

Report of the Examination of
1st Auto & Casualty Insurance Company
Madison, Wisconsin
As of December 31, 2018

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Tony Evers, Governor
Mark V. Afable, Commissioner

Wisconsin.gov

January 24, 2020

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Honorable Mark V. Afable
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

1ST AUTO & CASUALTY INSURANCE COMPANY
Madison, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of 1st Auto & Casualty Insurance Company (1st Auto or the company) was conducted in 2015 as of December 31, 2014. The current examination covered the intervening period ending December 31, 2018, and included a review of such 2019 transactions as deemed necessary to complete the examination.

The examination was conducted using a risk-focused approach in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*. This approach sets forth guidance for planning and performing the examination of an insurance company to evaluate the financial condition, assess corporate governance, identify current and prospective risks (including those that might materially affect financial condition, either currently or prospectively), and evaluate system controls and procedures used to mitigate those risks.

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, annual statement instructions, and Wisconsin laws and regulations. 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 at the end of the "Financial Data" section in the area captioned "Reconciliation of Surplus per Examination."

Emphasis was placed on those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's loss and loss adjustment expense reserves. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1991 as 1st Auto & Casualty Insurance Company and commenced business on September 25, 1991. The company is a wholly owned insurance subsidiary of Wisconsin Reinsurance Corporation (WRC), a Wisconsin-domiciled property and casualty insurance company. 1st Auto was initially capitalized with \$500 paid-in capital and \$2,999,500 paid-in surplus. WRC contributed \$2 million of additional capital in 1997. On April 14, 2009, the company amended its articles of incorporation to increase the aggregate number of shares from 10,000 shares to 10,000,000 shares. Subsequent to this change, the company declared a stock split under which each share of common stock issued and outstanding was split from one to 10,000 shares. The company had 500 shares before the stock split and had 5,000,000 shares issued and outstanding as of December 31, 2018.

1st Auto does not have any employees, and all operating functions of the company are performed by WRC pursuant to intercompany services agreements. Services performed by WRC include insurance underwriting, marketing, and policy issuance, reinsurance administration, claims administration and adjudication, and accounting and financial reporting. Further discussion of the WRC holding company organization, description of the significant affiliates of the company, and description of the company's affiliated agreements is included in the section of this report captioned "Affiliated Companies."

The company is licensed in Wisconsin, South Dakota, Arkansas, Iowa, Illinois, and Missouri. In 2018, the company wrote direct premium in the following states:

Wisconsin	\$ 8,890,721	33.59%
Illinois	5,730,168	21.65
Missouri	5,651,073	21.35
Iowa	3,219,142	12.16
South Dakota	2,338,565	8.83
Arkansas	<u>640,584</u>	<u>2.42</u>
Total	<u>\$26,470,253</u>	<u>100.00%</u>

The major products marketed by the company include private passenger automobile liability and physical damage insurance, personal and farm umbrella and liability, and commercial automobile liability and commercial automobile physical damage insurance. The major products are marketed through 450 agencies, many of whom represent a mutual company that is reinsured

by WRC; however, the company's policyholders are not required to be policyholders of the mutual company.

The following table is a summary of the net insurance premiums written by the company in 2018. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Farmowners multiple peril	\$ 221,289	\$	\$ 221,289	\$
Homeowners multiple peril	153,967		153,967	
Other liability – occurrence	1,026,489		789,989	236,500
Private passenger auto liability	12,309,483		615,708	11,693,775
Commercial auto liability	1,328,660		66,458	1,262,202
Auto physical damage	11,429,070		383,637	11,045,433
Boiler and machinery	<u>1,295</u>	–	<u>1,295</u>	<u> </u>
Total All Lines	<u>\$26,470,253</u>	\$	<u>\$2,232,343</u>	<u>\$24,237,910</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members. Each 1st Auto director is elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Each member of the 1st Auto board of directors is an officer of either 1st Auto or the company's parent, Wisconsin Reinsurance Corporation. 1st Auto's board members are not paid specific remuneration as compensation for serving on the company's board of directors.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Ann Carlson New Glarus, Wisconsin	Vice President—Finance and Treasurer Wisconsin Reinsurance Corporation	2020
Jason Fogg Sun Prairie, Wisconsin	Chief Operating Officer Wisconsin Reinsurance Corporation	2020
Elizabeth A. Guilfoyle Madison, Wisconsin	Director of Claims 1st Auto & Casualty Insurance Company	2020
Lisa Johnson Sun Prairie, Wisconsin	Vice President—Underwriting 1st Auto & Casualty Insurance Company	2020
Cathleen McAnaugh Odessa, Florida	Chief Operating Officer 1st Auto & Casualty Insurance Company	2020
Lisa Russell Madison, Wisconsin	General Counsel and Secretary Wisconsin Reinsurance Corporation	2020
Terry Wendorff Deforest, Wisconsin	President and Chief Executive Officer Wisconsin Reinsurance Corporation	2020

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2018 Compensation*
Terry H. Wendorff	Chairman and President	\$608,541
Lisa M. Russell	Executive Vice President—General Counsel and Secretary	233,888
Cathleen R. McAnaugh	Chief Operating Officer	233,392
Ann J. Carlson	Treasurer	201,658
Lisa K. Johnson	VP—Underwriting	158,389
Elizabeth A. Guilfoyle	Director of Claims	144,047

*This is total compensation; a portion is allocated to WRC and 1st Auto.

