REPORT OF EXAMINATION

OF THE

PREFERRED EMPLOYERS INSURANCE COMPANY

AS OF

DECEMBER 31, 2013

Filed May 20, 2015

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Los Angeles, California
March 17, 2015

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PREFERRED EMPLOYERS INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 1455 Frazee Road, Suite 1000, San Diego, California 92108.

SCOPE OF EXAMINATION

We have performed our multi-state coordinated examination of the Company. The previous examination of the Company was made as of December 31, 2009. This examination covers the period from January 1, 2010 through December 31, 2013. The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination was a coordinated examination and was conducted concurrently with other insurance entities in the W.R. Berkley Corporation Group, and included participation with Arizona, Delaware, New Hampshire, North Carolina, North Dakota, and Texas Departments of Insurance, Iowa Insurance Division, and Minnesota Department of Commerce, Insurance Division. The insurance entities reviewed, by state, during the examination are: Arizona; Nautilus Insurance Company; Delaware; Admiral Indemnity Company, Admiral Insurance Company, Berkley Insurance Company, Berkley Regional Insurance Company, Berkley Regional Specialty Insurance Company, Firemen's Insurance Company, Gemini Insurance Company, Midwest Employers Casualty Company, and StarNet Insurance Company; Iowa; Berkley Assurance Company, Berkley National Insurance Company, Carolina Casualty Insurance Company, Clermont Insurance Company, Continental Western Insurance Company, and Union Insurance Company; Minnesota; Riverport Insurance Company and Tri State Insurance Company of Minnesota; New Hampshire; Acadia Insurance Company; North Carolina; Key Risk Insurance Company; North Dakota; Great Divide Insurance Company; and Texas; Union Standard Lloyds; with Delaware serving as the lead state.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; and statutory deposits.

SUBSEQUENT EVENTS

Berkley Insurance Company (BIC) entered into an inter-company pooling agreement with nineteen of its U.S. property Casualty insurance subsidiaries (Pool, Affiliates), effective January 1, 2013, BIC is the lead entity and retains 100% of the pool. Midwest Employers Casualty Company (MECC), a wholly owned subsidiary of BIC, is one of the Pool Affiliates and has zero net retention.

In addition, effective January 1, 2013, the Company, a wholly-owned subsidiary of BIC, has in place a 100% quota share reinsurance agreement with BIC.

As a result of these agreements, 100% of the California workers' compensation reserves of MECC and the Company were ceded to BIC as of January 1, 2013. The impact to the December 31, 2013 California Schedule P filings (submitted March 1, 2014) was as follows:

- BIC is required to increase its securities on deposit with California by $90 million
- MECC and the Company are entitled to decrease its securities on deposit with California by $53 million and $21 million, respectively

BIC submitted the required forms to transfer the excess securities on deposit from MECC (approximately $53 million) and the Company (approximately $21 million) to BIC.

In 2014, in conjunction with the 100% quota share arrangement between the Company and BIC, the California Department of Insurance authorized the Company to transfer its excess securities on deposit to and in the name of its parent, BIC, so that BIC adequately meets the workers' compensation deposit requirements for California under California Insurance Code Section 11691(2)(f)(2).

BIC will in effect buy these securities from MECC and the Company, and increased its securities on deposit with California by an additional $16 million by March 31, 2014.

COMPANY HISTORY

The Company was incorporated in California on December 11, 1997, and commenced transacting workers compensation insurance on June 1, 1998. On January 1, 2013, all outstanding shares of the Company owned by its then immediate parent, Midwest Employers Casualty Company (MECC), were transferred as a dividend to its controlling parent, Berkley Insurance Company (BIC). The California Department of Insurance

(CDI) issued its approval regarding the ownership transfer from MECC to BIC pursuant to a Form A Exemption application filed under California Insurance Code Section 1215.2(g) on March 7, 2013.

