

REPORT OF EXAMINATION
OF THE
STERLING CASUALTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2021

Insurance Commissioner

A handwritten signature in blue ink, appearing to be 'D. DeLoach', written over a horizontal line.

Filed on June 20, 2023

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Los Angeles, California
April 21, 2023

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

STERLING CASUALTY INSURANCE COMPANY

(hereinafter also referred to as the Company). The statutory home office is located at 1403 North Tustin Avenue, Suite 370, Santa Ana, California 92705.

SCOPE OF EXAMINATION

We have performed a single-state examination of the Company. The previous examination of the Company was as of December 31, 2017. This examination covered the period from January 1, 2018 through December 31, 2021.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is

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

This examination report includes significant 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.

SUMMARY OF SIGNIFICANT FINDINGS

As a result of this examination, surplus as regards to policyholders has been reduced by \$2,340,316 to \$7,452,461 as of December 31, 2021. The adjustment was due to an accumulation of uncollected balances from prior periods that resulted in the overstatement of premiums and agents' balances in course of collection. Please refer to Comments on Financial Statement Items for additional details.

COMPANY HISTORY

The Company was incorporated in the State of California on December 13, 1947 and commenced business on December 9, 1982.

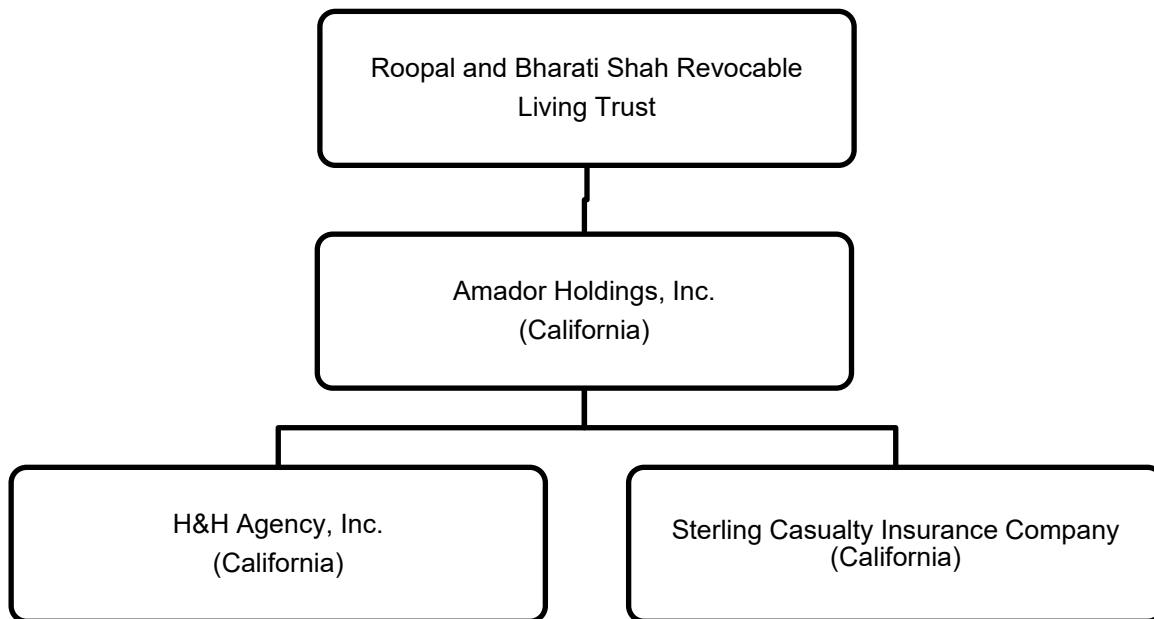
Capitalization

The Company has 25,000 shares of common stock authorized, issued and outstanding with a par value of \$120 per share.

