

REPORT OF EXAMINATION
OF THE
CALIFORNIA INSURANCE GUARANTEE ASSOCIATION
AS OF
JUNE 30, 2020

Insurance Commissioner

A handwritten signature in blue ink, appearing to read "D. P. ...", is positioned to the right of the text "Insurance Commissioner".

FILED ON June 4, 2021

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Los Angeles, California
May 20, 2021

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA INSURANCE GUARANTEE ASSOCIATION

(hereinafter also referred to as the Association). Its home office is located at 330 North Brand Boulevard, Glendale, California 91203.

SCOPE OF EXAMINATION

We have performed our single-state examination of the Association. The previous examination of the Association was as of June 30, 2015. This examination covered the period from July 1, 2015 through June 30, 2020.

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 Association'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 Association were considered in accordance with the risk-focused examination process. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an

evaluation of the overall financial statement presentation, and an analysis of the Association's projected cash flows through 2030.

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 Association's financial statements.

This examination report includes general information about the Association 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 Association.

ASSOCIATION HISTORY

The Association was created by California legislation in 1969 to establish a fund from which insureds could obtain financial and legal assistance in the event their insurers became insolvent. The Association was organized pursuant to, and operates in accordance with California Insurance Code (CIC), Division 1, Part 2, Article 14.2, Section 1063. In addition, the Association functions pursuant to a Plan of Operation approved by the California Department of Insurance. The purpose of the Association is to provide against loss arising from the failure of an insolvent insurer to discharge its obligations under its insurance policies.

The Association is a statutory entity that depends on the Guarantee Act (CIC Sections 1063-1063.77) for its existence and for a definition of the scope of its powers, duties and protections. The Association issues no policies, collects no premiums, makes no profits, and assumes no contractual obligations from policyholders.

MANAGEMENT AND CONTROL

Management of the Association is vested in a thirteen-member Board of Governors, nine shall be member insurers who shall be appointed by the California Insurance Commission. At least five of the member insurers shall be domestic insurers, at least three shall be stock insurers, and at least three shall be nonstock insurers. In addition, the membership shall also include one public member appointed by the President Pro Tempore of the California State Senate, one public member appointed by the Commissioner, and one labor member appointed by the Commissioner.

A listing of the members of the Board and principal officers serving at June 30, 2020 follows:

Governors

<u>Name</u>	<u>Principal Business Affiliation</u>
Lloyd Benedetti	Vice President, Controller Inter-Insurance Exchange of the Automobile Club of Southern California
Andrew Chick	President and Chief Executive Officer Lawyers' Mutual Insurance Company
Richard De La Mora	Head of Personal Lines, Specialty Lines and Strategy Mid Century Insurance Company
Stephen Festa	Chief Operating Officer Employers Insurance Group
Peter Guastamachio	Chief Financial Officer State Compensation Insurance Fund
Shane Gusman ^(a)	Administrator Broad & Gusman, LLP
Jeffrey Huebner	EVP and Chief Risk Officer CSAA Insurance Exchange

<u>Name</u>	<u>Principal Business Affiliation</u>
Amy Juknelis	Senior Actuary and Pricing Director Allstate Insurance Company
Carol Kim ^(b)	Vice President of Community Investment and Public Affairs Health Net
Joyce Mellinger	Senior Vice President and General Counsel Zurich American Insurance Company
Alex Timm	Chief Executive Officer Root Insurance Company
Thomas Wilson ^(c)	Managing Director Monterey Peninsula Surgery Center, LLC

(a) Public member appointed by the Insurance Commissioner to represent labor.

(b) Public member appointed by Speaker of the Assembly.

(c) Public member appointed by the Insurance Commissioner to represent Business.

Principal Officers

<u>Name</u>	<u>Title</u>
Brad Roeber	Executive Director
Adriana Ortiz	Director of Audit
Anthony Kennedy	Director of Finance
Terri Harrison	Director of Workers' Compensation

Management Agreements

Authorization for the direct management of the Association's investment portfolio has been granted to two separate investment management firms, Payden & Rygel and Western Asset Management Company. Both agreements have been in effect for over 20 years. Each firm is responsible for the management of a designated segment of the

Association's investment portfolio. Within the confines of the Association's codified guidelines, each investment management firm has authority to execute transactions without prior consultation with the Association's management. In addition, the Association has approximately five (5) percent of its unrestricted investments in an S&P 500 commingled fund managed by State Street Bank & Trust Company.

