

EXAMINATION REPORT OF  
ARAG INSURANCE COMPANY  
DES MOINES, IOWA  
AS OF DECEMBER 31, 2019

Des Moines, Iowa  
June 10, 2021

HONORABLE DOUG OMMEN  
Commissioner of Insurance  
State of Iowa  
Des Moines, Iowa

Commissioner:

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

ARAG INSURANCE COMPANY

DES MOINES, IOWA

AS OF DECEMBER 31, 2019

at its home office located at 500 Grand Avenue, Suite 100, Des Moines, Iowa.

#### INTRODUCTION

ARAG Insurance Company, hereinafter referred to as the “Company”, was last examined as of December 31, 2014 by the Iowa Insurance Division (the Division).

#### SCOPE OF EXAMINATION

This is the regular comprehensive financial examination of the Company covering the intervening period from January 1, 2015 to the close of business on December 31, 2019, including any material transactions and events occurring and noted subsequent to the examination period.

The examination was conducted in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The Handbook requires that the Division plan and perform the examination to evaluate the financial condition, identify current and prospective risks of the company 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 insurer and its financial condition.

#### HISTORY

The Company was incorporated on June 27, 1989 and commenced business August 10, 1989, with authority to transact business for prepaid legal services insurance under Chapter 515, Code of Iowa.

CAPITAL STOCK AND DIVIDENDS TO THE STOCKHOLDER

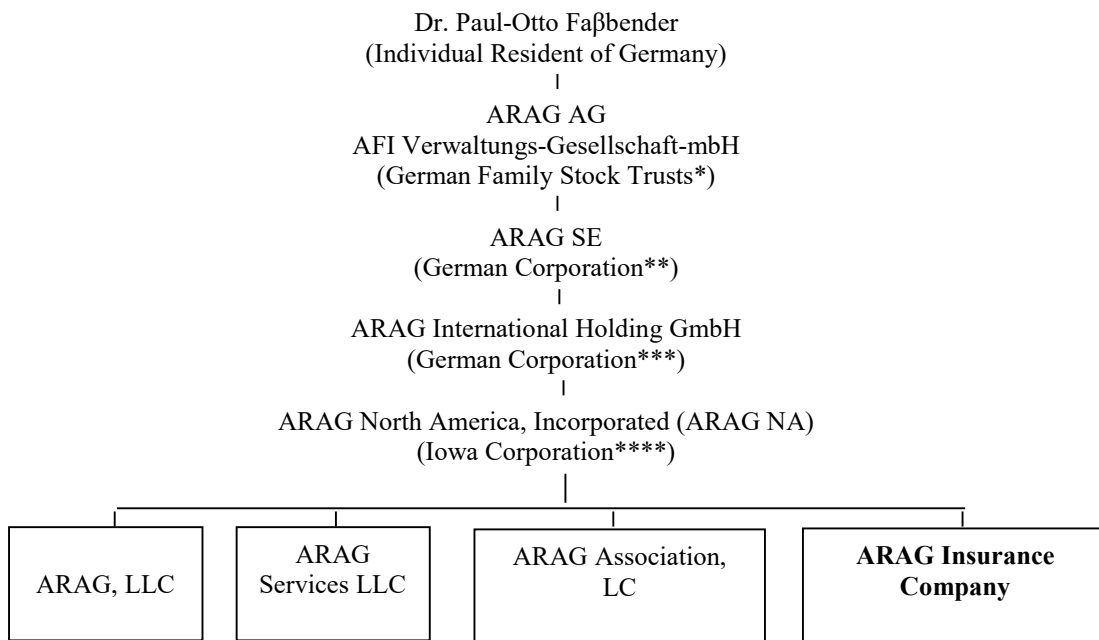
Authorized capital is \$6,000,000 represented by 400,000 shares of common stock Class A with a par value of \$12.50 and 1,000,000 shares of common stock Class B with a par value of \$1. Each share of Class A and B common stock has equal rights, including, without limitation, voting rights and redemptive value upon liquidation.