The Company received a capital cash contribution in the amount of \$3,000,000 in 2018 from Amador.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which the Roopal and Bharati Shah Revocable Living Trust is the ultimate controlling person. The following organizational chart depicts the Company's relationship within the holding company system: (all ownership is 100%)



The two members of the board of directors, who are elected annually, manage the

business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2021:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Roopal P. Shah Granite Bay, California	Chairman of the Board Amador Holdings, Inc.
Helen L. Haden Irvine, California	Board Member, Counsel, and Senior Vice President First American Financial Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Roopal P. Shah	President and Chief Executive Officer
Charles J. Williamson	Vice President, Chief Financial Officer, and Secretary

Affiliated Management Agreements

Consolidated Federal Income Tax Agreement: Effective November 17, 2006, the Company, Amador Holdings, Inc. (Amador), H&H Agency, Inc. (H&H), Dashers Insurance Services, Inc. (Dashers), and D&H Claims Services, Inc. (D&H) entered into a Consolidated Federal Income Tax Agreement. Under the terms of the agreement, the method of allocation among the entities is subject to Internal Revenue Service Regulation and approval by the board of directors. Allocation is based upon separate return calculations with current credit for net losses. Federal income tax payables and receivables are required to be settled within thirty days subsequent to the filing of consolidated return. During the examination period, the Company did not pay any federal taxes due to loss carryforward from prior years. The agreement was approved by the California Department of Insurance (CDI) on December 23, 2016.

Cost Sharing Agreement: Effective January 1, 2012, the Company, Amador, H&H, Dashers, and D&H entered into a Cost Sharing Agreement. Under the terms of the agreement, all entities under the holding company group share common management

and/or ownership, and routinely share personnel, facilities, equipment, and services. Each entity incurs all of its direct costs, plus an allocated proportion of shared of costs. The allocated costs shall not exceed the fair market value for such services or expenses. Under the terms of the agreement, H&H provides certain facilities and administrative services to the Company, both continuously and on an as-needed basis. Reimbursements for services are based on actual costs or services provided. For 2018, 2019, 2020, and 2021, the Company reimbursed H&H \$554,678, \$537,903, \$414,069, and \$411,591, respectively. The agreement was approved by CDI on September 11, 2012.

As of December 31, 2021, Dashers and D&H were dissolved. Therefore, it is recommended that the Company update its affiliated management agreements to reflect the current holding company structure and to submit the agreements to the CDI for approval in accordance with California Insurance Code (CIC) Section 1215.5(b)(4).

Nonaffiliated Management Agreements

Program Administrator Agreement: Effective September 1, 2017, for a term of five years, the Company entered into a Program Administrator Agreement with Pronto California General Agency, LLC (PCGA). Under the terms of this agreement, the Company designates PCGA to solicit and negotiate applications for new and renewal non-standard automobile personal automobile liability and automobile physical damage policies in California. PCGA also agrees to underwrite, execute, bind, deliver, and issue such policies in accordance with the Company's underwriting guidelines. The Company in turn compensates PCGA a commission rate of 21% of the collected premiums, if the loss ratio (LR) is between 56.5% and 66.5%. In the event of the LR is below 56.5% or higher than 66.5%, the commission rates shall be 26% and 16%, respectively. The Company renewed the agreement, effective August 31, 2022, for a three-year term.

Claims Administration Agreement: Effective September 1, 2017, the Company entered into a Claims Administration Agreement with Pronto California Claims, LLC (PCCL). Under the terms of the agreement, the Company designates PCCL to administer and ensure appropriate claims handling for all losses incurred by the Company during the

policy term. PCCL will use the claim guidelines established by the Company, which may be amended from time to time, with the close input and advice from PCCL. Under the term of this agreement, the Company compensates PCCL a claims servicing fee equal to 11% of the collected net written premium for the first year and 10.5% of collected premiums, thereafter.

CIC Section 769.81(c) provides that a Managing General Agent (MGA) includes an entity who either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than 5% of the policyholder surplus as reported in the last annual statement of the insurer in any one quarter or year together with one or more of the following: (1) adjusts or pays claims in excess of an amount determined by the commissioner, or (2) negotiates reinsurance on behalf of the insurer. PCGA, who underwrites premiums for the Company, and PCCL, who adjusts and pays claims on behalf of the Company, are affiliated entities and together meet the definition of an MGA pursuant to CIC Section 769.81(c).

