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SENT ELECTRONICALLY

Kenneth B. Schnoll
General Counsel and Deputy Commissioner
CALIFORNIA DEPARTMENT OF INSURANCE
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Emma Hirschhorn
Division Chief, Financial Analysis
CALIFORNIA DEPARTMENT OF INSURANCE
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Re: Form A, Statement Regarding the Acquisition of Control of or Merger With a Domestic Insurer (California Insurance Company)

WORKERS' COMP EXECUTIVE™
A SEMIMONTHLY PUBLICATION FOR THE WORKERS' COMP EXECUTIVE

Dear Mr. Schnoll and Ms. Hirschhorn,

On behalf of my over 30 clients with ongoing disputes in both the courts and before the Department of Insurance regarding activities of the domestic company the subject of this Form A, specifically on the proposed acquisition of control of California Insurance Company (CIC) by Mr. Steven M. Menzies, who currently is President and Chief Operating Officer of CIC, I am submitting for your consideration the following comments.

My clients have, over the years, paid tens of millions of dollars in premiums to various entities subject to this acquisition through their contentious EquityComp program. The unreasonableness of this program, now subject to a Stipulated Consent Cease and Desist Order dated September 6, 2016 and a litigation Settlement Agreement between the Department and CIC, to which this Form A filed with you relates, continues to be the subject of ongoing litigation in the courts in California as well as administrative hearings before the Department. Applied Underwriters Captive Risk Assurance Company (AUCRA), an Iowa domiciled insurer licensed in California, was also a party to the Order and to the Settlement Agreement.
As noted in the Form A, *Statement Regarding the Acquisition of Control of or Merger With a Domestic Insurer* dated April 3, 2019 as amended and supplemented August 30, 2019 filed by Mr. Steven M. Menzies with the Iowa Division of Insurance:

> "The Applicant intends to continue business operations of the Domestic Insurers as currently conducted, subject to changes in a manner consistent with sound business practices and the growth and stability of their business, and in accordance with applicable law including any required regulatory approvals." (p.5)

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And:

> "After the Acquisition, the business operations of the Domestic Insurers will remain the same but may change in a manner consistent with sound business practices and the growth and stability of its businesses, including maintaining a conservative ratio of premium writings to surplus and in accordance with applicable law, including any required regulatory approvals…
>
> There will be no change of management and as described in this paragraph, the Applicant has no present plans for the Domestic Insurers to declare a dividend (whether or not extraordinary), to liquidate the Domestic Insurers, to sell any of its assets, or to merge the Domestic Insurer with any person or persons." (p.7)

I am assuming for purposes of this letter that similar representations have been made to the California Department. As noted in Insurance Code § 1215.2(a), the Form A is required to have certain statutorily mandated information. The Commissioner may also require, "…any additional information as the commissioner may by rule or regulation prescribe as necessary or appropriate in the public interest or for the protection of policyholders or shareholders." Department regulations, 10 CCR § 2683.21, state, "Each person filing under these regulations shall, in addition to the information called for by the regulations and instructions, furnish any other or further information and material as may be needed to make the information otherwise to be contained in such filing not misleading. "

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The aforementioned disputes with my clients and AUCRA and CIC are not the only complaints being litigated against these entities or that are the subject of ongoing administrative adjudication before the Department. From briefings filed in the Los Angeles County Superior Court "Writ" Cases, we have learned that CIC sold approximately 289 EquityComp programs in the State of California. While this office certainly has handled a large number of litigations with Applied (total = 49), one can use the current status of open cases still within this office as a sampling size for evaluation of the necessary reserves to cover the claims of employers this illegal insurance policy extorted out of these California employers (who depend upon you for their protection).

