REPORT OF EXAMINATION

OF THE

PACIFIC SPECIALITY INSURANCE COMPANY

AS OF

DECEMBER 31, 2024

Insurance Commissioner 

Filed on June 30, 2026

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Los Angeles, California
May 15, 2026

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PACIFIC SPECIALITY INSURANCE COMPANY

(hereinafter also referred to as the Company). The Company's statutory home office and primary location of its books and records is at 5515 East La Palma Avenue, Suite 150, Anaheim, California 92807.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2020. This examination covered the period from January 1, 2021, through December 31, 2024.

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 examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This report includes findings of facts 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 whereby California was the lead state of the Western Service Contract Group. It was conducted concurrently with the examination of the Pacific Specialty Property and Casualty Company, with participation from Texas.

COMPANY HISTORY

The Company is a wholly-owned subsidiary of Western Service Contract Corporation (WSCC), a California corporation. The Company was incorporated under the laws of California in April 1988. It obtained its Certificate of Authority in December 1989 and commenced business in January 1990.

Capitalization

The Company is authorized to issue 100,000 shares of $291.67 par value common stock. As of December 31, 2024, there were 12,000 shares issued and outstanding shares. There were no changes to the common and outstanding stock during the examination period.

Dividends

The Company paid ordinary cash dividends to its parent, WSCC, in the amount of $10,400,000, $9,336,026, $1,000,000, and $5,000,000 in 2021, 2022, 2023, and 2024, respectively. In accordance with California Insurance Code Section 1215.4(f) the Company properly notified the California Department of Insurance of the dividend payments.

MANAGEMENT AND CONTROL

The Company is wholly-owned by Western Service Contract Corporation (WSCC), a privately-owned company and insurance holding company incorporated in California. The Company has one subsidiary, Pacific Specialty Property and Casualty Company (PSPCC). The holding company group is ultimately controlled and equally owned by two individuals, John M. McGraw and Michael J. McGraw. The following organization listing shows the interrelationship of the companies within the holding company system as of December 31, 2024. All ownership is 100% unless otherwise indicated.

John M. McGraw (50%) and Michael J. McGraw (50%) (Shareholders)
- Western Service Contract Corporation (California)
  - McGraw Insurance Services L.P. (Delaware)
  - **Pacific Specialty Insurance Company (California)**
    - Pacific Specialty Property and Casualty Company (Texas)
- McGraw Insurance Inc. (S. Corp) (Delaware)
  - McGraw Insurance Services L.P. (Delaware) [(a)]
  - Western Service Leasing LLC (Florida)

[(a)] McGraw Insurance Services L.P. (Delaware) is 99.9% owned by McGraw Insurance Inc. and 0.1% owned by Western Service Contract Corporation.

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 on December 31, 2024:

Directors

Name and Location	Principal Business Affiliation
Michael F. Der Manouel Jr. Fresno, California	President Der Manouel Insurance Group
Ross C. Goodman Las Vegas, Nevada	Owner Goodman Criminal Defense Lawyer
Kevin J. Kendrick [(a)] San Francisco, California	Partner Andros Group
John M. McGraw Anaheim, California	Shareholder Western Service Contract Corporation
Michael J. McGraw Anaheim, California	President and Chairman of the Board Pacific Specialty Insurance Company
John L. Ratcliffe [(b)] Rockwell, Texas	Counsel Lamberth Ratcliffe Covington

Principal Officers

Name	Title
Michael J. McGraw	President and Chief Executive Officer
Paul J. Cash	Chief Financial Officer and Treasurer
Kevin J. Judice	Chief Operating Officer
Anisha B. Liebert	General Counsel and Secretary

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

(a) Effective January 1, 2025, Kevin J. Kendrick resigned and was replaced by Marian K. Walters as a board member.
(b) Effective January 1, 2025, John L. Ratcliffe resigned and was replaced by Michele A. Ratcliffe as a board member.

Management Agreements

General Agency Agreement: Effective September 1, 1995, the Company entered into a General Agency Agreement (Agency Agreement) with The McGraw Company (TMC),

dba McGraw Insurance Services, a licensed insurance agent. Under the terms of the Agency Agreement, TMC served as the Company's general agent, responsible for underwriting, filing, and rating functions; receiving and accepting proposals for insurance; collecting and remitting premiums; and providing sales and administrative services. All premiums received by the TMC shall be deposited in the premium trust account and held by the TMC as trustee for the sole and exclusive benefit of the Company until delivered to the Company according to the settlement terms of the Agency Agreement. On March 26, 2012, the Company filed a Second Amended Agency Agreement to replace the length of term of the agreement and provide for a five-year term, with an obligation for the parties to negotiate renewal in good faith, effective March 1, 2012. The California Department of Insurance (CDI) approved both the original and the Second Amended Agency Agreements on November 26, 2013, pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

In 2015, a joinder to the Agency Agreement was made to add McGraw Insurance Services L.P. (McGraw LP) as a party to the Agency Agreement. The Company will pay McGraw LP a 25% commission of gross written premiums for all product lines, and premiums collected must be remitted to the Company within 30 days after the end of the month in which business is written. As a result of a corporate restructuring, TMC was dissolved and McGraw LP became the Company's exclusive general agent. The amended Agency Agreement became effective upon CDI approval on January 20, 2015, pursuant to CIC Section 1215.5(b)(4).

