

EXAMINATION REPORT OF
APPLIED UNDERWRITERS CAPTIVE RISK ASSURANCE COMPANY, INC.
CEDAR RAPIDS, IOWA
AS OF DECEMBER 31, 2017

Omaha, Nebraska
March 28, 2019

Honorable Doug Ommen
Commissioner of Insurance
Iowa Insurance Division
601 Locust St., 4th Floor
Des Moines, Iowa 50309

Commissioner:

In accordance with your authorization and pursuant to Iowa statutory provisions, an examination has been made of the records, business affairs and financial condition of

APPLIED UNDERWRITERS CAPTIVE RISK ASSURANCE COMPANY, INC.

CEDAR RAPIDS, IOWA

AS OF DECEMBER 31, 2017

at the Company's administrative office, 10805 Old Mill Road, Omaha, NE.

INTRODUCTION

Applied Underwriters Captive Risk Assurance Company, Inc., hereinafter referred to as the "Company", was last examined as of December 31, 2013 by the Iowa Insurance Division.

SCOPE OF EXAMINATION

This is the regular comprehensive financial examination of the Company covering the intervening period from December 31, 2013 to the close of business on December 31, 2017, including any material transactions and/or events occurring and noted subsequent to the examination period.

The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the organization, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, when applicable to domestic state regulations.

All accounts and activities of the organization were considered in accordance with the risk-focused examination process. The Company's assets were verified and evaluated and the liabilities determined to reflect herein a statement of its financial condition as of December 31, 2013.

HISTORY

Applied Underwriters Captive Risk Assurance Company, Inc. was incorporated in Iowa on August 29, 2011 and is authorized to write workers' compensation. The company merged with Applied Underwriters Captive Risk Assurance Company, Inc., a British Virgin Islands

company, which ceased to exist after the merger. The Company is wholly-owned by North American Casualty Co. an indirect subsidiary of Berkshire Hathaway Inc. The Company assumes workers' compensation premiums and losses through a reinsurance agreement with affiliate California Insurance Company. The Company is licensed in California and Iowa and currently does not write any direct business in workers' compensation.