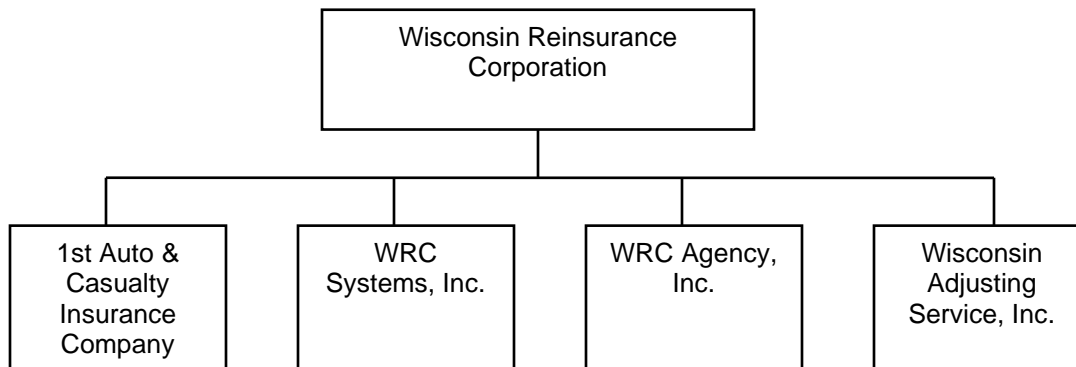
Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The company approved a formal Audit Committee charter at its December 13, 2011, board meeting and has chosen the full board of directors to serve as the Audit Committee.

IV. AFFILIATED COMPANIES

1st Auto & Casualty Insurance Company is a member of the Wisconsin Reinsurance Corporation holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates follows the organizational chart.

**Organizational Chart
As of December 31, 2018**



Wisconsin Reinsurance Corporation

Wisconsin Reinsurance Corporation is a Wisconsin-domiciled stock property and casualty insurance company. WRC provides a variety of reinsurance products to mutual insurers in Wisconsin, Iowa, Missouri, Arkansas, South Dakota, and Illinois. As of December 31, 2018, the audited financial statements of Wisconsin Reinsurance Corporation reported assets of \$94,597,245, liabilities of \$34,463,418, and capital and surplus of \$60,133,827. Operations for 2018 produced net income of \$2,631,902. WRC is the subject of a separate examination report concurrent with that of 1st Auto.

WRC Systems, Inc.

WRC Systems, Inc., had provided computer hardware, computer software, and system support services primarily to town mutual clients of WRC insurers. As of January 1, 2008, WRC Systems, Inc., effectively ceased operations and has been retained as a non-operating shell corporation. As of December 31, 2018, the unaudited GAAP-basis financial statement of WRC Systems, Inc. reported total assets of \$0, liabilities of \$0, and net equity of \$0. Operations for 2018 show no activity.

WRC Agency, Inc. (Agency)

WRC Agency, Inc., provides insurance brokerage services through which agents of WRC client companies may place coverage for lines of insurance that the client companies are unable to offer as a direct insurer. As of December 31, 2018, the unaudited GAAP-basis financial statements of Agency reported total assets of \$173,945, liabilities of \$191,294, and net equity of \$(17,350). Operations for 2018 resulted in net income of \$(17,350).

Wisconsin Adjusting Service, Inc. (WASI)

Wisconsin Adjusting Service, Inc., provides loss adjustment services related to liability claims for WRC and its client companies. Services provided to WRC are pursuant to an administrative services agreement. As of December 31, 2018, the unaudited GAAP-basis financial statements of WASI reported total assets and total liabilities of \$186,708 and net owner's equity of \$0. Operations for 2018 resulted in net income of \$0.

Agreements with Affiliates**Services Agreements**

WRC maintains separate services agreements with each of its active subsidiaries. Each agreement was executed on January 1, 2017. All the agreements are continuous with respect to automatic annual renewals. Pursuant to the agreements, WRC provides accounting, data processing, software access, marketing, receptionist, secretarial services, and all other administrative services necessary for the respective affiliates to conduct their normal business operations. WRC accounts for the time spent by its employees on behalf of the respective affiliates in providing administrative services. Postage, office supplies, and copier charges are reimbursed at actual cost. Pursuant to the agreements, WRC costs allocated to the affiliates and WRC direct expenses on behalf of the respective affiliates are reimbursed by the affiliates. The intercompany amounts due shall be determined within 30 days of the end of the month, and final settlement of intercompany amounts is due within 90 days from the 27th of every month.

