

REPORT OF EXAMINATION
OF THE
INTERINSURANCE EXCHANGE
OF THE AUTOMOBILE CLUB
AS OF
DECEMBER 31, 2019

Filed on December 15, 2020

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Los Angeles, California
December 11, 2020

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

INTERINSURANCE EXCHANGE OF THE AUTOMOBILE CLUB

(hereinafter also referred to as the Company) at its home office and primary location of its books and records, at 3333 Fairview Road, Costa Mesa, California 92626.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Exchange. The previous examination of the Exchange was as of December 31, 2015. This examination covered the period from January 1, 2016 through December 31, 2019.

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, 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 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 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 Exchange.

This was a coordinated examination with California serving as the lead state and was conducted concurrently with the examinations of the following insurance entities in the holding company group:

<u>Company</u>	<u>State of Domicile</u>
Automobile Club Inter-Insurance Exchange (MO Exchange)	MO
Auto Club Family Insurance Company (ACFIC)	MO
Motor Club Insurance Company (MCIC)	RI
Auto Club Casualty Company (ACCC)	TX
Auto Club County Mutual Insurance Company (ACCM)	TX
Auto Club Indemnity Company (ACIC)	TX

EXCHANGE HISTORY

The Exchange, a reciprocal insurer organized under the laws of the state of California, was incorporated on October 4, 1912. The Exchange offers automobile, homeowner, watercraft, and personal excess liability insurance primarily to members of its affiliate, the Automobile Club of Southern California (ACSC) and its subsidiaries and affiliates, and to other non-affiliated American Automobile Association clubs.

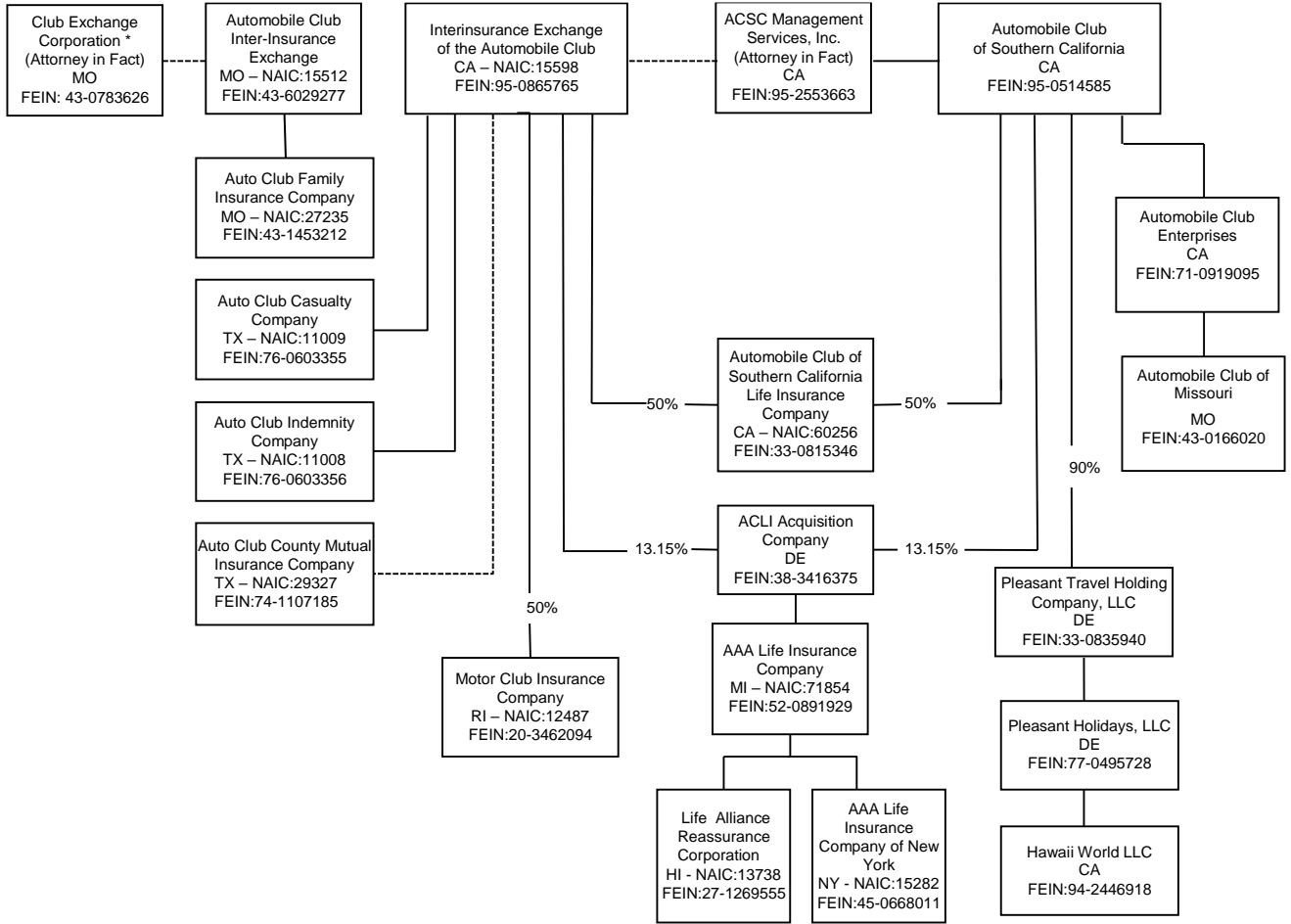
ACSC is a non-profit benefit corporation incorporated in the state of California. The general objective of ACSC is to provide members with services that meet their motoring and travel needs. These services include, but are not limited to, emergency road service,

