

EXAMINATION REPORT
OF
ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG
AS OF
DECEMBER 31, 2020

TRINIDAD NAVARRO
COMMISSIONER



STATE OF DELAWARE
DEPARTMENT OF INSURANCE

REPORT ON EXAMINATION
OF
ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG
AS OF
DECEMBER 31, 2020

The above-captioned report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the company as reflected in the report.

This report is hereby accepted, adopted and filed as an official record of this Department.

Handwritten signature of Trinidad Navarro in blue ink.

Trinidad Navarro
Insurance Commissioner

Dated this 26th day of May, 2022

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May 12, 2022

Honorable Trinidad Navarro
Commissioner of Insurance
Delaware Department of Insurance
1351 West North Street, Suite 101
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provision contained in Examination Certification No. 21.034, dated October 14, 2021, an examination has been made of the affairs, financial condition and management of

ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG

hereinafter referred to as AEIC or the Company. The Company was incorporated under the laws of the State of Delaware, with its statutory home office located at 1209 Orange Street, Wilmington, Delaware 19801. The administrative office of the Company is located at 2056 Westings Avenue, Suite 20, Naperville, Illinois 60563. The examination was conducted remotely given office closures and travel restrictions in connection with the COVID-19 pandemic. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

We have performed our examination of the Company. The last examination of the Company was conducted as of December 31, 2016, by the Delaware Department of Insurance (Department). This examination covered the period of January 1, 2017 through December 31, 2020.

We conducted our examination in accordance with the *National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook* (Handbook) and generally accepted statutory insurance examination standards consistent with the Insurance Code and Regulations of the State of Delaware. The NAIC Handbook requires that we 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, pursuant to the General Corporation Law of the State of Delaware, as required by 18 *Del. C.* § 321, along with general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature, are not included within the examination report but separately communicated to other regulators and/or the Company.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Strohm Ballweg, LLP (Strohm). Certain auditor work papers were incorporated into the work papers of the examiners. The workpapers were utilized in

determining the examination scope, areas of emphasis in conducting the examination, and in areas of risk mitigation and substantive testing.

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings or material changes in financial statements as a result of this examination.

COMPANY HISTORY

The Company was organized and incorporated on July 8, 1987, as a stock insurance company under the captive insurance laws of the State of Delaware, specifically 18 *Del. C.* § 6906, with the designation as a risk retention group (RRG) as described under 18 *Del. C.* § 80 and pursuant to the federal Liability Risk Retention Act of 1986 (LRAA).

In accordance with the LRAA, all policyholders of the Company must also be shareholders, and a policyholder terminating coverage must relinquish all shares owned. The Company maintains a Shareholder Agreement (SA), originally effective January 4, 1988, and last amended and restated effective June 14, 2005, whereby the rights and obligations of each shareholder/policyholder are stipulated. The cost of each share is determined by the Company's Board of Directors (Board) and the redemption value is limited to the lesser of book value as determined from the annual audited financial statements of the Company or the amount paid for the shares in accordance with the SA. Currently, each new policyholder is required to purchase one share of common stock with a par value of \$5.00 and an additional paid-in capital contribution of \$135.00. The Company's SA also stipulates the terms whereby a shareholder may utilize promissory notes to fund a portion of its purchase of shares in the Company. The Company has been partially capitalized by these promissory notes since its inception. The promissory notes are backed by irrevocable letters of credit that have no maturity date or stated interest rate.

As a condition of the Department's issuance of the Company's authority to begin operations, the Company agreed to not pay distributions to its shareholders except for shareholder redemptions made in accordance with the applicable provisions of the Company's SA until the Company achieved a capital and surplus amount of \$15 million. The Company's SA limits the Company from fulfilling shareholder redemption requests until the Company has capital and surplus of at least \$10 million and a ratio of capital and surplus to gross written premium as specified in the SA. Additionally, the SA grants the Company's Board authority to defer repayment of redeemed shares for an indefinite period as the Board may deem necessary to preserve the financial condition of the Company.

