

REPORT ON EXAMINATION
OF
HERITAGE CASUALTY INSURANCE COMPANY
7101 COLLEGE BOULEVARD, SUITE 1400
OVERLAND PARK, KANSAS 66210
AS OF
DECEMBER 31, 2017

FILED

JUN 28 2019

VICKI SCHMIDT
Commissioner of Insurance

TABLE OF CONTENTS

<u>SUBJECT</u>	<u>PAGE NUMBER</u>
SALUTATIONS	1
SCOPE OF EXAMINATION	1
Independent Audit Reports	3
SUMMARY OF SIGNIFICANT FINDINGS	3
COMPANY HISTORY	3
Capital Stock	4
Dividends and Capital Contributions	4
MANAGEMENT AND CONTROL	5
INSURANCE HOLDING COMPANY SYSTEM	7
Intercompany/Cost Sharing Agreements	8
TERRITORY AND PLAN OF OPERATION	9
SELECT FINANCIAL INFORMATION	9
REINSURANCE	9
FINANCIAL STATEMENTS	10
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS	16
COMMENTS ON FINANCIAL STATEMENTS	16
SUBSEQUENT EVENTS	16
SUMMARY OF RECOMMENDATIONS	16
CONCLUSION	17

Overland Park, Kansas
May 1, 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:

HERITAGE CASUALTY INSURANCE COMPANY

with its statutory home office and main administrative office at:

**7101 COLLEGE BOULEVARD, SUITE 1400
OVERLAND PARK, KANSAS 66210**

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

SCOPE OF EXAMINATION

The examiners have performed a multi-state financial examination of Heritage Casualty Insurance Company, a Kansas domiciled property and casualty insurance company. The last examination covered the four-year period from January 1, 2009, through December 31, 2012. This examination covers the five-year period from January 1, 2013, through December 31, 2017.

The Company is part of the North American Life and Health (“NALH”) business unit, which consists of Kansas domiciled insurers, Employers Reassurance Corporation (“ERAC”) and Union Fidelity Life Insurance Company (“UFLIC”), as well as their non-

insurance subsidiaries. The Examination Reports for the insurers, ERAC and UFLIC will be issued under separate cover.

The examination was conducted in accordance with the rules, regulations and directives of the Kansas Insurance 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 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, 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 Company.

Independent Audit Reports

Financial statements of the Company were audited by KPMG, LLP for the years ending December 31, 2013, 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 Company 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 Kansas Insurance 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

HCIC was originally incorporated as Montgomery Ward Insurance Company under the laws of Illinois on June 4, 1974, and began writing business on October 2, 1974. At that time, ownership of its direct parent, Signature Financial/Marketing Inc. ("SFM"), resided with Montgomery Ward & Co., Inc. ("Montgomery Ward") which in turn was owned by Mobil Corporation. In 1988, Montgomery Ward was purchased by Montgomery Ward Holding Corp., an investor group headed by senior management with the majority financial control held by subsidiaries of General Electric Company ("GE").

In June of 1997, Montgomery Ward, filed for Chapter 11 bankruptcy protection. Montgomery Ward emerged from that protection when it was purchased on July 30, 1999, by General Electric Capital Corporation (“GECC”), a subsidiary of GE. GECC passed ownership of Montgomery Ward Insurance Company to its downstream holding company, GE Financial Assurance Holdings, Inc. (“GEFA”). The operations of Montgomery Ward Insurance Company were subsequently folded into the insurance operations of GEFA. On April 1, 2004, the name of Montgomery Ward Insurance Company was changed to Heritage Casualty Insurance Company.

In June of 2009, HCIC, through a series of dividend, sales and contribution transactions became the wholly owned subsidiary of UFLIC. UFLIC is wholly owned by ERAC, with the ultimate parent being GE.

On December 31, 2011, the Company re-domesticated from Illinois to Kansas.

