

REPORT OF EXAMINATION  
OF THE  
LAWYERS' MUTUAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2017



Insurance Commissioner

FILED 3-1-19

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Los Angeles, California  
December 13, 2018

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**LAWYERS' MUTUAL INSURANCE COMPANY**

(hereinafter also referred to as the Company) at its home office located at 3110 West Empire Avenue, Burbank, California 91504.

**SCOPE OF EXAMINATION**

We have performed our single-state examination of the Company. The previous examination of the Company was as of December 31, 2013. This examination covered the period of January 1, 2014 through December 31, 2017.

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. The examination also included identifying and evaluating significant risks that could cause the Company'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 includes 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 an adjustment was identified during the course of the examination, the impact of such adjustment would 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.

## COMPANY HISTORY

The Company was incorporated in the state of California in June 1978, and commenced transacting business in September 1978.

### Capitalization

At the Company's inception, the California Department of Insurance (CDI) authorized the infusion of capital via the issuance of up to \$24.3 million in certificates of contribution (certificates) to its policyholders. The funds were solicited in order to provide the surplus needed to adequately capitalize the growth of the Company. The certificates do not bear interest, and repayment is subject to prior approval by the Company's Board of Directors and the CDI.

As of the examination date, the Company has repaid a total of \$22.4 million in contribution certificates. The total policyholder contribution certificates remaining as of

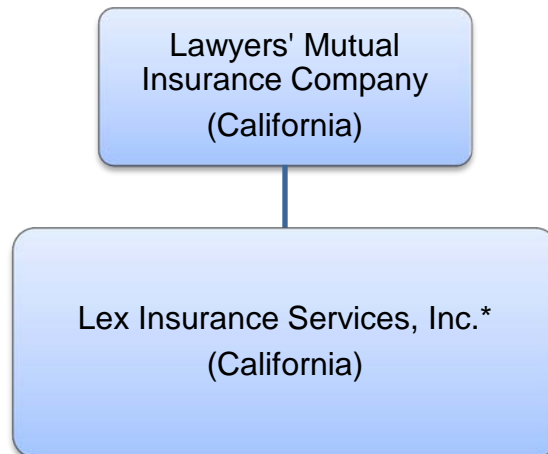
December 31, 2017 was \$1.9 million. There was no repayment of principal made during the examination period.

### Dividends

During the years 2014, 2015, 2016, and 2017, the Company paid cash dividends to all eligible policyholders at 10% of in-force premiums, totaling \$3.7 million, \$3.7 million, \$3.7 million, and \$3.6 million, respectively. The Company has paid policyholder dividends for twenty-two consecutive years.

### MANAGEMENT AND CONTROL

As a mutual insurer, the Company is owned by its policyholders. The following organizational chart depicts the Company's relationship within the holding company system. All ownership is 100%.



\* The Company's wholly-owned subsidiary, Lex Insurance Services, inc., has been inactive since 2003.

Management of the Company is vested in a ten-member Board of Directors. The directors serve staggered terms of five years. Each director must be a policyholder of

the Company or a named insured. The following are members of the board and principal officers of the Company serving at December 31, 2017:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Thomas H. Ault * Rancho Santa Fe, California	Attorney at Law
Hal H. Bolen II Fresno, California	Attorney at Law Bolen, Fransen & Sawyers, LLP
Alan K. Brubaker San Diego, California	Attorney at Law Wingert Grebing Brubaker & Juskie, LLP
John W. Burke Dove Canyon, California	Insurance Broker William & Christopher Insurance Brokers
Gary E. Davis Oceanside, California	Retired Chief Executive Officer Lawyers' Mutual Insurance Company
Karen D. Kadushin Denver, Colorado	Attorney at Law
Gail Mosse Burlingame, California	Attorney at Law
George R. McCambridge Summerland, California	Attorney at Law
Royal F. Oaks La Crescenta, California	Attorney at Law Hinshaw & Culbertson, LLP
Angela E. Oh Redondo Beach, California	Attorney at Law Fair Employment & Housing, Los Angeles

## Principal Officers

<u>Name</u>	<u>Title</u>
Andrew M. Chick	President and Chief Executive Officer
Brian A. Rawers	Secretary and General Counsel
Abiy W. Moges	Treasurer and Chief Financial Officer
Cathleen M. Sargent	Vice President, Underwriting
Kim T. Spirito	Vice President, Claims and Loss Prevention

\*Mr. Thomas H. Ault passed away on December 15, 2017, and was replaced by Mr. Gary E. Davis on April 13, 2018.