On December 2, 2021, the Company filed a Third Amended Agency Agreement to provide for renegotiation of the agreement terms and provisions no less than once every three years, a revision of the insolvency provision to provide the Company with a right to terminate upon specified insolvency events, added a new receivership provision, and increased the maximum premium volume to $300 million. All other terms remained unchanged. The CDI approved the Third Amended Agency Agreement on December 29, 2021, pursuant to CIC Section 1215.5(b)(4).

On May 3, 2024, the Company filed a Fourth Amended Agency Agreement to add a non-

exclusivity provision allowing McGraw LP to place business with non-affiliated insurers through its independent producer network, and to include a one-year non-solicitation restriction following termination. The Fourth Amendment also added provisions that the Company will maintain ultimate control over delegated functions and monitor services annually, and that the advancement of funds to McGraw LP is prohibited except for services defined in the Agency Agreement. All other terms and conditions remained unchanged. The CDI approved the amendment on May 17, 2024, pursuant to CIC Section 1215.5(b)(4), effective May 30, 2024. The Company paid McGraw LP commissions totaling $72,082,991, $76,442,527, $84,824,140, and $79,652,238 for 2021, 2022, 2023, and 2024, respectively.

CIC Section 1733 provides that premium funds received by a licensee are held in a fiduciary capacity, and any person who diverts those fiduciary funds to that person's own use is guilty of theft and punishable for theft as provided by law. In addition, CIC Section 1215.5(a) provides that transactions by the Company with its affiliates are subject to fair and reasonable treatment, and the books, accounts, and records of each party to all transactions shall be so maintained as to clearly and accurately disclose the precise nature and details of the transaction. Further, CDI Bulletin No. 80-6 provides that all payments by the insured that are part of the cost of insurance are considered premiums and subject to premium tax.

During the course of the examination, it was noted that: (1) although the premium trust account was properly reconciled at the end of the month, premium funds held in that premium trust account were transferred to bank accounts owned by other WSCC entities or other than McGraw LP's operating account prior to the settlement with the Company of the month's premium collections and commission expenses; (2) multiple premium trust fund advances were processed during the month. Although the monthly settlement was reconciled to the Agreement terms, there was no numerical calculation/analysis of each transfer made during the month. Total monthly premium trust fund advances did not match the "Net Premiums Written" as defined in the Agreement, and were not supported by the Company premium billings or a monthly report and remittance form in accordance with the Agreement's settlement terms, which require settlement within 30 days after

month-end in which the business is written; (3) certain policy-related fees charged to policyholders were not supported by executed governing documentation; and (4) the Company and McGraw LP maintained separate premium trust records. However, based on the records and process description provided, McGraw LP's records appear to serve as the primary source of detail supporting premium transaction processing. The Company's records reflect premium activity on a net-settlement basis (i.e., net of commissions and fees), rather than maintaining insurer-level records on a gross premium basis.

As a result, it is recommended that the Company ensure that McGraw LP does not transfer premium trust funds to bank accounts owned by other WSCC entities or other McGraw LP's operating account prior to the settlement with the Company of the month's premium collections and commission expenses so that compliance with CIC Section 1733 is clear.

It was also determined that the Company was not in compliance with 1215.5(a) and CDI Bulletin No. 80-6.

1. The current General Agency Agreement does not clearly authorize and describe all policyholder fee types, and therefore it is recommended that the Company execute a new/amended General Agency Agreement with McGraw LP and file the agreement with the CDI prior to implementation. The new/amended agreement should comply with CIC Section 1215.5(a) and CDI Bulletin No. 80-6, and include the provisions noted below:
    - Clear authorization and description of all policyholder fee types (e.g., policy, endorsement, cancellation, reinstatement, and installment fees);
    - Specify fee amounts and refundability terms;
    - Define fee retention and remittance arrangements between McGraw LP and the Company; and
    - Address state premium tax treatment and related compliance obligations for the states the Company actively writes in.
2. The Company should also implement procedures and controls to ensure that premium collection, fiduciary handling of premium funds, and commission settlements are performed in accordance with the newly executed General

Agency Agreement.

Furthermore, pursuant to CIC Section 734, CDI will engage independent experts to better evaluate the cash flow of the premium trust account and, if necessary, rewrite, post, and balance the Company's books and records for the years in question and ensure compliance with CIC Section 923.

