

REPORT OF EXAMINATION
OF THE
HOMESITE INSURANCE COMPANY OF CALIFORNIA
AS OF
DECEMBER 31, 2021

Insurance Commissioner

A handwritten signature in blue ink, appearing to read "De la", is positioned to the right of the "Insurance Commissioner" text.

Filed on June 8, 2023

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Los Angeles, California
May 24, 2023

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HOMESITE INSURANCE COMPANY OF CALIFORNIA

(hereinafter also referred to as the Company). The Company's statutory home office is located at 2710 Gateway Oaks Drive, Suite 150N, Sacramento, California 95833. The Company's main administrative office is located at One Federal Street, Suite 400, Boston, Massachusetts 02110.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2016. This examination covered the period from January 1, 2017 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 with Wisconsin as the lead state of the American Family Insurance Group. It was conducted concurrently with other insurance entities in the holding company group. The following states participated on the examination: California, Florida, Georgia, Illinois, Indiana, Minnesota, New York, and Texas.

COMPANY HISTORY

Effective January 1, 2017, the Company is wholly-owned by Homesite Underwriting Managers LLC (Homesite Underwriting), which in turn is wholly-owned by Homesite Group Incorporated (HGI). HGI and its affiliated companies are ultimately owned by American Family Insurance Mutual Holding Company, a Wisconsin mutual holding company.

Capitalization

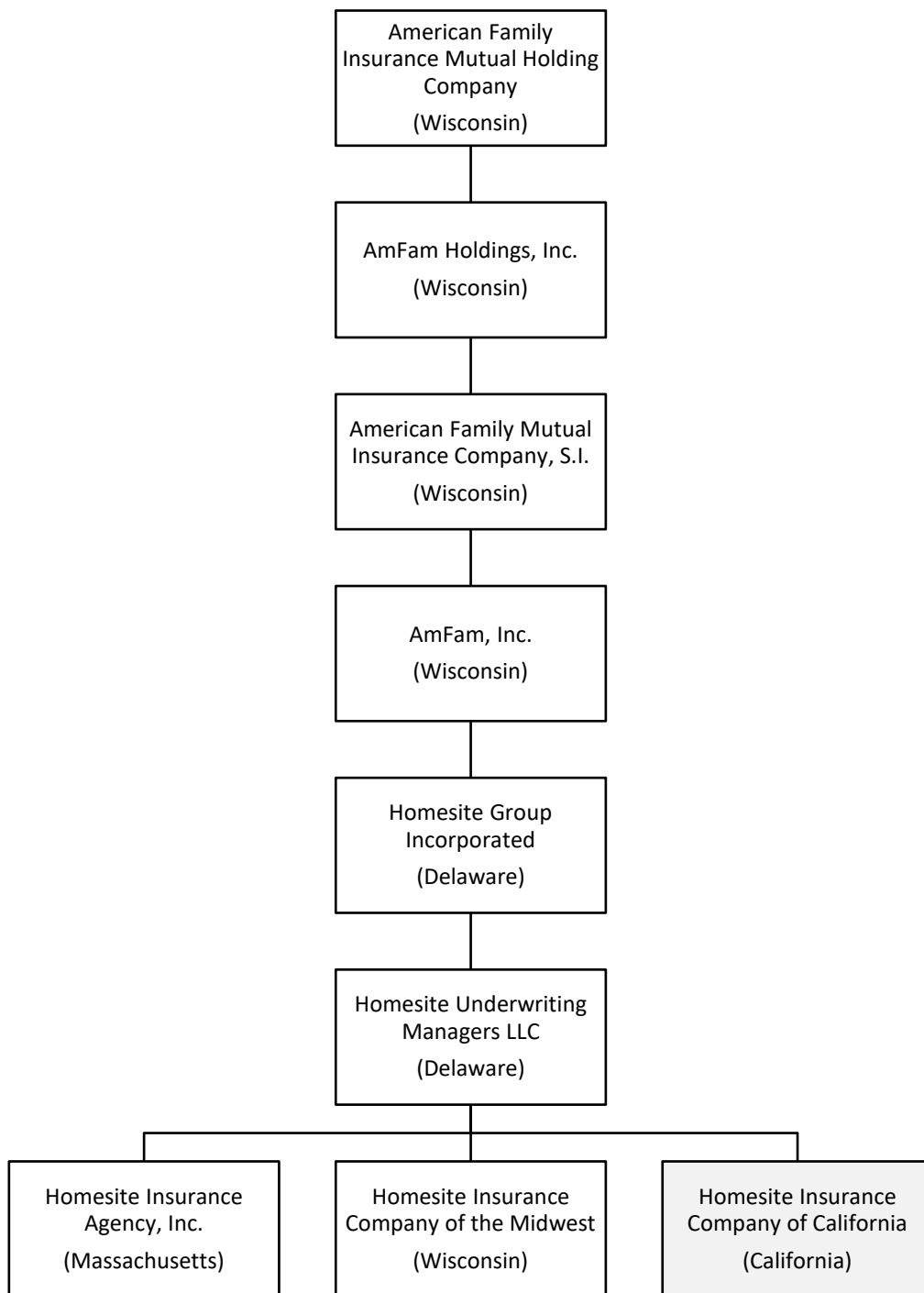
As of December 31, 2021, the Company has 200,000 shares of \$50 par value common stock authorized and 52,000 shares issued and outstanding.