CIC Section 769.84(a), requires in part, that insurers have on file an independent financial examination, in a form acceptable to the commissioner, of each MGA with which it has done business. During the review of the Company's MGA, the Company could not produce an independent financial examination for PCGA and PCCL. Additionally, CIC Section 769.84(c) requires insurers to periodically, at least semiannually, to conduct an onsite review of the underwriting and claims processing operations of the MGA. For the years covered by this examination, the Company performed an annual review of PCGA's underwriting operations and PCCL claim operations which did not meet the minimum semiannual review requirement per CIC Section 769.84(c). It is recommended that the Company implements procedures to comply with CIC Section 769.84(a) and (c).

Subsequent to the examination period, the Company entered into a Claims Administrator Agreement with PCGA, effective August 31, 2022. Under the terms of this agreement, the Company grants PCGA authority to settle claims on behalf of the Company. The Company in turn compensates PCGA a claims servicing fee of 10.5% of collected premiums.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in California to transact automobile and liability classes of insurance business and writes only non-standard private passenger automobile liability and automobile physical damage insurance coverage. The Company wrote the direct premiums written in the amount of \$22.1 million, \$19.6 million, \$17.1 million, and \$14.2 million for the year of 2018, 2019, 2020, and 2021, respectively.

In 2021, the Company obtained a license in Florida to write non-standard automobile insurance. As of the examination date, the Company had not written any business in Florida.

REINSURANCE

Assumed

The Company did not assume any reinsurance during the examination period.

Ceded

The Company did not have any ceded reinsurance agreements in-force as of the examination date.

ACCOUNTS AND RECORDS

Annual Statement Instructions

California Insurance Code (CIC) Section 900 states that every insurer doing business in the state of California shall file a financial statement as prescribed by the commissioner for the preceding year, on or before the first of every March. Based on a review of the Company's 2021 Annual Statement, the following deficiencies were noted:

- (1) In accordance with the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, Schedule T should identify the reporting entities status for each state or territory. As of the examination date of December 31, 2021, the Company was licensed in California and Florida but inadvertently failed to

properly reflect its licensed status in Florida in its 2021 Annual Statement.

- (2) In accordance with the NAIC Annual Statement Instructions Schedule P – Part 5B, Section 1 should report closed claims on a cumulative basis. During the course of this examination, it was observed that the Company did not report claim counts on a cumulative basis in its 2021 Annual Statement Schedule P – Part 5B.
- (3) In accordance to the NAIC Annual Statement Instructions Schedule D – Part 1, \$8.2 million of U.S Government bonds including notes issued by U.S Treasury, the Federal Home Loan Bank or the Federal Farm Credit Bank are not guaranteed by the full faith of the U.S. Government, and thus should be reported in Line 3199999 for U.S. Special Revenue and Special Assessment Obligation. During the course of this examination, it was observed that the Company incorrectly reported investments in the Federal Home Loan Bank and the Federal Farm Credit Bank in its 2021 Annual Statement Schedule D – Part 1.

Based on the above, it is recommended that the Company implement procedures to ensure compliance when completing its Annual Statement in accordance with the NAIC Annual Statement Instructions.

Vehicle Fraud Assessment

CIC Section 1872.8(a) requires each insurer doing business in California to pay an annual vehicle fraud assessment fee for each vehicle insured under an insurance policy issued in California. California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b) states that the vehicle fraud assessment shall be due on each vehicle, identified by its vehicle identification number for each quarter that a policy is in force on such vehicle and when a vehicle is added to or replaced one under an existing policy.

During the course of the examination, the 2021 first and second quarterly vehicle assessment files maintained by the Company did not include a Vehicle Identification Number (VIN). Additionally, the data provided by the Company could not be verified for completeness and accuracy.

It is recommended that the Company identify insured vehicles in all quarterly vehicle assessment files by VIN to comply with the requirements of CCR, Section 2698.62(d). Based on this recommendation, and during the course of the examination, the Company implemented procedures to identify vehicles by their VIN in compliance with CCR, Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b).

