

**Government of the District of Columbia**  
**Department of Insurance, Securities and Banking**



**Thomas E. Hampton**  
**Commissioner**

**BEFORE THE**  
**INSURANCE COMMISSIONER OF**  
**THE DISTRICT OF COLUMBIA**

Re: Report on Examination - **Pinnacle Risk Retention Group, Inc.**, as of December 31, 2007

**ORDER**

An Examination of **Pinnacle Risk Retention Group, Inc.**, as of December 31, 2007 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

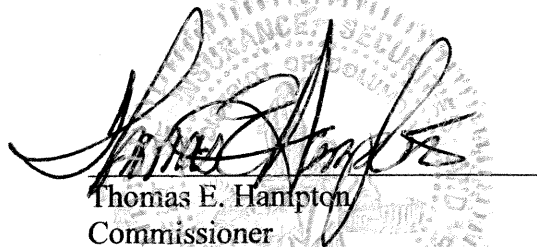
It is hereby ordered on this 23rd day of July, 2009, that the attached financial condition examination report be adopted and filed as an official record of this Department.

In addition, it is hereby ordered that the Company comply with the recommendations in the attached financial condition examination report.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.



Thomas E. Hampton  
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

PINNACLE RISK RETENTION GROUP, INC.

AS OF

DECEMBER 31, 2007

NAIC NUMBER 11858

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Washington, D.C.  
March 30, 2009

Honorable Thomas E. Hampton  
Commissioner  
Department of Insurance, Securities and Banking  
Government of the District of Columbia  
810 First Street, NE, Suite 701  
Washington, D.C. 20002

Dear Sir:

In accordance with Section 31-3931.14 of the District of Columbia Official Code, we have examined the financial condition and activities of

**Pinnacle Risk Retention Group, Inc.**

hereinafter referred to as the “Company” or “Pinnacle”, at the office of its program manager, located at 11800 Sunset Hills Road, Vienna, Virginia 20190.

**SCOPE OF EXAMINATION**

This full-scope examination, covering the period January 5, 2004 through December 31, 2007, including any material transactions and/or events noted occurring subsequent to December 31, 2007, was conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

Our examination was conducted in accordance with examination procedures established by the Department and procedures recommended by the National Association of Insurance Commissioners (“NAIC”) and, accordingly, included such tests of the accounting records and such other examination procedures as we considered necessary in the circumstances.

Our examination included a review of the Company’s business policies and practices, management and corporate matters, a verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Company has been audited annually by an independent public accounting firm. The firm expressed an unqualified opinion on the Company’s financial statements for all years under examination. We placed substantial reliance on the audited financial statements for calendar years 2004 through 2006, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2007. We obtained

and reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2007. We placed reliance on the work of the auditor and directed our efforts, to the extent practical, to those areas not covered by the independent auditors.

### **STATUS OF PRIOR EXAMINATION FINDINGS**

This is the first examination of the Company.

### **HISTORY**

#### **General:**

The Company was incorporated as an association captive insurer under the captive laws of the District of Columbia and obtained a certificate of authority on January 5, 2004, operating as a risk retention group.

The Company was organized to provide excess of loss insurance coverage on the contractual liability risks of administrator obligors (“AOs”) which are in the business of selling and/or administering vehicle service contracts (“VSCs”). Auto4Life, LLC (“Auto4Life”) and Elite Administration, LLC (“Elite”), both AOs, are the Company’s sole policyholders, and own 90 percent and 10 percent of the Company’s common stock, respectively.

#### **Ownership:**

The Company was formed as a stock insurance company. As a risk retention group, it is wholly owned by its policyholders. The Company is authorized to issue 10,000,000 shares of common stock, with a par value of \$1 per share. As of December 31, 2007, 250,000 shares of common stock were issued and outstanding to the Company’s two owners/policyholders, Auto4Life and Elite, which hold 225,000 and 25,000 shares respectively.

#### **Dividends and Distributions:**

The Company did not declare or pay any dividends or other distributions during the period under examination.

### **MANAGEMENT**

The following persons were serving as the Company’s directors as of December 31, 2007:

<u>Name and State of Residence</u>	<u>Principal Occupation</u>
Joseph T. Prendergast Virginia	President Auto4Life, LLC
W. Scott Prendergast Virginia	President Apex Custom Homes
Linzie M. Zinone Virginia	Manager Auto4Life, LLC

The following persons were serving as the Company's officers as of December 31, 2007:

<u>Name</u>	<u>Title</u>
Joseph T. Prendergast	President/Treasurer
Linzie M. Zinone	Vice President/Secretary
Heather Ross	Assistant Secretary

Committees:

As of December 31, 2007, the Company's board of directors had not established any committees.

Conflicts of Interest:

Our review of the conflict of interest statements signed by the Company's directors and officers for the period under examination disclosed no conflicts that would adversely affect the Company. Furthermore, no additional conflicts of interest were identified during our examination.

Corporate Records:

We reviewed the minutes of the meetings of the shareholders and board of directors for the period under examination. Based on our review, it appears that the minutes documented the board's review and approval of the Company's significant transactions and events.

**CAPTIVE MANAGER**

Risk Services, LLC provides captive management services, including accounting, records retention and regulatory services, to the Company.

## **AFFILIATED PARTIES AND TRANSACTIONS**

As indicated in the “History” section of this report, the Company had two owners/policyholders as of December 31, 2007. Auto4Life is the majority stockholder and owns 90 percent of the Company’s common stock and Elite owns 10 percent of the Company’s common stock.

