

REPORT ON EXAMINATION
OF
ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG
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 the

ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG

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

Attest By: Raymond Brown

Date: June 4, 2018



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 13th day of June, 2018.

Trinidad Navarro
Trinidad Navarro
Insurance Commissioner

Trinidad Navarro
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
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ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG
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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 13th day of June, 2018

TABLE OF CONTENTS

SALUTATION	1
SCOPE OF EXAMINATION	1
SUMMARY OF SIGNIFICANT FINDINGS	3
COMPANY HISTORY	3
MANAGEMENT AND CONTROL	4
Directors	4
Board Committees	5
Officers	5
Holding Company System	6
TERRITORY AND PLAN OF OPERATION	8
REINSURANCE	8
FINANCIAL STATEMENTS	9
Assets	10
Liabilities, Surplus and Other Funds	11
Statement of Income	12
Reconciliation of Capital and Surplus	13
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS FROM EXAMINATION	13
COMMENTS ON FINANCIAL STATEMENTS	14
SUBSEQUENT EVENTS	14
COMPLIANCE WITH PRIOR REPORT OF EXAMINATION	14
SUMMARY OF RECOMMENDATIONS	14
CONCLUSION	15

SALUTATION

May 9, 2018

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

Dear Commissioner:

In accordance with instructions and pursuant to statutory provisions contained in Examination Authority No. 17.038, dated May 3, 2017, an examination has been made of the affairs, financial condition and management of

ARCHITECTS & ENGINEERS INSURANCE COMPANY RRG

hereinafter referred to as (Company or AEIC), incorporated under the laws of the State of Delaware, with its statutory home office located at 1209 Orange Street, Wilmington, Delaware 19801. The main administrative office of the Company is located at 2056 Westings Avenue, Suite 20, Naperville, Illinois 60563.

The examination report thereon is respectfully submitted.

SCOPE OF EXAMINATION

The Delaware Department of Insurance (Department) has performed a full-scope risk-focused surveillance examination of the Company. The last examination of the Company was conducted as of December 31, 2013. This examination covered the period of January 1, 2014 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 by the Department as a single state risk-focused examination and was conducted 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 examination, consideration was given to work performed by the Company's external independent accounting firm, Strohm Ballweg, LLP (Strohm). Certain auditor work papers were incorporated into the work papers of the examiners and 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

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

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.* § 8002 and per the federal Liability Risk Retention Act (LRRRA) of 1986. As a condition of the Department's issuance of a Certificate of Authority, the Company cannot pay dividends or other distributions without the approval of the Department until it has achieved a capital and surplus amount of \$15.0 million.

In accordance with RRG formations, all policyholders must be shareholders of the Company. Any policyholders terminating their insurance coverage must relinquish their shareholder interest in the Company. Redemption funds due to a withdrawn or terminated shareholder are retained as capital.

The Company primarily writes three-year professional liability insurance policies to architectural and engineering consulting firms on a direct basis, providing up to \$10.0 million of coverage on a claims-made basis. The professional liability policies include; Professional, Directors and Officers, Employment Practices, and Benefit Trust Liability.

Capitalization

The Company is required to maintain a minimum capital and surplus of \$1,000,000, which is the minimum amount required of a RRG under 18 *Del. C.* §6905(a). As of December 31, 2016, the Company's capital and surplus was approximately \$9.8 million.

The Company was initially capitalized through the sale of common stock to prospective policyholders as a condition of obtaining coverage. Many of the larger stock subscriptions were purchased with promissory notes backed by irrevocable Letters of Credit (LOC). As the Company became more capitalized, less stock ownership by each insured was required. Currently, each new insured is required to purchase one share of common stock, with a par value of \$5.00 and an additional contribution of \$135.00 (total of \$140). As of December 31, 2016, the Company's amended Certificate of Incorporation authorizes the issuance of 500,000 shares of common stock with a par value of \$5.00 per share.

MANAGEMENT AND CONTROL

Directors

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 are exercised by or under the direction of the Company's Board of Directors (Board). The Company's bylaws provide that the Company's business and affairs shall be under the control of its Board.