It is also 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).

Unclaimed Property

California Code of Civil Procedure (CCP) Part 3, Title 10, Chapter 7, Article 3, Sections 1530 and 1532 (Unclaimed Property Law) requires that all tangible personal property located in the state of California that is held or owing in the ordinary course of business and has remained unclaimed by the owner for more than three years after it became payable or distributable, be escheated to the California State Controller's Office (SCO). During the review of the Company's Escheatable Funds Claims account, it was observed that the Company failed to escheat checks older than three years to SCO.

It is recommended that the Company escheat the unclaimed property to SCO in accordance with CCP Sections 1530 and 1532. Based on this recommendation, and during the course of the examination, the Company began the process of identifying unclaimed property.

Form B Filing Instructions

CIC Section 1215.4(b) requires, in part, that every insurer file a registration statement with the commissioner on a form and in a format prescribed by the NAIC. The NAIC's Form B filing instructions, indicate that any ultimate controlling person (UCP) who is an individual may file personal financial statements that are reviewed rather than audited by an independent public accountant. Personal financial statements need to be accompanied by the independent public accountant's standard review report. During the review of the Company's Form B filings for the period under examination, it was observed

that the UCP's financial statements were not accompanied by independent public accountant's standard review report.

It is recommended that the Company include the required independent public accountant's Standard Review Report with its Form B Filing to ensure compliance with CIC Section 1215.4(b) and the NAIC's Form B Filing Instructions.

Premium Taxes

During the review of the Company's California premium tax filings for the years 2019, 2020, and 2021, several reporting errors were observed that resulted in incorrect net taxable premium amounts. The Company did not properly include finance and service charges, taxable fees, and premium receivables when reporting premiums on a cash basis.

It is recommended that the Company amend and refile its 2019, 2020, and 2021 California premium tax filings to properly report all premium, finance and service charges, and to pay any additional premium taxes due. Based on this recommendation, and during the course of the examination, the Company amended and refiled its 2019, 2020, and 2021 premium tax filings. As of the date of this report, the amended premium tax filings were under review by the CDI Premium Tax Audit Unit to determine any additional premium tax due.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2021. The accompanying comments 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.

Statement of Financial Condition as of December 31, 2021

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

Reconciliation of Surplus as Regards Policyholders from December 31, 2017 through
December 31, 2021

Analysis of Changes to Surplus as of December 31, 2021

Statement of Financial Condition
as of December 31, 2021

	<u>Ledger and</u>				
<u>Assets</u>	<u>Nonledger</u>	<u>Assets Not</u>	<u>Admitted</u>	<u>Net Admitted</u>	<u>Notes</u>
	<u>Assets</u>	<u>Admitted</u>		<u>Assets</u>	
Bonds	\$ 11,891,402	\$		\$ 11,891,402	
Common stocks	1,785,134			1,785,134	
Cash and short-term investments	1,811,790			1,811,790	
Investment income due and accrued	69,566			69,566	
Premiums and agents' balances in course of collection	3,205,084	2,889,609		315,475	(1)
Premiums, agents' balances and installments booked but deferred and not yet due	1,661,750			1,661,750	
Amount recoverable from reinsurers	80,736			80,736	
Electronic data processing equipment and software	944			944	
Recoverables from parent, subsidiaries and affiliates	51,361			51,361	
Aggregate write-ins for other than invested assets	<u>744,350</u>	<u> </u>		<u>744,350</u>	(2)
Total assets	<u>\$ 21,302,107</u>	<u>\$ 2,889,609</u>		<u>\$ 18,412,538</u>	