Services and Expense Allocation Agreement: Effective January 1, 2019, the Company entered into a Services and Expense Allocation Agreement (Service Agreement) with the Western Service Contract Corporation (WSCC); McGraw Insurance Services L.P. (McGraw LP); and Pacific Specialty Property and Casualty Company (PSPCC). Under the terms of the agreement, the Company provides various administrative and operational services to WSCC, McGraw LP and PSPCC, including accounting and financial reporting, tax compliance, policy issuance and administration, underwriting, loss control, actuarial services, claims administration, treasury operations, budgeting and cost accounting, personnel services, electronic funds transfer, legal support, office services, information technology, computer and communications support, policy records maintenance, sales, marketing, and other related services. WSCC also provides the Company with software services, including access to the Duck Creek policy administration and claims management system. Compensation for these services is based on actual costs, with no profit factor included. Costs are determined using appropriate time studies, activity counts, expense sharing models, or other recognized methods. Both direct costs and indirect or shared expenses are allocated in accordance with a cost allocation methodology consistent with Statements of Statutory Accounting Principles (SSAP) No. 70. All expenses incurred by the Company and WSCC are billed to the participating entities and settled monthly. The CDI approved the Service Agreement on December 6, 2018, pursuant to CIC Section 1215.5(b)(4). The Company allocated general expenses totaling $460,750, $303,468, $2,134,329, and $6,261,693 for 2021, 2022, 2023, and 2024, respectively, to WSCC and McGraw LP in the aggregate. In addition, the Company allocated a fixed software services expense totaling $681,571 for the years 2021 through 2024 to WSCC. No general expenses were allocated to PSPCC, which has been in runoff since 2021.

General expenses allocated to McGraw LP and WSCC increased significantly beginning in 2023, primarily due to IT-related system initiatives, including policy management system upgrades, development of a new document management system, and Duck Creek system version upgrades. The increase was also impacted by normal inflationary increases in salary and benefit costs.

Tax Allocation Agreement: Effective January 1, 2006, the Company entered into a Tax Allocation Agreement (Tax Agreement) with WSCC, its parent, and affiliated entities. Under the terms of the Tax Agreement, participants in the group file a consolidated federal income tax return. WSCC is responsible for filing the consolidated return and making federal income tax payments on behalf of all participants. Tax liabilities are allocated based on separate return calculations, with each participant settling its tax obligation as if separate returns had been filed. Any tax balance payable or receivable is settled within 30 days of the consolidated return filing date. The CDI approved the Tax Agreement on February 8, 2007, pursuant to CIC Section 1215.5(b)(4). The Company filed Amendments No. One and No. Two, to add and remove various parties from the agreement and include an indemnification provision required by Texas Administrative Code Section 7.204(a)(2)(E) for Texas insurers. The amendments were approved by the CDI on November 30, 2018, pursuant to CIC Section 1215.5(b)(4).

The Company paid federal income taxes totaling $4,056,751, $953,000, $0, and $2,228,000 for 2021, 2022, 2023, and 2024, respectively.

Related Party Transactions

Credit Agreement: On June 26, 2014, Western Service Contract Corporation (WSCC) entered into a Credit Agreement with City National Bank (Lender) for a $40,000,000 term loan, as amended (Credit Agreement). In connection with the Credit Agreement, WSCC pledged the stock of the Company to the lender as collateral. The Company filed an application with the California Department of Insurance (CDI) requesting an exemption from the Form A filing requirement pursuant to California Insurance Code (CIC) Section 1215.2(g), which was granted on May 7, 2014.

On February 21, 2018, the Credit Agreement was amended to include McGraw Insurance Inc. and McGraw Insurance Services L.P. as additional borrowers. The term loan bears interest at a variable rate based on the bank's base rate plus a margin determined by leverage thresholds defined in the Credit Agreement. Loan payments are made in quarterly installments of principal and interest. The original maturity date of the term loan was June 30, 2022.

On May 11, 2021, the Credit Agreement was further amended to extend the maturity date to May 11, 2026, and to increase the loan amount to $44,500,000. As of December 31, 2024, the outstanding principal and accrued interest totaled $31,000,000.

Effective July 25, 2025, the Credit Agreement was amended to replace the pre-approved term loan and revolving credit facility with a single fully amortizing $25,000,000 term loan and to extend the maturity date to June 25, 2030. The amended term loan requires fixed quarterly principal payments of $892,857 beginning October 1, 2025. As of March 31, 2026, the outstanding balance had decreased to $22,500,000.

TERRITORY AND PLAN OF OPERATION

The Company is a property and casualty insurance company licensed in all 50 states and the District of Columbia. It is primarily operated as a California personal lines writer. Its personal lines include property (fire and homeowners' multiple peril), marine (watercraft and boats), private passenger automobile (primarily motorcycles), stand-alone earthquake, and personal liability coverage. Its commercial products serve used car dealerships, landscaping and janitorial operations, and business owners' package policies. The Company has three offices, which are in Anaheim, California; Rancho Cordova, California; and Las Vegas, Nevada.