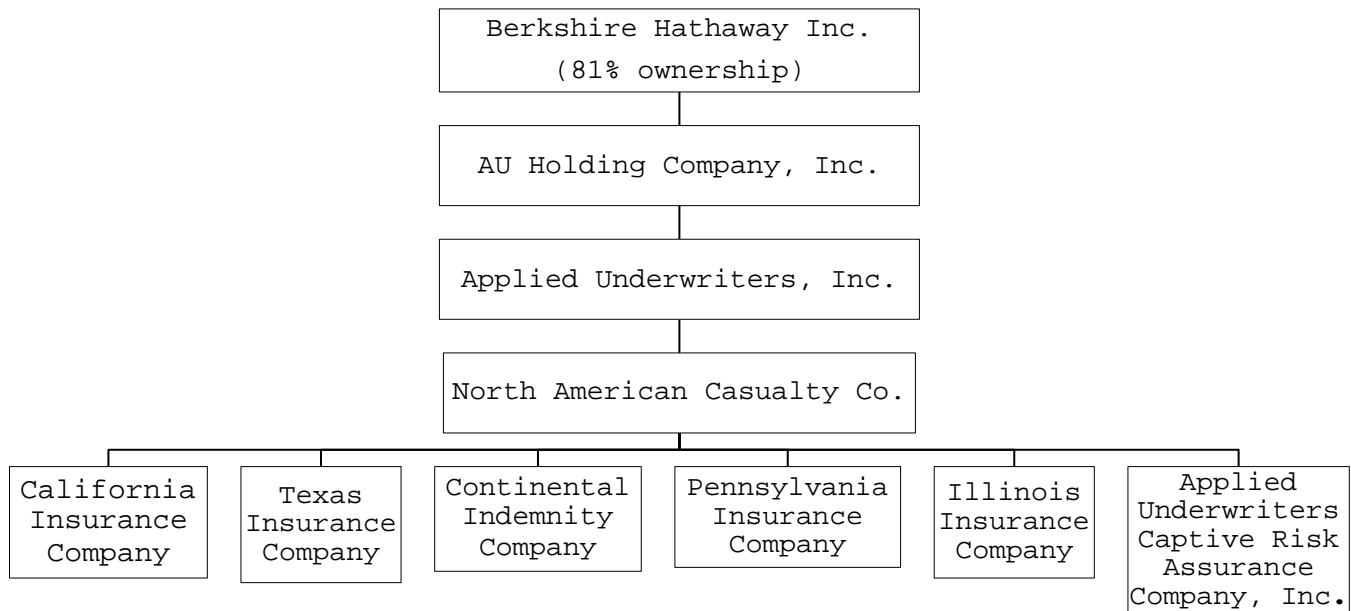
CAPITAL STOCK

The Amended Articles of Incorporation provide that the authorized capital of the Company is \$20,000,000 consisting of 20,000,000 shares of common stock at \$1 par value each. At December 31, 2017, the Company had 14,200,000 shares of common stock issued and outstanding with a total par value of \$14,200,000 and \$31,350,000 of gross paid in and contributed surplus. All shares were owned by North American Casualty Co.

The Company did not pay any stock dividends during the examination period.

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system as defined by Chapter 521A, Code of Iowa. A simplified organizational chart as of December 31, 2017, reflecting the ultimate parent and holding company system, is shown below. Schedule Y of the Company's 2017 annual statement provided a list of all related companies of the holding company group.



MANAGEMENT AND CONTROL

STOCKHOLDERS

The Articles of Incorporation of the Company state that the annual meeting of the shareholders for the election of directors, for the consideration of reports to be laid before such meeting and for the transaction of such other business as may properly come before such meeting, shall be held each year at a location to be determined on the first Monday in September.

Meetings of the shareholders may be called only by the Chairman of the Board, the President, or in the case of the President's absence, death, or disability, the Vice President authorized to exercise the authority of the President; the Secretary; the directors by action at a meeting, or a majority of the directors acting without a meeting; or the holders of at least 50 percent of all shares outstanding and entitled to vote thereat.

All meetings of shareholders shall be held at the principal office of the corporation, unless otherwise provided by action of the directors. Meetings of shareholders may be held at any place within or without the State of Iowa.

At any meeting of shareholders, the holders of a majority in amount of the voting shares of the corporation then outstanding and entitled to vote thereat, present in person or by proxy, shall constitute a quorum for such meeting.

BOARD OF DIRECTORS

In accordance with the Articles of Incorporation, the business and affairs of the Company shall be managed by a Board of Directors consisting of not less than five nor more than 21 as may be fixed by the shareholders at each annual meeting or, if no number is so fixed, of five directors, and each of whom shall be elected annually by the shareholders at each annual meeting to serve for a term of one year or until a successor has been elected and qualified.

The annual meeting of the Board of Directors shall be held immediately following the annual shareholders meeting. Special meetings of the Board of Directors may be held as directed by the Chairman or a majority of the Board of Directors.

Qualified directors serving on the Board as of December 31, 2017 were:

<u>Name</u>	<u>Principal Occupation</u>	<u>Term Expires</u>
Sidney R. Ferenc Highland Beach, Florida	Chief Executive Officer Applied Underwriters, Inc. Affiliates	2018
Steven M. Menzies Omaha, Nebraska	Chief Operating Officer Applied Underwriters, Inc.	2018
Jeffrey A. Silver Omaha, Nebraska	Executive Vice President Applied Underwriters, Inc.	2018
Jon M. McCright Cedar Rapids, Iowa	Attorney Lynch Dallas P.C.	2018
Marc M. Tract Nassau, New York	Attorney Katten Muchin Rosenmann LLP	2018

COMMITTEES

The Board of Directors may designate from their own number an executive committee, an investment committee and one or more other committees. Committees designated were as follows:

<u>Audit Committee</u>	<u>Investment Committee</u>
Jeffrey A. Silver	Sidney R. Ferenc
Marc M. Tract	Steven M. Menzies
Jon M. McCright	Jeffrey A. Silver

The full Board of Directors reviews and approves investments at least quarterly.