Capital Stock

As of December 31, 2017, the authorized number of common stock shares was 600,000 with 300,000 shares having been issued and outstanding. The par value of the stock was \$10.00 per share, bringing the Company's total paid-up capital stock to \$3,000,000. No preferred stock was authorized. As of December 31, 2017, 100% of the Company's stock was owned by UFLIC.

Dividends and Capital Contributions

On December 5, 2013, the Company paid a cash dividend of \$6.60 million to UFLIC. On November 17, 2016, the Company paid a \$50 million cash dividend to UFLIC.

MANAGEMENT AND CONTROL

The minutes of the meeting of the stockholder and the board of directors (“Board”) adequately approved and supported the Company’s transactions and events. Minutes of the various committees were reviewed for decisions made or actions taken on behalf of the Company.

Board of Directors

The Company’s bylaws consist of eleven (11) articles that provide the framework for the operation, management and control of the property and casualty insurance company. The Company is controlled by its shareholder and managed by its Board. The Board consist of no less than (5), but no more than (11) directors. Directors are elected annually by the shareholder to serve a one (1) year term or until a successor has been duly elected and qualified, unless such director has been sooner removed, has been disqualified or resigned.

The Company’s directors as of December 31, 2017 were as follows:

<u>Director’s Name</u>	<u>Position</u>
Ronald D. Peters	Chairman, President & Chief Executive Officer
Brian D. Connor	Chief Information Officer
Irwin L. Don	Chief Operating Officer
Dale E. Filsinger	Chief Risk Officer
Clark A. Ramsey	Chief Actuary
William J. Steilen	Chief Financial Officer

In addition to the Board of Directors, committees also provided oversight of the operations of the Company. In 2017, the Board decommissioned the Risk Management Committee and its subcommittees and replaced with four new board committees. The Board will function as the Risk Management Committee and has delegated the oversight of the respective business activities to the four new board committees (Investment, Compliance, Operation & Digital (“COD”), Insurance Liability, Capital Planning).

The Capital Planning Committee will provide oversight over the capital levels of the insurance entities while the COD Committee is charged with identifying and monitoring processes, which mitigate compliance, digital, and operational risks. The Investment Committee provides supervising and oversight of the NALH investment and related activities. The Insurance Liability Committee will be primarily responsible for the review of assumptions for, and results of, key actuarial processes.

Officers

The bylaws stipulate the officers of the Company shall be a chairman of the board, president, secretary, treasurer, and any other officers as deemed necessary, all of whom shall be elected annually at the first regular meeting of the Board. The chairman of the board and the president shall be elected from the membership of the Board. One person may hold multiple offices, except no one person may hold the office of both president and secretary. The Board may leave any office unfilled except that of the president, treasurer and secretary.