The Company utilizes multiple distribution platforms to market its products. Most of the Company's direct business is produced through its affiliated agency, McGraw Insurance Services L.P. The Company's motorcycle and personal watercraft policies are also offered through dealers possessing insurance licenses. Other distribution channels are

direct, independent agents, and brokers. In 2024, approximately $129,700,000 (49.7%) of the business was distributed by Ivantage Select Agency, Inc., an affiliate of Allstate Insurance Company; $102,100,000 (39.1%) was generated by independent agencies and brokers; $26,700,000 (10.2%) was produced by Farmers Insurance; and $2,200,000 (0.8%) was generated directly.

In May 2023, the Company withdrew from its personal watercraft and pleasure boat programs and began non-renewing these programs on July 22, 2023.

In July 2024, the Company withdrew from its stand-alone earthquake program and entered into a renewal rights sale agreement with Palomar Specialty Insurance Company. The Company began nonrenewing its full earthquake book of business on January 1, 2025.

In 2024, the Company reported direct premiums written totaling $276,902,625. These consisted of homeowners' multiple peril (92.0%), earthquake (5.0%), other liability (1.8%), other private passenger automobile liability (0.6%), and private passenger automobile physical damage (0.5%). Most direct premiums were written in California (85.3%), followed by Connecticut (7.0%), Arizona (3.9%), New Jersey (3.4%), Oklahoma (0.2%), and Utah (0.2%).

During 2025, the Company reported new business production in Arizona, Connecticut, and New Jersey, reflecting a degree of geographic diversification outside of California.

REINSURANCE

Assumed

The Company assumed 90% of the business written by its subsidiary, Pacific Specialty Property and Casualty Company (PSPCC), under a quota share agreement effective January 1, 2009. PSPCC ceased to write new business and non-renewed its policies in 2020. On February 27, 2021, PSPCC fully exited the property business. As a result, the

Company did not assume any premiums from PSPCC during the examination period.

Ceded

The following is a summary of the principal reinsurance agreements in-force as of December 31, 2024:

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
Earthquake Quota Share Reinsurance Contract	Authorized GeoVera Specialty Insurance Company (100%)	50% of losses under the policies, loss adjustment expense, extra- contractual obligations, and loss in excess of policy limits covered under this contract.	50% of losses under the policies, loss adjustment expense, extra- contractual obligations, and loss in excess of policy limits covered under this contract.
Property Net Quota Share	Authorized Insurance Company of The West (50%) Unauthorized SCOR Reinsurance Company (50%)	70% of the first $10,000,000 each loss occurrence.	30% of the first $10,000,000 each loss occurrence.
Personal Umbrella Quota Share Reinsurance Contract	Authorized Trans Reinsurance Corporation (100%)	5% of the first $1,000,000 each loss occurrence.	95% of the first $1,000,000 each loss occurrence; and 100% excess of $1,000,000 each loss occurrence.
Multiple Lines Excess of Loss Reinsurance Contract First Layer	Authorized Hannover Ruck SE (30%) Renaissance Reinsurance U.S. Inc. (12%) Allied World Insurance Company (23%) Odyssey Reinsurance Company (20%) Various reinsurers (10%) Unauthorized American Agricultural Insurance Company (5%)	$1,000,000 each loss, each risk, each loss occurrence.	Coverage A (Property): $1,500,000 excess of $1,000,000 each loss, each risk. Aggregate limit of $2,000,000 each loss occurrence. Coverage B (Casualty): $1,500,000 excess of $1,000,000 each loss occurrence. Coverage C (Property and Casualty): $1,000,000 excess of $1,000,000 each loss occurrence.

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
Second Layer	Authorized Hannover Ruck SE (30%) Renaissance Reinsurance U.S. Inc. (12%) Allied World Insurance Company (23%) Odyssey Reinsurance Company (20%) Various reinsurers (10%) Unauthorized American Agricultural Insurance Company (5%)	$2,500,000 each loss, each risk, each loss occurrence	Coverage A (Property): $1,000,000 excess of $2,500,000 each loss, each risk. Aggregate limit of $3,000,000 for all losses. Coverage B (Casualty): $1,000,000 excess of $2,500,000 each occurrence, and further subject to a limit of $3,000,000 for all loss occurrences.
Third Layer	Authorized Hannover Ruck SE (30%) Renaissance Reinsurance U.S. Inc. (9%) Allied World Insurance Company (24%) Odyssey Reinsurance Company (24%) Various reinsurers (7%) Unauthorized American Agricultural Insurance Company (6%)	$3,500,000 each loss, each risk, each loss occurrence	Coverage A (Property): $5,000,000 excess of $3,500,000 each loss, each risk. Aggregate limit of $15,000,000 for all losses. Coverage B (Casualty): $5,000,000 excess of $3,500,000 each occurrence, and further subject to a limit of $15,000,000 for all loss occurrences.
Property Catastrophe Excess of Loss Reinsurance Contract First Layer	Authorized Arch Reinsurance Ltd (28%) Lloyd's of London (9%) Various reinsurers (23.5%) Unauthorized R+V Versicherung AG (14.5%) Various Reinsurers (25%)	$5,000,000 each loss occurrence	$15,000,000 excess of $5,000,000 each loss occurrence; limited to $30,000,000 for all loss occurrences.
Second Layer	Authorized Arch Reinsurance Ltd (15%) Lloyd's of London (9%) Various reinsurers (32.75%) Unauthorized R+V Versicherung AG (12.5%) Various Reinsurers (30.75%)	$20,000,000 each loss occurrence	$20,000,000 excess of $20,000,000 each loss occurrence; limited to $40,000,000 for all loss occurrences.