Dividends

On January 8, 2021, the California Department of Insurance approved the Company's request for an extraordinary cash dividend of \$24,688,560 to its sole shareholder Homesite Underwriting.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which American Family Insurance Mutual Holding Company is the ultimate controlling entity. The following is an abridged organizational chart of the entities within the holding company system at December 31, 2021 (all ownership is 100% unless otherwise indicated):



The six 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

| <u>Name and Location</u> | <u>Principal Business Affiliation</u> |
|---|--|
| Susan G. Anderson Quincy, Massachusetts | General Counsel Homesite Group Incorporated |
| Fabian J. Fondriest Concord, Massachusetts | Chief Executive Officer Homesite Group Incorporated |
| Andrew A. McElwee, Jr. New London, New Hampshire | Executive Vice President and Chief Operating Officer Homesite Group Incorporated |
| James T. Morahan, Jr. Foxboro, Massachusetts | Vice President Homesite Group Incorporated |
| Anthony M. Scavongelli Duxbury, Massachusetts | Executive Vice President and General Counsel Homesite Group Incorporated |
| Troy P. Van Beek Waunakee, Wisconsin | President and Chief Financial Officer Homesite Group Incorporated |

Principal Officers

| <u>Name</u> | <u>Title</u> |
|------------------------------------|--|
| Fabian J. Fondriest ^(a) | Chief Executive Officer |
| Troy P. Van Beek ^(b) | President and Chief Financial Officer |
| Anthony M. Scavongelli | Executive Vice President, Chief Legal Officer, and Secretary |
| Susan G. Anderson | Senior Vice President, General Counsel, and Assistant Secretary |
| David M. Pfahler, Jr. | Senior Vice President |
| Benjamin P. Wright | Senior Vice President |
| James T. Morahan, Jr. | Vice President |
| Mary A. Theilen | Assistant Treasurer |

The following changes in management occurred subsequent to the examination date:

- (a) Fabian J. Fondriest, Chief Executive Officer, resigned, effective January 8, 2022. The Chief Executive Officer position was not filled during the next annual appointment of officers, effective March 31, 2022.
- (b) Michael D. Lorion was appointed to the office of President, effective March 31, 2022. Mr. Van Beek continues in the office of Chief Financial Officer.

Management Agreements

Intercompany Service Agreement: On November 3, 1999, the Company entered into an Intercompany Service Agreement with Homesite Group, Inc. (HGI) for the leasing of employees and facilities to the Company. Under the terms of the agreement, the Company reimburses HGI for salaries, administrative services, and facilities based on the actual costs of these services. The agreement was amended, effective April 1, 2014, in order to add American Family Mutual Insurance Company, S.I. (AFMICS I) to provide investment services. On April 10, 2014, the amendment was approved by the California Department of Insurance (CDI). The agreement, including the amendment, was terminated effective October 1, 2022. The amounts paid by the Company for 2017, 2018, 2019, 2020, and 2021 were \$17,312,372, \$17,569,478, \$17,947,903, \$17,348,730, and \$18,529,768, respectively.