travel agency services, Department of Motor Vehicle related services, financial services, and map distribution.

ACSC Management Services, Inc. (Management Services) is a wholly-owned subsidiary of ACSC and is the corporate attorney-in-fact for the Exchange. Management Services employs all personnel of the Exchange.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Exchange and its affiliated insurance companies, depicts the Exchange's relationship within the holding company system at December 31, 2019. All ownership is 100% unless otherwise indicated.



* Club Exchange Corporation, a Missouri corporation, the attorney-in-fact of the Automobile Club Inter-Insurance Exchange, is a wholly owned subsidiary of Automobile Club of Missouri.

Possession of 100% of voting interests unless otherwise noted = ____

Contractual or other relationship = - - - - -

The Exchange is managed and controlled by a seven-member board of governors who are members of, and appointed by, the board of directors of the Automobile Club of Southern California (ACSC). A listing of the board of governors and principal officers of the Exchange and principal officers of its Attorney-in-Fact serving on December 31, 2019 follows:

Governors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Peter K. Barker Los Angeles, California	Retired Investment Banking Executive JPMorgan Chase & Co.
Robert T. Bouttier Los Angeles, California	Chair and Retired Executive Automobile Club of Southern California
Anthony J. Buzzelli Somerset, Virginia	Retired Certified Public Accountant Deloitte LLP
Richard S. Hamilton Allison Park, Pennsylvania	Chairman and Governing Director AAA East Central
Antonia Hernandez Pasadena, California	President and Chief Executive Officer California Community Foundation
Thomas V. McKernan Arcadia, California	Vice Chair and Retired Executive Automobile Club of Southern California
Ralph E. Struzziero Cape Elizabeth, Maine	Independent Business Consultant

Principal Officers

<u>Name</u>	<u>Title</u>
Gail C. Louis	Secretary
Avery R. Brown ^(a)	Assistant Secretary

Principal Officers of ACSC Management Services, Inc. (*)

<u>Name</u>	<u>Title</u>
John F. Boyle	President and Chief Executive Officer and Manager
Avery R. Brown ^(a)	Senior Vice President, General Counsel, and Assistant Secretary
Greg L. Backley	Senior Vice President
Christopher M. Baggaley	Senior Vice President
Michael A. Johnson	Senior Vice President
Katherine A. Sieck ^(a)	Senior Vice President
Raju T. Varma	Senior Vice President, Chief Financial Officer, and Treasurer
Suzanne J. Wisdom	Senior Vice President
Gail C. Louis	Corporate Secretary

(*) Attorney-in-Fact of the Interinsurance Exchange of the Automobile Club

(a) Katherine A. Sieck replaced Avery R. Brown as Senior Vice President, General Counsel, and Assistant Secretary as of January 1, 2020

Acquisition of the Motor Club Insurance Company and Alliance Agreement

On December 1, 2017, the Exchange acquired control of the Motor Club Insurance Company (MCIC), a Rhode Island domiciled insurer, through the purchase of 50% of the issued and outstanding capital stock of MCIC from AAA Northeast Holding, Inc. (ANEH), a wholly-owned subsidiary of AAA Northeast (ANE). The Exchange's acquisition was made pursuant to the terms of a Stock Purchase Agreement dated June 20, 2017, among the Exchange, ANE, and ANEH. The cash purchase price for the 50% ownership was \$25,315,500. Regulatory approvals were obtained on October 26, 2017.