Capitalization

The Company's maintains two classes of capital stock including common capital stock and redeemable capital stock, as follows:

- The Company's Certificate of Incorporation authorizes the issue of 500,000 shares of common capital stock with a par value of \$5.00 per share. As of December 31, 2020, the Company had 60,642.2 common shares issued and outstanding totaling \$303,211 in common capital stock at par value. Of the total issued and outstanding, 35,866.2 or 59.14% of outstanding common shares are owned by AELC and the remaining 24,776 or 40.86% are owned by the Company's current policyholders. Two other shareholders owned greater than 5% of the Company's outstanding common capital stock. As of December 31, 2020, the Company reported gross paid in and contributed surplus from shareholders in the amount of \$4.4 million. Of the total common capital stock at par value and gross paid in and contributed surplus \$1.7 million was funded by promissory notes receivable secured by irrevocable letters of credit. The promissory notes receivable are callable upon demand

of the Company. The Company's shareholders have maintained a policy to draw upon the letters of credit when a policyholder terminates insurance coverage and must relinquish shareholder interest in the Company. The shareholder policy to draw upon the letters of credit of former policyholders was discontinued subsequent to the examination period.

- As of December 31, 2020, the Company held 28,182 shares of \$5.00 par value redeemable capital stock with total redemption value of \$2.5 million. The redeemable capital stock is held for the benefit of former policyholders that relinquished shareholder interest in the Company upon termination of insurance coverage in accordance with the restrictions of the Company's SA. In accordance with the Company's SA, these shareholders are considered unsecured creditors of the Company. As of December 31, 2020, three former shareholders each held over 5% of the redeemable shares outstanding. The redemption value of these shares is reported in the NAIC Annual Statement as an aggregate write-in for other than special surplus funds (provision for redeemable capital stock).

MANAGEMENT AND CONTROL

Directors

Pursuant to the General Corporation Law of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, the business and affairs of the Company must be exercised by, or under the authority of, its Board. The Company's bylaws require its Board consist of no fewer than three (3) but not more than seven (7) directors. Directors duly elected and serving as of December 31, 2020, were as follows:

<u>Name</u>	<u>Title</u>
Mitchell Sellett	President, Chief Executive Officer and Board Chairman Architects & Engineers Insurance Company
George Cannon	Director, Vice President and Treasurer Architects & Engineers Insurance Company

Jason Peterson	Director, and Corporate Secretary Architects & Engineers Insurance Company
Lisa Green	Chief Legal Officer HOK Group, Inc.
Pradeep Patel	Principal Ewing Cole, Inc.
Joseph Kelly	Chief Financial Officer Ewing Cole, Inc.

Officers

The Company's officers were elected in accordance with its bylaws during the period under examination. The bylaws require the appointment of a Chairman of the Board, a President, one or more Vice Presidents, a Treasurer and a Secretary. The Board may also appoint, or authorize the appointment of, an Assistant Treasurer and an Assistant Secretary. Any number of offices may be held by the same person. The Company's primary officers serving as of December 31, 2020, were as follows:

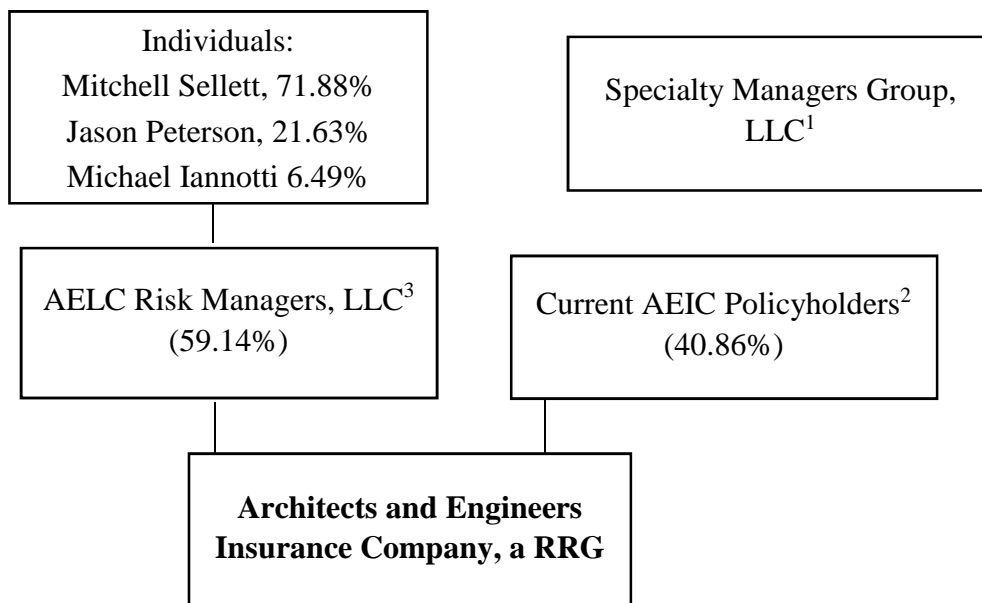
<u>Name</u>	<u>Title</u>
Mitchell Sellett	President and Chief Executive Officer
George Cannon	Vice President and Treasurer
Jason Peterson	Secretary

Corporate Records

The recorded minutes of the shareholder and Board were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events including approval of investment transactions as required by 18 *Del. C.* § 1304. In addition, the review of Company files indicated that written correspondence was submitted to the Department with regards to the changes in officers and directors during the period under examination in compliance with 18 *Del. C.* § 4919.

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined under 18 Del. C. § 5001. The following is an organizational chart of the insurance holding company system as of December 31, 2020, followed by a summary of significant affiliated agreements.



¹Specialty Managers Group, LLC (SMG) is owned by Mitchell Sellett. In accordance with SSAP No. 25 – *Affiliates and Other Related Parties*, SMG is an affiliate company given Mitchell Sellett also controls AELC and AELC’s majority ownership interest in the Company. SMG functions as the Company’s program administrator and performs the day-to-day operational activities for the Company in accordance with a Program Administration Agreement with the Company.

²As of December 31, 2020, two policyholders held greater than 5% of the outstanding shares of the Company. HOK Group, Inc and Ewing Cole, Inc. held 18.13% and 6.09% of the outstanding shares of the Company, respectively. Subsequent to the examination period, HOK Group, Inc.’s shares in the Company were redeemed and Ewing Cole, Inc.’s shareholder interest was increased to 9.77% pursuant to a share redemption approved by the Company’s Board.

³Subsequent to the examination period AELC’s ownership in the Company was increased to 89.29% pursuant to a share redemption approved by the Company’s Board.

Affiliated Agreements

The following is a summary of the Company’s significant affiliated agreements in force as of December 31, 2020:

Program Administration Agreement

Effective January 1, 2014, and amended October 2, 2018, the Company entered a Program Administration Agreement with SMG. In accordance with the agreement, SMG provides program administration, claims and risk management services for the day-to-day operations of the Company. Services include but are not limited to the following functions: underwriting, sales and marketing, shareholder relations, financial and managerial reporting, investment and banking relations, regulatory compliance, reinsurance, claims administration and risk management services. In return, the Company pays SMG \$200,000 per quarter for program administration fees. These fees are subject to an annual adjustment, so that total annual compensation does not exceed \$600,000 if the Company's direct written premium for the reporting year is below \$5 million, nor less than \$1 million if direct written premium for the report year is above \$6 million. Additionally, the Company pays SMG \$72,000 annually for risk management services and \$235 per hour for claims management services.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2020, the Company was licensed to transact business solely in the State of Delaware and was registered as a non-domiciled RRG in forty (40) other states. Policies are written on a master policy basis through the AEIC Purchasing Group (Purchasing Group), which is also administered by SMG. Each insured is required to be a member of the Purchasing Group and is a 'certificate holder' under the master policy.

Plan of Operation

The Company primarily writes three-year professional liability insurance policies to architectural and engineering consulting firms on a direct basis, providing up to \$10 million of

coverage on a claims-made basis. The professional liability policies include Professional, Directors and Officers, Employment Practices and Benefit Trust Liability.