The services agreements between WRC and WASI and between WRC and Agency each provide that WRC will reimburse its subsidiary for all costs necessary to bring the equity position of the subsidiary equal to zero. In addition, the service agreement between WRC and

1st Auto was amended effective as of December 31, 2018. This was done to change the compensation arrangement to incorporate the new policy administration system. Eighty percent of the capital costs for the new policy administration system will be allocated from WRC to 1st Auto, and the leasing fee will be over 15 years from the effective date of each implementations' go-live date. If 1st Auto were to discontinue its use of the new policy administration system, any remaining balance of the capital costs allocated from WRC to 1st Auto shall be expensed by 1st Auto within 90 days. All direct expenses (e.g., maintenance, hosting, training, etc.) associated with 1st Auto's use of the system are allocated from WRC to 1st Auto.

Office Lease Agreements

WRC maintains separate office lease agreements with each of its active affiliates, executed on October 1, 2011, for a term of 15 months from October 1, 2011, to and including January 1, 2013. All the agreements may be extended for an additional term or terms under the same terms and conditions. The agreements provide for the lease of office space in the WRC headquarters building, and the agreements are identical except for their respective specifications of leased WRC space and applicable annual rents. The agreements provide that WRC pays for maintenance and upkeep of the leased spaces and for utility services, excluding telephone.

Consolidated Federal Income Tax Agreement

WRC, 1st Auto, Agency, and WASI are party to a consolidated federal income tax agreement, executed February 1, 2014. The agreement provides that WRC will file a consolidated federal tax return for all parties to the agreement. The method used for allocation of federal taxes among the agreement participants is as prescribed by the Internal Revenue Service, and any regular tax liability of participants will be allocated based on the individual taxable income of each participant in proportion to the total consolidated taxable income. The final settlement of tax allocation is due by the respective participants within 90 days of the 27th day of the month of the filing of the consolidated federal tax return.

V. REINSURANCE

The company's reinsurance portfolio and strategy are described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Affiliated Ceding Contracts

The following is a summary of the company's affiliated ceding reinsurance contracts with its parent, Wisconsin Reinsurance Corporation

1. Type: Personal Liability Quota Share Reinsurance
Reinsured: 1st Auto & Casualty Insurance Company
Scope: Business classified by 1st Auto as personal liability business
Coverage: 100% of 1st Auto's net liability
Commissions: 35% of ceded premium
Effective date: January 1, 2019
Termination: On any January 1, by either party giving 90 days' prior notice
2. Type: Automobile Physical Damage Catastrophe Excess Reinsurance
Reinsured: 1st Auto & Casualty Insurance Company
Scope: Business classified by 1st Auto as automobile physical damage business
Retention: \$300,000 of ultimate net loss liability each loss occurrence, plus 2.5% of the excess up to \$1,200,000
Coverage: 97.5% of ultimate net loss in excess of \$300,000 each loss occurrence, up to the limit of 97.5% of \$1,200,000 each loss occurrence with two reinstatements
Effective date: January 1, 2019
Termination: On any January 1, by either party giving 90 days' prior notice
3. Type: Aggregate Excess of Loss Reinsurance
Reinsured: 1st Auto & Casualty Insurance Company
Scope: Business classified by 1st Auto as automobile, umbrella, and personal liability business
Retention: Ultimate net loss equal to 59% of 1st Auto's net earned premium for the calendar year, plus 2.5% of 20.0% in excess of 59%

Coverage: 97.5% of 20.0% in excess of 59% of 1st Auto's net earned premium for the calendar year

Effective date: January 1, 2019

Termination: On any January 1, by either party giving 90 days' prior notice

Nonaffiliated Ceding Contracts

The following is a summary of the company's nonaffiliated ceding reinsurance contracts. The company cedes portions of its written business to third-party reinsurers for risk management purposes and to mitigate risk in the event of catastrophic loss.

1. Type: First and Second Multiple Line Excess of Loss Reinsurance
- Reinsurers: The brokered reinsurers and their respective participation for both first and second layers were as follows:

<u>Reinsurer</u>	<u>Participation</u>
AXIS Reinsurance Company	8.33%
Hannover Rück SE	8.34
QBE Reinsurance Corporation	12.50
Renaissance Reinsurance U.S., Inc.	30.00
SCOR Reinsurance Company	8.33
The Toa Reinsurance Company of America	20.00
XL Reinsurance America	<u>12.50</u>
Total	<u>100.00%</u>

Reinsured: Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company

Scope: Business classified by WRC as fire and allied lines, homeowners, farmowners, and commercial business, including earthquake, assumed by WRC under Class B — Pro Rata and/or Class C — Excess Per Risk property reinsurance contracts or Class A — Casualty reinsurance contracts issued to companies reinsured by WRC and personal and farm liability business assumed from 1st Auto

