

**REPORT ON EXAMINATION
OF
ARMED FORCES INSURANCE EXCHANGE
550 EISENHOWER ROAD
LEAVENWORTH, KS 66048
AS OF
DECEMBER 31, 2017**

FILED

JUN 28 2019

**VICKI SCHMIDT
Commissioner of Insurance**

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Leavenworth, Kansas
May 28, 2019

Honorable Vicki Schmidt
Commissioner of Insurance
Kansas Insurance Department
420 SW 9th Street
Topeka, Kansas 66612-1678

Dear Commissioner:

In accordance with your authorization and pursuant to K.S.A. 40-222 – *Examination of condition of company*, an examination has been conducted of the financial condition and business affairs of:

ARMED FORCES INSURANCE EXCHANGE

with its statutory home office at:

**550 EISENHOWER ROAD
LEAVENWORTH, KS 66048**

and main administrative office at:

**550 EISENHOWER ROAD
LEAVENWORTH, KS 66048**

hereinafter referred to as the “Exchange” or “AFIE”. The following report on such examination is respectfully submitted.

SCOPE OF EXAMINATION

The examiners have performed a multi-state financial examination of Armed Forces Insurance Exchange, a Kansas domiciled property & casualty insurance company. The last examination covered the four-year period from January 1, 2010, through December 31, 2013. This examination covers the four-year period from January 1, 2014, through December 31, 2017.

The examination was conducted in accordance with the rules, regulations and directives of the Kansas Insurance Department (the Department) and the observed guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* (Handbook). The Handbook requires the examiners plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Exchange 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 Exchange 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 Exchange's financial statements.

This examination report includes significant findings of fact, as mentioned in K.S.A. 40-222, *Examination of condition of company*, and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Exchange.

Independent Audit Reports

Financial statements of the Exchange were audited by Deloitte & Touche, LLP for the years ending December 31, 2014, through December 31, 2017. In each of the years under examination, the auditors concluded that the financial statements present fairly, in all material respects, the admitted assets, liabilities and policyholders' surplus of the Exchange as of December 31, 2017 and the results of its operations and its cash flows for the years then ended in accordance with the accounting practices prescribed or permitted by the Department.

The independent auditor's work papers were reviewed and analyzed by the examiners; whereby significant reliance was placed on select work papers during the course of this examination.

SUMMARY OF SIGNIFICANT FINDINGS

No significant findings were noted during the course of the examination.

COMPANY HISTORY

General

The Army Co-operative Fire Association (Association) was organized on February 7, 1887 for the sole purpose of insuring the personal property of all commissioned officers of the United States Army, and acting assistant surgeons actually on duty with the troops, for loss by fire. After World War II, catastrophic coverage was added, as many members were living in places prone to typhoon, flood and earthquake risk. Membership was expanded to include officers of the Air Force, Navy, Marine Corps, Coast Guard and career reservists of the armed forces. Insurance against loss by theft and other perils was offered in 1954, with homeowners' coverage being offered in 1960. On February 7, 1962, the Association's name was changed to the "Armed Forces Cooperative Insurance

Association” to effectively recognize the changed status of the Association through the years as an insuring group of officers of the armed forces.

The expansion into homeowners insurance and the increased emphasis on state regulation of insuring organizations required the Association to be regulated by state insurance departments. To address this need, Armed Forces Insurance Exchange was established under K.S.A. 40-1601, *et seq.* – *Reciprocal or interinsurance contracts* and commenced business on August 1, 1982. The Exchange was formed to assume the Association’s business and by July 1, 1992, all assets and liabilities of the Association had been merged with and into the Exchange, with the Exchange being the surviving entity. In conjunction with the merger, Armed Forces Insurance Corporation (AFIC) was established to act as attorney-in-fact in accordance with statutory provisions.

MANAGEMENT AND CONTROL

Pursuant to Article II of AFIE’s bylaws, the following are eligible to be subscribers of the Exchange and are entitled to its benefits:

- active, retired, or honorably discharged former commissioned, warrant, or non-commissioned officers of the regular service, the reserve components, the retired reserve list, or the retired reserve components of the U.S. Army, Air Force, Navy, Marine Corps, or Coast Guard;
- active, retired, or former commissioned officers of the Public Health Service;
- active, retired, or former commissioned officers of the National Oceanic and Atmospheric Administration;
- cadets or midshipmen of the Service Academies and any midshipmen of the U.S. Merchant Marine Academy;
- ROTC cadets or midshipmen enrolled in an advanced ROTC program who have accepted a contractual service obligation;
- active or retired persons in those enlisted grades of the regular service, the reserve components, the retired reserve list or the retired reserve components, as authorized by the Attorney-in-Fact;
- honorably discharged veterans of the active and reserve components as authorized by the Subscribers’ Advisory Committee;
- all active or retired civilian employees of the U.S. Department of Defense;

- surviving spouses, former spouses, and ex-dependent children of current or former member subscribers;
- employees of AFIE, the Armed Forces Insurance Corporation, or any other affiliated of the aforementioned organizations and any person who has retired directly from the employment of any of these organizations or affiliations;
- any person who was previously a member subscriber based on criteria as described in the eligibility requirements above.