The Company's products are distributed through independent agents and wholesale agencies. The target participant market includes: all design disciplines with annual billings exceeding \$1,000,000, deductibles starting at \$10,000 and favorable loss experience with limited exposure to residential design.

REINSURANCE

The Company reported the following distribution of gross and net premium written for the years ended December 31, 2020, and the prior examination date of December 31, 2016:

	2020	% of Gross Premium Written	2016	% of Gross Premium Written
Direct business	\$ 5,267,474	100%	\$ 7,592,340	100%
Reinsurance assumed	-	-	-	-
Gross premiums written	\$ 5,267,474	100%	\$ 7,592,340	100%
Reinsurance ceded to non-affiliates	4,668,509	88.6%	6050550	79.7%
Net premiums written	<u>\$ 598,965</u>	11.4%	<u>\$ 1,541,790</u>	20.3%

Ceded Reinsurance

The Company's reinsurance program throughout the years has sought to limit maximum retention per occurrence. For the years under examination, the Company has maintained reinsurance to limit its maximum retention to \$250,000 for 2020/2019, \$325,000 for 2018 and \$425,000 for 2017.

The Company utilizes i-intermediary as their reinsurance broker. Quarterly, i-intermediary prepares a report reflecting the total premium received, direct and ceded premium, the ceding commission due the Company, along with claims reimbursement due and net ceded premium. The

Company had the following two (2) reinsurance contracts administered by i-intermediary effective January 1, 2020, and in place on December 31, 2020:

Primary Reinsurance

The Company was party to a Quota Share (QS) reinsurance contract with a \$10 million limit on each claim, each insured. Counterparties to the QS contract include Transatlantic Reinsurance Company, accepting a 30% share; Partner Reinsurance Company of the U.S., accepting a 20% share; Validus Reinsurance Ltd, accepting a 10% share and General Reinsurance Company, accepting a 15% share.

Excess Reinsurance

The Company was party to an Excess Cessions (Excess) reinsurance contract with a \$9 million limit in excess of \$1 million, on each claim, each insured. Counterparties to the Excess contract include several Lloyds' Syndicates (Lloyds) and Hannover Reinsurance (Hannover). The Company's retention is \$250,000 under the first \$1 million layer and retains no risk \$1 million to \$10 million under both reinsurance contracts, by ceding 75% under the \$10 million QS contract and 25% to Lloyds and Hannover under the Excess contract.

FINANCIAL STATEMENTS

The following financial statements, as reported and filed by the Company with the Department, are reflected in the following:

- Statement of Assets as of December 31, 2020
- Statement of Liabilities, Surplus, and Other Funds as of December 31, 2020
- Statement of Income for the Year Ended December 31, 2020
- Reconciliation of Capital and Surplus for the Period from the Prior Examination as of December 31, 2016, to December 31, 2020

Statement of Assets
As of December 31, 2020

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$ 3,769,701	\$ -	\$ 3,769,701
Stocks:			
Common stocks	4,733,149	-	4,733,149
Cash, cash equivalents and short-term investments	8,382,554	-	8,382,554
Subtotals, cash and invested assets	<u>\$ 16,885,404</u>	<u>\$ -</u>	<u>\$ 16,885,404</u>
Investment income due and accrued	53,435	-	53,435
Uncollected premiums and agents' balances in course of collection	5,012,603	-	5,012,603
Amounts recoverable from reinsurers	166,786	-	166,786
Current federal and foreign income tax recoverable and interest thereon	43,258	-	43,258
Net deferred tax asset	39,452		39,452
Aggregate write-ins for other than invested assets:			
Prepaid Expenses	31,432	31,432	-
Notes Receivable	1,730,856	-	1,730,856
Total Assets	<u><u>\$ 23,963,226</u></u>	<u><u>\$ 31,432</u></u>	<u><u>\$ 23,931,794</u></u>