The officers listed below were serving in their designated capacity as of

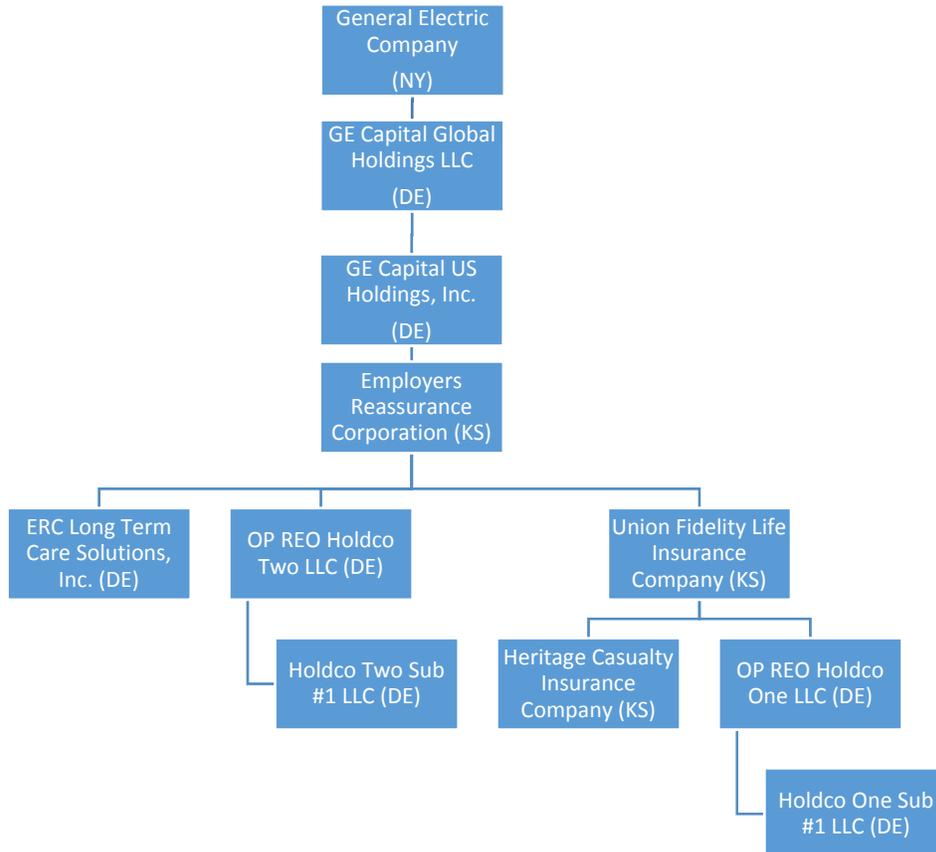
December 31, 2017:

<u>Officer's Name</u>	<u>Position</u>
Ronald D. Peters	Chairman, President & Chief Executive Officer
John A. Buhring	Actuary
Sandra G. Chapman	Controller
Brian D. Connor	Chief Information Officer
Irwin L. Don	Chief Operating Officer
Dale E. Filsinger	Chief Risk Officer
Jane B. Kipper	Treasurer
Nancy M. Liu	Assistant Secretary
Kathleen A. Russell	General Counsel & Secretary
William J. Steilen	Chief Financial Officer

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 Company has submitted Form “B” and “C” registration statements to the Kansas Insurance Department for each of the years under examination. A review of the registration statements indicated that the Company is properly reporting items and events as required by statute.

The organizational chart below 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

Management Services Agreement

Effective January 1, 2009, the Company was party to a Management Services Agreement, with ERAC pursuant to which the Company receives the following services: leadership, actuarial, accounting and financial, tax, legal, risk management, investment services and other miscellaneous services. The monthly fee paid by HCIC is based on the actual and allocated cost to provide the services.

Capital Maintenance Agreement

The Company is party to a Capital Maintenance Agreement (“CMA”) entered into during 2004 in conjunction with a loss portfolio transfer agreement. GE is required to indemnify the Company for payments made under the contingent premium clause related to a loss portfolio transfer via a capital contribution up to \$50 million and under the CMA to maintain the Company’s minimum capital at 250% of its Company Action Level risk based capital requirements as defined from time to time by the NAIC.

Tax Allocation Agreement

ERAC, UFLIC and HCIC, together with their U.S. affiliates (as defined in the U.S. Tax Code), are included in the consolidated federal income tax return filed by the ultimate controlling entity, GE. The Company is subject to the income tax sharing arrangement among GE and its various subsidiaries. The method of income tax allocation is generally based upon separate return liabilities, including recognition of the benefits of losses and credits that will or could be utilized in the group’s consolidated income tax return. Intercompany balances are settled periodically with a final true-up after filing of the federal income tax return.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company was authorized to transact business in all states and the District of Columbia, except for New Hampshire and New Jersey.

The Company is in run-off and no longer actively markets or underwrites insurance products.

SELECT FINANCIAL INFORMATION

The exhibit below shows select financial information of the Company (in thousands) for the period of December 31, 2013, through December 31, 2017. The financial amounts were obtained from annual statements filed by the Company.