With respect to 1st Auto, the contract also includes business classified by the company as private passenger and commercial automobile liability business

First Layer:

- Retention:
- A. Property
\$300,000 ultimate net loss any one risk, each loss
 - B. Casualty
\$300,000 ultimate net loss each loss occurrence
 - C. Combined property, casualty, and net umbrella

\$300,000 loss liability for combined coverages each loss occurrence. For losses involving coverages of A and B, recoveries made under these coverages will inure to the benefit of the reinsurance provided under C

- Coverage:
- A. Property
700,000 excess of \$300,000 ultimate net loss any one risk, each loss. Reinsurance limit \$2,100,000 any one loss occurrence
 - B. Casualty
\$700,000 excess of \$300,000 ultimate net loss each loss occurrence
 - C. Combined property and casualty
\$300,000 excess of \$300,000 ultimate net loss liability each loss occurrence for combined coverages

Second Layer:

- Retention:
- A. Property
\$1,000,000 ultimate net loss any one risk, each loss
 - B. Casualty
\$1,000,000 ultimate net loss each loss occurrence

- Coverage:
- A. Property
\$1,500,000 excess of \$1,000,000 ultimate net loss any one risk, each loss and \$3,000,000 in all respects all risks involved in any one occurrence. Reinsurance limit \$6,000,000 in all during the term of the contract.
 - B. Casualty
\$1,000,000 excess of \$1,000,000 ultimate net loss each loss occurrence and \$3,000,000 in all during the term of the contract.

Effective date: January 1, 2019 to January 1, 2020

Termination: The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.

2. Type: Umbrella Liability Quota Share Reinsurance

Reinsurers:	AXIS Reinsurance Company	8.33%
	Hannover Rück SE	8.34
	QBE Reinsurance Corporation	12.50
	Renaissance Reinsurance U.S., Inc.	30.00
	SCOR Reinsurance Company	8.33
	The Toa Reinsurance Company of America	20.00
	XL Reinsurance America	<u>12.50</u>
	Total	<u>100.00%</u>

Reinsured:	Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company																			
Scope:	Business classified by WRC as personal and commercial umbrella liability as written on a direct basis by 1st Auto or assumed by WRC																			
Retention:	30% of the first \$1,000,000 of net liability per policy, per occurrence																			
Coverage:	Part 1 70% of the first \$1,000,000 of net liability per policy, per occurrence																			
	Part 2 100% of \$4,000,000 excess of \$1,000,000 net liability per policy, per occurrence																			
Commissions:	33.0% of ceding premium																			
Effective date:	January 1, 2019 to January 1, 2020																			
Termination:	The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.																			
3. Type:	Property Per Risk Reinsurance																			
Reinsurers:	<table border="0"> <tr><td>AXIS Reinsurance Company</td><td>8.33%</td></tr> <tr><td>Hannover Rück SE</td><td>8.34</td></tr> <tr><td>Lloyd's — 2007 NVA</td><td>4.17</td></tr> <tr><td>Lloyd's — 5886 WBC</td><td>8.33</td></tr> <tr><td>Renaissance Reinsurance U.S., Inc.</td><td>30.00</td></tr> <tr><td>SCOR Reinsurance Company</td><td>8.33</td></tr> <tr><td>The Toa Reinsurance Company of America</td><td>20.00</td></tr> <tr><td>XL Reinsurance America</td><td><u>12.50</u></td></tr> <tr><td>Total</td><td><u>100.00%</u></td></tr> </table>	AXIS Reinsurance Company	8.33%	Hannover Rück SE	8.34	Lloyd's — 2007 NVA	4.17	Lloyd's — 5886 WBC	8.33	Renaissance Reinsurance U.S., Inc.	30.00	SCOR Reinsurance Company	8.33	The Toa Reinsurance Company of America	20.00	XL Reinsurance America	<u>12.50</u>	Total	<u>100.00%</u>	
AXIS Reinsurance Company	8.33%																			
Hannover Rück SE	8.34																			
Lloyd's — 2007 NVA	4.17																			
Lloyd's — 5886 WBC	8.33																			
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SCOR Reinsurance Company	8.33																			
The Toa Reinsurance Company of America	20.00																			
XL Reinsurance America	<u>12.50</u>																			
Total	<u>100.00%</u>																			
Reinsured:	Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company																			
Scope:	Business classified by WRC as property business, but not limited to fire and allied lines, the property portions of homeowners, farmowners, and commercial business, including earthquake, assumed by WRC under Class B — Pro Rata and/or Class C — Excess Per Risk property reinsurance contracts issued to companies reinsured by WRC																			
Retention:	2,500,000 ultimate net loss any one risk, each loss																			
Coverage:	\$7,500,000 any one risk, each loss excess of \$2,500,000 any one risk, each loss. Reinsurance limit \$7,500,000 losses raising out of any one loss occurrence or \$22,500,000 all losses during the term of the contract																			
Effective date:	January 1, 2019 to January 1, 2020																			