Alliance Agreement

At the closing of the above acquisition of MCIC, the Exchange, ACSC, ANE, ANEH and MCIC entered into an Alliance Agreement.

Pursuant to the Alliance Agreement, MCIC began writing AAA-branded automobile and homeowners personal lines insurance in Rhode Island in 2018 and from time to time thereafter in each additional jurisdiction added to the territory covered by the Alliance Agreement.

Management Agreements

Management Agreement with Attorney-in-Fact

ACSC and its affiliates, including ACSC Management Services, Inc. (Management Services), the attorney-in-fact for the Exchange, employ all personnel of the Exchange. The Exchange reimburses Management Services for salaries and other employee-related costs through a management service fee. A portion of the employee benefit costs are also allocated directly to the Exchange.

Pursuant to the Management Agreement, Management Services performs all of the operations of the Exchange. Management Services provides services related to the acquisition and issuance of insurance and the administrative activities associated with the business of the Exchange. In consideration of services rendered, the Exchange pays Management Services the following:

- (1) A sum equal to 1% of the premiums earned less the tax computed according to the provisions of California Insurance Code (CIC) Section 1530; and
- (2) A sum equal to the amount of the operating expenses incurred (i.e. cost reimbursement) by Management Services for the performance of the aforementioned services. Each quarter, cost allocation studies are performed to determine the cost to be allocated to the Exchange.

Fees paid under the terms of the agreement for the years 2016, 2017, 2018, and 2019 were \$572,293,000, \$614,998,000, \$664,647,000 and \$719,864,420, respectively. This agreement went into effect December 19, 1996, before the prior approval provisions of California Insurance Code (CIC) Section 1215.5 (b)(4) went into effect and has never been amended.

Administrative Service Agreements

Effective February 1, 2000, the Exchange entered into separate Administrative Service Agreements with subsidiaries, Auto Club Indemnity Company (ACIC) and Auto Club Casualty Company (ACCC). Under the terms of these agreements, the Exchange provides the following services to ACIC and ACCC personnel services, financial services, management information systems support, facilities support, procurement support, insurance support services, marketing, advertising and promotional activities, and legal services. The services are provided on a cost allocation/reimbursement basis in accordance with insurance accounting principles. Fees paid by ACIC to the Exchange under the terms of the agreement for the years 2016, 2017, 2018, and 2019 were \$29,080,000, \$32,585,000, \$32,736,000 and \$37,873,000, respectively. No fees were paid by ACCC to the Exchange under the terms of the agreement for the years under examination due to ACCC ceasing writing business.

The California Department of Insurance (CDI) approved these two agreements on November 2, 1999.

Managerial Service Agreement

On September 30, 2002, the Exchange entered into a Management Service Agreement that allows it to manage Auto Club County Mutual Insurance Company (ACCM), a Texas mutual insurer formerly known as AAA Texas County Mutual Insurance Company. Fees paid by ACCM to the Exchange under the terms of the agreement for years 2016, 2017, 2018, and 2019 were \$78,586,000, \$92,302,000, \$112,580,000, and \$116,988,000, respectively. This agreement was approved by the CDI on November 13, 2002.

Effective December 31, 2009, the Exchange entered into an Amendment No. 1 to add new language to promote the timely settlement of amounts owed between the parties in accordance with Statements of Statutory Accounting Principles No. 96 and to provide a right of setoff clause between the parties under the agreement. The amendment was approved by the CDI on January 8, 2010.

Administrative Services Agreement

As previously noted, the Exchange and AAA Northeast Holding, Inc., a wholly-owned subsidiary of AAA Northeast (ANE), each own 50% of Motor Club Insurance Company (MCIC), a Rhode Island domiciled insurer. Under the terms of an Administrative Services Agreement dated December 1, 2017, the Exchange provides MCIC with a broad range of services to support its operations, including product development and management, pricing, underwriting, claims handling, and other support services. ANE provides certain marketing and distribution services for MCIC.

Services fees are based on a cost-reimbursement basis and are allocated in accordance with Statement of Statutory Accounting Principles No. 70. Service fees allocated and paid to the Exchange during 2018 and 2019 were \$716,928 and \$2,297,704, respectively.

The CDI approved the Administrative Services Agreement on November 13, 2017.