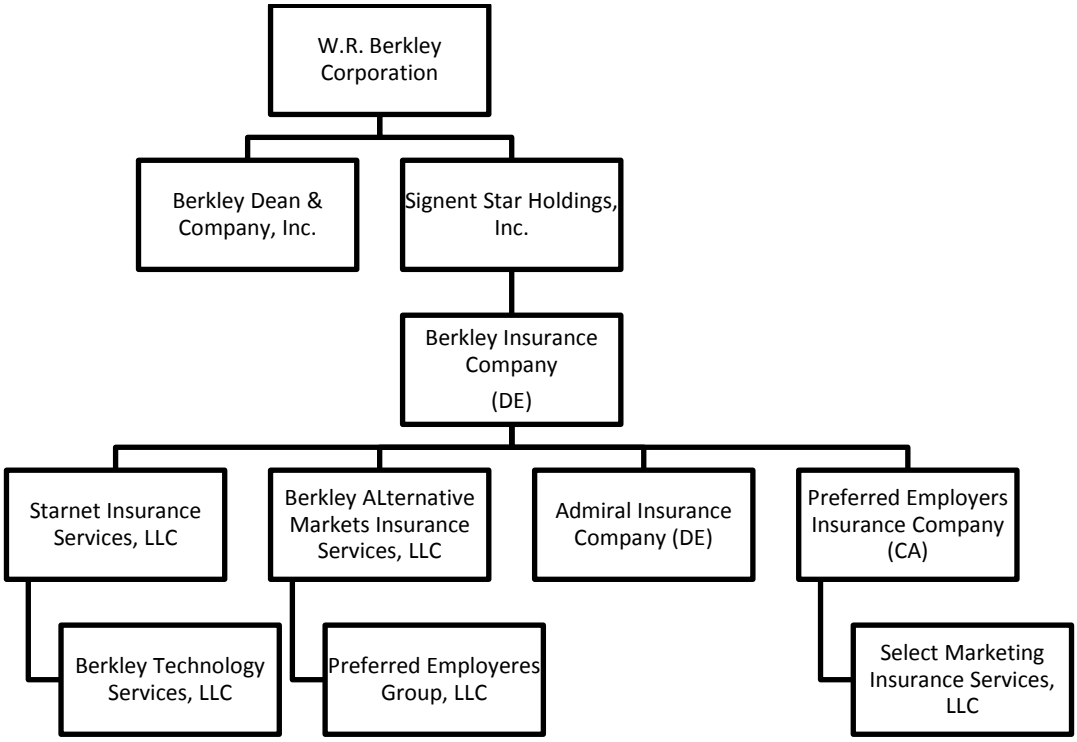
The ultimate controlling parent, W.R. Berkley Corporation, is an insurance holding company that is publicly traded on the New York Stock Exchange, whose business strategy focuses on being a commercial lines property and casualty insurance provider.

Dividends Paid to Parent

The Company paid ordinary dividends of $4,340,473, $4,289,518, and $4,218,278 for the years 2010, 2011, and 2012, respectively, in cash and or securities to its parent at the time, Midwest Employers Casualty Company. The dividend transactions did not exceed the thresholds requiring CDI approval.

MANAGEMENT AND CONTROL

The Company is part of an insurance holding company system of which W.R. Berkley Corporation is the ultimate controlling entity. The following abridged organizational chart depicts the Company's relationship within the holding company system: (all ownership is 100%):



The four members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2013:

Directors

Name and Location	Principal Business Affiliation
Eugene Ballard Katonah, New York	Senior Vice President and Chief Financial Officer W.R. Berkley Corporation
Steven A. Gallacher San Diego, California	President and Chief Executive Officer Preferred Employers Insurance Company
Ira S. Lederman Bedford, New York	Senior Vice President W.R. Berkley Corporation
Robert D. Stone Westport, Connecticut	Senior Vice President W.R. Berkley Corporation

Principal Officers

Name	Title
Steven A. Gallacher	President and Chief Executive Officer
Marc J. Beaulieu	Senior Vice President
Timothy J. Wiebe	Vice President, Chief Financial Officer, and Treasurer
Jan A. Beaver	Vice President and Secretary
John C. Bennett	Vice President
Tammy Ebnet	Vice President
Rosa E. Arden	Assistant Vice President
Edward G. Bradford II	Assistant Vice President
Stephanie G. Graham	Assistant Vice President
Eric M. Hansen	Assistant Vice President