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
Third Layer	Authorized Lloyd's of London (9%) Various reinsurers (37.25%) Unauthorized R+V Versicherung AG (12.5%) Sirius Point Bermuda Insurance Company Ltd (12%) Various Reinsurers (29.25%)	$40,000,000 each loss occurrence	$60,000,000 excess of $40,000,000 each loss occurrence; limited to $120,000,000 for all loss occurrences.
Fourth Layer	Authorized Lloyds of London (9%) Various reinsurers (45%) Unauthorized R+V Versicherung AG (10%) Fidelis Insurance Bermuda Ltd (7.5%) Various Reinsurers (28.5%)	$100,000,000 each loss occurrence	$50,000,000 excess of $100,000,000 each loss occurrence; limited to $100,000,000 for all loss occurrences.
Fifth Layer	Authorized Lloyd's of London (9%) Various reinsurers (47.75%) Unauthorized R+V Versicherung AG (10%) Fidelis Insurance Bermuda Ltd (7.5%) Various Reinsurers (25.75%)	$150,000,000 each loss occurrence	$50,000,000 excess of $150,000,000 each loss occurrence; limited to $100,000,000 for all loss occurrences.
Sixth Layer	Authorized Arch Reinsurance Ltd (100%)	$200,000,000 each loss occurrence	$25,000,000 excess of $200,000,000 each loss occurrence; limited to $50,000,000 for all loss occurrences.
Seventh Layer	Authorized Arch Reinsurance Ltd (100%)	$225,000,000 each loss occurrence	$25,000,000 excess of $225,000,000 each loss occurrence; limited to $100,000,000 for all loss occurrences.

Line of Business and Type of Contract	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limit
Home Cyber Protection, Home System Protection and Service Line Reinsurance Agreement	Authorized The Hartford Steam Boiler Inspection And Insurance Company (100%)	None	Home Cyber Protection: $50,000 annual aggregate, any one policy Home System Protection: $100,000 for any one breakdown, any one policy Service Line: $10,000 for any one service line failure, any one policy

ACCOUNTS AND RECORDS

Annual Statement Instructions

Pursuant to the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, the Appointed Actuary must report to the Board of Directors each year on items within the scope of the Actuarial Opinion. The Actuarial Opinion and the supporting Actuarial Report are required to be made available to the Board of Directors. In addition, the minutes of the Board of Directors should reflect that such information was presented by the Appointed Actuary and identify the manner of presentation (e.g., written report, in-person presentation, or webinar).

During the examination, it was noted that the Appointed Actuary reported to the Board of Directors in 2022 and 2023; however, no such reporting occurred in 2021 or 2024. This is a repeat finding from the previous Examination Report. It is again recommended that the Company implement appropriate procedures to ensure that the Appointed Actuary reports annually to the Board of Directors on matters within the scope of the Actuarial Opinion, and that such reporting is documented in the minutes of the Board of Directors, including the manner of presentation in accordance with the NAIC Annual Statement Instructions.

Vehicle Fraud Assessment

California Insurance Code (CIC) Section 1872.8(a) requires each insurer transacting insurance in California to pay an annual vehicle fraud assessment fee for each vehicle insured under a policy issued in this state. Title 10, California Code of Regulations (CCR), Section 2698.62(b) further requires that the vehicle fraud assessment shall be due on each vehicle, identified by its vehicle identification number, for each quarter in which a policy is in force on such vehicle, including when a vehicle is added to or replaced under an existing policy.

During the examination, it was noted that the vehicle count data provided by the Company did not reconcile to its quarterly vehicle fraud assessment filings for the examination period, nor did it provide a reasonable justification for the discrepancy. As a result, the examination was unable to verify the accuracy of the reporting and determine the compliance with CIC Section 1872.8(a) and Title 10 CCR Section 2698.62(b). This is a repeat finding from the previous Examination Report. It is again recommended that the Company evaluate its system and processes to ensure that vehicle count data supporting the vehicle fraud assessment is complete, accurate, and in full compliance with CIC Section 1872.8(a) and Title 10 CCR Section 2698.62(b).