Tax Sharing Agreement

The Exchange files a consolidated federal income tax return with Auto Club Casualty Company (ACCC) and Auto Club Indemnity Company (ACIC). Allocation is based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually when tax payments are remitted to the Internal Revenue Service. The Exchange paid taxes in amounts of \$1,724,498, \$15,965,466, \$27,039,811 and \$47,221,968 in 2016, 2017, 2018, and 2019, respectively. The CDI approved this agreement on August 27, 1999.

Affiliation Agreement

An Affiliation Agreement was executed on March 1, 2006 among the Exchange, ACSC, Auto Club Enterprises Insurance Group (ACEIG), Automobile Club of Missouri (ACM), Automobile Club Inter-Insurance Exchange (MO Exchange), Auto Club Family Insurance Company (ACFIC), ACSC Management Services (Management Services), and Club Exchange Corporation (CEC). The agreement sets forth provisions for control among the companies and various terms and conditions agreed upon in order to effect the consummation of transactions detailed in the agreement.

Pursuant to the agreement, the Exchange, MO Exchange, and ACFIC entered into an Inter-company Pooling Agreement, as noted under the "Reinsurance" caption in this report.

Amended and Restated Multiple Cedant Allocation Agreement

Effective January 1, 2008, the Exchange entered into an Amended and Restated Multiple Cedant Allocation Agreement with MO Exchange to allocate reinsurance premiums, reinstatement premiums, and reinsurance recoveries under their single reinsurance program. The allocation method for reinsurance premiums is based on the average annual losses, and the reinsurance recoveries are based on the actual claim payments. This agreement was approved by the CDI on March 28, 2008.

Related Party Transactions

Exchange Commitment – Capital Contributions to ACSCCLIC

The Exchange and ACSC each have a 50% ownership in the Automobile Club of Southern California Life Insurance Company (ACSCCLIC). A 2013 written Commitment Letter filed with the CDI requires the Exchange and ACSC to make capital contributions to ACSCCLIC in order for that entity to maintain a particular Risk-Based Capital (RBC) level. A new letter, which is effective January 1, 2018 and expires December 31, 2020, extended the commitments on the same terms as the 2013 commitment letter.

The Exchange's capital contributions totaled \$5,000,000, \$2,250,000, \$17,150,000 and \$13,500,000 in 2016, 2017, 2018, and 2019, respectively. Through year-end 2019, the Exchange's cumulative capital contributions totaled \$130,400,000.

ACLI Acquisition Company Commitment

The Exchange has a 13.15% ownership interest in ACLI Acquisition Company (ACLI), a holding company of AAA Life Insurance Company (AAA Life). As part of the Third Amended and Restated Shareholder Agreement, effective June 30, 2014, the Exchange has a contingent commitment to make capital contributions to ACLI in order to maintain a particular RBC level of AAA Life. Although the Exchange made no capital contributions during the examination period, it has previously made capital contributions totaling \$15,016,418. The agreement was not subject to prior approval by the CDI.

Automobile Club Insurance Holdings, LLC Commitment

The Exchange had a 50% ownership interest in Automobile Club Insurance Holdings, LLC (ACIH), a holding company for Automobile Club Insurance Company of Florida (ACICF). Pursuant to the Second Amended and Restated Operating Agreement of ACIH, effective April 1, 2014, the Exchange had a contingent commitment to make capital contributions to ACIH in order to maintain minimum surplus levels of ACICF. During the examination period, the Exchange did not make any capital contributions. The agreement was not subject to prior approval by the CDI.

Effective May 1, 2018, the Exchange sold its 50% interest in ACIH to Auto Club Insurance Association (ACIA) for \$124 million (\$76.5 million gain). ACIA is not an affiliate of the Exchange, and this sale was not subject to prior approval by the CDI.

As a result of the sale, the Exchange no longer owns ACIH and its subsidiary, ACICF.

Intelematics North America, LLC Commitment

The Exchange had a 25% ownership interest in Intelematics North America, LLC (INA). Pursuant to the Operating Agreement of INA, effective April 3, 2015, the Exchange had a contingent commitment to make capital contributions to INA. Other than an initial \$500,000 capital contribution in 2015, the Exchange made no additional capital contributions during the examination period. The agreement was not subject to prior approval by the CDI.

Effective December 31, 2017, INA was sold to an unaffiliated third party for a purchase price of \$430,000.