Termination:	The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.																	
4. Type:	Excess Casualty Clash Reinsurance																	
Reinsurers:	<table border="0"> <tr> <td>AXIS Reinsurance Company</td> <td style="text-align: right;">8.33%</td> </tr> <tr> <td>Hannover Rück SE</td> <td style="text-align: right;">8.34</td> </tr> <tr> <td>Lloyd's — 0435 FDY</td> <td style="text-align: right;">25.00</td> </tr> <tr> <td>Lloyd's — 0609 AUW</td> <td style="text-align: right;">33.34</td> </tr> <tr> <td>Lloyd's — 4444 CNP</td> <td style="text-align: right;">16.66</td> </tr> <tr> <td>SCOR Reinsurance Company</td> <td style="text-align: right;"><u>8.33</u></td> </tr> <tr> <td colspan="2"> </td> </tr> <tr> <td>Total</td> <td style="text-align: right;"><u>100.00%</u></td> </tr> </table>	AXIS Reinsurance Company	8.33%	Hannover Rück SE	8.34	Lloyd's — 0435 FDY	25.00	Lloyd's — 0609 AUW	33.34	Lloyd's — 4444 CNP	16.66	SCOR Reinsurance Company	<u>8.33</u>			Total	<u>100.00%</u>	
AXIS Reinsurance Company	8.33%																	
Hannover Rück SE	8.34																	
Lloyd's — 0435 FDY	25.00																	
Lloyd's — 0609 AUW	33.34																	
Lloyd's — 4444 CNP	16.66																	
SCOR Reinsurance Company	<u>8.33</u>																	
Total	<u>100.00%</u>																	
Reinsured:	Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company																	
Scope:	<p>Business classified by WRC as homeowners, farmowners, and commercial business, assumed by WRC under Class A — Casualty reinsurance contracts and personal and farm liability business assumed from 1st Auto</p> <p>With respect to 1st Auto, the contract also includes business classified by 1st Auto as private passenger and commercial automobile liability business.</p>																	
Retention:	\$2,000,000 ultimate net loss each occurrence																	
Coverage:	\$5,000,000 excess of \$2,000,000 ultimate net loss each occurrence. Reinsurance limit \$10,000,000 in all during the term of the contract.																	
Effective date:	January 1, 2019 to January 1, 2020																	
Termination:	The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.																	
5. Type:	Excess Catastrophe Reinsurance																	

Reinsurers:	<u>Reinsurer</u>	<u>First Layer</u>	<u>Second Layer</u>	<u>Third Layer</u>
	Axis Reinsurance Company	8.33%	8.33%	8.33%
	Hannover Re (Bermuda) Ltd.	2.00	4.00	4.00
	Hannover Rück SE	8.34	8.34	8.34
	Houston Casualty Company	0.00	0.00	5.75
	Lansforsakringar Sak Forsakringsaktiebolag	0.00	2.00	2.00
	Lloyd's Underwriters	41.00	40.00	31.75
	Munich Reinsurance America, Inc.	10.00	10.00	10.00
	R+V Versicherung AG	20.00	13.00	12.50
	Renaissance Reinsurance U.S. Inc.	2.00	2.00	3.00
	SCOR Reinsurance Company	8.33	8.33	8.33
	Sirius International Insurance Corporation	<u>0.00</u>	<u>4.00</u>	<u>6.00</u>
	Total	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

Reinsured: Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company

Scope: Business classified by WRC as section I of homeowners and farmowners, fire and allied lines, and commercial business, including earthquake, issued to companies reinsured by WRC

The agreement also includes property business classified by 1st Auto and assumed by WRC.

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Retention	\$ 3,000,000	\$10,000,000	\$ 20,000,000
Reinsurer's Limit Per Occurrence	7,000,000	10,000,000	60,000,000
Reinsurer's Annual Limit	21,000,000	20,000,000	120,000,000

Effective date: January 1, 2019 to January 1, 2020

Termination: The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.