Third Party Administrators

The majority of the Association's workers compensation claims are administered by third-party administrators (TPAs). As of June 30, 2020, there are two TPAs under contract: Intercare Holdings Insurance Services, Inc., and Tristar Risk Management. Under limited circumstances, the Association has the right to cancel the contracts. Fees paid to the TPAs are based on the number of claims filed. Some of the claims handling fees were paid at the inception of the agreements, whereas other contract fees are paid on monthly or annual cycle based on the number of open claims. The TPAs have the authority to issue claim payments up to \$25,000. Claim payments in excess of \$25,000 require the approval of the Association's management.

TERRITORY AND PLAN OF OPERATION

The purpose of the Association is to provide insolvency insurance for each member insurer and to protect policyholders against loss arising from the failure of an insolvent, admitted insurer to discharge its obligations under its insurance policies. The Association obtains funds to pay its covered claims through assessments of admitted insurers, release of special statutory security deposits previously placed with the state of California by the insolvent carriers, distributions from insolvent carriers' estates, and investment income.

Insurance companies writing property and casualty insurance business in California are required to participate in the California Insurance Guarantee Association. If an admitted property and casualty insurance company becomes insolvent, the Association

administers unpaid claims and may assess each property and casualty insurance company up to 2% for all lines of written premium in the appropriate category(ies) if required. California Insurance Code (CIC) Section 1063.145 requires all property and casualty insurance companies to surcharge policies to recover these assessments.

The Association has the responsibility to pay and discharge covered claims of insurers as of the date of court of competent jurisdiction declares the property and casualty insurance company insolvent and a liquidator is appointed. Covered claims primarily include the policy obligations of insolvent insurers arising from property and liability coverages (exclusive of those lines not included per CIC Section 1063.1).

The Association allocates its claim payments and costs, incurred or estimated to be incurred, to one or more of the following categories: (a) workers' compensation claims; (b) homeowners' claims, and automobile claims, which include: automobile material damage, automobile liability (both personal injury and death, and property damaged), medical payments and uninsured motorist claims; and (c) claims other than workers' compensation homeowners, or automobile. Separate premium charges (assessments) are required for each category. The assessments for each category are used to pay the claims and costs allocated to that category. The CIC and labor laws establish the maximum claim settlement amounts for workers' compensation claims. Workers' compensation claims are paid in full. Claims for damage to, or loss of, a dwelling structure under a policy of residential property insurance are paid at full value up to one million dollars (\$1,000,000) or the policy limit, whichever is less. All other claims, including automobile and personal injury claims, are paid at full value up to \$500,000 or the policy limits, whichever is less.

When a property and casualty insurance company becomes insolvent, the control of its assets transfers to the state insurance liquidator in its domiciliary state. The liquidator uses the assets of the insolvent insurance company to settle the outstanding liabilities of the company. Liquidators may advance funds to the Association prior to the settlement of all outstanding debts. The Association recognizes these advances as revenue when received. The advances are utilized to discharge claims against the insolvent insurance

companies. The respective liquidator can recall these advances, in whole or in part. The Association recognizes any recall of advances when notified by the respective liquidator or receiver.

To the extent that assets, including advances from liquidators, are insufficient to discharge claim obligations, additional premium charges are assessed from member insurers when determined necessary by the Board of Governors (Board) of the Association. Conversely, to the extent that the assets exceed the ultimate cost of claim obligations for insolvent insurers, the excess fund balance, if any, will be applied to reduce future premium charges by the Association in the appropriate category.

Premium charges are accrued as of the date declared by the Board of the Association and become due from the member insurers when billed. The rate of premium charges to each member is initially based on the written premium shown on the latest year's annual financial statement on file with the California Insurance Commissioner.

In the event of a natural disaster, the Association, to the extent it determines necessary or desirable, may request the California Department of Insurance (CDI) to issue bonds pursuant to Article 14.25 (commencing with CIC Section 1063.50) to provide funds to pay covered claims of insolvent insurers. The Association may act as agent of the CDI to collect premium payments levied by the CDI on its member insurers.

Additionally, CIC Section 1063.70 authorizes the Association to request the issuance of bonds by the California Infrastructure and Economic Development Bank, to more expeditiously and effectively provide for the payment of covered claims that arise as a result of the insolvencies of insurance companies providing workers compensation insurance. Proceeds for the sale of bonds shall be deposited into a separate account, the Workers' Compensation Bond Fund. Notwithstanding any other limits on assessments, the Association shall have authority to levy upon member insurers special bond assessments in the amount necessary to pay the principal of and interest on the bonds. Any bonds issued to provide funds covered claim obligations for workers' compensation claims shall be issued prior to January 1, 2023 in an aggregate principal amount outstanding at any one time not to exceed \$1.5 billion. As of June 30, 2020, there were

no outstanding bonds.