Statement of Liabilities, Surplus and Other Funds
As of December 31, 2020

		<u>Notes</u>
Losses	\$ 2,615,809	1
Loss adjustment expenses	127,467	1
Commissions payable, contingent commissions and other similar charges	95,889	
Other expenses	14,646	
Taxes, licenses and fees	10,535	
Unearned premiums	1,291,272	
Ceded reinsurance premiums payable	<u>7,350,299</u>	
Total Liabilities	<u>\$ 11,505,917</u>	
Common capital stock	\$ 303,211	
Aggregate write-ins for other than special surplus funds (Provision for redeemable capital stock)	2,532,788	
Gross paid-in and contributed surplus	4,353,259	
Unassigned funds	<u>5,236,619</u>	
Surplus as regards policyholders	<u>\$ 12,425,877</u>	
Totals	<u>\$ 23,931,794</u>	

Statement of Income
For the Year Ended December 31, 2020

UNDERWRITING INCOME

Premiums earned	\$ 858,543
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DEDUCTIONS:

Losses incurred	540,882
Loss adjustment expenses incurred	60,098
Other underwriting expenses incurred	131,149
Total Underwriting Deductions	<u>\$ 732,129</u>

Net Underwriting Gain or (Loss)	<u>\$ 126,414</u>
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INVESTMENT INCOME

Net investment income earned	\$ 111,457
Net realized capital gains (losses) less capital gains tax	<u>71,505</u>
Net investment Gain or (Loss)	<u>\$ 182,962</u>

Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 309,376
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Dividends to policyholders	<u>-</u>
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Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 309,376
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Federal and foreign income taxes incurred	(18,936)
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Net Income	<u><u>\$ 328,312</u></u>
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Reconciliation of Capital and Surplus
For the Period from the Prior Examination
As of December 31, 2016, to December 31, 2020

	Common Capital Stock	Provision for Redeemable Capital Stock	Gross Paid In & Contributed Surplus	Unassigned Funds (Surplus)	Total
December 31, 2016	\$ 313,131	\$ 2,295,380	\$ 4,579,347	\$ 2,635,579	\$ 9,823,437
2017 Net Income	-	-	-	607,381	607,381
2017 Other Changes ¹	-	-	-	407,527	407,527
2017 Increase in redeemable common stock	(157)	30,985	(30,828)	-	-
2017 Common stock purchased	15	-	406	-	420
December 31, 2017	<u>\$ 312,989</u>	<u>\$ 2,326,365</u>	<u>\$ 4,548,925</u>	<u>\$ 3,650,486</u>	<u>\$ 10,838,765</u>
2018 Net Income	-	-	-	500,724	500,724
2018 Other Changes ¹	-	-	-	(887,200)	\$ (887,200)
2018 Increase in redeemable common stock	(10)	253	(243)	-	-
December 31, 2018	<u>\$ 312,979</u>	<u>\$ 2,326,618</u>	<u>\$ 4,548,682</u>	<u>\$ 3,264,010</u>	<u>\$ 10,452,289</u>
2019 Net Income	-	-	-	296,430	296,430
2019 Other Changes ¹	-	-	-	862,306	862,306
2019 Increase in redeemable common stock	(1,696)	44,454	(42,758)	-	-
2019 Common stock purchased	<u>10</u>	<u>-</u>	<u>270</u>	<u>-</u>	<u>280</u>
December 31, 2019	<u>\$ 311,293</u>	<u>\$ 2,371,072</u>	<u>\$ 4,506,194</u>	<u>\$ 4,422,746</u>	<u>\$ 11,611,305</u>
2020 Net Income	-	-	-	328,312	328,312
2020 Other Changes ¹	-	-	-	485,560	485,560
2020 Increase in redeemable common stock	(8,107)	161,716	(153,609)	-	-
2020 Common stock purchased	<u>25</u>	<u>-</u>	<u>675</u>	<u>-</u>	<u>700</u>
December 31, 2020	<u><u>\$ 303,211</u></u>	<u><u>\$ 2,532,788</u></u>	<u><u>\$ 4,353,259</u></u>	<u><u>\$ 5,236,619</u></u>	<u><u>\$ 12,425,877</u></u>

¹Other Changes in Unassigned Funds (Surplus) for each year include changes in net unrealized capital gains (losses), net deferred tax and non-admitted assets.