<u>Liabilities, Surplus and Other Funds</u>	<u>Current Year</u>	<u>Not</u>	
		<u>es</u>	
Losses	\$ 5,396,056	(3)	
Loss adjustment expenses	741,000	(3)	
Commissions payable, contingent commissions and other similar charges	258,672		
Other expenses	1,002,950		
Taxes, licenses and fees	(65,874)		
Unearned premiums	3,334,646		
Ceded reinsurance premiums payable	218,611		
Aggregate write-ins for liabilities	<u>74,016</u>		
Total liabilities	 10,960,077		
Common capital stock	3,000,000		
Surplus notes	1,400,000		
Gross paid-in and contributed surplus	9,001,411		
Unassigned funds (surplus)	<u>(5,948,950)</u>		
Surplus as regards policyholders	<u>7,452,461</u>		
Total liabilities, Surplus, and other funds	 <u>\$ 18,412,538</u>		

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

State of Income

<u>Underwriting Income</u>	<u>Current Year</u>
Premium earned	\$ 15,250,986
Deductions:	
Losses incurred	\$ 8,417,254
Loss adjustment expenses incurred	1,374,971
Other underwriting expenses incurred	<u>5,142,849</u>
Total underwriting deductions	<u>14,935,074</u>
Net underwriting gain	315,912
<u>Investment Income</u>	
Net investment income earned	\$ 242,761
Net realized capital gain	<u>29,046</u>
Net investment gain	271,807
<u>Other Income</u>	
Net income from agents' or premium balances charged off	\$ 15,282
Finance and service charges not included in premiums	<u>27,689</u>
Total other income	<u>42,971</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes	630,690
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes	<u>630,690</u>
Net income	<u>\$ 630,690</u>
<u>Capital and Surplus Account</u>	
Surplus as regards policyholders, December 31, 2020	\$ 8,368,113
Net income	\$ 630,690
Change in net unrealized capital gains	136,480
Change in nonadmitted assets	(1,140,316)
Aggregate write-ins for losses in surplus	<u>(542,506)</u>
Change in surplus as regards policyholders for the year	<u>(915,652)</u>
Surplus as regards policyholders, December 31, 2021	<u>\$ 7,452,461</u>

Reconciliation of Surplus as Regards to Policyholders
from December 31, 2017 through December 31, 2021

Surplus as regards policyholders, December 31, 2017			\$ 6,165,946
	Gain in Surplus	Loss in Surplus	
Net income	\$ 539,339	\$	
Net unrealized capital gains	136,480		
Change in nonadmitted assets		1,177,812	
Surplus adjustment: Paid-in	3,000,000		
Aggregate write-ins for gains and losses in surplus	<u> </u>	<u>1,211,492</u>	
Total gains and losses	<u>\$ 3,675,819</u>	<u>\$ 2,389,304</u>	
Net increase in surplus as regards policyholders			<u>1,286,515</u>
Surplus as regards policyholders, December 31, 2021			<u>\$ 7,452,461</u>

Analysis of Changes to Surplus as of December 31, 2021

As a result of the examination, the following adjustment was made to the Company's reported balance sheet items. Premiums and agents' balances in course of collection were decreased due to the nonadmitted assets. Please refer to Comments on Financial Statement Items for additional details. The sum of the effect on surplus is shown below:

Surplus as regards policyholders, December 31, 2021, per Annual Statement			\$ 9,792,777
	<u>Increase</u>	<u>Decrease</u>	
Premiums and agents' balances in course of collection		\$(2,340,316)	
Net decrease			<u>(2,340,316)</u>
Surplus as regards policyholders, December 31, 2021, after adjustment			<u>\$ 7,452,461</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Premiums and Agents' Balances in the Course of Collection

Statement of Statutory Accounting Principles (SSAP) No. 6 requires that uncollected premiums and agents' balances receivable which are over ninety days due be accounted for as a non-admitted asset, as defined by SSAP No. 4. Further, it requires that amounts determined to be uncollected be written off. During the course of this examination, it was observed that the Company failed to properly identify and write off uncollected premiums and agents' balances receivable. The examination determined that \$2,340,316 of the reported premiums and agents' balances receivable as of December 31, 2021 were over 90 days past due and should have been non-admitted and/or written off. An examination adjustment was made to non-admit that portion from the premiums and agents' balances receivable as of December 31, 2021.

