**REPORT ON EXAMINATION**

**OF**

**AMERICAN ALTERNATIVE INSURANCE CORPORATION**

**AS OF**

**DECEMBER 31, 2016**

Trinidad Navarro
Commissioner

Delaware Department of Insurance

I, Trinidad Navarro, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2016 of

**AMERICAN ALTERNATIVE INSURANCE CORPORATION**

is a true and correct copy of the document filed with this Department.

Attest By: ______________________

Date: May 31, 2018

Insurance Commissioner of the State of Delaware

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 6th day of June, 2018.

______________________
Trinidad Navarro
Insurance Commissioner

Trinidad Navarro
Commissioner

Delaware Department of Insurance

REPORT ON EXAMINATION

OF

AMERICAN ALTERNATIVE INSURANCE CORPORATION

AS OF

DECEMBER 31, 2016

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.

Trinidad Navarro
Insurance Commissioner

Dated this 6th day of June, 2018

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<u>**TABLE OF CONTENTS**</u>

## SALUTATION

April 30, 2018

Honorable Trinidad Navarro
Delaware Insurance Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Dear Commissioner;

In compliance with instructions and pursuant to statutory provisions contained in the Exam Authority No. 17.012, dated April 5, 2017, an examination has been made of the affairs, financial condition and management of the

**AMERICAN ALTERNATIVE INSURANCE CORPORATION**

hereinafter referred to as the “Company” or “AAIC” and incorporated under the laws of the State of Delaware. The examination was conducted at the administrative offices of the Company, located at 555 College Road East, Princeton New, Jersey, 08543. The report of examination thereon is respectfully submitted.

## SCOPE OF EXAMINATION

The Delaware Department of Insurance (Department) performed a risk-focused financial examination of the Company. The Company’s registered office in the State of Delaware is at 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808. The last examination covered the period of January 1, 2009 through December 31, 2012. This examination covers the period of January 1, 2013 through December 31, 2016 and encompassed a general review of transactions during the period, the Company’s business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of the Company as of December 31, 2016. Transactions after the examination date were reviewed where deemed necessary.

The examination of the Company was performed as part of the examination of the Munich Re America Corporation (MRAC) insurance group of companies as of December 31, 2016. The examination was conducted concurrently with that of its Delaware domiciled affiliate companies, Munich Reinsurance America, Inc. (MRAm) and The Princeton Excess and Surplus Lines Insurance Company (PESLIC).

We conducted the 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 the Department 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 Laws 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 auditing firm, KPMG LLP (KPMG), New York, NY. Certain auditor work papers have been incorporated into the work papers of the examination.

## SUMMARY OF SIGNIFICANT FINDINGS

This examination had no material adverse findings, significant non-compliance findings, material changes in financial statements, or updates on other significant regulatory information disclosed in the previous examination.

## COMPANY HISTORY

### General

The Company was incorporated in New York on April 26, 1923, as American Union Insurance Company of New York. The Company's name was changed to American Union Reinsurance Company in 1987.

On January 1, 1994 American Re Corporation acquired the Company from American States Insurance Company, an Indiana domiciled insurer. American Re Corporation (name changed to MRAC on September 5, 2006) is a Delaware holding company and the sole owner of the Company.

On August 13, 1996 MRAC, the Company's immediate parent, entered into an Agreement and Plan of Merger with Munchener Ruckversicherungs-Gesellschaft

Aktiengesellschaft (MRG) and Puma Acquisition Corporation (Puma), a Delaware corporation and wholly-owned subsidiary of MRG. Pursuant to the terms of the Agreement and Plan of Merger, on November 25, 1996, following the approval of the merger by MRAC's stockholders and applicable regulatory authorities, Puma was merged with MRAC with the latter being the surviving entity. There have been no ownership changes since September 2000.

Capitalization

The Company is authorized to issue 3,200 shares of common capital stock with a par value of $1,600 per share. As of December 31, 2016, all 3,200 common stock shares are issued, outstanding and owned by MRAC. The Company has one Surplus debenture outstanding. The debenture was issued October 1, 2000 at the amount noted below, with an interest rate of 5%. The Surplus note and associated interest payments have been approved and authorized by the Department.