Exchange Required to Maintain Surplus Ratio of Missouri Exchange

Pursuant to the Affiliation Agreement described within the “Management Agreements” section of this report, the Exchange is required to maintain, at all times prior to the termination of the Intercompany Pooling Agreement and subject to the receipt of any required regulatory approvals, the surplus ratio of the MO Exchange at not less than 60% after giving effect to the pooling under the InterCompany Pooling Agreement, either through the purchase of additional surplus notes or through other methods as may be mutually acceptable to the Exchange and the MO Exchange. As of December 31, 2019 and 2018, the surplus of the MO Exchange exceeded the minimum requirement.

Purchase of Surplus Note from the Missouri Exchange

Pursuant to the Affiliation Agreement previously noted, on June 30, 2006, the Exchange purchased a \$50,000,000 surplus note from the MO Exchange. The surplus note has a stated interest rate of prime plus 1% per annum on the unpaid balance until the scheduled maturity date of June 30, 2026. Any payment of principal and interest shall be paid only with the prior approval of the Director of Insurance of the Missouri Department of Insurance. This Affiliation Agreement was approved by the CDI on June 27, 2006.

On December 30, 2016, the MO Exchange made an interest payment to the Exchange in the amount of \$2,261,301, representing substantially all interest accrued in calendar year 2016 and some additional interest accrued in 2015.

On April 5, 2017, following the Missouri Department of Insurance's approval, the MO Exchange repaid in full the \$50,000,000 outstanding principal balance and unpaid interest of \$631,164.

Repayment of Surplus Note

On April 30, 2018, Auto Club County Mutual Insurance Company (ACCM) made a repayment in full of the principal and all unpaid interest on a \$750,000 surplus note issued by ACCM to the Exchange. The repayment amounted to \$1,544,784, which consisted of the principal amount of the \$750,000 and unpaid interest through April 30, 2018 in the amount of \$794,784.

Capital Contribution to ACCM

The Exchange made a capital contribution of \$5,000,000 to the surplus of ACCM (ACCM Note) pursuant to the terms of the Subordinated Surplus Debenture that provides for principal repayment on the maturity date. On May 14, 2018, the Texas Department of Insurance (TX DOI) approved the payment of unpaid interest through December 31, 2012 on the ACCM Note. On May 21, 2018, ACCM settled the payment in the amount of \$1,617,671. On May 22, 2018, the TX DOI approved the extension of the ACCM Note to

May 19, 2023 and the change to the interest rate from a variable rate based on the twelve month London Inter-Bank Offered Rate (LIBOR) to a fixed rate of 0.5%.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2019, the Exchange was licensed to write various lines of property and casualty business in the following states:

California	New Mexico	Vermont
Hawaii	Ohio	Virginia
Maine	Pennsylvania	
New Hampshire	Texas	

In 2019, the Exchange wrote \$3.5 billion in direct premiums. Of the direct premiums written, \$3.3 billion (94.1%) was written in California, and \$207.2 million (5.9%) was written in eight other states. The Exchange is licensed in Ohio but does not write policies on a direct basis. The Exchange is also an accredited reinsurer in Florida, Michigan, and Missouri.

During 2019, \$3.485 billion (98.8%) of the Exchange's direct business written was automobile and homeowners insurance. The Exchange offers insurance to members of the Automobile Club of Southern California (ACSC) and its affiliated motor clubs as well as non-members in some states. Business is predominately acquired through the agents of ACSC, affiliated through ACSC's ownership of its attorney-in-fact, ACSC Management Services, Inc. (Management Services), which manages the Exchange.

REINSURANCE

Intercompany Reinsurance Pooling Agreement

Effective July 1, 2006, the Exchange (lead company) is party to an Intercompany Reinsurance Pooling Agreement (Pooling Agreement) with its affiliates, Automobile Club Inter-Insurance Exchange (MO Exchange) and Auto Club Family Insurance Company (ACFIC). This Pooling Agreement was a part of the previously noted Affiliation Agreement described within the "Management Agreements" section of this report. The following are the pooling participation percentages under the terms of this agreement:

<u>Company</u>	<u>State of Domicile</u>	<u>Pooling Share</u>
Interinsurance Exchange of the Automobile Club	CA	95%
Automobile Club Inter-Insurance Exchange	MO	4%
Auto Club Family Insurance Company	MO	<u>1%</u>
Pool Total		<u>100%</u>

Under the Pooling Agreement, the participants pool all their net underwriting business after cessions to non-affiliated reinsurers. The Pooling Agreement also provides for the sharing of various underwriting assets and liabilities. Investments and investment-related operating items, income taxes and non-insurance related assets and liabilities are excluded from the pooling program.