Insurance Holding Company System Annual Registration Statement

CIC Section 1215.4(b)(3) and the NAIC instructions for the Insurance Holding Company System Annual Registration Statement (Form B), Item 5 (Transactions and Agreements), require that intercompany agreements be described in sufficient detail to permit proper evaluation by the Commissioner. Specifically, the instructions require disclosure of: "…the nature and purpose of the transaction, the nature and amounts of any payments or transfers of assets between the parties, the identity of all parties to the transaction, and the relationship of the affiliated parties to the registrant."

During the examination, it was noted that the Company's 2023 Form B filing did not include disclosure of the amounts of payments between the parties for certain

intercompany agreements, as prescribed by CIC Section 1215.4(b)(3) and the NAIC instructions.

Furthermore, the Company's operational funds were transferred between the Company and Western Service Contract Corporation (WSCC) to support and service the debt obligation of WSCC to City National Bank, discussed in the "Management and Control" under the Credit Agreement section. These transactions between WSCC and the Company constitute affiliate loans, extensions of credit, or other financing arrangements that were not properly documented, recorded, or disclosed as required under CIC Sections 1215.4(b)(3)(A) and 1215.5(a), nor submitted to the California Department of Insurance (CDI) when subject to filing requirements.

It is recommended that the Company ensure that Form B includes complete disclosure of the required information for all intercompany agreements in force between the Company and its affiliates, in accordance with CIC Section 1215.4(b)(3)(A) and the NAIC Form B instructions. It is also recommended that any funding arrangement between the insurer and an affiliate should be supported by a written intercompany agreement, clearly recorded in the Company's books and records to reflect the true nature of the transaction, disclosed in holding-company filings, and submitted to the CDI when required under CIC Sections 1215.4(b)(3)(A) and 1215.5(a).

Direct Written Premiums, Policy-Related Fees, and Advance Premiums

CIC Section 923 requires the insurer to file the Annual Statement in conformity with the NAIC Accounting Practices and Procedures Manual adopted by the NAIC. The NAIC Statement of Statutory Accounting Principles (SSAP) No. 53, Property/Casualty Contracts – Premiums, requires, in part, that written premium be recorded as of the policy effective date, that additional premium for endorsements and coverage changes be recorded as of the endorsement effective date and recognized as earned premium in the income statement, and that flat fee service charges be reported as other underwriting income (finance and service charges) when non-refundable, or included in premium and subject to unearned premium guidelines when refundable. In addition, SSAP No. 53 provides that advance premiums liability arises when policies are processed, and

premiums are paid prior to the effective date, and that such amounts are reported as liability and are not included in written premium or unearned premium.

A review of the Company's 2024 premium data indicated that (1) written premiums were recorded based on transaction dates rather than policy effective dates; (2) policy fees were earned at the time of billing instead of policy effective dates; and (3) advance premiums were reported as the system generated the renewal rather than premiums paid prior to the effective date of coverage. Timing differences between policy and billing system records were addressed through write-offs of written and advance premiums rather than by correcting the underlying recognition methodology. Based on the anomalies noted, the examination was unable to determine if the Company's reporting of direct written premiums, policy fees, and advance premiums was in compliance with SSAP No. 53.

After the California Department of Insurance (CDI) raised concerns regarding the Company's premium and policy fee reporting, the Company provided regenerated premium information based on policy effective dates and represented that the aggregate difference compared with its current billing-transaction-date reporting was less than 1%. However, the data still contained anomalies, and the examination was unable to determine whether the Company's alternative methodology complied with statutory reporting requirements. As noted in the "Management and Control - Management Agreement" section pursuant to CIC Section 734, the CDI will engage independent experts to rewrite, post, and balance the Company's books and records for the years in question, if necessary, to comply with SSAP 53.

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, 2024. These financial statements were prepared by management and are the responsibility of management. No adjustments were made to the statutory financial statements filed by the Company.

Statement of Financial Condition as of December 31, 2024

Underwriting and Investment Exhibit for the Year Ended December 31, 2024

Reconciliation of Surplus as Regards Policyholders from December 31, 2020 through December 31, 2024

Statement of Financial Condition
as of December 31, 2024

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 247,286,321	$	$ 247,286,321	
Common stocks	5,907,614		5,907,614	
Properties held for the production of income	20,929,144		20,929,144	
Cash, cash equivalents, and short short-term investments	16,026,777		16,026,777	
Other invested assets	13,999,783		13,999,783	
Investment income due and accrued	2,530,397		2,530,397	
Uncollected premiums and agents' balances in the course of collection	529,938		529,938	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,702,142		1,702,142	
Amounts recoverable from reinsurers	3,641,580		3,641,580	
Current federal and foreign income tax recoverable and interest thereon	4,034,866		4,034,866	
Net deferred tax asset	7,274,883		7,274,883	
Furniture and equipment	76,146	76,146	0	
Receivables from parent, subsidiaries and affiliates	2,565,222		2,565,222	
Aggregate write-ins for other than invested assets	13,456,079	8,349,868	5,106,210	
Total assets	$ 339,960,892	$ 8,426,014	$ 331,534,877	