The following table reflects the Company's capitalization activity since the prior examination:

| | Common Stock | Surplus Notes | Gross Paid in & Contributed Surplus |
|---|---|---|---|
| December 31, 2012 | $ 5,120,000 | $ 92,500,000 | $ 8,611,387 |
| Activity During the Exam Period | 0 | 0 | 0 |
| December 31, 2016 | $ 5,120,000 | $ 92,500,000 | $ 8,611,387 |

Dividends

According to Company records for the years indicated, as reflected in the Board of Directors (Board) meeting minutes, dividends were paid to the sole stockholder and approved by the Department as follows:

| Declared Date | Paid Date | Paid Amount | Type | Form |
|---|---|---|---|---|
| December 11, 2013 | December 27, 2013 | $22,597,420 | Ordinary | Cash |
| December 19, 2014 | December 29, 2014 | 27,278,794 | Ordinary | Cash |
| January 4, 2016 | January 19, 2016 | 29,252,004 | Ordinary | Cash |

## MANAGEMENT AND CONTROL

Pursuant to the General Corporation Laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, all corporate powers and its business property and affairs are managed by, or under the direction of, its Board. The Board shall consist of at least three members and subject to a maximum of eleven members.

The Board as of December 31, 2016, was comprised of nine members, each elected or appointed in accordance with Company bylaws. Each Director shall hold office until his successor is elected and qualified, or until earlier resignation or removal.

### Directors

The Board, duly elected in accordance with the Company’s bylaws and serving as of December 31, 2016, was as follows:

| Directors Name | Principal Business Affiliation |
|---|---|
| Charles A. Bryan | Independent Director |
| James J. Butler | Independent Director |
| Anthony J. Kuczinski | Munich Reinsurance America, Inc. |
| M. Steven Levy | Munich Reinsurance America, Inc. |
| Stephen J. Morello | Munich Reinsurance America, Inc. |
| Richard A. Olsen | Munich Reinsurance America, Inc. |
| William A. Robbie | Independent Director |
| John P. Vasturia | AAIC and PESLIC |
| Robin H. Willcox | Munich Reinsurance America, Inc. |

### Committees

The standing Board committees as of December 31, 2016, were constituted as follows:

**Audit Committee**
Hermann Pohlchristoph, Chair
Charles A. Bryan

James J. Butler
William A. Robbie

**Investment Committee**
Richard A. Olsen, Chair
Michael Bös
René Gobonya
Peter Richter
Paul Wolfe

Officers

The bylaws of the Company state the principal officers shall be a President, a Chairman, and Vice Chairman, a President, and any other Vice-Presidents, a Secretary, one or more Assistant Vice Presidents, one or more Assistant Secretaries, and such other officers, assistant officers or agents as the Board from time to time may determine.

As of December 31, 2016, the Company's principal officers and their respective titles were as follows:

| Officer Name | Title |
|---|---|
| John P. Vasturia | President |
| Robin H. Willcox | Senior Vice President, General Counsel & Secretary |
| Richard A. Olsen | Senior Vice President & Chief Financial Officer |
| Jen Ughetta | Senior Vice President & Head of Human Resources |
| Melissa A. Salton | Senior Vice President & Chief Risk Officer |

The minutes of the meetings of the Stockholder and Board, which were held during the period of examination, were read and noted. Attendance at meetings, election of directors and officers and approval of investment transactions were also noted.

Inspection of Company files indicated that an ethics statement/conflict of interest statement was completed by all employees for the examination period. A review of the Company's bylaws revealed that no changes were made during the examination period.

During our review for compliance with 18 *Del. C.* § 4919 it was noted that the Company properly reported changes in directors and principal officers.

