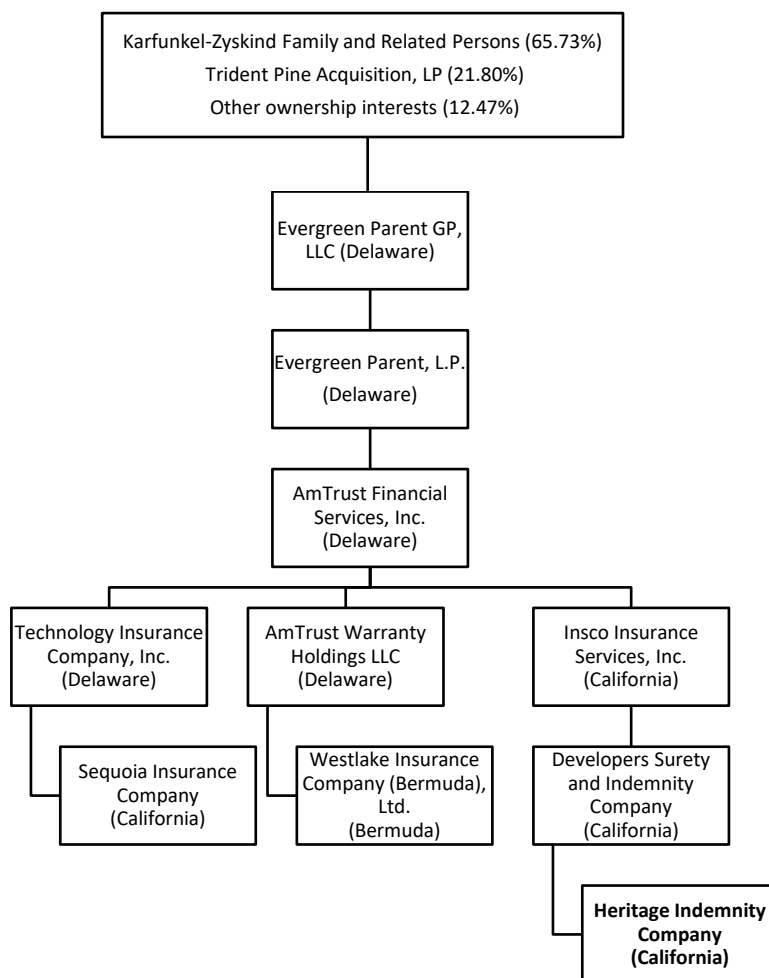
ownership of all issued and outstanding shares of the Company by AmTrust Financial Services, Inc.

Capitalization

The Company has 100,000 shares of class A, \$120 par value common stock authorized, and 25,000 shares issued and outstanding

MANAGEMENT AND CONTROL

The Company is a member of the AmTrust Financial Services, Inc. (AFSI) insurance holding company system of which the ultimate controlling entity is Evergreen Parent GP, LLC. The following is an abridged organizational chart. All ownership is 100%.



The three 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, 2021:

Directors

Name and Location

Principal Business Affiliation

Susan C. Fisch
San Francisco, California

Retired Insurance Executive

Name and Location

Principal Business Affiliation

Evan M. Greenstein
Jericho, New York

Senior Vice President, Commercial Lines
AmTrust Financial Services, Inc.

Stephen B. Ungar
North Hills, New York

Executive Vice President and General
Counsel
AmTrust Financial Services, Inc.

Principal Officers

Name

Title

Christopher H. Foy
Harry Schlachter *
Stephen B. Ungar
Jeffrey H. Mayer
Barry W. Moses

President
Treasurer
Secretary
Chief Actuary
Vice President, Senior Regulatory
Counsel, and Assistant Secretary

* Harry Schlachter resigned, effective February 1, 2022, and was replaced by Ellen Dion.

Management Agreements

Intercompany Management Agreement: Effective September 25, 2015, the Company entered into an Intercompany Management Agreement with AFSI. Under the terms of the agreement, AFSI provides 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 California Department of Insurance (CDI) approved the agreement on April 16, 2016. For the years of exam 2018 through 2021, the Company did not pay service fees. As part of the Reinsurance Pooling Agreement, Technology Insurance Company assumed and settled all cost-incurred expenses.

Tax Allocation Agreement: Effective September 25, 2015, 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 CDI approved the agreement on December 31, 2015. The Company paid/(received) tax settlements of \$(3,240,327), \$(6,187), \$(229,158), and \$(229,158) for 2018, 2019, 2020, and 2021, respectively.

TERRITORY AND PLAN OF OPERATION

The Company primarily insures vehicle service contracts administered and marketed by affiliated companies through automobile dealers and original equipment manufacturers throughout the United States. As of December 31, 2021, the Company was licensed in all 50 states and the District of Columbia. In 2021, the Company wrote \$63.76 million of direct premiums. The top five states by premiums are listed below:

<u>State</u>	<u>Amount</u>	<u>Percentage</u>
California	\$8.98 million	14.08%
Georgia	\$6.54 million	10.26%
North Carolina	\$4.75 million	7.45%
Florida	\$3.75 million	5.88%
Texas	\$3.66 million	5.74%

REINSURANCE

Reinsurance Pooling Agreement

Effective October 1, 2017, the Company entered into a Reinsurance Pooling Agreement (Pooling Agreement) with sixteen of its U.S. property and casualty insurance affiliates. Under the Pooling Agreement, the Company cedes to Technology Insurance Company, Inc. (TIC), and TIC assumes: (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.