It is recommended that the Company implement procedures to ensure that premiums and agents' balances determined to be uncollectible be written off to comply with the requirements of SSAP No.6., as defined by SSAP No. 4. Subsequently, the Company recognized the full adjustment of \$2,340,316 on the overstated premiums and agents' balances in its quarterly statement as of June 30, 2022.

(2) Aggregate Write-ins for Other Than Invested Assets

On November 19, 2021, the California Department of Insurance (CDI) granted an approval for a permitted accounting practice to admit a \$741,000 claim service obligation receivable as an asset, that otherwise deviates from the SSAP No. 4. The approval was for the financial statements ending December 31, 2021, March 31, 2022, June 30, 2022, and September 30, 2022.

(3) Losses and Loss Adjustment Expenses

CDI Casualty Actuary reviewed and evaluated the loss and loss adjustment expense reserves as of December 31, 2021. Based on the analysis, the loss and loss adjustment

expense reserves as of December 31, 2021 were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Affiliated Management Agreements – Consolidated Federal Income Tax Agreement and Cost Sharing Agreement (Page 5): It is recommended that the Company update its affiliated management agreements to reflect the current holding company structure and to submit the agreements to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code (CIC) Section 1215.5(b)(4).

Nonaffiliated Management Agreements – Program Administrator Agreement and Claims Administration Agreement (Page 6): It is recommended that the Company implement procedures to ensure compliance with CIC Section 769.84(a) and (c).

Accounts and Records – Annual Statement Instructions (Page 7): It is recommended that the Company implement procedures to ensure compliance when completing its Annual Statement in accordance with the National Association of Insurance Commissioners Annual Statement Instructions.

Accounts and Records – Vehicle Fraud Assessment (Page 8): It is recommended that the Company identify insured vehicles in the quarterly vehicle assessment files by Vehicle Identification Number to comply with the requirements of California Code of Regulation (CCR), Section 2698.62(d).

It is also 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).

Accounts and Records – Unclaimed Property (Page 9): It is recommended that the Company escheat the unclaimed property to the California State Controller's Office in accordance with the California Code of Civil Procedure, Sections 1530 and 1532. Based

on this recommendation, and during the course of the examination, the Company began the process of identifying unclaimed property.

Accounts and Records – Form B Filing Instructions (Page 9): It is recommended that the Company includes the required independent public accountant's Standard Review Report with its Form B Filing to ensure compliance with CIC Section 1215.4(a) and the NAIC Form B Filing Instructions.

Accounts and Records – Premium Taxes (Page 10): It is recommended that the Company amend and refile its 2019, 2020 and 2021 California premium tax filings to properly report all premium, finance and service changes and to pay any additional premium taxes due. Based on this recommendation, and during the course of the examination, the Company amended and refiled its 2019, 2020, and 2021 premium tax filings.

Comments on Financial Statement Items – Premiums and Agents' Balance in the Course of Collection (Page 16): It is recommended that the Company implement procedures to ensure that agent's receivables determined to be uncollectible be written off to comply with the requirements of Statement of Statutory Accounting Principles (SSAP) No. 6., as defined by SSAP No. 4.

Previous Report of Examination

Accounts and Records – Premiums and Agents' Balances in Course of Collection (Page 11): It was recommended that the Company establish and implement procedures to ensure that premiums and agents' balances in course of collection are aged to comply with the requirements of Statement of Statutory Accounting Principles No. 4. The Company did not comply with the recommendation.

Accounts and Records - Annual Statement Cash Flow Page (Page 11): It was recommended that the Company establish and implement procedures to ensure that filings of the Annual Statements are correct and accurate. During the course of the examination, it was determined that the Company implemented procedures to ensure

future compliance with this recommendation. The Company did not comply with the recommendation.

Accounts and Records - Information Systems Controls (Page 12): It was recommended that the Company address the recommendations and make appropriate changes to strengthen its information systems controls. Based on the course of the examination, it is determined that the Company make appropriate changes to strengthen its information systems controls. 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,

Tzuwen Meyer, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Cuauhtémoc Beltrán, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California