Corporate Records

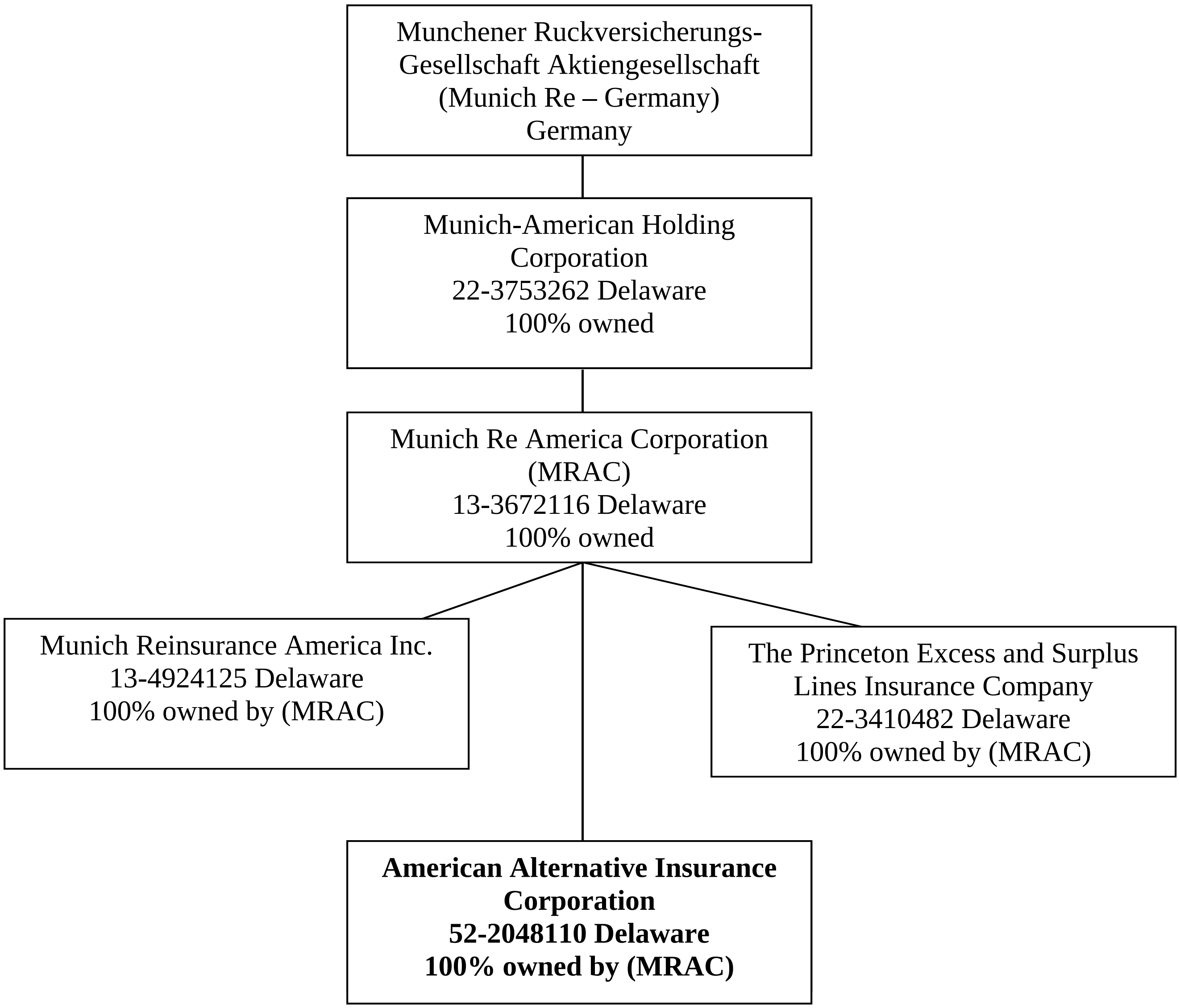
The recorded minutes of the Board, were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events, including the approval of investment transactions in accordance with 18 *Del. C.* § 1304.

Insurance Holding Company System

The Company is a member of an Insurance Holding Company System as defined under Chapter 50 of the Delaware Insurance Code. As previously noted, the immediate parent of the Company as of December 31, 2016, was MRAC and the Ultimate Parent is MRG. The Munich Re Group, led by MRG, maintains liaison offices in over 60 locations serving clients worldwide. The 2016 amounts below were reported in the most recent MRG annual report based on International Financial Reporting Standards (IFRS), converted from Euros to U.S. dollars as of December 31, 2016 (conversion rate of 0.95034 Euro/$1.00 U.S.).

| | | |
|---|---|---|
| Assets | U.S. $ | 281.8 Billion |
| Equity | U.S. $ | 33.5 Billion |
| Gross Premium Written | U.S. $ | 51.5 Billion |
| Gain from Operations (pre-tax) | U.S. $ | 4.2 Billion |

The following holding company system, as of December 31, 2016, reflects only identities and interrelationships between the Company and its direct parent, its intermediate parent, and its ultimate parent and affiliates concurrently examined.




A review of the Annual Form B and Form C filings made by AAIC for all years under examination revealed that the Company had complied with the requirements of 18 *Del. C.* §5004 and 18 *Del. Admin. C.* § 1801.

<u>Affiliated Agreements</u>

The Company was a party to the following significant agreements and arrangements in effect as of December 31, 2016:

*Consolidated Income Tax Allocation Agreement*

Effective March 2, 2012, the Company entered into an Amended and Restated Tax Allocation Agreement with Munich-American Holding Corporation (MAHC) and all of its subsidiaries including MRAm and PESLIC, for tax years ending December 31, 2011 and later. Under this agreement, income tax expenses are computed on a separate company basis as if each affiliate filed a separate tax return. Intercompany balances are settled on a quarterly basis. The current tax allocation agreement was approved by the Department on January 30, 2012. The agreement was subsequently non-materially amended on August 9, 2012 and January 7, 2014 to add and remove certain affiliated companies. These amendments did not require prior approval but were filed with the Department on an informational basis.