6. Type: Aggregate Catastrophe Excess of Loss Reinsurance
- Reinsurers:
- | | |
|--|----------------|
| Axis Reinsurance Company | 8.33% |
| Hannover Re (Bermuda) Ltd. | 8.00 |
| Hannover Rück SE | 8.34 |
| Lansforsakringar Sak Forsakringsaktiebolag | 1.00 |
| Lloyd's Underwriters | 28.75 |
| Munich Reinsurance America, Inc. | 12.50 |
| R+V Versicherung AG | 19.75 |
| Renaissance Reinsurance U.S. Inc. | 5.00 |
| SCOR Reinsurance Company | <u>8.33</u> |
| Total | <u>100.00%</u> |
- Reinsured: Wisconsin Reinsurance Corporation and 1st Auto & Casualty Insurance Company
- Scope: Business classified by WRC as section I of homeowners and farmowners, fire and allied lines, and commercial business, including earthquake, issued to companies reinsured by WRC
- The agreement also includes property business classified by 1st Auto and assumed by WRC.
- Retention: \$7,000,000 aggregate ultimate net loss for the term of contract. Losses arising out of loss occurrences may not contribute to the ultimate net loss unless the company's total losses arising out of the loss occurrence exceed \$750,000.
- Coverage: \$13,000,000 excess \$7,000,000 aggregate ultimate net loss for the term of contract.
- Effective date: January 1, 2019 to January 1, 2020
- Termination: The company may terminate or reduce a reinsurer's percentage share at any time by giving 30 days' written notice to the reinsurer in the event that certain named circumstances occur.
7. Type: Equipment Breakdown 100% Quota Share Reinsurance
- Reinsurers: Factory Mutual Insurance Company
- Reinsured: 1st Auto & Casualty Insurance Company
- Scope: Equipment breakdown endorsement to farmowner's and homeowner's policies or equipment breakdown coverage sections within farmowner's and homeowner's policies, other policies agreed in writing between 1st Auto and the reinsurer, and any equipment breakdown insurance coverage wordings that have prior written approval of the reinsurer
- Retention: 0%

Coverage: 100% of 1st Auto's net retained liability and pro rata share of loss adjustment expense. Without prior written agreement of the reinsurer, farmowners business cessions should not exceed \$10,000,000 on any one risk, and homeowners business cessions should not exceed \$100,000 on any one risk.

Commissions: 35% of ceding premium

Effective date: January 1, 2015

Termination: Maybe terminated on April 1, July 1, October 1, or January 1, in any year by either party giving the other party 90 days' notice by certified letter.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2018, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination." Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation.

1st Auto & Casualty Insurance Company
Assets
As of December 31, 2018

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$16,759,430	\$	\$16,759,430
Stocks:			
Common stocks	2,362,795		2,362,795
Cash, cash equivalents, and short-term investments	1,154		1,154
Investment income due and accrued	140,477		140,477
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	308,107	6,701	301,406
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	2,257,587		2,257,587
Reinsurance:			
Amounts recoverable from reinsurers	1,193,703		1,193,703
Current federal and foreign income tax recoverable and interest thereon	323,403		323,403
Net deferred tax asset	90,548		90,548
Write-ins for other than invested assets:			
Prepaid Expenses	76,238	76,238	
State Income Tax Receivable	<u>68,592</u>	<u> </u>	<u>68,592</u>
Total Assets	<u>\$23,582,034</u>	<u>\$82,939</u>	<u>\$23,499,095</u>

1st Auto & Casualty Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2018

Losses		\$ 2,988,316
Loss adjustment expenses		1,763,457
Commissions payable, contingent commissions, and other similar charges		444,037
Other expenses (excluding taxes, licenses, and fees)		225,262
Taxes, licenses, and fees (excluding federal and foreign income taxes)		49,301
Unearned premiums		7,012,693
Advance premium		573,132
Ceded reinsurance premiums payable (net of ceding commissions)		126,055
Remittances and items not allocated		1,743
Payable to parent, subsidiaries, and affiliates		<u>600,774</u>
 Total Liabilities		 13,784,770
 Common capital stock	 \$5,000,000	
Unassigned funds (surplus)	<u>4,714,325</u>	
 Surplus as Regards Policyholders		 <u>9,714,325</u>
 Total Liabilities and Surplus		 <u>\$23,499,095</u>

1st Auto & Casualty Insurance Company
Summary of Operations
For the Year 2018

Underwriting Income

Premiums earned		\$23,424,059
Deductions:		
Losses incurred	\$14,493,647	
Loss adjustment expenses incurred	2,868,208	
Other underwriting expenses incurred	<u>8,163,540</u>	
Total underwriting deductions		<u>25,525,395</u>
Net underwriting gain (loss)		(2,101,336)

Investment Income

Net investment income earned	379,475	
Net realized capital gains (losses)	<u>(3)</u>	
Net investment gain (loss)		379,472

Other Income

Finance and service charges not included in premiums		<u>294,881</u>
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		(1,426,983)
Federal and foreign income taxes incurred		<u>(323,070)</u>
Net Income		<u><u>\$ (1,103,913)</u></u>