Liabilities, Surplus and Other Funds				Notes
Losses			$ 43,841,186	(1)
Loss adjustment expenses			20,958,999	(1)
Other expenses			3,567,424	
Taxes, licenses and fees			405,448	
Unearned premiums			107,307,187	(2)
Advance premiums			8,070,608	(2)
Ceded reinsurance premiums payable			5,436,345	
Payable for securities			1,038,229	
Total liabilities			190,625,426	
Common capital stock		$ 3,500,000		
Gross paid-in and contributed surplus		15,359,109		
Unassigned funds (surplus)		122,050,342		
Surplus as regards policyholders			140,909,451	
Total liabilities, surplus, and other funds			$ 331,534,877	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2024

Statement of Income

Underwriting Income			
Premium earned		$ 196,900,710	(2)
Deductions:			
Losses incurred	$ 86,616,452		
Loss adjustment expenses incurred	20,083,545		
Other underwriting expenses incurred	85,471,178		
Total underwriting deductions		192,171,175	
Net underwriting gain		4,729,535	
Investment Income			
Net investment income earned	$ 7,794,770		
Net realized capital gains	2,813,769		
Net investment gain		10,608,539	
Other Income			
Finance and service charges not included in premiums	$ 1,202,459		(2)
Aggregate write-ins for miscellaneous income	(3,997,534)		
Total other income		(2,795,075)	
Net income after dividends to policyholders, after capital gains tax, and before all other federal and foreign income taxes		12,542,999	
Federal and foreign income taxes incurred		1,821,591	
Net income		$ 10,721,408	

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2023		$ 141,145,618
Net income	$ 10,721,408	
Change in net unrealized capital losses	(1,551,721)	
Change in net deferred income tax	297,759	
Change in nonadmitted assets	(4,703,613)	
Dividends to stockholders	(5,000,000)	
Change in surplus as regards policyholders for the year		(236,167)
Surplus as regards policyholders, December 31, 2024		$ 140,909,451

Reconciliation of Surplus as Regards to Policyholders from December 31, 2020, through December 31, 2024

Surplus as regards policyholders, December 31, 2020			$ 141,564,831
	Gain in Surplus	Loss in Surplus	
Net income	$ 19,905,993	$	
Change in net unrealized capital gains	2,397,064		
Change in net deferred income tax	1,623,113		
Change in nonadmitted assets		2,820,214	
Surplus adjustments: Paid-in	3,974,690		
Dividend to stockholders		25,736,026	
Total gains and losses	$ 27,900,860	$ 28,556,240	
Net decrease in surplus as regards policyholders			(655,380)
Surplus as regards policyholders December 31, 2024			$ 140,909,451

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Senior Casualty Actuary of the California Department of Insurance reviewed the actuarial reports prepared by the Company's independent actuary and concurred that the Company's loss and loss adjustment expense reserves as of December 31, 2024, were reasonable and have been accepted for the purpose of this examination.

(2) Advance Premiums
(2) Premium Earned
(2) Finance and Service Charges not Included in Premium

The Company's premium and policy-related fee reporting is discussed in the "Management and Control" and "Account and Records" sections.

SUBSEQUENT EVENTS

In January 2025, the Southern California Palisades and Eaton wildfires occurred, resulting in widespread property damage and significant insured loss activity. The Company reported estimated ultimate losses related to these events of $150,800,000. Under the reinsurance treaties in effect, the Company reported recoveries of approximately $111,900,000 during 2025. As of September 30, 2025, the Company reported a net retained loss of $10,800,000 and reinstatement premiums of approximately $15,900,000. The Company reported policyholders' surplus of $136,270,350 as of December 31, 2025, compared to $140,909,451 as of December 31, 2024, and a 2025 Risk-Based Capital ratio of 419.1%.

In addition, the Company is a participant in the California FAIR Plan Association and paid a $17,000,000 assessment in March 2025 related to these wildfire losses. The Company billed the assessment to its reinsurers in accordance with applicable reinsurance agreements. The Company expects to recover 50% of the assessment from policyholders over a two-year period, and any amount recovered from policyholders will be ceded to reinsurers pursuant to the terms of the applicable reinsurance treaties.

Subsequent to the examination period, the Company entered into Assignments of Subrogation Claims Agreements with third-party purchasers to sell certain subrogation claim rights related to California wildfire losses. The agreements were executed in February 2025 and June 2025. As a result of these transactions, the Company received proceeds of $44,300,000 in March 2025 and $2,500,000 in July 2025 from the initial settlements, and an additional $3,500,000 in October 2025 from a subsequent settlement related to the assigned subrogation claims.