*General Service and Administrative Agreements*

Effective September 1, 2009, the Company entered into a General Services and Cost Allocation Agreement with MAHC and numerous affiliates. Parties to the agreement may provide the following services to each other: accounting, tax, auditing, underwriting, claims, actuarial, information technology, legal, payroll, human resources, corporate finance, public relations, executive, engineering, loss mitigation and inspection, intellectual property and other services. The agreement requires that charges and expenses incurred be allocated according to Delaware Insurance Laws and Statement of Statutory Accounting Principles (SSAP) 70. Charges are settled within thirty days of the end of each calendar quarter. The terms of this agreement are considered fair and equitable. This agreement was approved by the Department on July 1, 2009. The agreement has been amended eight times subsequent to inception, the most recent amendment effective as of October 4, 2016. The amendments have been filed with and approved by the Department. The Company reported $34 million in incurred expenses in 2016 under this agreement.

*Letter of Credit Facility*

Effective October 13, 2009, the Company entered into an Amended and Restated Letter of Credit (LOC) Facility Fee Reimbursement Agreement with MRG, MRAm and PESLIC. MRG shall from time to time provide collateral for reinsurance in the form of letters of credit to MRAm, AAIC and PESLIC from MRG's existing LOC facilities to support unaffiliated unauthorized liabilities. MRAm, AAIC and PESLIC shall pay MRG a fee of fifty basis points for any issuances of LOCs made by the Company under any of MRG's LOC facilities. This agreement was approved by the Department on October 23, 2009. The Company reported $0 in incurred expenses in 2016 under this agreement.

*Agency Agreements*

Effective December 1, 2015, the Company entered into an Amended and Restated Managing General Agency Agreement with affiliate Munich Re Stop Loss, Inc. (MRSL), which wrote $125 million in direct business in 2016 on behalf of the Company. This agreement was approved by the Department on November 24, 2015.

Effective March 1, 2011, the Company entered into a Managing General Agency Agreement with affiliate Roanoke Insurance Group, Inc. (Roanoke) [formerly known as Roanoke Trade Services, Inc.] which wrote $22 million in direct business in 2016 on behalf of the Company. This agreement was approved by the Department on March 9, 2011. This agreement was most recently amended effective July 30, 2012, and was approved by the Department on July 5, 2012.

Unaffiliated Agreements

*Custodial Agreements*

Effective May 27, 1999, the Company entered into a custodial agreement with State Street Bank and Trust Company (State Street), which provides for the safekeeping of the Company's invested assets. The custodial agreement, which was most recently amended effective June 2, 2003, contains the required protective language specified by NAIC guidelines. The most recent SSAE16 Report for State Street was obtained and reviewed without exception.

*Agency Agreements*

The Company is a party to various managing general agency agreements and general agency agreements which write business on behalf of the Company. Where premiums were considered material, the underlying agreements were reviewed without exception.

## TERRITORY AND PLAN OF OPERATION

Territory

The Company is currently licensed to write business in all fifty U.S. States, the District of Columbia and Puerto Rico. In addition, the Company is authorized as an acceptable Surety writer by the U.S. Treasury.

Plan of Operation

The Company's clients are traditional insurance buyers (i.e., commercial corporations) and the alternative market (i.e., risk retention groups, risk purchasing groups, captives, and risk managers of commercial companies). AAIC primarily markets its products through the use of Managing General Agents (MGA) and Third Party Administrators (TPA). During 2016, the seven largest MGA/TPA's authorized by the Company produced approximately $608 million, or 73.5%, of the $828 million in direct written premium as follows:

| MGA/TPA | Premiums | Percent |
|---|---|---|
| Volunteer Fireman’s Insurance Services (VFIS) | $ 212,836,234 | 25.70% |
| Global Aerospace, Inc. (GA) | 60,385,125 | 7.30% |
| Munich Re Stop Loss, Inc. (MRSL) [affiliate] | 124,962,614 | 15.10% |
| Personal Umbrella.com Insurance Services, Inc. (PUIS) | 56,069,114 | 6.80% |
| Glatfelter Underwriting Services (GUS) | 98,265,772 | 11.90% |
| Allied National (AN) | 34,099,966 | 4.10% |
| Roanoke Trade Services, Inc. (RTS) [affiliate] | 21,805,163 | 2.60% |
| Total | $ 608,423,988 | 73.50% |

The applicable MGA/TPA agreements, state licenses, audit schedules and selected audit reports were reviewed. Proper licensing was noted and the selected audit reports indicated no conflicts with the Company's underwriting guidelines. All of the MGA/TPA’s noted above have been granted underwriting and binding authority along with the authority to collect premiums.