Article III, Section 1, of the Company's bylaws states that the Board shall consist of no fewer than three (3) but not more than seven (7) directors. As of December 31, 2016, the members of the Board together with their principal business affiliations were as follows:

<u>Director's Name</u>	<u>Principal Business Affiliation</u>
Harold A. Dombeck	Board Chairman
Mitchell A. Sellett #	Director, President and Chief Executive Officer
George X. Cannon	Director, Vice President and Treasurer
Jason A. Peterson	Director and Secretary
Pradeep Patel	Director
# New Director in 2016	

Board Committees

Article III, Section 13, of the Company's bylaws states that the majority of the Board may create one or more Board committees and appoint members to serve on the committee or committees. Each Board committee shall have two or more members who serve on the Board and each committee may exercise the authority of the Board, except as otherwise provided by law. As of December 31, 2016, the Board had the following designated committees:

<u>Audit Committee</u>	<u>Advisory Committee</u>	<u>Investment Committee</u>
George X. Cannon #	Mitchell A. Sellett #	Harold A. Dombeck #
Harold A. Dombeck	Pradeep Patel	Mitchell A. Sellett
Mitchell A. Sellett		
# Committee Chairman		

Officers

Article V of the Company's bylaws states that the Company's officers shall consist of a Chairman of the Board, a President, one or more Vice Presidents, a Treasurer and Assistant

Treasurer (if needed) and a Secretary and Assistant Secretary (if needed). As of December 31, 2016, the Company's principal officers and their respective titles were as follows:

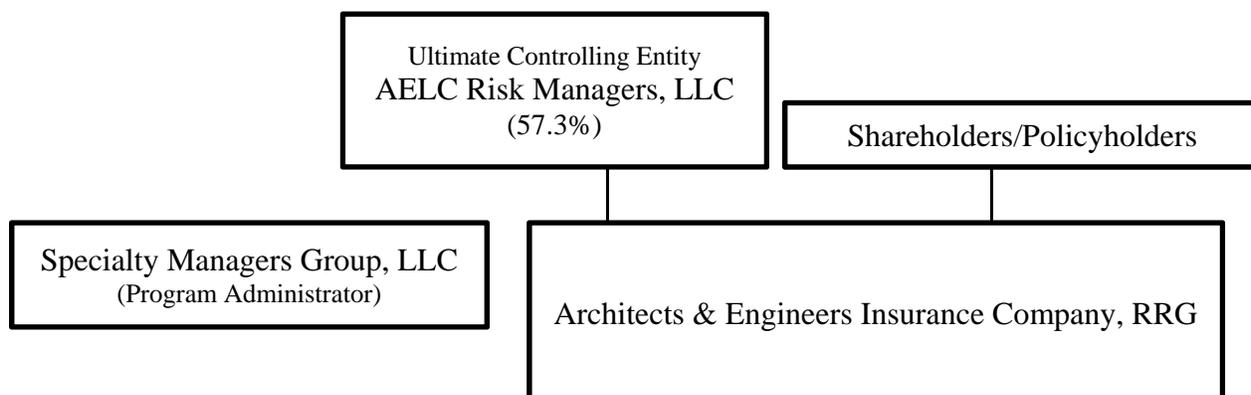
<u>Officer's Name</u>	<u>Principal Occupation</u>
Mitchell A. Sellett	President and Chief Executive Officer
George X. Cannon	Vice President and Treasurer
Jason A. Peterson	Secretary

Holding Company System

The Company is a member of an insurance holding company system as defined under 18 *Del. C.* § 5001(6) "Insurance Holding Company System." The Company's Insurance Holding Company System Registration Statement (Annual Form B) was filed timely with the Department for each year under examination.

The holding company, AELC Risk Managers, LLC (AELC), has a controlling interest of 57.3% in the Company as of December 31, 2016. Specialty Managers Group, LLC (SMG), an affiliate company, functions as the Company's program administrator. SMG performs the day-to-day operational activities for the Company.

The organizational chart below reflects the identities and interrelationships within the holding company system as of December 31, 2016:



Affiliated Agreements

The Company had two (2) affiliated agreements in place as of December 31, 2016, and during the examination period.

Program Administration Agreement

Effective January 1, 2014, the Company became party to a Program Administration Agreement with SMG. Under terms of the agreement, SMG provides all of the Company's policyholder, broker, claims management and risk management services. With direct access to underwriters, SMG handles all policy administration for the Company and provides risk management services from its Risk Review Program, by sending a consultant to the insured's office to assist in improving the firm's operations from a risk and loss mitigation perspective, as well as from a technical and managerial perspective. The Company pays a flat fee of \$200,000 each quarter (\$800,000 annually) for program administrative services, to include policy administration, \$48,000 annually for risk management services and \$235.00 per hour for claims management services. Prior to January 1, 2014, administrative costs for management services were 15.0% of direct premiums written.