Management Agreements

Administrative Service Agreement: Effective February 1, 2006, the Company entered into an Administrative Service Agreement with its wholly owned subsidiary, Select Marketing Insurance Services, LLC (SMI). Under the terms of the Agreement, SMI markets and solicits workers' compensation insurance business on behalf of the Company, and is compensated by the Company based on the actual cost of the services it provides. Conversely, the Company provides SMI with human resources, accounting functions, computer resources, and office facilities, and is compensated by SMI for the actual costs of these services. For 2010, 2011, 2012, and 2013, the Company paid SMI $299,845, $369,356, $357,425, and $342,929, respectively, under the terms of this Agreement. The California Department of Insurance (CDI) approved this Agreement on December 27, 2005.

Management and Administration Agreement: Since January 1, 2009, the Company had been a party to a Management and Administration Agreement with an affiliate, Preferred Employers Group, LLC (PEG). Under the terms of the Agreement, the Company had appointed PEG as its legal representative and lawful attorney for the purpose of transferring the servicing and performance of most of its administrative and operational functions to PEG, such as personnel, management, facilities, accounting, books and

record maintenance, premiums collections, underwriting, claims handling, reinsurance assistance, marketing assistance, and information technology systems. The Company compensated PEG the actual cost of these services. For 2010, 2011, and 2012, the Company paid PEG $169,000, $131,000, and $95,000, respectively, under the terms of the Agreement. The CDI had approved this Agreement on November 20, 2008.

Effective January 1, 2013, the Management and Administration Agreement with PEG was terminated and replaced with a new Management and Administration Agreement, summarized as follows: Effective January 1, 2013, the Company entered into a Management and Administration Agreement with its parent, Berkley Insurance Company (BIC). Under the terms of the Agreement, BIC provides the following services to the Company: underwriting, collection and handling of premiums, claims adjustment and payment and other insurer functions. The Company paid BIC $98,000 in 2013. The CDI approved this Agreement May 21, 2013.

Computer Service Agreement: Effective January 1, 2002, the Company entered into a Computer Services Agreement with its affiliate, Berkley Technology Services, LLC (BTS). Under the terms of the Agreement, BTS provides the Company with computer and data processing services, including programming, network management, operations, and consulting services. BTS is compensated by the Company for the actual cost of these services. For 2010, 2011, 2012, and 2013, the Company paid BTS $1,303,955, $1,205,584, $1,151,508, and $1,297,221, respectively, under the terms of this agreement. The CDI approved this Agreement on February 15, 2002.

Tax Allocation Agreement: The Company is a party to a Tax Allocation Agreement with its affiliates and its ultimate parent, W.R. Berkley Corporation (WRB). Under the terms of this Agreement, all the companies in the group file a consolidated federal income tax return. The consolidated federal income tax liability is allocated between the companies in the ratio that each company's separate tax return liability bears to the total consolidation federal tax liability. This agreement was approved by the CDI on April 27, 1998. The Company paid/(recovered) the following taxes during the years under review

for 2010, 2011, 2012, and 2013, in the amounts of $883,116, $785,143, $368,264, and $(47,084), respectively.

Investment Advisory Agreement: Effective April 23, 1998, the Company entered into an Investment Advisory Agreement with an affiliate, Berkley Dean & Company, Inc. (BDC). In accordance with the Company's investment guidelines, BDC provides investment advisory and management services. BDC is compensated based on an annual fee equal to 0.25% of the first $10 million dollars and 0.20% thereafter of the net asset value of the portfolio at the end of each quarter. The CDI approved this Agreement on April 27, 1998. For the 2010, 2011, 2012, and 2013 years, the Company paid BDC $137,157, $136,516, $134,716, and $85,690, respectively, under the terms of this Agreement.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2013, the Company was licensed to transact workers' compensation insurance in Arizona, California, Nevada, and Oregon; with business currently written in California only. In 2013, the Company wrote $121,755,683 of direct premiums, consisting exclusively of workers' compensation business. Currently there are more than fourteen thousand policy holders, and the Company focuses most of its business on the particular needs of smaller sized businesses that employ fewer than fifty employees.

The business is marketed and produced through a network of independent agents located throughout California. The Company's statutory home office is in San Diego, California, and has a claims adjusting office located in Walnut Creek, California.