Issued and outstanding common stock, as of December 31, 2019, consisted of 361,688 shares of Class A shares and 123,533 Class B shares, with all outstanding shares held by ARAG North America, Inc. (ARAG NA). During the examination period the Company made dividend distributions to its shareholder as follows:

2015	\$12,288,277
2016	9,685,127
2017	10,640,291
2018	10,542,772
2019	15,275,872

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of a Holding Company System as defined by Chapter 521A, Code of Iowa. Dr. Paul-Otto Faßbender is the Ultimate Controlling Person for the group. An abbreviated organizational chart identifying the Companies within the Holding Company System follows:



\*The German family stock trusts are 100 percent owned or controlled by Dr. PaulOtto Faßbender, an individual resident of Germany.

\*\*ARAG SE has fifty percent of its voting stock owned by ARAG AG and fifty percent owned by AFI Verwaltungs-GmbH.

\*\*\*ARAG International Holding GmbH has 100 percent of its voting stock owned by ARAG SE.

\*\*\*\*ARAG NA has 100 percent of its voting stock owned by ARAG International Holding GmbH.

## MANAGEMENT AND CONTROL

### STOCKHOLDERS

The Bylaws specify that all meetings of shareholders shall be held at such place, either within or without the State of Iowa, on such date and at such time as may be determined from time to time by the Board of Directors (or the Chairman of the Board of Directors in the absence of a designation by the Board of Directors).

Unless directors are elected by written consent in lieu of an annual meeting, an annual meeting of the shareholders of the Company shall be held for the election of directors and for the transaction of such other business as properly may come before such meeting.

Special meetings of the shareholders for any proper purpose or purposes may be called at any time by the Board of Directors, the Chairman of the Board of Directors, the Chief Executive Officer or the President and shall be called by the Secretary of the Company immediately upon receipt of a written demand of the shareholders of record owning at least ten percent (10%) of the then issued and outstanding shares of capital stock of the Company entitled to vote on matters to be submitted to shareholders of the Company.

Except as otherwise required by Iowa Law or the Articles of Incorporation, the presence in person or by proxy of the shareholders of record owning a majority of the then issued and outstanding shares of capital stock of the Company entitled to vote at a meeting of shareholders shall constitute a quorum for the transaction of business at such meeting. Each shareholder shall be entitled to one vote for each item then issued and outstanding share of capital stock held by such shareholder.

Unless otherwise provided in the Articles of Incorporation, any action required to be taken at any annual or special meeting of shareholders, or any action which may be taken at any annual or special meeting of shareholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of the outstanding capital stock having not less than ninety percent (90%) of the votes entitled to be cast at a meeting at which all shares entitled to vote thereon were present and voted.

### BOARD OF DIRECTORS

The business and affairs of the Company shall be managed by a Board of Directors. The Bylaws provide that the number of Directors shall be fixed from time to time by the affirmative vote of the shareholders, but shall not be fewer than five (5) nor more than twenty-one (21). Each director (whenever elected) shall hold office until such person's successor has been duly elected and qualified, or until such person's earlier death, resignation or removal.

Any vacancy occurring in the Board of Directors may be filled at such meeting by the affirmative vote of the holders of a majority of the shares entitled to vote for the election of directors, or by written consent as permitted by Iowa law.

The Board of Directors shall hold its meetings at such place, either within or without the State of Iowa, or by remote communication, and at such time, as may be determined from time to time by the Board (or the Chairman of the Board in the absence of a determination by the Board of Directors). Regular meetings of the Board may be held without notice.

Special meetings of the Board may be called by the Chairman, Chief Executive Officer or the President and shall be called by the Chairman, Chief Executive Officer, the President or the Secretary on the written request of any director. Notice of special meetings of the Board shall be given to each director at least forty-eight (48) hours before the date and time of the meetings.

At all meetings of the Board of Directors, the presence of a majority of the total authorized number of directors shall constitute a quorum for the transaction of business. Except as otherwise provided by Iowa law, the Articles of Incorporation or the Bylaws, the vote of a majority of the directors present at any meeting at which a quorum is present shall be the act of the Board of Directors.

Unless otherwise restricted by the Articles of Incorporation or the Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors may be taken without a meeting if all members of the Board of Directors consent thereto in writing.

