

EXAMINATION REPORT OF  
ILLINOIS INSURANCE COMPANY  
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

ILLINOIS INSURANCE COMPANY

CEDAR RAPIDS, IOWA

AS OF DECEMBER 31, 2017

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

INTRODUCTION

Illinois Insurance Company, hereinafter referred to as the "Company", was last examined as of December 31, 2013.

SCOPE OF EXAMINATION

This is the regular comprehensive financial examination of the Company covering the intervening period from January 1, 2014 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, 2017.

HISTORY

Illinois Insurance Company was organized in 1988 in the state of Georgia. It remained a shell until the company began writing business during the fiscal year 1992. The company re-domiciled to Wisconsin on December 19, 2003. The Company was purchased by North American Casualty Co. on December 17, 2010. North American Casualty Co. became

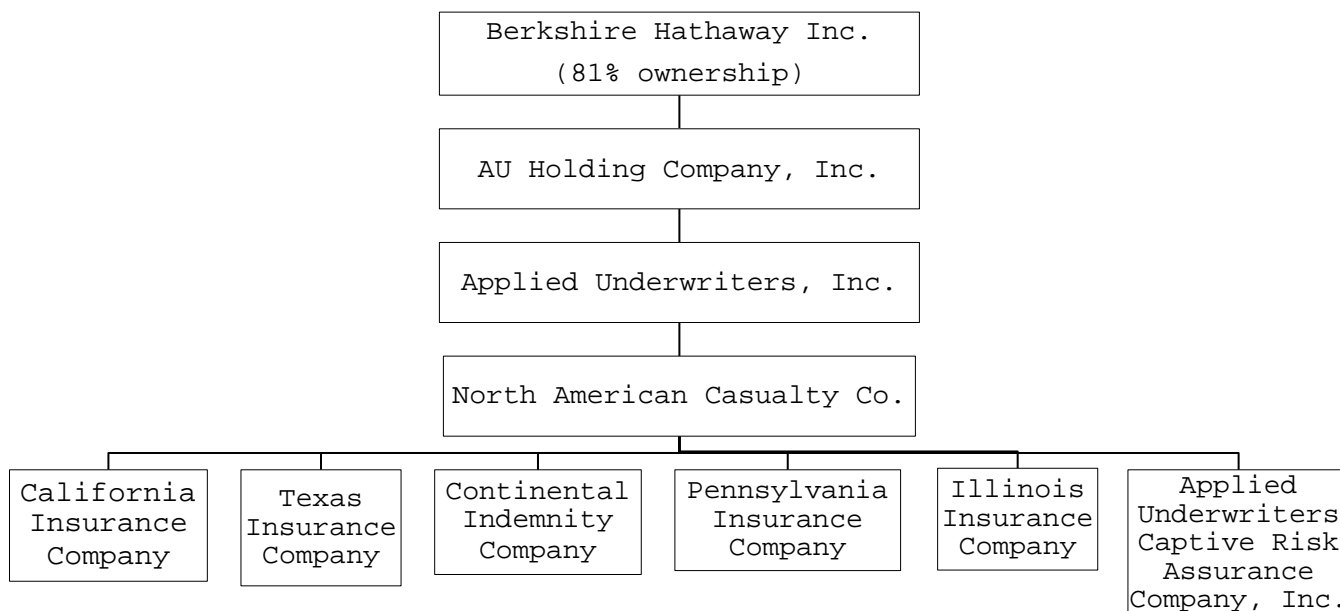
the Direct Parent of the Company on December 17, 2010 pursuant to approval from the Wisconsin Department of Insurance. Thereafter, the Company re-domiciled from Wisconsin to Iowa with approval from both the Wisconsin Department of Insurance and the Iowa Insurance Division on December 28, 2010 and changed its name to Illinois Insurance Company in 2012. The Company is licensed in 36 States and the District of Columbia but does not currently write any direct business. The Company is a party to the intercompany pool agreement and assumes a 5 percent share.

CAPITAL STOCK

The Amended Articles of Incorporation provide that the authorized capital of the Company is \$3,420,000 consisting of 3,420,000 shares of common stock at \$1 par value each. At December 31, 2017, the Company had 3,420,000 shares of common stock issued and outstanding with a total par value of \$3,420,000 and \$4,030,000 of gross paid in and contributed surplus. All shares were owned by North American Casualty Co.