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
<i>(in thousands)</i>					
Admitted Assets	60,485	61,663	64,436	18,432	15,594
Liabilities	155	183	424	3,885	87
Capital and Surplus	60,330	61,480	64,012	14,547	15,507
Net Underwriting Gain/(Loss)	(971)	(880)	(833)	(2,501)	1,161
Net Income	695	1,184	2,485	(10)	1,483
Net Premiums Written	-	-	-	-	-

REINSURANCE

Effective October 1, 2004, the Company entered into a loss portfolio transfer agreement with Ge Reinsurance Corporation, an affiliated company, to cede 100% of its exposure under the business assumed from the 21st Century Centennial Insurance Company and the 21st Century Premier Insurance Company coinsurance treaties ("LPT Agreement"). Swiss Reinsurance America Corporation (SRAC) acquired all rights and obligations under the LPT Agreement as successor by merger with GE Reinsurance

Corporation. The LPT Agreement contained a contingent premium adjustment clause, which required the Company to cover up to \$50 million in adverse development from losses that exceed the premiums collected. The Company has made total contingent premium payments to SRAC of approximately \$27,620,356 from inception to date under the terms of the agreement, resulting in a net exposure under this clause of approximately \$22,379,644 as of December 31, 2017.

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.

**HERITAGE CASUALTY INSURANCE COMPANY
STATEMENT OF ASSETS
AS OF DECEMBER 31, 2017**

	<u>Assets</u>	<u>Assets Nonadmitted</u>	<u>Net Admitted Assets</u>
Bonds	\$11,908,770	\$0	\$11,908,770
Cash and short-term investments	3,590,888	-	3,590,888
Receivables for securities	2,563	-	2,563
Investment income due and accrued	82,417	-	82,417
Current federal and foreign income tax recoverable	9,287	-	9,287
Total	<u>\$ 15,593,925</u>	<u>\$ -</u>	<u>\$15,593,925</u>

HERITAGE CASUALTY INSURANCE COMPANY
STATEMENT OF LIABILITIES AND SURPLUS
AS OF DECEMBER 31, 2017

Other expenses	\$ 63,275
Net deferred tax liability	5,368
Payable to parent, subsidiaries and affiliates	<u>18,120</u>
Total liabilities	86,763
Common capital stock	3,000,000
Gross paid in and contributed surplus	11,292,414
Unassigned funds (surplus)	<u>1,214,748</u>
Surplus	<u>12,507,162</u>
Surplus as regards policyholders	<u>15,507,162</u>
Totals	<u><u>\$15,593,925</u></u>

**HERITAGE CASUALTY INSURANCE COMPANY
STATEMENT OF OPERATIONS
AS OF DECEMBER 31, 2017**

UNDERWRITING INCOME

Other underwriting expenses incurred	\$ (1,161,068)
Total underwriting deductions	(1,161,068)
Net underwriting gain	1,161,068

INVESTMENT INCOME

Net investment income earned	312,082
Net realized capital gains less capital gains tax of \$1,001)	(1,002)
Net investment gain	311,080

OTHER INCOME

Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	1,472,148
Dividends to policyholders	-
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	1,472,148
Federal and foreign income taxes incurred	(10,381)
Net income	\$ 1,482,529

**HERITAGE CASUALTY INSURANCE COMPANY
CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2017**

Surplus as regards policyholders, December 31, 2016	\$ 14,547,155
Net income	1,482,529
Change in net deferred income tax	<u>(522,522)</u>
Change in surplus as regards policyholders for the year	<u>960,007</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$ 15,507,162</u></u>

**HERITAGE CASUALTY INSURANCE COMPANY
CAPITAL AND SURPLUS ACCOUNT
RECONCILIATION OF CAPITAL AND SURPLUS SINCE LAST EXAMINATION**