During 2021, the Company ceded \$30,118,589 in premiums to TIC, or approximately 47.24% of the Company's direct business of \$63,759,829. The Company does not retain a share of the profits and/or losses of the pooled business. The agreement was approved by the California Department of Insurance (CDI) on December 15, 2017. Amendment No. 1 to the pooling agreement was approved by the California Department of Insurance on July 30, 2021. Effective January 1, 2021, pursuant to Amendment No. 1, the pooled business allocated among the pool participants are as follows:

<u>Pool Participants</u>	<u>State of Domicile</u>	<u>Pooling Share</u>
Technology Insurance Company, Inc.	DE	58.0%
Wesco Insurance Company	DE	22.0%
Security National Insurance Company	DE	12.0%
Developers Surety and Indemnity Company	CA	<u>8.0%</u>
Total		<u>100.0%</u>

Assumed

The Company assumes an insignificant amount of business, only \$1,933, as compared to its direct writings of \$63,756,896. The assumed business is from Aria (Sac), Ltd., a Bermuda based insurance company.

Ceded

Other than the aforementioned Pooling Agreement, the Company is also a party to a 100% quota-share Service Contract Liability Reinsurance Contract, effective March 1, 1984, and subsequently amended on October 25, 2004, with its affiliate, Westlake Insurance Company (Bermuda), Ltd. (Westlake). Per the agreement, ceding commission was amended from 10% to 0% for service contract liability insurance policies written on or after January 1, 2004. During 2021, the Company ceded \$33,641,307 in premiums to Westlake, or approximately 52.76% of the Company's direct business of \$63,759,829. The agreement was approved by the CDI on June 18, 1996, in accordance with California Insurance Code Section 1215.5(c).

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, 2021. The accompanying comments on financial statements to the amounts reported in the annual statements and should be considered an integral part of the financial statements.

Statement of Financial Condition as of December 31, 2021

Underwriting and Investment Exhibit for the Year Ended December 31, 2021

Reconciliation of Surplus as Regards Policyholders from December 31, 2017
through December 31, 2021

Statement of Financial Condition
as of December 31, 2021

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 20,524,605	\$	\$ 20,524,605	
Cash, cash equivalents, and short-term investments	876,792		876,792	
Investment income due and accrued	70,024		70,024	
Current federal and foreign income tax recoverable and interest thereon	39,997		39,997	
Net deferred tax asset	<u>135,629</u>		<u>135,629</u>	
Total assets	<u>\$ 21,647,047</u>	<u>\$</u>	<u>\$ 21,647,047</u>	
 <u>Liabilities, Surplus and Other Funds</u>				<u>Notes</u>
Losses			\$ 0	(1)
Loss adjustment expenses			0	(1)
Ceded reinsurance premiums payable			698,933	
Payable to parent, subsidiaries and affiliates			<u>1,096,715</u>	
Total liabilities			1,795,648	
Common capital stock		\$ 3,000,000		
Gross paid in and contributed surplus		25,784,907		
Unassigned funds (surplus)		<u>(8,933,508)</u>		
Surplus as regards policyholders			<u>19,851,399</u>	
Total liabilities, surplus, and other funds			<u>\$ 21,647,047</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2021

State of Income

Underwriting Income

Premium earned	\$	0
Deductions:		
Other underwriting expenses incurred	1,021	
Total underwriting deductions		(1,021)
Net underwriting loss		(1,021)

Investment Income

Net investment loss	\$ (433,003)	
Net realized capital gain	8,892	
Net investment loss		(424,111)

Other Income

Total other income		0
Net loss before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		(425,132)
Net loss after dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		(425,132)
Federal and foreign income taxes incurred		(265,266)
Net loss		\$ (159,866)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2020		\$ 20,184,142
Net loss	\$ (159,866)	
Change in net deferred income tax	(172,877)	
Change in surplus as regards policyholders for the year		(332,743)
Surplus as regards policyholders, December 31, 2021		\$ 19,851,399

Reconciliation of Surplus as Regards to Policyholders
from December 31, 2017 through December 31, 2021

Surplus as regards policyholders, December 31, 2017			\$ 17,655,823
	Gain in Surplus	Loss in Surplus	
Net income	\$ 2,514,107	\$	
Change in net deferred income tax		864,997	
Change in nonadmitted assets	<u>546,466</u>	<u></u>	
Total gains and losses	\$ 3,060,573	\$ 864,997	
Net increase in surplus as regards policyholders			<u>2,195,576</u>
Surplus as regards policyholders, December 31, 2021			<u>\$ 19,851,399</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 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, 2021 reserves for losses and loss adjustment expenses were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Management and Control – Related Party Transactions (Page 6): A review of the Company's related party transactions disclosed various activities, such as premiums collection and claims handling services, were undertaken between the Company and its affiliate, Warranty Solutions Management Corporation (WSMC), without any documented agreements. It was recommended the Company enter into an agreement with WSMC. The Company complied with the recommendation.

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,

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

Ralph Oseguera, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California