The Association was providing insolvency insurance for 133 insolvent companies including both active and inactive insurers at June 30, 2020.

REINSURANCE

Reinsurance entered into by insurers prior to their insolvencies is administered by the California Department of Insurance, Conservation and Liquidation Office (CLO) or the domestic liquidator of a non-California domiciled company, and is therefore excluded from the Association's financial statements. Reinsurance recoveries made by the CLO or the domestic liquidator may be advanced to the Association subject to the priority needs of the estate in liquidation. Ancillary liquidations may also have a demand on assets recoverable including reinsurance recoverable.

Senate Bill No. 430 approved by the Governor on September 23, 2017, authorizes the Association to reinsure with, or transfer liabilities to, a California admitted and authorized reinsurer or other reinsure approved by the Insurance Commissioner in order to limit or eliminate adverse development, to stabilize or limit the need for assessments, or to reduce its potential ultimate liability for covered claims, provided certain conditions are met. The Association researched potential reinsurance opportunities, however it was determined to not be cost effective for the Association to pursue at this time.

ACCOUNTS AND RECORDS

The financial statements presented by the Association, which are regularly audited by independent certified public accountants, are prepared on a Generally Accepted Accounting Principles basis with the fiscal year ended June 30th. The Association's financial statements are prepared on a conservative basis (i.e., full value of estimated California-risk reserves are established with no deduction for inuring reinsurance recoverables, no anticipation of advances from estates in liquidation, and advances are

recorded only when received).

FINANCIAL STATEMENTS

The following financial statements are based on the annual audited reports filed by the Association with the California Department of Insurance and present the financial condition of the Association for the period ending June 30, 2020. The accompanying comments to the amounts in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the financial statements reported by the Association.

Statement of Financial Condition as of June 30, 2020

Statement of Comprehensive Income for the Fiscal Year Ended June 30, 2020

Statement of Cash Flow for the Fiscal Year Ended June 30, 2020

Statement of Financial Condition
as of June 30, 2020

<u>Assets</u>	<u>Net Admitted</u> <u>Assets (000s)</u>	<u>Notes</u>
Cash and cash equivalents:		
Unrestricted	\$ 336,605	
Restricted for workers' compensation claims	11,496	
Investments in debt securities available-for-sale, at fair value:		
Unrestricted	3,270,224	
Restricted for workers' compensation claims	315,633	
Investments in equity securities, at fair value:		
Unrestricted	161,344	
Accrued investment income	14,928	
Receivable for unsettled securities	160,382	
Fixed assets, net	2,138	
Deposits and other assets	<u>1,484</u>	
 Total assets	 <u>\$ 4,274,234</u>	
 <u>Liabilities, and Fund Surplus</u>		
Reserve for claims	\$ 1,480,769	(1)
Reserve for claims adjustment and administrative expenses	70,489	(1)
Reserve for excess liquidator advances and statutory deposits	27,334	(1)
Payable for unsettled securities	162,237	
Premium charge credits due to members	28,500	
Accounts payable and accrued expenses	<u>3,860</u>	
 Total liabilities	 <u>1,773,189</u>	
 Fund surplus:		
Workers' compensation	1,089,215	
Automobile and homeowners	367,753	
All other	<u>976,674</u>	
Lines of business (LOB) fund surplus	2,433,642	
Accumulated other comprehensive income	<u>67,403</u>	
 Total fund surplus	 <u>2,501,045</u>	
 Total liabilities, and fund Surplus	 <u>\$ 4,274,234</u>	

Statement of Comprehensive Income
for the Fiscal Year Ended June 30, 2020

	<u>(000s)</u>
Assessment and Investment Activity:	
Premium credits, net	\$ (28,500)
Net investment income	79,017
Net realized and unrealized investment gain	46,667
Liquidator Activity:	
Advances from liquidators	161,864
Statutory deposits	96
(Increase) decrease in reserve for excess liquidator advances and statutory deposits	(16,458)
Claims activity:	
Claims paid	\$ (139,843)
Claim adjustment expenses paid	(36,602)
Decrease in reserve for claims	207,919
Decrease in reserve for claims adjustment and administrative expenses	<u>11,902</u>
	43,376
Unearned premiums activity	
Unearned premiums paid	(81)
Decrease in reserve for unearned premium	<u>1,090</u>
	1,009
Administrative expense activity:	
Administrative expenses	<u>(27,819)</u>
Net Income	<u>259,252</u>
Other Comprehensive Income:	
Net unrealized gain on debt securities available-for-sale arising during the year	76,470
Reclassification adjustment for sale of debt securities available for sale included in net income	<u>(35,337)</u>
	<u>41,133</u>
Comprehensive income	<u>\$ 300,385</u>