Consultant Agreement

Effective June 13, 2007, the Company became party to a Consultant Agreement with Dombeck Associates, Inc. (Dombeck). Under terms of the agreement, Dombeck provides marketing and public relations services, financial and accounting services, administrative and other insurance services. In return for services rendered, Dombeck receives a monthly retainer fee of \$3,500.00. In addition, Dombeck is reimbursed for miscellaneous expenses, to include travel, lodging and meals, which are itemized with receipts monthly.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2016, the Company was licensed to transact business solely in the State of Delaware and was registered as a non-domiciled RRG in thirty-six (36) other states. All of the Company's direct premiums written in 2016 were reported in the State of Delaware.

Plan of Operation

The Company's products are distributed through independent agents and wholesale agencies. The target participant market includes all design disciplines with annual billings exceeding \$1,000,000.00, deductibles starting at \$10,000.00 and above-average loss experience with limited exposure to residential design. There are no new distribution channels since the prior examination.

REINSURANCE

For the year ended December 31, 2016, the Company reported the following components of net premiums written:

Direct	\$ 7,592,340
Reinsurance assumed	<u>-</u>
Total direct and assumed	\$ 7,592,340
Reinsurance ceded (to non-affiliates)	<u>6,050,550</u>
Net premiums written	<u>\$ 1,541,790</u>

Ceded Reinsurance

The Company utilizes Beach and Associates, Ltd. (Beach) as their reinsurance broker. Quarterly, Beach 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. From this report, the Company determines and records the payable/receivable to/from Beach.

The Company had the following two (2) reinsurance contracts administered by Beach effective January 1, 2016, and in place as of December 31, 2016:

Primary Reinsurance

The Company was party to a Quota Share (QS) reinsurance contract with a \$10.0 million limit on each claim, each insured. Other parties to the QS contract include, Transatlantic Reinsurance Company, accepting a 30.0% share, Partner Reinsurance Company of the U.S., accepting a 20.0% share and Hiscox Agency Limited under binding authority from Hiscox 3624 at Lloyd's, accepting a 10.0% share of the Company's net retained liabilities under the contract.

Excess Reinsurance

The Company was party to an Excess Cessions (Excess) reinsurance contract with a \$9.0 million limit in excess of \$1.0 million, on each claim, each insured. Other parties to the Excess contract include several Lloyds' Syndicates (Lloyds) and Hannover Reinsurance (Hannover). The Company's retention is \$400,000.00 under the first \$1.0 million layer and retains no risk from \$1.0 million to \$10.0 million under both reinsurance contracts, by ceding 60.0% under the \$10.0 million QS contract and 40.0% to Lloyds and Hannover under Excess contract.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Department and present the financial condition of the Company for the period ended December 31, 2016:

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Reconciliation of Capital and Surplus

Assets
As of December 31, 2016

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$ 5,990,072	\$ -	\$ 5,990,072
Stocks:			
Common stocks	2,533,332		2,533,332
Cash, cash equivalents and short-term investments	6,584,166		6,584,166
Investment income due and accrued	75,519		75,519
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	1,505,608		1,505,608
Deferred premiums, agents' balances and installments booked but deferred	4,052,854		4,052,854
Reinsurance:			
Amounts recoverable from reinsurers	159,908		159,908
Current federal and foreign income tax recoverable and interest thereon	17,324		17,324
Net deferred tax asset	849,843	443,277	406,566
Aggregate write-ins for other than invested assets:			
Notes Receivable	1,847,310		1,847,310
Prepaid Expenses	24,880	24,880	
Total Assets	<u>\$ 23,640,816</u>	<u>\$ 468,157</u>	<u>\$ 23,172,659</u>

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

		<u>Comments</u>
Losses	\$ 3,791,684	1
Loss adjustment expenses	274,212	1
Commissions payable, contingent commissions and other similar charges	32,677	
Other expenses	109,471	
Taxes, licenses and fees	15,185	
Unearned premiums	2,331,062	
Ceded reinsurance premiums payable	6,794,931	
Total Liabilities	<u>\$ 13,349,222</u>	
Common capital stock	313,131	
Aggregate write-ins for other than special surplus funds (Provision for redeemable capital stock)	2,295,380	
Gross paid-in and contributed surplus	4,579,347	
Unassigned funds	2,635,579	
Surplus as regards policyholders	<u>\$ 9,823,437</u>	
Total Liabilities, Capital and Surplus	<u>\$ 23,172,659</u>	

Statement of Income
For the Year Ended December 31, 2016

UNDERWRITING INCOME

Premiums earned	\$ 1,426,355
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DEDUCTIONS