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 starting in 2012. Special meetings of the shareholders may be held upon call by the President or majority of the Board of Directors and shall

be held upon written request subscribed by not fewer than one-tenth in interest of the shareholders and submitted to the President or the Board of Directors. Notice of the meeting shall be given as prescribed in the Bylaws.

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.

A majority of the whole authorized number of directors shall be necessary to constitute a quorum for a meeting of directors, except that a majority of the directors in office shall constitute a quorum for filling a vacancy in the Board.

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 Amended 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 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.

The Articles of Incorporation and Bylaws were not amended during the examination period.

## INTER-COMPANY SERVICE AGREEMENT

The Company is a part of the intercompany pooling arrangement with an affiliate, California Insurance Company (CIC), Texas Insurance Company (TIC), Continental Indemnity Company (CNI), and Pennsylvania Insurance Company (PIC) for Workers' Compensation, including Mandatory Reinsurance, Employment Practices Liability, Warranty, Accidental Death & Dismemberment, and Non-occupational Income Replacement lines of business. CIC is the lead company, assuming a 70 percent share, CNI assuming a 15 percent share, the Company, TIC and PIC each assume a 5 percent share. This arrangement also requires that balances be settled within 30 days.

Effective June 8, 2011, the Company became a party to an inter-company service agreement with the indirect parent Applied Underwriters, Inc. Services provided under the agreement include certain management, claims processing, premium processing, and data processing services at actual cost for the company. The Company shares these costs as part of the restated intercompany pooling agreement with its affiliates CIC, TIC, CNI and PIC. This agreement may be terminated upon a sixty-day written notice by the authorized officers of either the company or Applied Underwriters, Inc.

Effective January 1, 2018, the Company entered into an Agency Agreement with an affiliate, Applied Risk Services, Inc. (ARS), in which ARS receives premium from policyholders and pays commissions to brokers on behalf of the Company. The agreement requires that intercompany balances be settled within 30 days.

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:

### Assumed

The Company's only materially assumed risk from its intercompany pooling arrangement with California Insurance Company, Texas Insurance Company, Continental Indemnity and Pennsylvania Insurance Company. The Company assumed five percent of the pool.

## 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 Iowa for the benefit of all policyholders totaled \$5,139,296. The Company had securities and other assets on deposit with the Iowa Insurance Division in excess of the minimum statutory requirements. The company has additional deposits in seven (7) states with a book/adjusted carrying value of \$17,822,897 for the purpose of workers compensation policies.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed in 36 states and the District of Columbia. The Company is not currently writing any lines of business but assumes five percent of the intercompany pool.

## 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>	<u>2013</u>
Premiums Earned	22,023,822	18,258,049	19,016,611	16,031,666	12,973,653
Net Underwriting Gain/(Loss)	6,152,628	4,998,028	8,914,696	6,449,115	4,722,266
Net Income	4,446,067	3,628,793	6,072,864	4,331,670	3,030,663
Total Assets	60,350,431	50,962,664	43,203,601	35,348,550	30,950,905
Total Liabilities	24,220,089	18,778,695	14,433,414	12,494,443	12,513,344
Surplus As Regards Policyholders	36,130,342	32,183,969	28,770,187	22,854,107	18,437,561

## 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 27, 2018, the Company declared a dividend of \$4,400,000 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	\$ 27,938,495	\$	\$ 27,938,495
Cash & Short term investments	29,988,940		29,988,940
Investment income due and accrued	113,840		113,840
Premiums and considerations:			
Deferred premium	1,667,817		1,667,817
Reinsurance			
Amounts recoverable	32,109		32,109
Current federal income tax recoverable	118,491		118,491
Net deferred tax asset	603,059	170,209	432,850
Guaranty funds receivable or on deposit	57,159		57,159
Aggregate write-ins			
Policyholder Surcharges	0		0
Prepaid Expenses	11,046	11,046	0
NE Sales Taxes Paid	730		730
Domain name	2,269	2,269	0
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Total assets	\$ 60,533,955	\$ 183,524	\$ 60,350,431