The directors duly elected and serving as of December 31, 2019 were:

<u>Name and Address</u>	<u>Principal Business Affiliation</u>	<u>Term Expires</u>
Klaus Heiermann Cologne, Germany	Chief Representative, Board Member ARAG SE	2020
Jeffrey David Lorenzen Des Moines, Iowa	Chief Investment Officer American Equity Life Insurance Company	2020
David Rodman Murray Carlisle, Iowa	Director, President and Chief Executive Officer ARAG North America, Inc.	2020
Werner Nicoll Herzogenrath, Germany	Retired Chief Financial Officer, Chairman of the Board ARAG SE	2020
Dr. Joerg Schwarze Düsseldorf, Germany	Chief Risk Officer, Board Member ARAG SE	2020

All directors were re-elected at the annual meeting of the shareholder held on October 8, 2020.

#### COMMITTEES

The Board of Directors may designate one or more committees, each committee to consist of one or more directors of the Company. The Board of Directors has established no such committees.

#### OFFICERS

The Bylaws provide that the principal officers of the Company shall be appointed by the Board of Directors and may consist of a President, one or more Vice Presidents, a Secretary and a Treasurer. The Board also may appoint such other principal officers, including a Chairman of the Board, a Chief Executive Officer, a Chief Financial Officer, a Controller and a Tax Officer.

An officer shall hold office until his or her successor has been appointed and qualified, or until his or her earlier death, resignation or removal. Any number of offices may be held by the same person. No officer need be a director of the Company.

The Company's principal officers serving at December 31, 2019 were as follows:

<u>Name</u>	<u>Title</u>
David Rodman Murray	President and Chief Executive Officer
Andrea Lee Morse	Chief Finance Officer and Treasurer
Ann Marie Cosimano	General Counsel and Secretary

All salaries of the officers are paid by ARAG NA pursuant to a services agreement.

The salaries of the above officers are shown in Exhibit A, found immediately following the signature page of this report.

#### CONFLICT OF INTEREST

The Company has an established procedure for the annual disclosure to its Board of Directors of any material interest or affiliation on the part of the directors, officers, responsible employees and members of their immediate family, which is in conflict with, or is likely to be in conflict with the official duties of such person.

The Company requires its officers, other executives, and directors to complete conflict-of-interest statements and disclose any known or potential conflict of interest as part of the annual disclosure process.

The examiners requested to review conflict of interest statements completed by the Company's directors, officers, and other members of its informal Executive Committee. No exceptions were noted in review of conflict of interest statements completed by the Company's directors and officers during the examination period. Conflict of interest statements were not consistently completed by the other members of the Company's informal Executive Committee during the examination period.

Additionally, the minutes of the meetings of the Board of Directors during the examination period did not reflect completion of the annual conflict of interest disclosure process.

#### CORPORATE RECORDS

Article II of the Restated Articles of Incorporation of the Company was amended on November 20, 2017 to change the address of the Company's registered office. The amendment was approved by the Iowa Insurance Division.

The Bylaws of the Company were not amended during the examination period.

The recorded minutes of the meetings of the shareholder and the Board of Directors were read and noted.

The minutes of the meetings of the Board of Directors did not show that the Examination Report as of December 31, 2014 by the Iowa Insurance Division was received by the Board.

#### FIDELITY BONDS AND OTHER INSURANCE

The Company is protected by a Financial Institution Bond up to a single loss limit of \$5,000,000. Other various interests of the Company are protected by appropriate policies of insurance.

#### RELATED PARTY AGREEMENTS

##### Services Agreement with ARAG NA

Effective June 1, 2017, the Company entered into a Services Agreement with ARAG NA under which the parties cooperate in the performance of administrative and special services and share facilities. Services set forth include accounting, tax, auditing, underwriting, claims, and functional support services (actuarial, telecommunication, electronic data processing, and legal services).

##### Services Agreement with ARAG LLC

Effective February 1, 2018, the Company entered into a Services Agreement with ARAG LLC under which ARAG LLC provides administrator services to the Company including collecting premium balances from insureds, agents, and program administrators; administering premiums; and paying commissions and brokerage fees.