Second Amended and Restated Intercompany Services and Cost Allocation Agreement: The Company entered into the Second Amended and Restated Intercompany Services and Cost Allocation Agreement with AFMICS I and its affiliates, via a Joinder Agreement, effective October 1, 2022. This agreement replaced the previously terminated Intercompany Service Agreement. These agreements streamline and make uniform the terms and conditions governing the management and provision of administrative services across all affiliated entities within the American Family Insurance Group. Under the terms of the agreements, AFMICS I provides goods, third-party services, and/or management services to the Company. Allocation of the services provided is on an actual cost and is to be settled on a net basis within forty-five days following the end of each quarter. On January 4, 2023, the Joinder Agreement was approved by the CDI pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Amended and Restated Consolidated Federal Income Tax Liability Allocation Agreement: Effective January 1, 2013, the Company and its affiliates are parties to an Amended and Restated Consolidated Federal Income Tax Liability Allocation Agreement with HGI. The tax allocation is based on separate return calculations. Intercompany tax balances are settled within thirty days after the filing of the consolidated income tax return by HGI. On February 3, 2015, Amendment No. 1 to the Amended and Restated Consolidated Federal Income Tax Liability Allocation Agreement to add Homesite General Agent, LLC to the agreement was approved by the CDI, with an effective date of December 31, 2014. The federal income tax paid/(recovered) by the Company for 2017, 2018, 2019, 2020, and 2021 were \$205,654, (\$21,375), \$256,909, \$302,006, and \$216,597, respectively.

Subsequently, the Company sought approval of a proposed amendment to the agreement to add a provision that allows for the settlement of intercompany accounts through interim cash settlements on a net basis through offsetting of the balances due among the various entities and agreements within the group. On January 5, 2023, the amendment was approved by the CDI pursuant to CIC Section 1215.5(b)(4), with an effective date of January 1, 2023. As of the date of this report, the amendment has not yet been finalized and is pending approval by the regulators of other insurance entities in the holding company group.

Agency Agreement: On January 1, 2017, the Company entered into an Agency Agreement with Homesite Insurance Agency, Inc. (HIA) to solicit potential customers and sell homeowners' insurance products on behalf of the Company. Under the terms of the agreement, the Company compensates HIA for its expenses and services provided based on actual cost. The agreement was approved by the CDI on January 9, 2017. Effective October 1, 2022, Amendment No. 1 provides for the settlement of accounts as frequently as mutually agreed by the parties, but no less frequently than quarterly, and for the settlement of intercompany accounts through interim cash settlements on a net basis through the offsetting of balances due among the various entities and agreements within the organization. On January 4, 2023, the amendment was approved by the CDI pursuant

to CIC Section 1215.5(b)(4). The Company did not incur any fees or make any payments pursuant to the Agency Agreement during the examination period.

TERRITORY AND PLAN OF OPERATION

At December 31, 2021, the Company is licensed to transact property and casualty insurance business in California and Massachusetts. Direct premiums written during 2021 totaled \$113 million with majority of the business written in California (99.9%), of which 96.1% was homeowners' multiple peril, 1.5% allied lines, and 2.4% earthquake. The Company's products are largely distributed through its program administrator, using exclusive and independent retail agents.

REINSURANCE

Assumed

The Company has no assumed reinsurance during the examination period.

Ceded

Loss Portfolio Transfer and 100% Quota Share Reinsurance Agreement: Effective January 1, 2014, the Company and other affiliates are parties to a Loss Portfolio Transfer and 100% Quota Share Agreement, where all of their business is ceded to Homesite Insurance Company of the Midwest (HMW). HMW then cedes all of its business to American Family Mutual Insurance Company, S.I. (AFMICSI). This agreement was approved by the California Department of Insurance (CDI) on September 5, 2014.

Subsequently, the agreement was amended to allow the settlement of accounts as frequently as mutually agreed by the parties, but no less frequently than quarterly, and for the settlement of intercompany accounts through interim cash settlements on a net basis through offsetting of the balances due among the various entities and agreements

within the group. On January 4, 2023, the amendment was approved by the CDI pursuant to California Insurance Code Section 1215.5(b)(3), with an effective date of October 1, 2022.