Liabilities, Surplus and Other Funds

Losses	\$ 18,914,484
Reinsurance payable on paid losses and loss adjustment expenses	622,223
Loss adjustment expenses	3,593,588
Commissions payable	66,563
Other expenses	5,135
Taxes, licenses and fees	137,328
Unearned premium	247,544
Ceded reinsurance premium payable	426,546
Payable to parent and affiliates	<u>206,678</u>
Total liabilities	<u>\$ 24,220,089</u>
Common capital stock	\$ 3,420,000
Gross paid in and contributed surplus	4,030,000
Unassigned funds (surplus)	<u>28,680,342</u>
Surplus as regards policyholders	<u>\$ 36,130,342</u>
Total liabilities, surplus and other funds	<u>\$ 60,350,431</u>

STATEMENT OF INCOME

PERIOD ENDING DECEMBER 31, 2017

Underwriting income

Premium earned \$ 22,023,822

Deductions

Losses incurred \$ 8,857,644  
Loss adjustment expenses incurred 2,197,097  
Other underwriting expenses incurred 4,816,453  
Total underwriting deductions 15,871,194

Net underwriting gain (loss) \$ 6,152,628

Investment Income

Net investment income earned \$ 452,680  
Net investment gain (loss) 452,680

Other Income

Finance and service charges not included in premium \$ 2,884  
Aggregate write-ins for miscellaneous income 1,518  
Total other income 4,402

Net income before Federal income tax \$ 6,609,710  
Federal & foreign income taxes 2,163,643

Net income \$ 4,446,067

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2012 \$ 32,183,969

Gains and (Losses) in Surplus

Net Income \$ 4,446,067  
Change in net deferred income tax (535,403)  
Change in non-admitted assets 35,709

Change in surplus as regards policyholders for the year \$ 3,946,373

Surplus as regards policyholders, December 31, 2013 \$ 36,130,342

CASH FLOW

Premium collected net of reinsurance	22,213,651
Net investment income	415,477
Miscellaneous income	4,402
Total	<u>22,633,530</u>
Benefit and loss related payments	<u>3,950,773</u>
Net transfers to separate, segregated & protected cell accounts	
Commissions, expenses paid and aggregate write-in for deductions	6,432,769
Dividends paid to policyholders	
Federal and foreign income taxes paid	<u>2,533,050</u>
Total	<u>12,916,592</u>
Net cash from operations	<u>9,716,938</u>
Proceeds from investments sold, matured or repaid:	
Bonds	<u>9,885,000</u>
Total investment proceeds	<u>9,885,000</u>
Cost of investments aquired (long-term only):	
Bonds	<u>13,094,156</u>
Total investment acquired	<u>13,094,156</u>
Net increase (decrease) in contract loans and premium notes	
Net cash from investments	<u>(3,209,156)</u>
Cash provided (applied):	
Other cash provided (applied)	<u>839</u>
Net cash from financing and miscellaneous sources	<u>839</u>
Net change in cash, cash equivalent & short term investments	6,508,621
Cash, cash equivalent & short term investments:	
Beginning of year	23,480,319
End of year	29,988,940

INCOME STATEMENT  
FOUR YEAR PERIOD ENDING DECEMBER 31, 2017

<u>Underwriting income</u>		
Premium earned		\$ 75,330,148
<u>Deductions</u>		
Losses incurred	\$ 21,693,431	
Loss adjustment expenses incurred	6,896,091	
Other underwriting expenses incurred	20,226,159	
Total underwriting deductions		<u>48,815,681</u>
Net underwriting gain (loss)		\$ 26,514,467
<u>Investment Income</u>		
Net investment income earned	<u>\$ 1,009,731</u>	
Net investment gain (loss)		1,009,731
<u>Other Income</u>		
Finance and service charges not included in premium	\$ 78,273	
Aggregate write-ins for miscellaneous income	<u>7,317</u>	
Total other income		<u>85,590</u>
Net income before Federal income tax		\$ 27,609,788
Federal & foreign income taxes		<u>(9,130,394)</u>
Net income		<u>\$ 18,479,394</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		<u>\$ 18,437,561</u>
<u>Gains and (Losses) in Surplus</u>		
Net Income		\$ 18,479,394
Change in net deferred income tax		(917,095)
Change in non-admitted assets		130,482
Change in surplus as regards policyholders for the years		<u>\$ 17,692,781</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 36,130,342</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 Illinois Insurance Company 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