##### Federal Tax Allocation Agreement

The Company files a consolidated Federal income tax return with ARAG NA, ARAG LLC, and ARAG Services LLC. Tax allocation is made primarily on a separate return basis with current credit for any net operating losses or other items utilized in the consolidated tax return. ARAG NA will make direct payments and intercompany balances are settled annually within 30 days of the date the return is filed or settlement is determined.

##### Promissory Note

The company holds a promissory note from ARAG NA originated December 1, 2017 for \$4,500,000 at an interest rate of 4.25%, due December 1, 2027. Interest payments are due and paid annually. The balance of the note was \$3,743,283 as of December 31, 2019.

## EMPLOYEE WELFARE

Qualified employees are provided with group life insurance, short and long-term disability, vision and legal expense insurance on a noncontributory basis. Group medical and dental coverages are provided on a contributory basis. In addition, the Company provides a 401(k) savings plan that enables employees to defer their income, up to the maximum allowed by the I.R.S., with a Company match of 100 percent up to nine percent of the employee's contributions.

## REINSURANCE

### Fronting Agreement

The Company assumes 100 percent of all prepaid legal expense policies written by GuideOne Mutual Insurance Company and GuideOne Specialty Mutual Insurance Company, in states where the Company is not licensed to write direct business. As part of the agreement, investments with a net book value of \$1,037,214, at December 31, 2019, are held in a trust account that is jointly controlled by the Company and the GuideOne companies. Premiums assumed during 2019 under these agreements totaled \$2,608,738 or 2.5% of gross written premiums.

### Aggregate Excess

During the examination period, the Company had a ceded aggregate excess reinsurance agreement with ARAG SE. The agreement was terminated December 31, 2018.

## STATUTORY DEPOSIT

As of December 31, 2019, the book/adjusted carrying value of special deposits held in trust, by the Iowa Insurance Commissioner, for the benefit of all policyholders totaled \$1,688,874. A schedule of the book/adjusted carrying value of all other special deposits follows:

Arizona	\$510,309	Nevada	\$239,270
Arkansas	114,845	New Mexico	423,499
Georgia	25,066	North Carolina	245,050
Massachusetts	131,589	Virginia	273,661

## TERRITORY AND PLAN OF OPERATION

The Company holds certificates of authority to transact business in 40 states and the District of Columbia.

The Company offers group pre-paid legal expense plans with benefits provided through a network of more than 15,000 independent attorneys. The core distribution channel, since inception, is to market these plans through employer groups as an employee benefit. The target audiences are companies in industries where there has been success in acquiring plan sponsors and high commitment to the program, leading to strong participation levels.

The five states with the largest amount of direct written premium in 2019 were as follows:

California	\$29,665,655
Minnesota	11,371,228
Washington	9,875,897
Ohio	7,393,150
Florida	7,045,232

## GROWTH OF COMPANY

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

<u>Year</u>	<u>Admitted Assets</u>	<u>Surplus to Policyholders</u>	<u>Net Premiums Earned</u>	<u>Net Losses Incurred</u>	<u>Investment Income Earned</u>
2015	70,631,882	53,295,391	69,213,817	28,631,952	1,877,200
2016	76,086,487	57,128,446	76,536,466	33,439,516	1,858,674
2017	82,900,826	61,315,324	85,171,266	37,700,557	1,997,000
2018	92,320,544	68,204,742	95,219,162	45,738,787	2,362,063
2019	103,151,319	74,084,974	103,508,864	53,842,365	2,716,679

## TREATMENT OF POLICYHOLDERS

### Claim Practices

The Examiners reviewed the claim handling process and procedures. The Examiners selected a random sample of 86 paid claims to ensure all claims were paid in a timely manner and according to policy coverage, as shown below. The Company provided adequate responses for the two claims that took over 30 days to pay. It appeared all policies, procedures, and samples were in compliance with state statutes and regulations.