National Flood Insurance Program

The Company writes flood business through the National Flood Insurance Program (NFIP) as part of the Write Your Own (WYO) flood insurance program. The NFIP was established pursuant to the National Flood Insurance Act of 1968 and is administered by the Federal Insurance Administration of the Federal Emergency Management Agency (FEMA). The NFIP is designed to involve private insurers in a WYO flood insurance program financially backed by FEMA at no risk to the insurer.

ACCOUNTS AND RECORDS

Notes to Financial Statements

Pursuant to the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, Notes to Financial Statements, 14D, Claims Related Extra Contractual Obligation and Bad Faith Losses Stemming from Lawsuits, the Company shall disclose the dollar amount paid for claims related extra contractual obligations losses and bad faith losses stemming from lawsuits, in the current reporting period on a direct basis.

The Company's 2018 to 2020 Annual Statement Notes to Financial Statements 14D were not prepared in accordance with the NAIC's Annual Statement Instructions and did not disclose the potential risk and/or uncertainties related to lawsuits in the manner or format required by the NAIC Annual Statement Instructions.

It is recommended that the Company implement procedures to ensure compliance with the NAIC Annual Statement Instructions and disclose the information accurately in the proper format in the Notes to Financial Statements.

Premium Tax Returns

California Code of Regulations (CCR) § 2327 provides guidance on the reporting and filing of premium taxes. An insurer may file its return for premium taxes on either a cash basis or accrual basis so long as the amount of taxes paid is equivalent to or greater than the amount of taxes that would be due for premium received by the insurer. The accounting methods used for premium tax calculation are (1) accrual basis: based upon direct premiums written, as identified on Schedule T of the insurer's Annual Statement, that are written by the insurer during a given tax year; or (2) cash basis: based upon premiums that are received and collected by the insurer during a given tax year, less any premiums returned during the same tax year.

The Company's premium tax returns during the years under the examination period used the direct premium written reported on Schedule T of the tax year annual statement as the basis for their premium tax calculation, subtracting premiums determined to be uncollectible from the insured. Uncollected premiums are not allowable deductions for insurers calculating taxable premiums under the accrual basis, using direct premiums written from Schedule T each tax year. The total uncollected premiums deducted from the 2017 to 2021 premium tax filings were \$1,852,170. In addition, the Company's 2018 premium tax return did not include finance and service charges not included in premiums in the amount of \$1,938,066, reported on Schedule T. The aggregate understatement of premium taxes for the period of January 1, 2017, through December 31, 2021, is \$89,071. This understatement amount is considered immaterial and does not impact the Company's financial condition. No adjustment to surplus as regards policyholders is deemed necessary.

It is recommended that the Company follow the guidance of the CCR § 2327 and determine the selection of the accounting method when filing future California premium tax returns and amend past premium tax filings to reflect the correct accounting method with the California Department of Insurance.

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 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, 2021

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

Reconciliation of Surplus as Regards Policyholders from December 31, 2016
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 | \$ 7,097,582 | \$ | \$ 7,097,582 | |
| Cash, cash equivalents and short-term investments | 1,480,234 | | 1,480,234 | |
| Investment income due and accrued | 8,594 | | 8,594 | |
| Uncollected premiums and agents' balances in the course of collection | 2,782,735 | | 2,782,735 | |
| Deferred premiums and agents' balances and Installments booked but deferred and not yet due | 10,106,652 | | 10,106,652 | |
| Amount recoverable from reinsurers | 8,571,455 | | 8,571,455 | |
| Current federal and foreign income tax recoverable and interest thereon | 4,691 | | 4,691 | |
| Net deferred tax asset | <u>5,499</u> | | <u>5,499</u> | |
| Total assets | <u>\$ 30,057,442</u> | <u>\$</u> | <u>\$ 30,057,442</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | | |
| Losses and loss adjustment expenses | | | \$ 0 | (1) |
| Commissions payable, contingent commissions and other similar charges | | | 1,758,551 | |
| Other expenses | | | 239,911 | |
| Taxes, licenses and fees | | | 498,027 | |
| Advance premiums | | | 3,659,036 | |
| Ceded reinsurance premiums payable | | | 7,371,348 | |
| Payable to parent, subsidiaries and affiliates | | | <u>894,086</u> | |
| Total liabilities | | | 14,420,959 | |
| Common capital stock | \$ 2,600,000 | | | |
| Gross paid-in and contributed surplus | 26,850,001 | | | |
| Unassigned funds (surplus) | <u>(13,813,518)</u> | | | |
| Surplus as regards policyholders | | | <u>15,636,483</u> | |
| Total liabilities, surplus and other funds | | | <u>\$ 30,057,442</u> | |