Surplus as regards policyholders, December 31, 2012			<u>\$ 66,213,653</u>
Net income	2013	694,936	
	2014	1,183,636	
	2015	2,485,396	
	2016	(10,440)	
	2017	<u>1,482,529</u>	5,836,057
Change in net deferred income tax	2013	303,697	
	2014	(368,542)	
	2015	31,168	
	2016	545,651	
	2017	<u>(522,522)</u>	(10,548)
Change in nonadmitted assets	2013	(308,876)	
	2014	308,876	
	2015	-	
	2016	-	
	2017	<u>-</u>	-
Change in provision for reinsurance	2013	27,000	
	2014	26,000	
	2015	15,000	
	2016	-	
	2017	<u>-</u>	68,000
Paid in surplus	2013	-	
	2014	-	
	2015	-	
	2016	(50,000,000)	
	2017	<u>-</u>	(50,000,000)
Dividends to stockholders	2013	(6,600,000)	
	2014	-	
	2015	-	
	2016	-	
	2017	<u>-</u>	(6,600,000)
Surplus as regards policyholders, December 31, 2017			<u>\$ 15,507,162</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 Company, as of December 31, 2017, was \$15,507,162, which was the same amount, reported by the Company in its 2017 filed Annual Statement.

COMMENTS ON FINANCIAL STATEMENTS

No changes were made to the financial statements as a results of this Examination.

SUBSEQUENT EVENTS

Subsequent to the year ending December 31, 2017, the Company filed a Form A Exemption Approval, adding an insurance holding company between GECUSH and ERAC. The new company formed is GE Capital NALH Holdings, LLC and was approved by the Kansas Insurance Department on August 6, 2018.

The President, Mr. Ronald D. Peters, resigned as of September 1, 2018. Mr. William J. Steilen was appointed acting president. Effective November 1, 2018, Mr. Timothy F. Kneeland became president of the Company.

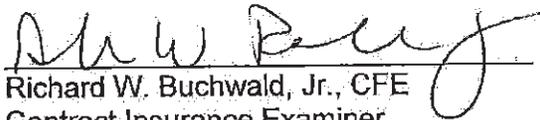
SUMMARY OF RECOMMENDATIONS

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

CONCLUSION

The assistance and cooperation by the officers of the Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Lester Schott, Chang Song, Paige Mayo, Adham McGuire, and Phil Schmoyer from Baker Tilly Virchow Krause, LLP, and Mike Mayberry from Lewis & Ellis, participated in this examination.

Respectfully submitted,



Richard W. Buchwald, Jr., CFE
Contract Insurance Examiner
Baker Tilly Virchow Krause, LLP
Examiner-in-Charge



Christopher W. Buchanan, CPA, CFE
Senior Financial Examiner
Kansas Insurance Department

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

State of Kansas,

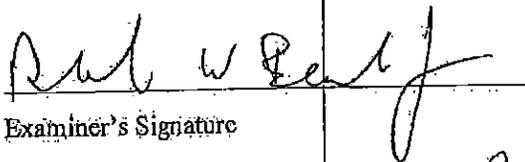
County of Shawnee,

Richard W Buchwald Jr

being duly sworn, states as follows:

1. I have authority to represent the Kansas Insurance Department in the examination of Heritage Casualty Insurance Company.
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 Heritage Casualty Insurance Company was performed in a manner consistent with the standards and procedures required by K.S.A. 40-222.

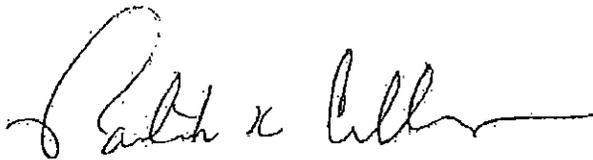
The affiant says nothing further.


Examiner's Signature

Subscribed and sworn before me by Richard W. Buchwald, Jr on this
28th day of May, 2019.

(SEAL)

Notary Public



My commission expires 12-10-2021
(date)

Patrick K. Collins
Notary Public, Harford County, MD.
My commission expires Dec. 10, 2021