<u>Number of days</u>	<u>Number of claims</u>	<u>Percentage of claims</u>
0 - 7 days	56	65%
8 - 14 days	18	21%
15 - 21 days	3	3%
22 - 30 days	7	8%
30+ days	<u>2</u>	<u>2%</u>
Total	86	100%

The Examiners reviewed a sample of 25 denied claims to ensure the claim file documentation is sufficient to support the denial, reason for denial was included in the letter sent to the consumer, and timeliness of denial. There were no exceptions. It appeared all policies, procedures, and samples were in compliance with state statutes and regulations.

### Complaints

The Examiners reviewed the complaint register and complaint handling procedures. The complaint register was not completed in its entirety for 16 of the 40 complaints on the register, and was not accurate as to the "Company Disposition After Receipt Column" which does not comply with Iowa Administrative Code section 191.15.13(1)b. The Company has an action plan in place to formalize its complaint procedures and remediate the errors identified in the complaint register. The Examiner pulled a judgmental sample of complaints files to ensure the Company responded to the complaint in a timely manner and effective manner. There were no exceptions noted in the sample.



## PRODUCER LICENSING AND APPOINTMENTS

The Examiners reviewed the Company's onboarding, appointment, and license monitoring procedures. The Examiners reconciled the Company's list of licensed and appointed Iowa producers with that on file with the National Insurance Producer Registry without exception. The Examiners also reconciled the list of terminated producers without exception. It appeared all policies, procedures, and producer files were in compliance with state statutes and regulations.

## ADVERTISING

The Examiners reviewed the Company's advertising policies and procedures and advertising log. The Examiners sampled 50 of the Company's advertising materials listed in the Company's advertising log to ensure compliance. It appeared all policies, procedures and samples were in compliance with state statutes and regulations.

## ACCOUNTS AND RECORDS

The Company uses electronic data processing equipment and related software for processing and maintaining its accounts, records and files. The Information Systems controls were reviewed by this examination. No material exceptions were noted to accepted control practices and procedures.

Trial balances of the Company's general ledger were taken for the examination years under review and were found to be in agreement with the office copy of the filed annual statements.

During the course of examination, no statutory violations or material differences with the amounts reflected in the financial statements, as presented in the annual statement at December 31, 2019, were identified.

## SUBSEQUENT EVENTS

### COVID-19 Pandemic

The Iowa Insurance Division is monitoring the impact of the COVID-19 global pandemic. The Iowa Insurance Division recognizes that COVID-19 could have a significant financial and operational impact on all of its domestic insurers, including the Company. As such, the Iowa Insurance Division will continue to monitor and share information with the Company as appropriate related to COVID-19 developments.

### Dividend Payment

The Company paid a dividend to its stockholder in the amount of \$15,071,487 in 2020.

### Release of Loss Reserves

As of December 31, 2020, the Company recognized \$3,191,106 of favorable development of net loss and loss adjustment expense reserves for accident years 2019 and prior.

FINANCIAL STATEMENTS  
AND COMMENTS THEREON

NOTE: The following financial statements are based on the statutory financial statements filed by the Company with the Iowa Insurance Division and present the financial condition of the Company for the period ending December 31, 2019.

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS  
PERIOD ENDING DECEMBER 31, 2019

	<u>ASSETS</u>		
	<u>Assets</u>	<u>Not Admitted</u>	<u>Admitted</u>
Bonds	\$ 74,058,208	\$	\$ 74,058,208
Common stocks	14,031,992		14,031,992
Cash, cash equivalents and short-term investments	5,611,831		5,611,831
Investment income due and accrued	571,994		571,994
Uncollected premiums and agents' balances in course of collection	3,696,761	389,323	3,307,438
Funds held by reinsured companies	1,037,214		1,037,214
Receivables from parent and affiliates	777,177		777,177
Accounts receivable	12,183		12,183
Prepaid expenses	33,910	33,910	
Note receivable from parent	3,743,283		3,743,283
Total Assets	\$103,574,552	\$423,233	\$103,151,319