## Management Agreements

During the examination period, the Company had five authorized equity managers and one fixed income securities manager to manage the Company's investment portfolio. The majority of the Company's investments are managed by Prime Advisors, Inc. Within the confines of the Company's investment guidelines, each investment management firm has authority to execute transactions without prior consultation from the Company's management. Management fees are predicated upon the application of a specified percentage to the market valuation of each managed portfolio.

In addition to the above, the Company also maintains an investment consulting agreement with Beacon Pointe Advisors (BPA). Among the services provided by BPA is the historical performance evaluation of the above referenced investment management firms. The fee for services by BPA is based on a percentage of the market value of the managed portfolios.

## TERRITORY AND PLAN OF OPERATION

The Company is a specialty carrier that underwrites professional liability insurance to members of the State Bar in California. Individual policyholders must engage in partnerships or professional corporations having their principal place of business in California. Covered firms must be comprised principally of attorneys who are residents of California and are licensed to practice law therein. The Company's current business profile consists primarily of smaller-sized law firms. The Company has approximately 7,084 policies in-force covering approximately 10,221 lawyers. About 1,869 endorsements separately cover tail exposures of attorneys who were previously insured by regular active policies.

Although policies are issued on a "claims-made" basis, the Company offers additional coverage for extended reporting period endorsements to cover exposures reported after the termination of the original policy. The Company's policy limits range from \$100,000/\$300,000 to \$5 million/\$7 million per claim/aggregate.

During 2017, the Company wrote \$38.6 million of direct premiums in California only. Approximately 65% of the Company's business is written on a direct basis; the remaining business is produced by 130 brokerage firms.

## REINSURANCE

### Assumed

The Company did not assume reinsurance during the examination period.



## Ceded

Following is a summary of the Company's ceded reinsurance contracts as of December 31, 2017. All reinsurers are authorized.

Type of Contract	Reinsurer	Company Retention	Reinsurer's Limits
Excess of Loss	64.5% Various Lloyd Syndicates 15.0% Hannover Ruck SE 12.5% Aspen Insurance UK Limited 8.0% Berkley Insurance Company	\$750,000	\$1 million ultimate net loss each occurrence excess of \$750 thousand.  \$2 million in excess of \$2 million in aggregate claims on one policy.  \$6.3 million excess of \$750 thousand, inclusive of any extra contractual obligations, loss in excess of policy limits, and loss expense.
Excess of Cessions	64.5% Various Lloyd Syndicates 15.0% Hannover Ruck SE 12.5% Aspen Insurance UK Limited 8.0% Berkley Insurance Company	\$2 million per ultimate net loss each claim, each policy, or \$4 million ultimate net loss in the aggregate per policy	\$3 million ultimate net loss each claim, or in the aggregate, each policy in excess of the Company's retention.  \$3 million of ultimate net loss for claims related extra contractual obligations and/or excess limits liability as respects each claim.
100% Quota Share-Cyber Coverage	100% Various Lloyd Syndicates	\$0	\$100 thousand per insured event and in the aggregate any one policy

## ACCOUNTS AND RECORDS

### Pension Liabilities

The Company has a qualified defined benefit pension plan covering substantially all employees. The Company also sponsors a nonqualified defined benefit pension plan, the Supplemental Executive Retirement Plan (SERP), to supplement the retirement benefits for certain executives beyond the limits imposed on qualified plans under the

Internal Revenue Code, Section 415. Prior to 2017, the benefit plans were recognized outside the statutory financial statement, but were disclosed in the notes to financials.

During 2017, the Company recognized assets and liabilities for the two pension plans in its statutory financial statements. The Company made adjustments to assets and liabilities to record the funded status of its qualified plan as a non-admitted asset of \$5.6 million; and to record the non-qualified SERP assets in the amounts of \$9.6 million included in invested assets, and \$9.2 million as a write-in liability. The accounting change in presentation did not have a material effect on surplus.

### 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, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements. There is no adjustments to the amounts reported in the annual statements.

Statement of Financial Condition as of December 31, 2017

Underwriting and Investment Exhibit for the Year Ended December 31, 2017

Reconciliation of Surplus as Regards Policyholders from December 31, 2013 through December 31, 2017