The Exchange is controlled by its member subscribers and managed by a Subscribers' Advisory Committee (SAC). The bylaws stipulate that the SAC be composed of not less than seven nor more than eight individuals, all of whom are current subscribers elected by member subscribers of the Exchange, plus an ex officio, the president of the attorney-in-fact. The elected term of office for members of the SAC is three years, with elected members being limited to two successive terms. Upon death, impairment or resignation of a SAC member, the remaining members select a replacement to serve until the next annual meeting of the Exchange's member subscribers. The SAC is to elect a Chairman and Vice Chairman from the elected members of the SAC. The SAC, in addition to elected independent directors, comprise the board of directors for the attorney-in-fact. As of December 31, 2017, in addition to the Ex-Officio, Kurt H. Seelbach, the members serving on the SAC were as follows:

<u>Military Rank</u>	<u>Name</u>	<u>Position</u>	<u>Term Expires</u>
Colonel (Retired)	Joyce P. DiMarco	Chair	2018
Colonel (Retired)	Myron J. Griswold	Vice Chair	2018
	Dana M. Abella	Member	2018
	Lucille K. Pittard	Member	2020
Colonel (Retired)	Paul D. VanGorden	Member	2018
Lt Col (Retired)	Michael J. Yaguchi	Member	2020
	George J. Zock	Member	2020
CMSgt. (Retired)	Danny R. Walker	Member	2021

The Exchange's bylaws stipulate that the SAC shall have oversight responsibility to supervise the attorney-in-fact's operations to such extent as necessary to assure

conformity with the subscriber's agreement and to supervise the finances of the Exchange. The SAC is trustee of the stock of AFIC for the subscribers with authority to vote, sell or purchase additional shares of said stock.

The affairs of the Exchange are under the direction of the attorney-in-fact as authorized by the power of attorney submitted by each subscriber. The officers of AFIE, as of December 31, 2017, are as follows:

<u>NAME</u>	<u>AFIE POSITION</u>
Kurt H. Seelbach	President
Arlen L. Briggs	Executive Vice President, Finance and Treasurer
Rebecca J. Turnbull	Asst. Vice President, Strategic Planning and Secretary
Kevin J. Lund	Vice President, Chief Information Officer
Michael T. Nixon	Senior Vice President, Insurance Operations & Underwriting
Loretta L. Stewart	Vice President, Claims
Lori L. Simmons	Vice President, Marketing & Corp Communications

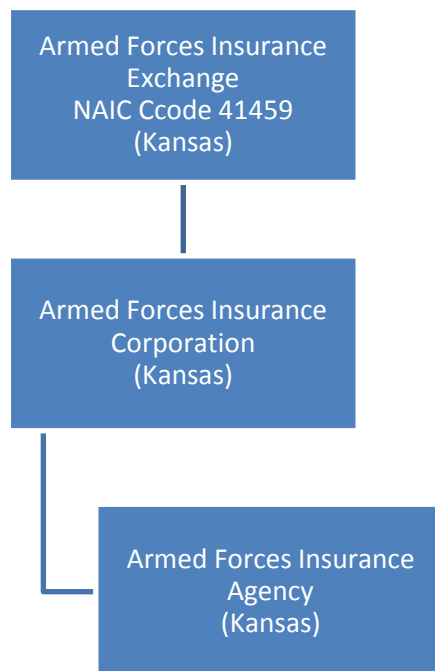
The elected independent board members of the attorney-in-fact as of December 31, 2017 are as follows:

<u>NAME AND RESIDENCE</u>	<u>PRINCIPAL OCCUPATION</u>
Stanley E Clarke III Danville, KY	Chairman Armed Forces Insurance Corporation
Paul E. Heacock Olathe, KS	President H. Dynamics, Inc. d/b/a Human Dynamics
Thomas M. Fogt Overland Park, KS	Retired AmerUs Annuity Group
Becky S. Blades Kansas City, MO	President Trozzolo Communications Group
Norm D. Greczyn Leavenworth, KS	Military Analyst Cubic Applications, Inc.
Gen. Antonio M. Taguba Alexandria, VA	President TDLS Consulting LLC

Insurance Holding Company System

K.S.A. 40-3301, *et seq.* - *Insurance Holding Companies*, requires a domestic insurer that is part of an insurance holding company system to file appropriate registration statements with the Commissioner of Insurance. The Exchange has submitted Form “B” and “C” registration statements to the Department for each of the years under examination. A review of the registration statements indicated that the Exchange is properly reporting items and events for Armed Forces Insurance Corporation (AFIC) and Armed Forces Insurance Agency (AFIA) as required by statute.