1st Auto & Casualty Insurance Company
Cash Flow
For the Year 2018

Premiums collected net of reinsurance		\$24,402,594
Net investment income		535,362
Miscellaneous income		<u>294,881</u>
Total		25,232,837
Benefit- and loss-related payments	\$17,634,015	
Commissions, expenses paid, and aggregate write-ins for deductions	10,946,294	
Federal and foreign income taxes paid (recovered)	<u>(397,218)</u>	
Total deductions		<u>28,183,091</u>
Net cash from operations		(2,950,254)
Proceeds from investments sold, matured, or repaid:		
Bonds	\$4,184,755	
Stocks	527	
Miscellaneous proceeds	<u>1,928</u>	
Total investment proceeds		4,187,210
Cost of investments acquired (long-term only):		
Bonds	2,456,108	
Stocks	<u>500</u>	
Total investments acquired		<u>2,456,608</u>
Net cash from investments		1,730,602
Reconciliation:		
Net Change in Cash, Cash Equivalents, and Short-Term Investments		(1,219,652)
Cash, cash equivalents, and short-term investments:		
Beginning of year		<u>1,220,806</u>
End of Year		<u>\$ 1,154</u>

**1st Auto & Casualty Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2018**

Assets		\$23,499,095
Less liabilities		<u>13,784,770</u>
Adjusted surplus		9,714,325
Annual premium:		
Lines other than accident and health	\$24,237,910	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>4,847,582</u>
Compulsory Surplus Excess (Deficit)		<u>\$ 4,866,743</u>
Adjusted surplus (from above)		\$ 9,714,325
Security surplus (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million, with a minimum factor of 110%)		<u>6,786,615</u>
Security Surplus Excess (Deficit)		<u>\$ 2,927,710</u>

1st Auto & Casualty Insurance Company
Analysis of Surplus
For the Four-Year Period Ending December 31, 2018

The following schedule details items affecting surplus during the period under examination as reported by the company in its filed annual statements:

	2018	2017	2016	2015
Surplus, beginning of year				\$11,438,219
Net income	\$10,955,010	\$11,227,733	\$11,900,038	533,025
Change in net unrealized capital gains/losses	(1,103,913)	(238,004)	(884,647)	
Change in net deferred income tax	(103,143)	220,255	140,395	(28,894)
Change in nonadmitted assets	405	(237,965)	3,386	28,931
	<u>(34,034)</u>	<u>(17,009)</u>	<u>68,561</u>	<u>(71,243)</u>
Surplus, End of Year	<u>\$ 9,714,325</u>	<u>\$10,955,010</u>	<u>\$11,227,733</u>	<u>\$11,900,038</u>

1st Auto & Casualty Insurance Company
Insurance Regulatory Information System
For the Four-Year Period Ending December 31, 2018

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

Ratio	2018	2017	2016	2015
#1 Gross Premium to Surplus	272%	224%	219%	196%
#2 Net Premium to Surplus	250	205	201	177
#3 Change in Net Premiums Written	8	-1	7	1
#4 Surplus Aid to Surplus	1	1	1	1
#5 Two-Year Overall Operating Ratio	105*	106*	103*	101*
#6 Investment Yield	1.8*	1.9*	2.0*	2.2*
#7 Gross Change in Surplus	-11*	-2	-6	4
#8 Change in Adjusted Surplus	-11*	-2	-6	4
#9 Liabilities to Liquid Assets	60	55	60	56
#10 Agents' Balances to Surplus	3	2	2	2
#11 One-Year Reserve Development to Surplus	4	-3	-2	0
#12 Two-Year Reserve Development to Surplus	-4	-4	1	-3
#13 Estimated Current Reserve Deficiency to Surplus	41*	26*	3	8

Ratio No. 5 measures the company's profitability over the previous two-year period. The unusual results of each year during the examination period were due to a combination of an increased expense ratio and loss ratio and decreased investment yield.

Ratio No. 6 measures the percentage of annual income on the company's investment portfolio. The company's unusual results for each year during the examination period were primarily due to the low interest rate environment.

Ratios No. 7 and No. 8 each provide a measure of improvement or deterioration in the insurer's financial condition during the year. The company's unusual results in 2018 were primarily due to the implementation costs of a policy administration system and the industry-wide elevated loss ratio of the personal automobile line of business.

Ratio No.13 provides an estimate on the adequacy of current reserves. The unusual results in 2017 and 2018 were primarily due to the reduction in the company's retention and participation share under an Aggregate Excess reinsurance arrangement with WRC in 2017 and 2018.

Growth of 1st Auto & Casualty Insurance Company

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2018	\$23,499,095	\$13,784,770	\$ 9,714,325	\$(1,103,913)
2017	25,480,981	14,525,971	10,955,010	(238,004)
2016	28,964,262	17,736,529	11,227,733	(884,647)
2015	28,608,866	16,708,828	11,900,038	533,025
2014	29,977,405	18,539,186	11,438,219	(37,351)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2018	\$26,470,253	\$24,237,910	\$23,424,059	74.1%	32.5%	106.6%
2017	24,575,505	22,442,817	22,503,501	73.8	33.0	106.8
2016	24,568,424	22,574,922	22,172,928	77.1	32.2	109.3
2015	23,368,513	21,085,899	21,071,188	66.6	33.6	100.2
2014	23,693,354	20,889,825	20,747,105	74.9	33.1	108.0

During the period under examination, the company's admitted assets decreased by 21.6% and liabilities decreased by 25.6%, resulting in a 15.1% decrease to surplus. The

company had net income in 2015 and net losses in the next three years due to the implementation of a policy administration system and the industry-wide increase in frequency and severity of the losses in the personal automobile line of business, along with the decreasing returns on fixed-income investments.