Statement of Financial Condition  
as of December 31, 2017

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 265,157,214	\$	\$ 265,157,214	
Common stocks	56,730,600	240,330	56,490,270	(1)
Property occupied by the company	3,350,259		3,350,259	
Cash and short-term investments	8,745,026		8,745,026	
Receivable for securities	75,779		75,779	
Investment income due and accrued	2,528,068		2,528,068	
Premiums and agents' balances in course of collection	2,457,712		2,457,712	
Premiums, agents' balances and installments booked but deferred and not yet due	202,459		202,459	
Amount recoverable from reinsurers	1,600		1,600	
Other amounts receivable under reinsurance contracts	1,001,220		1,001,220	
Net deferred tax asset	1,683,390	477,167	1,206,223	
Electronic data processing equipment and software	260,151	260,151	0	
Furniture and equipment	8,764	8,764	0	
Aggregate write-ins for other than invested assets	<u>6,648,779</u>	<u>5,638,783</u>	<u>1,009,996</u>	
 Total assets	 <u>\$ 348,851,021</u>	 <u>\$ 6,625,195</u>	 <u>\$ 342,225,826</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 44,922,422	(2)
Loss adjustment expenses			24,733,978	(2)
Commissions payable, contingent commissions and other similar charges			71,018	
Other expenses (excluding taxes, licenses and fees)			1,825,257	
Current federal and foreign income taxes			2,250,029	
Unearned premiums			18,128,817	
Advance premium			670,217	
Ceded reinsurance premium payable			169,606	
Funds held by company under reinsurance treaties			176,077	
Remittances and items not allocated			47,545	
Payable for securities			84,835	
Aggregate write-ins for liabilities			<u>9,213,024</u>	
 Total liabilities			 102,292,825	
 Gross paid-in and contributed surplus		 \$ 1,949,220		
Unassigned funds (surplus)		<u>237,983,781</u>		
 Surplus as regards policyholders			 <u>239,933,001</u>	
 Total liabilities, surplus and other funds			 <u>\$ 342,225,826</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2017

Statement of Income

Underwriting Income

Premiums earned \$ 35,248,283

Deductions:

Losses incurred	\$	6,189,096
Loss adjustment expenses incurred		11,998,444
Other underwriting expenses incurred		<u>5,833,848</u>

Total underwriting deductions 24,021,388

Net underwriting gain 11,226,895

Investment Income

Net investment income earned	\$	6,989,072
Net realized capital gain		<u>2,876,934</u>

Net investment gain 9,866,006

Other Income

Aggregate write-ins for miscellaneous income	\$	270,744
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Total other income 270,744

Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes 21,363,645

Dividend to policyholders 3,633,885

Net income after dividends to policyholders, after capital gains tax and before Federal and foreign income taxes 17,729,760

Federal and foreign income taxes incurred 3,678,523

Net income \$ 14,051,237

Capital and Surplus Account

Surplus as regards policyholders,  
December 31, 2016 \$ 224,044,356

Net income	\$	14,051,237
Change in net unrealized capital gains		3,148,054
Change in net deferred income tax		(2,311,519)
Change in nonadmitted assets		1,437,398
Aggregate write-ins for gains and losses in surplus		<u>(436,525)</u>

Change in surplus as regards policyholders for the year 15,888,645

Surplus as regards policyholders,  
December 31, 2017 \$ 239,933,001

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2013 through December 31, 2017

Surplus as regards policyholders, December 31, 2013			\$ 183,164,732
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 58,976,637	\$	
Change in net unrealized capital gains	684,184		
Change in net deferred income tax		1,878,119	
Change in nonadmitted assets	99,897		
Aggregate write-ins for gains and losses in surplus	<u>                    </u>	<u>1,114,330</u>	
Total gains and losses	<u>\$ 59,760,718</u>	<u>\$ 2,992,449</u>	
Net increase in surplus as regards policyholders			<u>56,768,269</u>
Surplus as regards policyholders, December 31, 2017			<u>\$ 239,933,001</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Common Stocks

The Company's investment in its wholly-owned subsidiary, Lex Insurance Services, Inc. (Lex), has a book value of \$240,300, but for statutory financial purposes, it was reported as a non-admitted asset. This occurred because the members of the Company's Audit Committee decided to non-admit the asset, rather than incur the associated costs of an audit for Lex.

### (2) Losses and Loss Adjustment Expenses

Based on an analysis by a Senior Casualty Actuary for the California Department of Insurance, the Company's losses and loss adjustment expense reserves as of December 31, 2017, were found to be reasonably stated and have been accepted for purposes of this examination.

## SUBSEQUENT EVENTS

Pursuant to California Insurance Code Section 1861.05 (Proposition 103), on August 13, 2018, the Company filed a 17% rate reduction with the California Department of Insurance (CDI). The 17% rate reduction was approved by the CDI on October 26, 2018.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None.

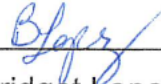
Previous Report of Examination

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,



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Bridget Lopez, CFE  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California



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Edward W. Aros, CFE  
Senior Insurance Examiner (Supervisor)  
Department of Insurance  
State of California