Losses incurred	898,603
Loss adjustment expenses incurred	99,845
Other underwriting expenses incurred	<u>(40,119)</u>
Total Underwriting Deductions	<u>\$ 958,329</u>
Net Underwriting Gain or (Loss)	<u>\$ 468,026</u>

NET INVESTMENT INCOME

Net investment income earned	\$ 122,400
Net realized capital gains (losses) less capital gains tax	<u>400</u>
Net investment Gain or (Loss)	<u>\$ 122,800</u>

OTHER INCOME

Net gain (loss) from agents' or premium balances charged off	\$ -
Aggregate write-ins for miscellaneous income	<u>-</u>
Total Other Income	<u>\$ -</u>

Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	590,826
Dividends to policyholders	<u> </u>
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 590,826
Federal and foreign income taxes incurred	<u>105,509</u>
Net Income (Loss)	<u>\$ 485,317</u>

Reconciliation of Capital and Surplus
From December 31, 2013 to December 31, 2016

	Common Capital Stock	Aggregate Write- Ins For Other Than Special Surplus Funds	Gross Paid-In and Contributed Surplus	Unassigned Surplus	Total
December 31, 2013	\$ 318,191	\$ 2,226,399	\$ 4,642,148	\$ 3,079,151	\$ 10,265,889
Operations 2014 (1)				(1,694,699)	(1,694,699)
Capital Change 2014 (2)	5				5
Paid-in Surplus 2014 (3)			24,593		24,593
Provision 2014 (4)		(24,318)			(24,318)
Operations 2015 (1)				430,640	430,640
Capital Change 2015 (2)	(40)				(40)
Paid-in Surplus 2015 (3)			(781)		(781)
Provision 2015 (4)		961			961
Operations 2016 (1)				820,487	820,487
Capital Change 2016 (2)	(5,025)				(5,025)
Paid-in Surplus 2016 (3)			(86,613)		(86,613)
Provision 2016 (4)		92,338			92,338
December 31, 2016	<u>\$ 313,131</u>	<u>\$ 2,295,380</u>	<u>\$ 4,579,347</u>	<u>\$ 2,635,579</u>	<u>\$ 9,823,437</u>

- (1) Operations defined as: Net income (loss), change in unrealized capital gains (loss), change in net deferred income tax and change in non-admitted assets.
(2) Common stock purchase or redemption (policyholders).
(3) Surplus adjustments Paid in.
(4) Provision for redeemable capital stock.

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

(1) Losses	\$ 3,791,684
Loss adjustments expenses	\$ 274,212

In order for the examination team to gain an adequate comfort level with the Companies' loss and loss adjustment expense (LAE) reserve estimates, the Department retained the actuarial services of INS Consultants, Inc. (INS) to perform a risk-focused review of the Companies' reserving activities. Certain risks within the reserving processes required Phase 5 substantive detail test work.

Based on the procedures performed and results obtained by INS, the examination team obtained sufficient evidence to support the conclusion that the Company's net loss and LAE reserves are reasonably stated as of December 31, 2016.

SUBSEQUENT EVENTS

There were no significant subsequent events that warranted disclosure in this examination report.

COMPLIANCE WITH PRIOR REPORT OF EXAMINATION

There were no recommendations in the prior report of examination.

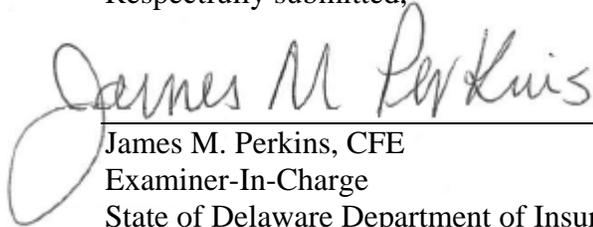
SUMMARY OF RECOMMENDATIONS

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

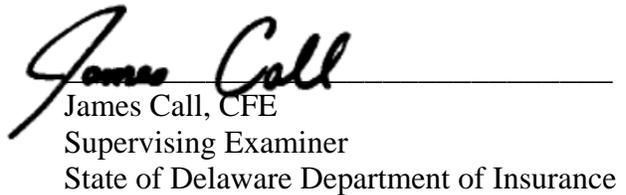
CONCLUSION

The assistance and cooperation of the Company's management is acknowledged. In addition, the assistance of the information systems specialist firm, INS Services, Inc., the consulting actuarial firm, INS, as well as the Company's outside audit firm, Strohm, was appreciated and is also acknowledged.

Respectfully submitted,



James M. Perkins, CFE
Examiner-In-Charge
State of Delaware Department of Insurance



James Call, CFE
Supervising Examiner
State of Delaware Department of Insurance