Effective December 31, 2010, the Pooling Agreement was amended to revise the definition of reinsurance recoveries to provide that any uncontrollable external reinsurance receivables are to be deducted from the amount retroceded by the Exchange to MO Exchange and ACFIC. In addition, the amendment revised certain commencement and termination provisions, and run-off of liabilities following termination. The amendment also adds a new section to provide for the reapportionment of the quota share percentages applicable to each pool member upon the termination of the MO Exchange or ACFIC. The amendment was approved by the California Department of Insurance (CDI) on December 13, 2010.

Assumed

Quota Share Reinsurance Assumed Agreements

The Exchange assumes 100% of the private passenger automobile business written by its subsidiary, Auto Club Casualty Company (ACCC), and 100% of the homeowners, inland marine, other liability, and private passenger automobile business written by its subsidiary, Auto Club Indemnity Company (ACIC), through two quota-share reinsurance agreements. These agreements were approved by the CDI on November 2, 1999.

The Exchange also assumes 100% of the private passenger automobile business written by the Auto Club County Mutual Insurance Company (ACCM) (formerly known as AAA Texas County Mutual Insurance Company) through a quota-share reinsurance agreement effective October 1, 2002. This agreement was approved by the CDI on November 13, 2002.

Effective January 1, 2007, the Exchange entered into a 50% Quota Share Reinsurance Agreement where the Exchange assumed 50% of the business written in the state of Ohio from Member Select Insurance Company (MSIC), a non-affiliated insurance entity, domiciled in Michigan.

As an expansion of the above 50% Quota Share Reinsurance Agreement, effective June 1, 2007, the Exchange assumed 50% of the business written in the states of West Virginia and Kentucky by Auto Club Property-Casualty Insurance Company (ACPC), a non-affiliated insurance entity, domiciled in Iowa.

Effective March 1, 2012, the quota share agreements with MSIC and ACPC were amended, whereby, MSIC and ACPC now cede to the Auto Club Insurance Association (ACIA), a non-affiliated insurance entity, domiciled in Michigan, then retrocede to the Exchange. The Exchange is an accredited reinsurer in the state of Michigan.

As of December 1, 2017, the Exchange entered into a quota share reinsurance agreement pursuant to which policies written on or after January 1, 2018 by Motor Club Insurance Company (MCIC) in Rhode Island are 100% ceded to and reinsured by the

Exchange.° MCIC is 50% owned by the Exchange and 50% owned by AAA Northeast Holding, Inc. (ANE). °MCIC is managed and operated by the Exchange pursuant to an Intercompany Administrative Services Agreement. In 2018, MCIC began writing homeowners and automobile insurance policies in Rhode Island.°

Effective March 29, 2018, the Exchange entered into new reinsurance agreements with ACIA, pursuant to which the Exchange assumes 100% of business written by ACIA in Ohio, West Virginia, and Kentucky starting January 1, 2018.

Retroactive Reinsurance

In March 2018, with an effective date of January 1, 2018, the Exchange commuted and terminated a series of reinsurance agreements with ACIA pursuant to which the Exchange had assumed 50% of the business written by ACIA in Ohio, West Virginia, and Kentucky, and the Exchange ceded to ACIA 50% of its business written in Pennsylvania. The Exchange purchased the loss portfolio noted above from ACIA on reserves as of January 2018. The loss portfolio that was purchased resulted in the initial recording of a liability for \$46,361,815 as retroactive reinsurance reserves assumed (reported as a write-in item in the annual statement). The transfer of unearned premium reserves resulted in a difference between premiums earned in the financial statements of \$22,119,273. The new agreements resulted in retroactive reinsurance accounting with no gain or loss recognized on the consideration received for the transfer of the reserve liability.

Overall, as of December 31, 2019, the Exchange reported total premiums assumed of \$1.1 billion, with 91.2% assumed from its affiliated entities.

Ceded

The following is a summary of the ceded reinsurance treaties inforce as of December 31, 2019:

Type of Contract	Reinsurer's Name	Exchange's Retention (In 000's)	Reinsurer's Maximum Limits (In 000's)
Catastrophe Excess of Loss			
1 st Layer (*)	Various Authorized and Unauthorized	(A) \$100,000 per Occurrence (B) \$200,000 per Occurrence	\$150,000 per Occurrence
2 nd Layer	Various Authorized and Unauthorized	(A) \$250,000 per Occurrence (B) \$350,000 per Occurrence	\$200,000 per Occurrence
3 rd Layer	Various Authorized and Unauthorized	(A) \$450,000 per Occurrence (B) \$550,000 per Occurrence	\$350,000 per Occurrence
4 th Layer	Various Authorized and Unauthorized	(A) \$800,000 per Occurrence (B) \$900,000 per Occurrence	\$50,000 per Occurrence
5 th Layer	Various Authorized and Unauthorized	(A) \$850,000 per Occurrence (B) \$950,000 per Occurrence	\$25,000 per Occurrence
6 th Layer (*)	Various Authorized and Unauthorized	(A) \$875,000 per Occurrence (B) \$975,000 per Occurrence	\$300,000 per Occurrence
7 th Layer (*)	Various Authorized and Unauthorized	(A) \$1,175,000 per Occurrence (B) \$1,275,000 per Occurrence	\$200,000 per Occurrence

(*) The Exchange participates at a rate of 6.983% in the 1st Layer, 11.182% in the 6th Layer, and 5% in the 7th Layer

- (A) All Other Markets
- (B) California Market Only

Catastrophe Reinsurance

The Exchange cedes reinsurance to control exposure to potential losses that may arise from catastrophies. The Exchange's reinsurance is affected under catastrophe excess-of-loss reinsurance contracts.

The Exchange made improvements in 2019 in managing its catastrophe exposure including the purchase of an additional \$231 million in coverage along with its brushfire re-underwriting efforts. Its catastrophe excess of loss treaty currently has a limit of \$1.275 billion above a \$200 million retention for California and above a \$100 million retention for all other states. The total amount of coverage after co-participation is \$1.221 billion.

The catastrophe exposure is being managed using a multi-dimensional approach. Underwriting, pricing, product design, computer modeling, and reinsurance are all used to manage the losses resulting from catastrophic events.

Other Quota Share Reinsurance Agreements

As previously noted under assumed reinsurance, effective December 1, 2017, the Exchange entered into a 100% quota share assumed reinsurance agreement with the Motor Club Insurance Company (MCIC). In addition, effective December 1, 2017, the Exchange entered into a quota share agreement with Motor Club Insurance Captive, LLC. (MCI Captive) to cede 50% of this assumed business from MCIC.

As of December 31, 2019, reinsurance recoverables (gross of ceded balances payable) for all ceded reinsurance totaled \$222.6 million or 2.8% of surplus as regards policyholders. Of the total reinsurance recoverables, \$212.4 million (or 95.4%) was from affiliates under the terms of the Intercompany Reinsurance Pooling Agreement. 95% of the recoverables are from authorized reinsurers.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Exchange with the California Department of Insurance and present the financial condition of the Exchange for the period ending December 31, 2019. There were no adjustments made to the statutory financial statements filed by the Exchange.

Statement of Financial Condition as of December 31, 2019

Underwriting and Investment Exhibit for the Year Ended December 31, 2019

Reconciliation of Surplus as Regards Policyholders from December 31, 2015
through December 31, 2019

Statement of Financial Condition
as of December 31, 2018

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 5,721,601,584	\$	\$ 5,721,601,584	
Preferred stocks	172		172	
Common stocks	5,384,933,058		5,384,933,058	(1)
Real Estate: Property occupied by the company	185,134,179		185,134,179	
Cash, cash equivalents, and short-term investments	100,101,238		100,101,238	
Other invested assets	5,866,281		5,866,281	
Receivables for securities	10,777,871		10,777,871	
Investment income due and accrued	71,535,615		71,535,615	
Uncollected premiums and agents' balances in the course of collection	164,614,044	1,589,632	163,024,412	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	866,559,279		866,559,279	
Amounts recoverable from reinsurers	13,516,167		13,516,167	
Current federal and foreign income tax recoverable and interest thereon	4,265,402		4,265,402	
Guaranty funds receivable or on deposit	168,703		168,703	
Electronic data processing equipment and software	106,550,790	90,580,099	15,970,691	
Furniture and equipment	18,177,391	18,177,391	0	
Receivables from parent, subsidiaries and affiliates	417,095		417,095	
Aggregate write-ins for other than invested assets	34,446,902	31,949,388	2,497,514	
Total assets	<u>\$12,688,665,771</u>	<u>\$ 142,296,510</u>	<u>\$12,546,369,261</u>	