The Holding Company Act makes several references to the protection of policyholders, ensuring that potential changes in the operations of the company once the acquisition is approved are fair and reasonable to policyholders. While it may appear that the representations cover the liabilities for the claims of my clients' employees, there is great concern that there is no provision in the proposed reserves to cover the liabilities for the return of premium to the employer as a reward for keeping its losses low in this loss sensitive policy.
As noted in the Report of Examination of the California Insurance Company as of December 31, 2017, filed with the Department on May 17, 2019:

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> "It is recommended that the Company enter into a new agreement with the California Department of Insurance that stipulates that the lower of the Company's LDFs and the Consent Order LDFs will be applied to all California policies issued in connection with a Reinsurance Participation Agreement (RPA), in force as of July 1, 2016. It is also recommended that the Company apply the new set of LDFs to California policies with active RPAs moving forward."

It is unclear, given the likely filing date of the Form A, whether this recommendation has been adopted by the Applicant. More important, however, is that CIC has seen its direct premium written drop over the past several years. Nevertheless, at year end 2018 CIC paid a dividend to North American Casualty Company, CIC's immediate parent, of $97 million. Likely this was in anticipation of the acquisition described in this Form A. The dividend amount was just below the threshold for making the dividend extraordinary and requiring Department approval. (2017 net income for CIC was $97,226.681.00)

For the protection of CIC policyholders, it is imperative that the Applicant address ongoing compliance with the Department Cease and Desist Order as well as the Settlement Agreement. In addition, the Applicant must provide information acknowledging that it is aware of significant contingent liabilities (even if allegedly not "material") arising from litigation over the EquityComp program and it is accounting for those potential liabilities in its plan of operation going forward.

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Of significant concern is found on Note 14.G. of the Notes to Financial Statements in the Quarterly Statement as of March 31, 2019 of the California Insurance Company, it is stated, "Lawsuits arise against the Company in the normal course of business. Contingent liabilities arising from litigation, income taxes, and other matters are not considered material in relation to the financial position of the Company."

This may be true, as it relates to the general statement of the effect of litigation on the financial position of an insurer. However, the litigation over the EquityComp program is not litigation arising in the "normal course of business". This is the result of a product, initially put into commerce to avoid regulatory scrutiny, that is now the subject of lawsuits in state and federal courts across the United States. It has also resulted in Cease and Desist Orders from multiple insurance regulatory authorities, including New Jersey, Vermont, and Wisconsin. It has prompted a precedential decision from the Department in *Shasta Linen*, AHB-WCA-14-31, a case referenced in the Senate Insurance Committee Analysis of AB 1922 (Daly), a 2016 bill that would have eased the filing requirements of "ancillary agreements" with the Department that was vetoed by Governor Jerry Brown.

This is not "normal".

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Because of this, I request the Department to require specific treatment of these contingent recoverables in the Plan of Operation of the Applicant. This may include a specific contingency reserve that will be maintained for a period of time and in an amount deemed adequate based upon anticipated returns of premium to *all aggrieved policyholders*, or the posting of dedicated security for litigation payments to policyholders that may occur in the foreseeable future. Such action should be linked to the approval of this application for the benefit of California policyholders.

To be clear, at some point these unique disputes arising from the EquityComp product will run their course. That point, however, is not September 30, 2019. Thus, there needs to be a reserve set up to cover these liabilities in spite of the fact that the Applicant says they are "immaterial'.

As we said, we can do a projection is this offices' 29 open cases to provide an estimate of what reserves should be maintained here by the Applicant, since they comprise approximately 10% of all EquityComp policies sold in California. Of my 29 still open clients, their premium payments during the coverage periods total $81,474,367. The estimated returned premium that is owed because of the obligations breached by AUCRA and CIC is $14,350,180, or roughly 18% of premium payments.

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We contend that the Applicant should be required to set aside more than this 18% of premium sufficient to cover any errors in the estimates here as a reserve for reimbursements to employers who have been induced to enter into this illegal insurance scheme. Perhaps a 25% reserve would be appropriate.

Thank you for your attention to this detail. We are comfortable that you will see the necessity of acting to protect the California businesses who have been entangled in this mess.

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