In March 2026, the Company filed a notice with the California Department of Insurance (CDI) to withdraw its other liability line of business under the personal umbrella program. This decision was made as the program's written premium volume is too low to support a sustainable rate of return. In addition, the Company is implementing a comprehensive upgrade to its claims and policy administration systems, and the cost required to transition this small program to the new platform is not feasible for a program of the Company's size.

In compliance with California's 60-day notice requirement, the Company will begin issuing nonrenewal notices to its other liability policyholders on January 1, 2027, allowing insureds time to secure replacement coverage with another carrier. In-force policies will be nonrenewed at expiration, and the Company will continue to service all related claims.

The Company is currently working with RLI Corporation (RLI) to provide policyholders, at policy expiration, with the option to transition coverage to RLI through RLI's existing producer.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control (Page 7): It is recommended that the Company ensure that McGraw Insurance Services L.P. (McGraw LP) does not transfer premium trust funds to bank accounts owned by other Western Service Contract Corporation (WSCC) entities or

other McGraw LP's operating account prior to the settlement with the Company of the month's premium collections and commission expenses so that compliance with California Insurance Code (CIC) Section 1733 is clear.

Management and Control (Page 7): It is recommended that the Company: (1) Execute a new General Agency Agreement with McGraw LP and file the agreement with the California Department of Insurance (CDI) prior to implementation. The agreement should comply with CIC Section 1215.5(a) and CDI Bulletin No. 80-6, and include provisions that: clearly authorize and describe all policyholder fee types (e.g., policy, endorsement, cancellation, reinstatement, and installment fees); specify fee amounts and refundability terms; define fee retention and remittance arrangements between the McGraw LP and the Company; and address state premium tax treatment and related compliance obligations. (2) The Company should also implement procedures and controls to ensure that premium collection, fiduciary handling of premium funds, and commission settlements are performed in accordance with the newly executed General Agency Agreement.

Accounts and Records – Annual Statement Instructions (Page 15): It is again recommended that the Company implement appropriate procedures to ensure that the Appointed Actuary reports annually to the Board of Directors on matters within the scope of the Actuarial Opinion, and that such reporting is documented in the minutes of the Board of Directors, including the manner of presentation in accordance with the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions.

Accounts and Records – Vehicle Fraud Assessment (Page 16): It is again recommended that the Company evaluate its system and processes to ensure that vehicle count data supporting the vehicle fraud assessment is complete, accurate, and in full compliance with CIC Section 1872.8(a) and Title 10 California Code of Regulation (CCR) Section 2698.62(b).

Accounts and Records – Insurance Holding Company System Annual Registration Statement (Form B) (Page 16): It is recommended that the Company ensure that Form B includes complete disclosure of the required information for all intercompany agreements

in force between the Company and its affiliates, in accordance with CIC Section 1215.4(b)(3)(A) and the NAIC Form B instructions. It is also recommended that any funding arrangement between the insurer and an affiliate should be supported by a written intercompany agreement, clearly recorded in the Company's books and records to reflect the true nature of the transaction, disclosed in holding-company filings, and submitted to the CDI when required under CIC Sections 1215.4(b)(3)(A) and 1215.5(a).

Previous Report of Examination

Accounts and Records – Unclaimed Property (Page 11): It was recommended that the Company escheat unclaimed property to the California State Controller's Office timely and implement procedures to ensure future compliance with California Code of Civil Procedure Sections 1530 and 1532. The Company has complied with this recommendation.

Accounts and Records – Annual Statement Instructions (Page 11): It was recommended that the Company implement appropriate procedures to ensure that its Appointed Actuary report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion; and that such reporting is documented in the minutes of the Board of Directors or Audit Committee. The Company partially complied with this recommendation.

Accounts and Records – Premium Taxes (Page 12): It was recommended that the Company report and pay the California premium taxes properly and accurately and implement procedures to ensure future compliance with California Revenue and Taxation Code Sections 12301 and 12302. The Company has complied with this recommendation.

Accounts and Records – Vehicle Fraud Assessment (page 12): It was recommended that the Company implement procedures to ensure its vehicle count data is accurate and comply with CIC Section 1872.8(a) and CCR Section 2698.62(b). The Company has not complied with this recommendation.

Comments on Financial Statement Items – Bonds, Common Stocks, Cash and Short-Term Investments (Page 18): It was recommended that the Company submit its custodian agreement with the California Department of Insurance (CDI) for approval in accordance with CIC Section 1104.9(d). 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 this examination.

Respectfully submitted,

Liu, Shelly

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Date: 2026.06.30 09:52:21 -07'00'

Shelly Liu, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

Fan, Vivien

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Vivien Fan, CFE
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