Gross premiums, net premiums, and premiums earned increased during the examination period. The loss and LAE ratio, expense ratio, and combined ratio fluctuated during the examination period primarily for reasons noted in the preceding paragraph.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2018, is accepted.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were four specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Disaster Recovery Plan—It is again recommended that the company periodically test the user department's portion of its disaster recovery plan.

Action—Compliance.

2. Custodial Agreement—It is recommended that the company amend its custodial agreement to include specific language prescribed in the NAIC *Financial Condition Examiners Handbook*.

Action—Compliance.

3. Executive Compensation—It is recommended that the company include all gross direct and indirect compensation paid or accrued during the year on its Report of Executive Compensation in accordance with ss. 601.42 and 611.62 (4), Wis. Stat.

Action—Compliance.

4. Holding Company Filing—It is recommended that the company include sufficient detail in their Form B filings to comply with ss. Ins 40.03 and 40.15, Wis. Adm. Code.

Action—Compliance.

Summary of Current Examination Results

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

Disclosure of Conflict of Interest

The examination's review of compliance with disclosure of conflict of interest requirements for its officers, directors, and responsible employees revealed that, in 2018, the company began to use a conflict of interest questionnaire that did not meet the standards set forth by the Wisconsin Office of the Commissioner of Insurance conflicts of interest directive, nor was it designed to evaluate compliance with s. Ins. 611.60, Wis. Stat., as it relates to a material transaction between the company and its directors and officers or between the company and another person in which any of its directors or officers has a material interest. The conflict of interest questionnaire did not address whether there had been a change in the individual's material interest or affiliation, which was in conflict or was likely to conflict with the official duties of such person. It is recommended that the company enhance its procedure for disclosing to its board of directors any material interest or affiliation on the part of any of its officers, directors, and responsible employees which conflicts or is likely to conflict with the official duties of such person, in accordance with the Wisconsin Office of the Commissioner of Insurance directive dated March 9, 1989.

Compliance with Underwriting Guidelines

The examination's review of compliance with underwriting guidelines revealed some exceptions in the approval process. There were instances when policy applications did not meet the company's underwriting criteria but were erroneously accepted by the automated system procedures. The frequency and design of the underwriting audit done by the company were not sufficient to detect these deficiencies. It is recommended that the company implement adequate policies and procedures to ensure compliance with its underwriting guidelines. Such policies might include effective underwriting audits, system controls, and other internal control procedures.

VIII. CONCLUSION

1st Auto & Casualty Insurance Company is a Wisconsin-domiciled property and casualty insurer. The company began writing business on September 25, 1991, as an operating insurance subsidiary of Wisconsin Reinsurance Corporation. The company was established with \$3 million of capital in 1991 and received \$2 million of additional capital contributed by WRC in 1997. The company made a change to its articles of incorporation during 2010 to increase the authorized number of shares from 10,000 shares to 10,000,000 shares and, after a 1:10,000 stock split, the number of shares issued and outstanding increased from 500 to 5,000,000 and have remained the same since December 31, 2010.

During the period under examination, the company's admitted assets decreased by 21.6% and liabilities decreased by 25.6%, resulting in a 15.1% decrease to surplus. The company had net income in 2015 and net losses in the next three years due to the implementation of a policy administration system and the industry-wide increase in frequency and severity of the losses in the personal automobile line of business, along with the decreasing returns on fixed-income investments.

Gross premiums, net premiums, and premiums earned increased during the examination period. The loss and LAE ratio, expense ratio, and combined ratio fluctuated during the examination period primarily for reasons noted in the preceding paragraph.

The examination resulted in no adjustments to surplus or reclassifications of account balances. The examination determined that the company was in compliance with all four recommendations made by the previous examination. The current examination resulted in two recommendations.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 29 - Disclosure of Conflict of Interest—It is recommended that the company enhance its procedure for disclosing to its board of directors any material interest or affiliation on the part of any of its officers, directors, and responsible employees which conflicts or is likely to conflict with the official duties of such person, in accordance with the Wisconsin Office of the Commissioner of Insurance directive dated March 9, 1989.
2. Page 29 - Compliance with Underwriting Guidelines—It is recommended that the company implement adequate policies and procedures to ensure compliance with its underwriting guidelines. Such policies might include effective underwriting audits, system controls, and other internal control procedures.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Joshua Daggett	Insurance Financial Examiner
James Lindell	Insurance Financial Examiner and ACL Specialist
David Jensen, CFE	IT Specialist
Jerry DeArmond, CFE	Reserve Specialist

Respectfully submitted,



Xiaozhou Ye
Examiner-in-Charge