The following organizational chart illustrates the identities and intercompany relationships among insurance and non-insurance companies and the controlling entities thereof, as of December 31, 2017.



Intercompany/Cost Sharing Agreements

The Exchange has entered into a federal income tax allocation agreement with its consolidated subsidiary, Armed Forces Insurance Corporation.

The Exchange has separate management agreements with both AFIC and Armed Forces Insurance Agency (AFIA). Each agreement is renewed annually and approved by the Kansas Insurance Department. As of December 31, 2017, AFIE and the Department were working on changes in language for inclusion in the 2017 AFIC and AFIE management service agreement to accurately reflect operational changes that were completed by the end of 2016.

The Exchange has renewed its lease agreements with AFIC, whereby, the Exchange leases office space at 655 Biddle Boulevard, Fort Leavenworth, Kansas and 550 Eisenhower Road, Leavenworth, Kansas. The Exchange, with prior approval from AFIC, subleases to AFIA office space at 550 Eisenhower Road to AFIA. The sublease includes rentable space located at 655 Biddle Boulevard, for the benefit of AFIA when needed.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Exchange is authorized to transact business in all fifty states and the District of Columbia. The NAIC Schedule T Exceptions Report was reviewed for each of the states where the Exchange is licensed. No exceptions were noted.

As of December 31, 2017, the Exchange's largest lines of business were homeowners multiple peril at 81.8% of direct premiums written, inland marine at 7.2% and allied lines at 4.4%. The remaining 6.6% represented fire and other liability business.

GROWTH OF COMPANY

The exhibit below shows the Exchange's financial status (in thousands) for the period of December 31, 2013, through December 31, 2017. The financial growth amounts were obtained from annual statements filed by the Exchange.

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
<i>(in thousands)</i>					
Admitted Assets	\$123,016	\$136,391	\$142,850	\$139,924	\$139,427
Liabilities	61,418	65,654	66,738	73,292	71,886
Capital and Surplus	61,598	70,737	76,112	66,632	67,541
Net Underwriting Gain/(Loss)	2,671	6,050	3,188	(13,017)	(2,590)
Net Income	7,685	9,910	7,143	(8,106)	2,050
Net Premiums Written	64,200	66,976	69,943	68,825	67,924

REINSURANCE

The Exchange's reinsurance program consists primarily of multi-line excess of loss, catastrophe, an aggregate excess of loss reinsurance and a 100% quota share agreement. The Exchange's maximum retention is \$500,000.

All reinsurance agreements reviewed during the course of the examination contained insolvency and cancellation clauses as required by K.S.A. 40-221a–*Reinsurance of risks of and by Kansas companies*. All reinsurance agreements reviewed provided for the transfer of risk.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Kansas Insurance Department and present the financial condition of the Company for the period ending December 31, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts

reported in the annual statement and should be considered an integral part of the financial statements.

**ARMED FORCES INSURANCE EXCHANGE
ANALYSIS OF ASSETS
AS OF DECEMBER 31, 2017**

	Assets	Assets Nonadmitted	Net Admitted Assets
Bonds	\$ 96,055,757		\$ 96,055,757
Preferred stocks	3,255,763		3,255,763
Common stocks	16,293,007		16,293,007
Cash and short-term investments	4,340,120		4,340,120
Investment income due & accrued	621,594		621,594
Uncollected premiums and agents' balances in the course of collection	8,978,847	\$ 8,599	8,970,248
Amounts recoverable from reinsurers	521,029		521,029
Current federal and foreign income tax recoverable	262,992		262,992
Net deferred tax asset	8,807,212	1,833,545	6,973,667
EDP equipment and software	3,534,698	3,154,268	380,430
Furniture and equipment	198,168	198,168	-
Receivables from parent, subsidiaries and affiliates	192,131		192,131
Aggregate write-ins for other than invested assets	2,622,759	1,062,755	1,560,004
Totals	\$ 145,684,077	\$ 6,257,335	\$ 139,426,742

**ARMED FORCES INSURANCE EXCHANGE
LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2017**

Losses	\$ 13,238,486
Loss adjustment expense	3,624,866
Other expenses	14,091,657
Taxes, licenses and fees	674,855
Unearned premiums	39,475,285
Advance premiums	1,174,020
Ceded reinsurance premiums payable	(557,288)
Funds held by company under reinsurance treaties	6,708
Amounts withheld or retained by company for account of others	107,844
Provision for reinsurance	18,000
Payable to parent, subsidiaries and affiliates	22,012
Aggregate write-ins for liabilities	9,459
Total liabilities	<u>71,885,904</u>
Unassigned funds	67,540,838
Surplus as regards policyholders	<u>67,540,838</u>
Totals	<u><u>\$ 139,426,742</u></u>