OFFICERS

The Bylaws and Regulations prescribe that the officers of the corporation to be elected by the directors shall be a President, one or more Vice Presidents, a Secretary, a Treasurer, and may, but shall not be required to include, one or more Assistant Vice Presidents, Assistant Secretaries or Assistant Treasurers, none of whom shall be required to be shareholders or directors. Any two or more offices may be held by the same person, but no officer shall execute, acknowledge, or verify any instrument in more than one capacity if such instrument is required by law, the Articles, the Bylaws and Regulations or the Bylaws to be executed, acknowledged or verified by two or more officers. Each officer shall be elected annually by the Board of Directors at each annual meeting to serve a term of office of one year or until a successor has been elected and qualified.

Officers elected and serving as of December 31, 2017 were as follows:

<u>Name</u>	<u>Office</u>
Sidney R. Ferenc	Chairman and Chief Executive Officer
Steven M. Menzies	President, Treasurer and Chief Operating Officer
Robert L. Stafford	Vice President of Finance
Justin Smith	Vice President and Chief Actuary
Jeffrey A. Silver	Secretary

The Company does not have any salaried officers or employees. Services and costs are shared under an inter-company service agreement.

CONFLICT OF INTEREST

The Company has a Conflict of Interest policy that states, "If an officer or director has an interest in or contemplates entering into a transaction that presents an actual or potential conflict of interest, the same must be disclosed in writing to the Company's Board of Directors and, if necessary, to the stockholder of the Company."

The annual Conflict of Interest questionnaires were reviewed, and it was noted that each of the officers and directors had completed and signed a questionnaire.

CORPORATE RECORDS

The minutes of the stockholders and Board of Directors meetings were read and noted. The minutes appeared to be complete and were properly attested.

The Articles of Incorporation and Bylaws were amended subsequent to the examination period. The total shares authorized were increased to 20,000,000 August of 2018.

The Board of Directors formally accepted the examination report as of December 31, 2013 delivered on February 4, 2015 by unanimous written consent on February 24, 2015.

INTER-COMPANY SERVICE AGREEMENT

The indirect parent, Applied Underwriters, Inc., has agreed to provide certain management, claims processing, premium processing, and data processing services for the Company at actual cost. The Company entered into a Cost Sharing Arrangement with this affiliate for rent, salaries, and general administrative expense, which has been approved by the Iowa Division of Insurance. All payments due for 2014 through 2017 were waived by the affiliate.

All agreements have been filed with the Iowa Insurance Division.

FIDELITY BONDS AND OTHER INSURANCE

The Company's indirect parent, Applied Underwriters, Inc. maintains fidelity bond coverage up to \$2,000,000, which adequately covers the suggested minimum amount of coverage for the Company as recommended by the NAIC. The Company is identified as a named insured on the fidelity bond.

The Company also maintains Property, Crime, General Liability, and Automobile coverages, along with an overall umbrella policy with a limit of \$10,000,000.

EMPLOYEE WELFARE

The Company does not have any salaried employees and is provided services from an inter-company service agreement.

REINSURANCE

The Company's current reinsurance program consists of the following:

The Company only assumes from the intercompany agreement with California Insurance Company. The premium assumed is for the profit sharing policies written by California Insurance Company and Continental Indemnity Company. The Company cedes Profit Sharing plans ceded premium and losses paid to client cells per contract rates. This is accounted for pursuant to a prescribed practice approved by the Iowa Division of Insurance. The Company also maintains an excess loss agreement with affiliate Commercial General Indemnity, Inc. This agreement covers the policies with losses that exceed the maximum losses covered in the profit sharing contract rates.

STATUTORY DEPOSIT

As of December 31, 2017, the book/adjusted carrying value of securities held in a custodial account and vested in the Insurance Commissioner of California for all other special deposits totaled \$267,553,286. The Company does not have securities or other assets on deposit with the Iowa Insurance Division.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in Iowa and California. The Company does not write any lines of business.

GROWTH OF COMPANY

The following significant data, taken from the Company's filed annual statements for the years indicated reflects the growth of the Company:

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Premiums Earned	0	0	0	0
Net Underwriting Gain/(Loss)	1,302,746	(1,825,001)	(383,302)	(1,758,610)
Net Income	4,449,811	3,212,628	14,348,545	3,885,567
Total Assets	847,137,837	970,874,591	867,015,666	674,814,188
Total Liabilities	772,845,269	911,467,646	814,163,843	642,765,021
Surplus As Regards Policyholders	74,292,568	59,406,945	52,851,823	32,049,167

ACCOUNTS AND RECORDS

The Company maintains its principal operational offices in Omaha, Nebraska, where this examination was conducted.