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS FROM EXAMINATION

There were no financial adjustments to the Company's financial statements as a result of this examination.

COMMENTS ON FINANCIAL STATEMENTS

Note 1:

Losses	\$2,615,809
Loss Adjustment Expenses	127,467

The Department retained the actuarial services of INS Consultants Inc. (Consulting Actuary) to perform a risk-focused review of the Company's significant reserving and pricing activities. The Consulting Actuary assisted in review of the inherent risks, management oversight and other mitigating controls over the Company's actuarial processes and procedures. The Consulting Actuary performed an independent reserve analysis including an assessment of the Company's reserves for compliance with applicable *Actuarial Standards of Practice* and the NAIC *Accounting Practices and Procedures Manual*.

SUBSEQUENT EVENTS

Subsequent events were evaluated through the date that this examination report was available to be issued. Based on this evaluation, the following significant transactions or events were deemed material for disclosure in this examination report.

Agreement with Lloyd's of London

Effective March 31, 2021, SMG signed an agreement with underwriters at Lloyd's of London for a professional liability insurance program that will be available to the Company's policyholders through the Purchasing Group for new and renewal business beginning in April 2021. The Company's Board approved the agreement. The agreement has caused a significant

reduction the Company's direct written premium through April of 2022 as all policyholders have elected to renew under the new program. As a result, the Company will be placed into run-off.

Sale of Common Stock Investments

As of December 31, 2020, the Company held common stock investments with a reported fair market value of \$4.7 million. The Company sold all its common stock investments in April 2021, realizing a net gain on the sale of approximately \$2.5 million. In December 2021, the Company acquired new common stock securities with a reported fair market value of approximately \$3.4 million as of December 31, 2021.

Changes in Capitalization and Shareholders

In accordance with the Company's SA, effective April 16, 2021, the Board approved an offer to redeem shares of common capital stock issued and outstanding. The redemption totaled \$1,805,856, which is comprised of \$75,000 cash and \$1,730,856 in notes receivable as an aggregate redemption price for AEIC member shares. As of December 31, 2021, \$461,037 remained as notes receivable and \$1,344,819 had been redeemed as treasury stock.

SUMMARY OF RECOMMENDATIONS

No examination report recommendations were noted as a result of this examination.

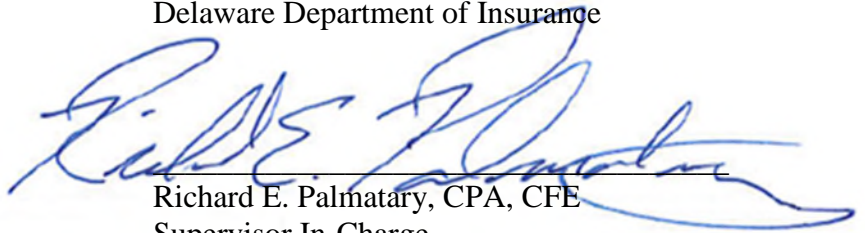
CONCLUSION

The assistance of the consulting actuary, the consulting information system specialist firm, INS Services, Inc., the Company's outside audit firm, Strohm, and the Company's management and staff was appreciated and is acknowledged.

Respectfully submitted,



Nicholas R. O'Dell
Examiner In-Charge
Delaware Department of Insurance



Richard E. Palmatary, CPA, CFE
Supervisor In-Charge
Delaware Department of Insurance

I, Nicholas R. O'Dell, hereby verify and attest, under penalty of perjury, that the above is a true and correct copy of the examination report and findings submitted to the Delaware Department of Insurance pursuant to Examination Certification No. 21.034.

A handwritten signature in black ink, appearing to read "Nicholas R. O'Dell", written in a cursive style. The signature is positioned above a horizontal line.

Nicholas R. O'Dell