**ARMED FORCES INSURANCE EXCHANGE
STATEMENT OF INCOME
CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2017**

Underwriting Income:

Premiums earned \$ 69,056,772

Deduct:

Losses incurred 36,375,096

Loss adjustment expenses incurred 8,267,895

Other underwriting expenses incurred 27,003,853

Total underwriting deductions 71,646,844

Net underwriting gain or (loss) (2,590,072)

Investment Income:

Net investment income earned 3,483,175

Net realized capital gains or (losses) 545,922

Net investment gain or (loss) 4,029,097

Other Income:

Net gain or (loss) from agents' or premium balances charged off (23,609)

Finance and service charges not included in premiums 76,298

Aggregate write-ins for miscellaneous income (25)

Total other income 52,664

Net income after dividends to policyholders and before

federal income taxes 1,491,689

Federal income taxes incurred (558,151)

Net income \$ 2,049,840

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2016 \$ 66,631,701

Net income 2,049,840

Change in net unrealized capital gains or (losses) 505,041

Change in net deferred income tax (4,129,544)

Change in nonadmitted assets 5,575,736

Change in provision for reinsurance 212,000

Aggregate write-ins for gains and losses in surplus (3,303,936)

Change in surplus as regards policyholders for the year 909,137

Surplus as regards policyholders, December 31, 2017 \$ 67,540,838

**ARMED FORCES INSURANCE EXCHANGE
CAPITAL AND SURPLUS ACCOUNT
RECONCILIATION OF CAPITAL AND SURPLUS SINCE LAST EXAMINATION**

Surplus as regards policyholders, December 31, 2013			<u>\$ 61,598,171</u>
Net income	2014	9,910,018	
	2015	7,143,171	
	2016	(8,105,995)	
	2017	<u>2,049,840</u>	10,997,034
Change in net unrealized capital gains or (losses)	2014	689,211	
	2015	(163,203)	
	2016	1,101,488	
	2017	<u>505,041</u>	2,132,537
Change in net deferred income tax	2014	(3,450,503)	
	2015	(2,577,565)	
	2016	3,887,584	
	2017	<u>(4,129,544)</u>	(6,270,028)
Change in nonadmitted assets	2014	7,378,621	
	2015	1,920,353	
	2016	(2,880,636)	
	2017	<u>5,575,736</u>	11,994,074
Change in provision for reinsurance	2014	-	
	2015	-	
	2016	(230,000)	
	2017	<u>212,000</u>	(18,000)
Aggregate write-ins for gains and losses in surplus	2014	(5,388,889)	
	2015	(947,743)	
	2016	(3,252,382)	
	2017	<u>(3,303,936)</u>	(12,892,950)
Surplus as regards policyholders, December 31, 2017			<u>\$ 67,540,838</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

No adjustments were made to surplus as a result of this examination. The capital and surplus of the Exchange, as of December 31, 2017, was \$67,540,838, which was the same amount reported by the Exchange in its 2017 filed Annual Statement.

COMMENTS ON FINANCIAL STATEMENTS

There were no significant or material findings resulting from the examination that warranted inclusion in the Report on Examination.

SUBSEQUENT EVENTS

There were no occurrence of subsequent events which would affect the current examination.

SUMMARY OF RECOMMENDATIONS

There were no significant or material findings resulting from the examination that warranted inclusion in the report on examination.

CONCLUSION

The assistance and cooperation by the officers of the Exchange during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Mr. Shane Mead, CISA, CISM, CRISC, an information technology examiner, Ms. Tamara House, CFE, a senior insurance examiner, and Mr. Richard Todd, CPA, PIR, an insurance examiner representing the Kansas Insurance Department, participated in this examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Tony Florez", is written over a horizontal line.

Tony Florez, CFE
Senior Insurance Examiner
Examiner-in-Charge

EXHIBIT S
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION

State of Kansas

County of Shawnee

Tony O. Florez, being duly sworn, states as follows:

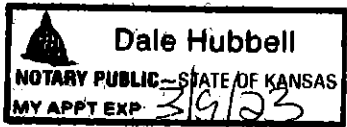
1. I have authority to represent the Kansas Insurance Department in the examination of Armed Forces Insurance Exchange.
2. The Kansas Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Armed Forces Insurance Exchange was performed in a manner consistent with the standards and procedures required by K.S.A. 40-222.

The affiant says nothing further.

Tony O. Florez
Examiner's Signature

Subscribed and sworn before me by Tony Florez on this 21 day of June, 2019.

(SEAL)



Dale Hubbell
Notary Public

My commission expires 3/9/23
(date)