Statement of Cash Flow
for the Fiscal Year Ended June 30, 2020

	<u>(000s)</u>
Cash flow and operating activities:	
Net income	\$ 259,252
Adjustment to reconcile net income to net cash provided by (used in) operating activities:	
Depreciation and amortization of fixed assets	\$ 3,175
Amortization of right-of-use asset	770
Realized and unrealized investment gain	(46,667)
Amortization of debt securities available-for-sale	7,593
Statutory deposits received in the form of investments	(16,183)
Decrease (increase) in:	
Accrued investment income	3,596
Accrued but not received statutory deposits	18,949
Deposits and other assets	<u>(34)</u>
	(28,801)
Increase (decrease) in:	
Reserve for claims, claim adjustment expenses, and administrative expenses	(219,821)
Reserve for excess liquidator advances and statutory deposits	16,458
Premium charge credits due to members	28,500
Accounts payable and accrued expenses	(3,938)
	<u>(178,801)</u>
Net cash provided by (used in) operating activities	<u>51,650</u>
Cash flows from investing activities:	
Debt securities available-for-sale:	
Purchases, unrestricted	(7,073,268)
Proceeds from sales, unrestricted	6,603,767
Proceeds from calls or maturities, unrestricted	490,226
Purchases, restricted for workers compensation claims	(633,570)
Proceeds from sales, restricted for workers compensation claims	624,994
Proceeds from calls or maturities, restricted for workers compensation claims	41,673
Equity securities:	
Proceeds from sales, unrestricted	30,020
Increase in receivable for unsettled securities	(145,698)
Increase in payable for unsettled securities	99,526
Purchase of fixed assets	<u>(1,627)</u>
Net cash provided by investing activities	<u>36,043</u>
Net increase in cash and cash equivalents including unrestricted balances	87,693
Cash and cash equivalents including restricted balances:	
Beginning of year	<u>260,408</u>
End of year	<u>\$ 348,101</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Reserves for Claims, Claims Adjustment and Administrative Expenses, and Excess Liquidator Advances and Statutory Deposits

The Association's reserves for claims and claims adjustment expenses are primarily comprised of workers' compensation reserves associated with insolvencies for workers' compensation carriers. The Association's workers' compensation reserves are 85% of its total stated reserves.

The Association provided the examiners with an actuarial report issued by Daniel Murphy, FCAS, MAAA of Trinostics, LLC prepared as of June 30, 2020.

For each year covered by this examination, the Association's external auditors issued a qualified opinion on the financial statements. The opinion stated in part that "the underlying claims information related to certain insolvencies was not sufficiently reliable or complete to enable the Association to estimate on a reasonable basis the reserve for claims, claim adjustment expenses and administrative expenses and the reserve for unearned premium."

A Casualty Actuary from the California Department of Insurance (Casualty Actuary) has opined that since the Association is an insolvency fund, the amount of claims and claims adjustment expense reserves are impractical to calculate with any degree of precision. Claims data emanating from different insurers with differing levels of data integrity create practical limits on producing claims estimates. With consideration given to the ability of the Association to issue additional bonds for funding as well as ongoing premium charges, the Casualty Actuary concluded that the Association does not require precise reserve requirements to function properly.

SUBSEQUENT EVENTS

COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared coronavirus disease (COVID-19) a pandemic. The pandemic has triggered unprecedented government mandates and health and safety measures which have significantly impact the U.S. and global financial markets, in particular, U.S. publicly traded equity securities, and impacts on yields and interest rates in the U.S. bond market. During the exam we reviewed COVID-19's impact on the Association's operations with no immediate solvency concerns noted. As of the date of this report, significant uncertainty remains on the effect that the pandemic will have on the insurance industry, economy, and the Association at large. The California Department of Insurance continues to closely monitor the impact of the pandemic on the Association and will take necessary action if a solvency concern arises.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

ACKNOWLEDGMENT

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

Respectfully submitted,

 Digitally signed by Lopez,
Bridget
Date: 2021.06.03 14:13:44
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Bridget Lopez, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

 Digitally signed by Briggs,
Anjanette
Date: 2021.06.03 14:22:54
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Anjanette Briggs, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California