Liabilities, Surplus, and Other Funds

			<u>Notes</u>
Losses		\$ 1,448,511,594	(2)
Reinsurance payable on paid loss and loss adjustment expenses		77,666,634	
Loss adjustment expenses		313,943,244	(2)
Other expenses		9,883,084	
Taxes, licenses and fees		24,922,595	
Net deferred tax liability		516,883,056	
Unearned premiums		2,030,641,899	
Advance premiums		35,809,607	
Dividends declared and unpaid: policyholders		68,213,278	
Ceded reinsurance premiums payable		79,302,095	
Amounts withheld or retained by company for account of others		7,424,911	
Remittances and items not allocated		3,170,276	
Payable to parent, subsidiaries and affiliates		54,929,152	
Payable for securities		26,289,421	
Aggregate write-ins for liabilities		<u>21,495,706</u>	
Total liabilities		4,719,086,552	
Common capital stock	\$	0	
Gross paid-in and contributed surplus		0	
Unassigned funds (surplus)		<u>7,827,282,709</u>	
Surplus as regards policyholders		<u>7,827,282,709</u>	
Total liabilities, surplus, and other funds		<u>\$12,546,369,261</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2019

Underwriting Income

Premium earned		\$ 4,229,363,585
Deductions		<u>\$ 2,145,115</u>
Losses incurred	\$ 2,622,826,925	
Loss adjustment expenses incurred	464,560,744	
Other underwriting expenses incurred	<u>971,331,465</u>	
Total underwriting deductions		<u>4,058,719,134</u>
Net underwriting gain		170,644,451

Investment Income

Net investment income earned	\$ 274,341,783	
Net realized capital gains	40,461,572	
Net investment gain		314,803,355

Other income

Net loss from agents' or premium balances charged off	\$ (14,153,765)	
Finance and service charges not included in premiums	112,249,741	
Aggregate write-ins for miscellaneous income	<u>5,206,483</u>	
Total other income		<u>\$ 103,302,459</u>
Net income before dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		588,750,265
Dividends to policyholders		<u>243,000,609</u>
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		345,749,656
Federal and foreign income taxes incurred		<u>37,039,186</u>
Net income		<u><u>\$ 308,710,470</u></u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2018		\$ 6,596,049,204
Net income	\$ 308,710,470	
Change in net unrealized capital losses	949,702,621	
Change in net deferred income tax	3,586,944	
Change in nonadmitted assets	<u>(30,766,530)</u>	
Change in surplus as regards policyholders for the year		<u>1,231,233,505</u>
Surplus as regards policyholders, December 31, 2019		<u><u>\$ 7,827,282,709</u></u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2015 through December 31, 2019

Surplus as regards policyholders, December 31, 2015			\$ 5,633,706,634
	Gain in Surplus	Loss in Surplus	
Net income	\$ 826,021,275	\$	
Change in net unrealized capital gains	1,474,627,683		
Change in net deferred income tax		25,449,056	
Change in nonadmitted assets		81,623,827	
Total gains and losses	\$ 2,300,648,958	\$ 107,072,883	
Net increase in surplus as regards policyholders			<u>2,193,576,075</u>
Surplus as regards policyholders, December 31, 2019			<u>\$ 7,827,282,709</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Common Stocks

The Exchange received an extension of a permitted practice from the California Department of Insurance (CDI) on September 17, 2019 to characterize its passively managed equity securities portfolio as one mutual fund for purposes of applying tests of other than temporary investment impairment. The permitted practice differs from the National Association of Insurance Commissioners Statutory Accounting Practices and Procedures, which requires analysis for other than temporary investment impairments at the individual security level. The permitted practice is effective October 1, 2019 through September 30, 2020.

For the year ended December 31, 2019, the application of this permitted practice had no impact on the Exchange's policyholder surplus.

(2) Losses and Loss Adjustment Expenses

Because the business of the Exchange's property and casualty companies were pooled, it was necessary to review the loss and loss adjustment expense reserves on a group-wide basis. Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Exchange's December 31, 2019 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for the purposes of this examination.

SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared coronavirus disease (COVID-19) a pandemic.° The pandemic has triggered unprecedented government mandates and health and safety measures which have significantly impacted the U.S. and global financial markets, in particular, U.S. publically traded equity securities, and impacts on yields and interest rates in the U.S. bond market. During the exam we

reviewed COVID-19's impact on the Exchange's business operations with no immediate solvency concerns noted. As of the date of this report, significant uncertainty remains on the effect that the pandemic will have on the insurance industry, economy, and the Exchange at large. °The CDI continues to closely monitor the impact of the pandemic on the Exchange and will take necessary action if a solvency concern arises.

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 Attorney-in-Fact's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/_____

Richard M. Stone, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California

_____/S/_____

Edward Aros, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California