REINSURANCE

Assumed

The Company does not assume reinsurance.

Ceded

The following is a summary of the principal reinsurance agreements in-force as of December 31, 2013:

Type of Contract and Lines of Coverage	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Quota Share 2010 thru 2012			
Quota Share	Berkley Insurance Company	10% of net liabilities	90% of net liabilities
Quota Share 2013			
Quota Share	Berkley Insurance Company	0% of net liabilities	100% of net liabilities
W.C. Excess of Loss			
Workers' Compensation First Layer	ARCH Reinsurance Co., AXIS Specialty Ltd., Munich Re America, Inc., Partner Re Co. of U.S, Various Lloyds' Syndicates	$5 million per occurrence	$5 million excess of $5 million per occurrence, limited to $10 million aggregate during term
Workers' Compensation Second Layer	Allied World Assurance Co., Ltd., Arch Reinsurance Co., AXIS Specialty Ltd., Hannover Rueckvrsicherung AG, Munich Re America, Inc.,	$10 million per occurrence	$15 million excess of $10 million per occurrence, limited to $30 million aggregate during term

Type of Contract and Lines of Coverage	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
	Partner Re Co. of U.S., Tokio Millennium Re Ltd., Various Lloyds' Syndicates		
Workers' Compensation Third Layer	ACE Tempest Re USA LLC, Allied World Assurance Co., Ltd., Arch Reinsurance Co., AXIS Specialty Ltd., Hannover Rueckversicherung AG., Munich Re America, Inc., Partner Re Co of U.S., Tokio Millennium Re Ltd.	$25 million	$20 million excess of $25 million per occurrence, limited to 40 million per term
Other Excess of Loss			
Casualty Contingency 2nd Excess of Loss	Hannover Rueckvrsicherung AG, QBE Reinsurance Corp., Various Lloyds' Syndicates	$5 million each loss occurrence	$5 million excess of $5 million per occurrence, limited to $20 million aggregate during term
Casualty Contingency 3rd Excess of Loss	Hannover Rueckvrsicherung AG, Various Lloyds' Syndicates	$10 million each loss occurrence	$25 million excess of $10 million per occurrence, limited to $50 million aggregate during term
W.C. CAT Excess of Loss			
1st Workers' Comp CAT Excess of Loss	Munich Re America, Inc., Allied Word Assurance Co., Ltd., Hannover Re (Bermuda) Ltd., Various Lloyds' Syndicates.	$5 million each loss occurrence	$50 million excess of $5 million per occurrence, with CAT reinsurance attached at $75M after underlying reinsurance layer or layers exhausted.
W.C. Per Employee Excess of Loss			
Workers' Comp per Employee Excess of Loss	Hannover Rueckvrsicherung AG, Transatlantic Reins Co.,	$3 million each employee	$4 million excess of $3 million per employee, limited to

Type of Contract and Lines of Coverage	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
	Various Lloyds' Syndicates		$12 million aggregate during term

All carriers are unauthorized California reinsurers except: ARCH Reinsurance, Berkley Insurance Company, Hannover Rueckvrsicherung, Lloyds Syndicate, Munich Re America Inc., Partner Re Company of U.S., QBE Reinsurance Corp., and Transatlantic Reinsurance.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2013

Underwriting and Investment Exhibit for the Year Ended December 31, 2013

Reconciliation of Surplus as Regards Policyholders from December 31, 2009 through December 31, 2013

Statement of Financial Condition
as of December 31, 2013

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 41,277,401	$	$ 41,277,401	
Cash and short-term investments	1,282,434		1,282,434	(1)
Other invested assets	1,000	1,000		
Receivable for securities	10,000		10,000	
Investment income due and accrued	333,319		333,319	
Premiums and agents' balances in course of collection	29,611,050	244,360	29,366,690	
Current federal and foreign income tax recoverable and interest thereon	827,746		827,746	
Net deferred tax asset	73,546		73,546	
Guaranty funds receivable or on deposit	4,570,635		4,570,635	(2)
Aggregate write-ins for other than invested assets	2,218,489	7,031	2,211,458	
Total assets	$ 80,205,620	$ 252,391	$ 79,953,229	