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

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|-----------------|-----------------|
| Premiums earned | | \$ 0 |
| Deductions: | | |
| Losses and loss expenses incurred | \$ 0 | |
| Other underwriting expenses incurred | <u>(69,402)</u> | |
| Total underwriting deductions | | <u>(69,402)</u> |
| Net underwriting gain | | 69,402 |

Investment Income

| | | |
|------------------------------|----------------|---------|
| Net investment income earned | \$ 2,991 | |
| Net realized capital gains | <u>659,062</u> | |
| Net investment gain | | 662,053 |

Other Income

| | | |
|---|-----------------|-------------------|
| Aggregate write-ins for miscellaneous income | \$ <u>(173)</u> | |
| Total other income | | <u>(173)</u> |
| Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes | | 731,282 |
| Federal and foreign income taxes incurred | | <u>28,152</u> |
| Net income | | <u>\$ 703,130</u> |

Capital and Surplus Account

| | | |
|---|---------------------|----------------------|
| Surplus as regards policyholders, December 31, 2020 | | \$ 39,612,690 |
| Net income | \$ 703,130 | |
| Change in net deferred income tax | 9,223 | |
| Dividends to stockholders | <u>(24,688,560)</u> | |
| Change in surplus as regards policyholders for the year | | <u>(23,976,207)</u> |
| Surplus as regards policyholders, December 31, 2021 | | <u>\$ 15,636,483</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2016 through December 31, 2021

| | | | |
|--|----------------------------|----------------------------|----------------------|
| Surplus as regards policyholders, December 31, 2016 | | | \$ 37,047,732 |
| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> | |
| Net income | \$ 3,253,611 | \$ | |
| Change in net deferred income tax | 23,702 | | |
| Dividends to stockholders | | <u>24,688,560</u> | |
| Total gains and losses | <u>\$ 3,277,312</u> | <u>\$ 24,688,560</u> | |
| Net decrease in surplus as regards policyholders | | | <u>(21,411,250)</u> |
| Surplus as regards policyholders, December 31, 2021 | | | <u>\$ 15,636,483</u> |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The lead state, Wisconsin, retained Lewis & Ellis (L&E) for the purpose of determining the reasonableness of the Group's loss and loss adjustment expense reserves as of December 31, 2021. Since the Company cedes 100% of its direct business to its affiliates and its indirect parent, the reserves were evaluated as part of the group-wide analysis by L&E. Based on the analysis by L&E and the review of their work by a Casualty Actuary from the California Department of Insurance, the Group's loss and loss adjustment expense reserves, including the Company's direct business, as of December 31, 2021 were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Notes to Financial Statements (Page 9): It is recommended that the Company implement procedures to ensure compliance with the National Association of Insurance Commissioners Annual Statement Instructions and disclose the information accurately in the proper format in the Notes to Financial Statements.

Accounts and Records – Premium Tax Returns (Page 10): It is recommended that the Company follow the guidance of the California Code of Regulation § 2327 and determine the selection of the accounting method when filing future California premium tax returns and amend past premium tax filings to reflect the correct accounting method with the California Department of Insurance.

Previous Report of Examination

Management and Control: Management Agreements – Tax Allocation Agreement: The Company was not in compliance with the thirty-day settlement provisions of its tax agreement. It was recommended that the Company implement procedures to ensure compliance with the settlement provisions of its tax agreement. The Company has complied with this recommendation.

Accounts and Records – Unclaimed Property: It was recommended that the Company escheat unclaimed property to the California State Controller Office and implement procedures to ensure future compliance with California Code of Civil Procedure Sections 1530 and 1532. The Company has complied with this 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,

Eric Coria
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Vivien Fan, CFE
Bureau Chief
Department of Insurance
State of California