VFIS, MRDSL, GUS, GA, AN and RTS all have claims adjustment and claims payment authority. None of the MGA/TPA’s are permitted to bind the Company to ceded reinsurance.

The premiums applicable to GA are subsequently 100% ceded to MRG under an agreement entered into during 2003 by AAIC, MRG and GA. Per the agreement, AAIC acts as the policy-issuing company, representing MRG, as a 25% participant in a pool that is managed by GA. The pool provides general aviation, airline, products liability, and space & satellite risk coverage to the North American aviation market.

The five largest lines of direct written premiums represent 79.4% of the 2016 total of $828 million as follows:

| Line | Premium | Percent |
|---|---|---|
| Commercial Multiple Peril | $ 216,411,592 | 26.14% |
| Other Accident and Health | 149,636,703 | 18.08% |
| Commercial Auto Liability | 119,739,067 | 14.46% |
| Other Liability - Occurrence | 103,225,666 | 12.47% |
| Auto Physical Damage | 68,296,315 | 8.25% |
| Total | $ 657,309,343 | 79.40% |

AAIC has remained conservative during the examination period in terms of the business being solicited and underwritten. The corporate philosophy is that risks underwritten should have adequate risk premium and AAIC appears to have applied this underwriting discipline over the examination period.

AAIC has appointed a Chief Risk Officer and heightened its awareness of risks assumed as a whole. With regards to Underwriting Risk Management, the Company has centralized the direction of underwriting guidelines. The Chief Risk Officer is closely aligned with the Integrated Risk Management Division of MRG in Germany. MRAC intends to continue to integrate itself into MRG's operations. MRAC underwriting goals and limitations are developed, reviewed and approved subsequently by MRG. MRG has an international (or group wide) Business Plan of which MRAC is a significant part.

A.M. Best Rating:

Based on A.M. Best's current opinion of the consolidated financial condition and operating performance of the Company, AAIC was assigned an A.M. Best rating of A+ (Superior) for the year ended 2016. A.M. Best notes that the rating reflects the Company’s solid returns and substantial improvement in risk adjusted capitalization.

## REINSURANCE

AAIC reported the following distribution of written premiums in 2016:

| | |
|---|---|
| Direct | $ 827,815,012 |
| Assumed from Non-affiliates | 1,460,026 |
| Gross Premiums Written | $ 829,275,038 |
| | |
| Ceded to Affiliates | $ 603,471,188 |
| Ceded to Non-affiliates | 225,803,850 |
| Total Ceded Premiums | $ 829,275,038 |
| | |
| Net Premiums Written | $ - |

Assumed

AAIC's assumed reinsurance is comprised of participations in pools and associations. As a direct writer of workers' compensation insurance and auto insurance, the Company is required to participate in various state-operated or sponsored plans or reinsurance facilities. AAIC participated in several involuntary pools or associations in 2016 with total premiums of approximately $1 million. AAIC also participated in two syndicates on a voluntary basis in 2016 with total premiums of $144 thousand.

Ceded to Affiliates

*Ceded to MRAm*

Through June 30, 2009, all of AAIC's business, net of the specific cessions noted below, were ceded to MRAm under the following property-casualty reinsurance program:

| | |
|---|---|
| Quota Share | 80% of most lines of business |
| Accident Year Stop Loss | 100% cession in excess of a 71% loss ratio |

Effective July 1, 2009, the Company commuted all of its prior reinsurance contracts with MRAm under a Commutation and Release Agreement as a first step in the establishment of a Reinsurance Pooling Agreement (Pooling Agreement) which covers 100% of the Company's net liabilities (defined as gross liability net of specific cessions to other reinsurers). The previously ceded business, along with the Company's retained business at June 30, 2009, is subject to the Pooling Agreement.