RSM US LLP., an independent CPA audited the Company's statutory basis financial statements annually for the years 2014, 2015, 2016 and 2017.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Division of Insurance.

An evaluation of the information technology and computer systems of the Company was completed during the examination.

During the course of the examination, no material statutory compliance issues were noted nor aggregate surplus differences identified from the amount reflected in the financial statements, as presented in the annual statement at December 31, 2017.

SUBSEQUENT EVENTS

On December 28, 2017, the Company declared a dividend of \$7,400,000 to be paid to its parent, North American Casualty Co.

Berkshire Hathaway announced plans to sell Applied Underwriters, Inc. (the company's indirect parent) and its subsidiaries.

F I N A N C I A L S T A T E M E N T S
A N D C O M M E N T S T H E R E O N

NOTE: Except as otherwise stated, the financial statements immediately following reflect only the transactions for the period ending December 31, 2017 and the assets and liabilities as of this date. Schedules may not add or tie precisely due to rounding.

STATEMENT OF ASSETS AND LIABILITIES

ASSETS

	<u>Ledger</u>	Not <u>Admitted</u>	<u>Admitted</u>
Bonds	\$ 385,946,980	\$	\$ 385,946,980
Common Stock	7,615,350		7,615,350
Cash & Short term investments	278,559,309		278,559,309
Investment income due and accrued	2,502,677		2,502,677
Premiums and considerations:			
Deferred premium	136,675,354	11,594,384	125,080,970
Reinsurance			
Amounts recoverable	16,531,280		16,531,280
Current federal income tax recoverable	194,565		194,565
Net deferred tax asset	8,504,125	2,929,957	5,574,168
Receivables from parent and affiliate	25,129,733		25,129,733
Aggregate write-ins			
NE Sales Taxes Paid	2,805		2,805
Prepaid Expenses	629	629	0
	<hr/>	<hr/>	<hr/>
Total assets	\$ 861,662,807	\$ 14,524,970	\$ 847,137,837

Liabilities, Surplus and Other Funds

Losses	\$ 65,872,279
Reinsurance payable on paid losses and loss adjustment expenses	16,534,215
Loss adjustment expenses	44,589
Other expenses	332,311
Taxes, licenses and fees	293,750
Ceded reinsurance premium payable	145,321,917
Funds held by company under reinsurance treaties	544,446,208
 Total liabilities	 <u>\$ 772,845,269</u>
 Common capital stock	 \$ 14,200,000
Gross paid in and contributed surplus	34,150,000
Unassigned funds (surplus)	<u>25,942,568</u>
 Surplus as regards policyholders	 <u>\$ 74,292,568</u>
 Total liabilities, surplus and other funds	 <u>\$ 847,137,837</u>

STATEMENT OF INCOME

PERIOD ENDING DECEMBER 31, 2017

Underwriting income

Premium earned		\$ -
 <u>Deductions</u>		
Losses incurred	\$ (4,964,192)	
Loss adjustment expenses incurred	5,133	
Other underwriting expenses incurred	3,656,313	
Total underwriting deductions		<u>(1,302,746)</u>
Net underwriting gain (loss)		\$ 1,302,746

Investment Income

Net investment income earned	\$ 6,276,568	
Net realized capital gains	50,859	
Net investment gain (loss)		<u>6,327,427</u>

Other Income

Net gain (loss) from agents' or premium balances charged off	\$ -	
Finance and service charges not included in premium	-	
Aggregate write-ins for miscellaneous income	(3,302,312)	
Total other income		<u>(3,302,312)</u>
Net income before Federal income tax		\$ 4,327,861
Federal & foreign income taxes		<u>(121,950)</u>
Net income		<u>\$ 4,449,811</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		<u>\$ 59,406,945</u>
 <u>Gains and (Losses) in Surplus</u>		
Net Income		\$ 4,449,811
Change in net unrealized capital gains(losses)		1,936,838
Change in net deferred income tax		(7,639,887)
Change in non-admitted assets		6,138,861
Capital Changes: Paid in		5,000,000
Surplus Adjustment: Paid in		<u>5,000,000</u>
Change in surplus as regards policyholders for the year		<u>\$ 14,885,623</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 74,292,568</u>