Liabilities, Surplus and Other Funds			
Commissions payable, contingent commissions and other similar charges		$ 2,657,684	
Other expenses		80,866	
Taxes, licenses and fees		5,331,501	(2)
Ceded reinsurance premiums payable		26,927,775	
Payable to parent, subsidiaries and affiliates		22,892	
Aggregate write-ins for liabilities		3,059,758	
Total liabilities		38,080,476	
Common capital stock	$ 3,500,000		
Gross paid-in and contributed surplus	7,500,000		
Unassigned funds (surplus)	30,872,753		
Surplus as regards policyholders		41,872,753	
Total liabilities, surplus and other funds		$ 79,953,229	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2013

Statement of Income

Underwriting Income		
Premiums earned		$ 0
Deductions:		
Losses and loss expenses incurred	$ 0	
Other underwriting expenses incurred	0	
Total underwriting deductions		0
Net underwriting loss		(0)
Investment Income		
Net investment income earned	$ 1,242,442	
Net realized capital gain	50,661	
Net investment gain		1,293,103
Other Income		
Net loss from agents' or premium balances charged off (amount recovered $0 amount charged off $113)	$ (113)	
Total other income		(113)
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		1,292,990
Federal and foreign income taxes incurred		(827,746)
Net income		$ 2,120,736

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2012		$ 40,797,047
Net income	$ 2,120,736	
Change in net deferred income tax	(944,278)	
Change in nonadmitted assets	261,387	
Aggregate write-ins for losses in surplus	(362,140)	
Change in surplus as regards policyholders for the year		1,075,706
Surplus as regards policyholders, December 31, 2013		$ 41,872,753

Reconciliation of Surplus as Regards Policyholders from December 31, 2009 through December 31, 2013

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2009 per Examination			$ 43,356,715
Net income	$ 11,728,346	$	
Net unrealized capital losses		13,563	
Change in net deferred income tax		1,490,920	
Change in nonadmitted assets	1,034,673		
Cumulative effect of changes in accounting principles	467,911		
Surplus adjustments: Transferred from Capital		12,848,269	
Aggregate write-ins for gains and losses in surplus		362,140	
Total gains and losses	$ 13,230,930	$ 14,714,892	
Net decrease in surplus as regards policyholders			(1,483,962)
Surplus as regards policyholders, December 31, 2013, per Examination			$ 41,872,753

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-term Investments

A review of the Company's cash accounts noted the following deficiency: The Company's cash accounts are in the name of its parent company, Berkley Insurance Company. California Insurance Code Section (CICS) 1100 requires that all investments and deposits of the assets of an insurer be made in its own name. It is recommended that the Company correct the deficiencies noted within its cash holdings accounts by complying with CICS 1100.

(2) Guaranty Funds Receivable or on Deposit
Taxes, Licenses and Fees

During the 2000 year, the California Insurance Guaranty Association began assessing the Company for its share of policyholder obligations relating to several insolvencies of companies writing workers' compensation business in California. The Company recoups the assessment through a 2% surcharge on its policyholders' premiums. As of December 31, 2013, the Company estimated a remaining asset of $4.57 million and remaining liability of $2.25 million (of the total reported $5.3 million) respectively.

The above captioned asset and liability accounts were established in accordance with Statement of Statutory Accounting Principle No. 35.

(3) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance analyzed the Company's loss and loss adjustment expense reserves. Based on the analysis, the Company's loss and loss adjustment expense reserves as of December 31, 2013 were determined to be reasonably stated and accepted for the purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Comments on Financial Statement Items – Cash and Short-term Investments (page 15): It is recommended that the Company correct the deficiencies noted within its cash holdings accounts by complying with CICS 1100.

Previous Report of Examination

Management Agreements – Underwriting Services Agreement (Page 4): It was recommended that the Company amend its most current Form B – Annual Registration Statement filing in order to update the current status of an Underwriting Service Agreement in accordance with the Insurance Holding Company Regulatory Act, and California Insurance Code Section (CICS) 1214.4(e). The Company complied with the recommendation.

Bonds (Page 12): It was recommended that the Company submit its executed custodial agreement to the California Department of Insurance, in accordance with CICS 1104.9(d). The Company complied with the recommendation.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/_____

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