The Company is a participant in the above stated Pooling Agreement with MRAm and PESLIC. The Reinsurance Pooling Agreement, effective July 1, 2009, covers all direct and assumed current and prior policies and contracts issued by AAIC and PESLIC. Under the Pooling Agreement, each of the companies cedes 100% of its net liabilities to the pool, MRAm is the lead company for the pooling agreement and has a 100% participation in the pooled business and AAIC and PESLIC each have a 0% participation in the pooled business. A provisional ceding commission of 24.5%, adjusted quarterly for actual acquisition expenses allocable to the net business subject to the agreement, is paid to AAIC and PESLIC. In addition, an override commission of 5.5% is paid to AAIC and PESLIC under the agreement. The override commission is in excess of the acquisition costs, and therefore, in accordance with SSAP 62R – paragraph 54, a deferred ceding commission liability equal to the difference between the reinsurance commission received and the acquisition costs was recorded as of December 31, 2016. The deferred ceding commission liability is amortized pro-rata over the effective period of the agreement in proportion to the amount of coverage provided. The Commutation and Release Agreement and Reinsurance Pooling Agreement were approved by the Department on September 29, 2009.

Total premium ceded by AAIC to MRAm in 2016 under the Pooling Agreement was $515 million. As of December 31, 2016 AAIC reported net reinsurance recoverable from MRAm of $887 million.

*Ceded to Other Affiliates*

The remaining business ceded to affiliates totaled $88 million in 2016:

- $60 million was ceded to parent MRG pursuant to a 100% Quota Share Reinsurance Agreement effective April 2003. In 2003, AAIC became the "nominated insurance company" within the Munich Re group that writes, on a direct basis, a portion of the business produced by Global Aerospace Underwriting Managers, $62 million and Associated Aviation Underwriters, ($2 million) relating to the Global Aerospace Underwriters Pool.

- $22 million was ceded to Watkins Syndicate at Lloyd's Syndicate 457, domiciled in Great Britain, pursuant to a Surety Quota Share Reinsurance Agreement effective March 1, 2011 and approved by the Department on March 9, 2011.

- $6 million was ceded to Hartford Steam Boiler Inspection and Insurance Company, domiciled in Connecticut, under various reinsurance agreements which were below the materiality thresholds and not required to be filed with the Department.

Ceded to Non-affiliates

AAIC ceded $226 million in premiums to non-affiliates in 2016 which includes a significant amount of business with the express purpose of ceding all or part of the loss exposure to designated reinsurers. These programs are referred to as Specific Reinsurance business and three programs dominated the Company's cessions in 2016, accounting for 92.3% of total premiums ceded to non-affiliates as follows:

- AAIC uses primarily MGA/TPAs to produce business. The largest MGA producing business for the Company is VFIS. The Company cedes 80% of the business produced by VFIS on a quota share basis to GIG Reinsurance Company, Ltd., (GIG Reinsurance), a captive reinsurer affiliate of VFIS. The loss cessions to GIG Reinsurance are limited to $800 thousand each occurrence. In addition, AAIC cedes 20% of the business produced by GUS, another MGA, on a quota share basis to GIG Reinsurance. The loss cessions to GIG Reinsurance for this program are limited to $250 thousand each occurrence. Total premiums ceded to GIG Reinsurance under these two programs in 2016 were $195 million, or 86.3%, of total premiums ceded to non-affiliates.

- AAIC also writes business through the Schools Program with CM Regent Insurance Company (CMR), which is domiciled in Pennsylvania and is rated "A" (Excellent) by A.M. Best. CMR is a commercial property and liability insurer serving public and private K-12 schools, colleges and universities. CMR provides property and liability insurance, workers' compensation, school leaders legal liability, excess liability, privacy protection and owner-controlled insurance. The Company ceded $9 million of premium in 2016 to CMR under the Schools Program, or 4.0% of total premiums ceded to non-affiliates.

- AAIC policies are also used by an MGA, ADM Crop Risk Services, Inc., to write insurance for the Multiple Peril Crop Insurance (MPCI) and Crop Hail Programs, which are federally-subsidized by the U.S. Government and administered on behalf of the Federal Crop Insurance Commission (FCIC) by the Risk Management Agency (RMA). The current program, authorized by Congress in 1996 to provide premium subsidies and reinsurance protection on eligible crop insurance contracts, is administered through a Standard Reinsurance Agreement (SRA) contract approved by the United States Department of Agriculture (USDA) between individual insurers and the FCIC through the RMA. There are currently 15 USDA-approved SRA holders in the United States. The SRA is consistent among all contract holders and is periodically revised by the RMA. AAIC cedes 100% of the premium and liability written by this program to Agrinational Insurance Company (AIC), an authorized reinsurer domiciled in Vermont. AIC is a wholly owned captive of Archer Daniels Midland (ADM), an international producer of farm equipment, seeds and fertilizer. AIC is an SRA holder and is not licensed in all states. The Company ceded $5 million of premium in 2016 to AIC, or 2.0% of total premiums ceded to non-affiliates. MRG is a participant on a reinsurance agreement with AIC.