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$ 24,801,000
Loss adjustment expenses		1,069,536
Other expenses		209,378
Taxes, licenses and fees		399,359
Current federal and foreign income taxes		418,599
Net deferred tax liability		480,242
Unearned premiums		288,837
Drafts Outstanding		1,399,393
Total Liabilities		\$ 29,066,345
Common capital stock		\$ 4,644,633
Gross paid in and contributed surplus		7,767,975
Unassigned funds (surplus)		61,672,365
Surplus as Regards Policyholders		\$ 74,084,974
Total Liabilities, Surplus and Other Funds		\$103,151,319

UNDERWRITING AND INVESTMENT EXHIBIT  
ONE-YEAR PERIOD ENDING DECEMBER 31, 2019

STATEMENT OF INCOME

<u>Underwriting Income</u>		
Premiums earned		\$103,508,864
<u>Deductions</u>		
Losses incurred	\$53,842,365	
Loss adjustment expenses incurred	2,350,062	
Other underwriting expenses incurred	<u>26,579,947</u>	
Total underwriting deductions		<u>82,772,374</u>
Net underwriting gain		\$ 20,736,490
<u>Investment Income</u>		
Net investment income earned	\$ 2,716,679	
Net realized capital gains	<u>303,572</u>	
Net investment gain		<u>3,020,251</u>
Net income before federal income tax		\$ 23,756,740
Federal & foreign income taxes incurred		<u>4,917,381</u>
Net Income		<u>\$ 18,839,359</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31 prior year		<u>\$ 68,204,742</u>
<u>Gains and (losses) in surplus</u>		
Net income		18,839,359
Change in net unrealized capital gains		2,155,467
Change in net deferred income tax		170,769
Change in non-admitted assets		(9,490)
Dividends to stockholder		<u>(15,275,872)</u>
Change in surplus as regards policyholders for the year		<u>\$ 5,880,232</u>
Surplus as regards policyholders, December 31 current year		<u>\$ 74,084,974</u>

STATEMENT OF CASH FLOWS  
PERIOD ENDING DECEMBER 31, 2019

Cash from Operations

Premiums collected net of reinsurance	\$102,926,494	
Net investment income	<u>3,042,980</u>	
Total		\$ 105,969,474
Benefit and loss related payments	\$ 49,618,365	
Commissions, expenses paid, and aggregate write-ins	28,589,859	
Federal and foreign income taxes paid	<u>4,456,209</u>	
Total		<u>82,664,433</u>
Net cash from operations		<u>\$ 23,305,041</u>

Cash from Investments

Proceeds from investments sold, matured, or repaid:		
Bonds	\$ 8,548,451	
Stocks	1,820,293	
Net gains on cash and short-term investments	<u>1,109</u>	
Total investment proceeds		\$ 10,369,853
Cost of investments acquired (long-term only):		
Bonds	\$ 16,377,065	
Stocks	<u>1,945,120</u>	
Total investments acquired		<u>18,322,185</u>
Net cash from investments		<u>\$ (7,952,331)</u>

Cash from Financing and Miscellaneous Sources

Dividends to stockholders	(15,275,872)	
Other cash provided (applied)	<u>\$ 2,214,297</u>	
Net cash from financing & miscellaneous sources		<u>\$(13,061,575)</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Net change in cash, cash equivalents and short-term investments		\$ 2,291,135
Cash, cash equivalents and short term investments:		
Beginning of year		<u>3,320,696</u>
End of year		<u>\$ 5,611,831</u>

## CONCLUSION

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

In addition to the undersigned, the following examiners participated in the examination and preparation of this report: Bob Wong, CFE and Josh Pietan, Examiner Senior.

The review of the Company's information systems for this examination was performed by John Albertini, CISA, CISM, CISSP of INS Services, Inc.

The review of the Company's loss and loss adjustment expense reserves for this examination was performed by David Macesic, ACAS, MAAA of INS Consultants, Inc.

Respectfully submitted,

/s/ Thomas Allen  
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Thomas Allen, CFE  
Examiner-in-Charge  
Examination Resources, LLC on behalf of the  
Iowa Insurance Division

/s/ Daniel Mathis  
\_\_\_\_\_  
Daniel Mathis, CFE  
Supervisor and Assistant Chief Examiner  
Iowa Insurance Division