CASH FLOW

Premium collected net of reinsurance	13,420,075
Net investment income	6,299,957
Miscellaneous income	<u>(3,302,312)</u>
Total	<u>16,417,720</u>
Benefit and loss related payments	(50,468,458)
Net transfers to separate, segregated & protected cell accounts	
Commissions, expenses paid and aggregate write-in for deductions	3,704,650
Dividends paid to policyholders	
Federal and foreign income taxes paid	<u>(1,109,348)</u>
Total	<u>(47,873,156)</u>
Net cash from operations	<u>64,290,876</u>
Proceeds from investments sold, matured or repaid:	
Bonds	63,500,000
Net gain (loss) on cash, cash equivalents & short term investments	<u>78,244</u>
Total investment proceeds	<u>63,578,244</u>
Cost of investments acquired (long-term only):	
Bonds	<u>122,618,140</u>
Total investment acquired	<u>122,618,140</u>
Net increase (decrease) in contract loans and premium notes	
Net cash from investments	<u>(59,039,896)</u>
Cash provided (applied):	
Capital and paid in surplus, less treasury stock	10,000,000
Other cash provided (applied)	<u>(178,021,145)</u>
Net cash from financing and miscellaneous sources	<u>(168,021,145)</u>
Net change in cash, cash equivalent & short term investments	(162,770,165)
Cash, cash equivalent & short term investments:	
Beginning of year	441,329,474
End of year	278,559,309

STATEMENT OF INCOME
FOUR YEAR PERIOD ENDING DECEMBER 31, 2017

<u>Underwriting income</u>		
Premium earned		\$ -
<u>Deductions</u>		
Losses incurred	\$ (6,208,451)	
Loss adjustment expenses incurred	177,070	
Other underwriting expenses incurred	8,705,549	
Total underwriting deductions		<u>2,674,168</u>
Net underwriting gain (loss)		\$ (2,674,168)
<u>Investment Income</u>		
Net investment income earned	\$ 12,650,191	
Net realized capital gains	50,859	
Net investment gain (loss)		<u>12,701,050</u>
<u>Other Income</u>		
Net gain (loss) from agents' or premium balances charged off	\$ -	
Finance and service charges not included in pre	-	
Aggregate write-ins for miscellaneous income	32,681,472	
Total other income		<u>32,681,472</u>
Net income before Federal income tax		\$ 42,708,354
Federal & foreign income taxes		<u>(16,811,804)</u>
Net income		<u>\$ 25,896,550</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		\$ <u>25,497,659</u>
<u>Gains and (Losses) in Surplus</u>		
Net Income		\$ 25,896,550
Change in net unrealized capital gains(losses)		2,113,791
Change in net deferred income tax		(4,142,896)
Change in non-admitted assets		(72,537)
Capital Changes: Paid in		11,300,000
Surplus Adjustment: Paid in		<u>13,700,000</u>
Change in surplus as regards policyholders for the year		<u>\$ 48,794,908</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 74,292,568</u>

CONCLUSION

The assistance extended by the officers and employees of the Company during the course of this examination is hereby acknowledged.

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of Applied Underwriters Captive Risk Assurance Company, Inc. as of December 31, 2017, consistent with the insurance laws of the State of Iowa.

In addition to the undersigned, the following examiners representing the Iowa Insurance Division participated in this examination:

Ryan Havick, CFE
Temi Nayin, CPA, CFE
Emilie Brady, CFE, AIE

In addition to the undersigned, Ber Vang, CFE, Lead State Exam and IT Supervisor, Donovan Han, CFE, Lead State EIC, Jack Lee, CFE, Associate Insurance Examiner, and Allen Lau, Associate Insurance Examiner participated in this examination representing the California Department of Insurance.

Respectfully submitted,

/s/ James Burch
James Burch, CFE
Examiner in Charge
Eide Bailly LLP on behalf of the
Iowa Insurance Division

/s/ Daniel Mathis
Daniel Mathis, CFE
Assistant Chief Examiner
Iowa Insurance Division