The Company is a party to several contracts which do not meet the risk transfer requirements established in SSAP 62R and are accounted for as $2 million in deposit assets (for ceded business) and $5 million in deposit liabilities (for assumed business).

## FINANCIAL STATEMENTS

The following pages contain the Company's Financial Statements for the year ended December 31, 2016, as determined by this examination, with supporting exhibits as detailed below:

Analysis of Assets,
Statement of Liabilities, Surplus and Other Funds
Underwriting and Investment Exhibit - Statement of Income
Reconciliation of Surplus since last Examination

# Analysis of Assets
## As of December 31, 2016

| | Assets | Nonadmitted Assets | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 169,803,613 | $ - | $ 169,803,613 | 1 |
| Cash | (1,115,059) | | (1,115,059) | |
| Cash Equivalents | 68,990,711 | | 68,990,711 | |
| Short-term investments | 24,006,009 | | 24,006,009 | |
| Receivables for securities | 4,506 | | 4,506 | |
| Investment income due and accrued | 1,134,260 | | 1,134,260 | |
| Uncollected premiums and agents' balances in the course of collection | 16,577,052 | | 16,577,052 | |
| Deferred premiums; agents' balances and installments booked but deferred and not yet due | 70,969,594 | | 70,969,594 | |
| Amounts recoverable from reinsurers | 91,138,357 | | 91,138,357 | |
| Funds held by or deposited with reinsured companies (reinsurance) | 199,317 | | 199,317 | |
| Current federal and foreign income tax recoverable and interest thereon | 1,551,568 | | 1,551,568 | |
| Net deferred tax asset | 3,853,131 | 35,049 | 3,818,082 | |
| Guaranty funds receivable or on deposit | 568,822 | - | 568,822 | |
| Receivables from parent; subsidiaries and affiliates | 2,207,271 | | 2,207,271 | |
| Aggregate write-ins for other than invested assets | 85,664,453 | 203,874 | 85,460,579 | |
| Totals | $ 535,553,605 | $ 238,923 | $ 535,314,682 | |

# Statement of Liabilities, Surplus and Other Funds
## As of December 31, 2016

| | | | Note |
|---|---|---|---|
| Losses | $ | - | 2 |
| Reinsurance payable on paid losses and loss adjustment expenses | | 3,489 | |
| Loss adjustment expenses | | - | 2 |
| Commissions payable, contingent commissions & other similar charges | | 3,444,352 | |
| Other expenses | | 2,051,754 | |
| Taxes, licenses, and fees | | 3,311,245 | |
| Ceded reinsurance premiums payable | | 262,417,928 | 3 |
| Funds held by company under reinsurance treaties | | 46,938,481 | |
| Payable to parent,subsidiaries and affiliates | | 114,941 | |
| Aggregate write-ins for liabilities | | 18,611,151 | |
| Total Liabilities | $ | 336,893,341 | |
| Common capital stock | $ | 5,120,000 | |
| Surplus Notes | | 92,500,000 | |
| Gross paid in and contributed surplus | | 8,611,387 | |
| Unassigned funds (surplus) | | 92,189,954 | |
| Surplus as regards policyholders | $ | 198,421,341 | |
| Total Liabilities, Capital and Surplus | $ | 535,314,682 | |

# Underwriting and Investment Exhibit - Statement of Income
For the Year Ended
December 31, 2016

| | | |
|---|---|---|
| **UNDERWRITING INCOME** | | |
| Premiums earned | $ | - |
| | | |
| **DEDUCTIONS** | | |
| Other underwriting expenses incurred | $ | (43,274,190) |
| Total underwriting deductions | $ | (43,274,190) |
| Net underwriting gain or (loss) | $ | 43,274,190 |
| | | |
| **INVESTMENT INCOME** | | |
| Net investment income earned | $ | 4,702,348 |
| Net realized capital gains or (losses) less capital gains tax of $7,715 | | 14,329 |
| Net investment gain or (loss) | $ | 4,716,677 |
| | | |
| **OTHER INCOME** | | |
| Net gain (loss) from agents' or premium balances charged off (amount recovered $5,926 amount charged off $5905 | $ | (114,466) |
| Finance and service changes not included in premiums | | 153,798 |
| Aggregate write-ins for miscellaneous income | | (4,945,878) |
| Total other income | $ | (4,906,546) |
| Net income; after dividends to policyholders; after capital gains tax and before all other federal and foreign income taxes | $ | 43,084,321 |
| Net income; after dividends to policyholders; after capital gains tax and before all other federal and foreign income taxes | $ | 43,084,321 |
| Federal and foreign income taxes incurred | | 15,231,405 |
| Net Income | $ | 27,852,916 |

Reconciliation of Surplus Since Prior Examination
As of December 31, 2016

| | | Capital Stock | Gross Paid in and Contributed Capital | Unassigned Surplus | Surplus Notes | Total |
|---|---|---|---|---|---|---|
| **Beginnng Balance (2012)** | | $ 5,120,000 | $ 8,611,387 | $ 50,000,995 | $ 92,500,000 | $ 156,232,382 |
| | 2013 1 | | | 28,113,400 | | 28,113,400 |
| | 2013 2 | | | (22,597,420) | | (22,597,420) |
| | 2013 3 | | | - | | - |
| | 2014 1 | | | 31,222,207 | | 31,222,207 |
| | 2014 2 | | | (27,278,794) | | (27,278,794) |
| | 2014 3 | | | 3,229,558 | | 3,229,558 |
| | 2015 1 | | | 30,538,138 | | 30,538,138 |
| | 2015 2 | | | - | | - |
| | 2015 3 | | | - | | - |
| | 2016 1 | | | 28,213,872 | | 28,213,872 |
| | 2016 2 | | | (29,252,004) | | (29,252,004) |
| | 2016 3 | | | - | | - |
| **Ending Balance (2016)** | | $ 5,120,000 | $ 8,611,387 | $ 92,189,952 | $ 92,500,000 | $ 198,421,339 |

1. Represents net income, change in unrealized capital gains(losses), change in unrealized foreign exchange gain(losses), change in net deferred income tax, change in non-admitted assets, change in reinsurance for unauthorized reinsurers
2. Dividends were approved by the Board.
3. Represents Aggregate Write-ins for gains and losses in surplus.

## ANALYSIS OF CHANGES IN THE FINANCIAL STATEMENTS RESULTING FROM EXAMINATION

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

## COMMENTS ON FINANCIAL STATEMENT ITEMS

**Note 1 - Bonds** **$169,803,613**

The above-captioned amount, which is the same as that reported by the Company in its Annual Statement, has been accepted for purposes of this report. With the exception of bonds held for statutory purposes, investments are held by State Street Bank and Trust, under a custodial agreement.  A review of corporate records indicates that the Board has approved the Company's investment transactions made during the examination period in accordance with 18 *Del. C.* § 1304.  Bonds rated by NAIC are as follows:

| Designation | Percentage of Portfolio |
|---|---|
| NAIC 1 | 77.8% |
| NAIC 2 | 19.3 % |

The Bond portfolio as of the December 31, 2016 examination date consisted of the following classes:

| Description | Book/Adjusted Carrying Value | Percentage Total |
|---|---|---|
| US Government Bonds | $ 56,556,793 | 33.31% |
| Canadian Giverment Bonds | 1,066,290 | 0.63% |
| Foreign Government Bonds | 10,487,332 | 6.18% |
| US Special Revenue | 27,376,565 | 16.12% |
| US Industrial and Miscelaneous | 66,055,708 | 38.90% |
| Canadian Industrial and Miscelaneous | 2,075,922 | 1.22% |
| Foreign Industrial and Miscelaneous | 6,185,003 | 3.64% |
| Total | $ 169,803,613 | 100.00% |

**Note 2 -Losses** **$ 0**
**Loss Adjustment Expenses** **$ 0**

The above-captioned amounts, which are the same as those reported by the Company in its Annual Statement, have been accepted for purposes of this report.  As part of a Reinsurance Pooling Agreement noted in the Reinsurance section above, the Company is a party to a Pooling Agreement in which all loses net of third party reinsurance are ceded to MRAm.

**Note 3 – Ceded Reinsurance Premiums Payable** **$262,417,928**

The above-captioned amount, which is the same as that reported by the Company in its Annual Statement, has been accepted for purposes of this report. Of the $262 million, $236 million, or 89.81%, is due to MRAm under the terms of the Pooling Agreement. The remainder is due to unaffiliated third parties.

## SUBSEQUENT EVENTS

On March 1, 2017, the Company's Board approved an ordinary cash dividend payment of $28 million to the Company's shareholder, which was paid on March 20, 2017.

## SUMMARY OF RECOMMENDATIONS

There were no recommendations as a result of this examination.

## CONCLUSION

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. and INS Services, Inc. is acknowledged. In addition, the assistance and cooperation of the Company's outside audit firm, KPMG, and the Company's management and staff were appreciated and are acknowledged.

Respectfully submitted,

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