During the period under examination, the Company had an “Administration Agreement” in place with Auto4Life. Based on the terms of the agreement, Auto4Life provides administrative services, including underwriting, claims handling, and premium collection to Pinnacle. The terms of the agreement do not provide for any compensation to be paid by the Company to Auto4Life for these services, but provides for a service fee of \$2 per contract sold by Auto4Life to be paid by Auto4Life to the Company. Amounts paid by Auto4Life to the Company totaled \$56,598 and \$27,754 in 2007 and 2006, respectively. The agreement is automatically renewed annually for one-year periods.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company has no employees and does not maintain fidelity bond coverage as of December 31, 2007. Under the terms of the Company’s Administration Agreement with Auto4Life, Auto4Life is required to maintain fidelity bond or employee dishonesty coverage, as well as errors and omissions insurance. However, the Administration Agreement does not specify a minimum amount for the fidelity bond or errors and omissions insurance. Auto4Life has not maintained these coverages during the period under examination as required by the Administration Agreement with Pinnacle. See the “Comments and Recommendations” section of this Report, under the caption “Fidelity Bond and Other Insurance,” for further comments regarding this condition.

## **PENSION AND INSURANCE PLANS**

The Company has no employees and therefore has no employee pension or insurance plans.

## **STATUTORY DEPOSITS**

As of December 31, 2007, the Company did not have a statutory deposit in the District of Columbia and is not required to maintain one. In addition, the Company was not required to maintain statutory deposits with any other jurisdictions.

## **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2007, the Company was licensed in the District of Columbia, registered as a risk retention group in 29 states, and was writing business in 12 states. During 2007, Pinnacle wrote premiums totaling \$707,475. \$446,050 (63 percent) of the Company's written premium in 2007 was in Virginia, \$82,425 (12 percent) in Pennsylvania, \$51,950 (7 percent) in New Jersey, \$42,550 (6 percent) in Maryland, \$33,050 (5 percent) in Iowa, \$27,875 (4 percent) in Mississippi, and 1 percent or less in Alabama, Arizona, Colorado, Illinois, Indiana, and Nevada.

Since inception, the Company has had no employees. Its owner/policyholder, Auto4Life, pursuant to the terms of the aforementioned Administration Agreement, acts as the Company's program manager and manages the Company's daily business activities, including business consultation, premium collection, claims handling, and other functions.

The Company provides aggregate excess of loss insurance coverage to automobile service contract providers, also known as AOs, which are in the business of selling and/or administering automobile extended service contracts. Auto4Life, an AO, sells and administers new and used car extended service contracts to a network of automobile dealers who issue them to consumers under Auto4Life's agreements with the dealers. Under these agreements, these contracts must be provided by the dealers to all eligible buyers/lessees of new cars but are optional for used car sales/leases.

The cost to the dealers of the VSCs varies based on the type of vehicle and whether the vehicle is new or used. The cost of the contracts is remitted to the AO monthly. The AO then administers the contracts and is liable for payments under the contracts.

Under its "Contractual Liability Aggregate Excess of Loss Policy" with the Company, Auto4Life pays a premium to the Company for each VSC sold. The premium has been fixed at \$25 since inception. These are the amounts recorded as direct premiums written on the Company's Schedule "T" in its Annual and Quarterly Statement filings. In addition Auto4Life pays an administrative fee of \$2 per VSC sold. These amounts are recorded as finance and service charges and are not included in premiums on the Company's Statement of Income in its Annual and Quarterly Statement filings.

The Company's aggregate excess of loss policies insure Auto4Life ("insured") for contractual liabilities related to the insured's obligations under its automobile extended service contracts. The Company's policies do not directly insure the VSCs or obligations to the purchasers of the VSCs but provide coverage to the insured for amounts in excess of the insured's deductible. During the examination, we noted that the standard VSC form issued by Auto4Life indicates the service contract holder has the right to bring a claim directly against Pinnacle in the event Auto4Life fails to fulfill its obligations under the contract. See the "Comments and Recommendations" section of this Report, under the caption "Company Financial Responsibility," for further comments regarding this condition.



The deductible for each policy term is equal to the amount of the underlying loss reserve fund (LRF) required to be established and maintained by each insured. Under terms of the Company's policies with the insured, the insured is required to establish and maintain a LRF consisting of a portion of the insured's revenue on each service contract sold. In addition, accrued investment income becomes part of the LRF. Claim payments to the purchasers of the automobile extended service contracts are made directly by the insured and are deducted from the LRF. The contract revenue amount required to be placed in the LRF has been fixed since inception at \$65 for each VSC regardless of type of vehicle, mileage, new or used. The assets backing the LRF are held pursuant to an "Insurance Treaty Trust Account Agreement" under which the Company is beneficiary and Auto4Life is grantor. The LRFs are held in a number of accounts by Auto4Life. During the examination, we noted some discrepancies in the Company's operations compared to the provisions of the aggregate excess of loss insurance policies. See the "Comments and Recommendations" section of this Report, under the caption "Contractual Liability Aggregate Excess of Loss Policy," for further comments regarding these conditions.

The Company's financial responsibility triggers only upon satisfaction by the insured of the deductible each policy term, which is defined as the amount of the loss reserves set aside for VSCs sold each policy term plus investment income earned thereon. Once losses incurred by the insured equal the deductible, the Company is then responsible for any further claims. The deductible is calculated based on the amount that is required to be in the LRF, regardless of the amount actually maintained in the LRF. If the LRF is not maintained at the required funding, the deductible does not change, and is still calculated at the amount required to be maintained in the LRF. See Note 1 in the "Notes to Financial Statements" section of this report for additional comments regarding the LRF.

As of December 31, 2007, all states in which the Company does business have accepted the standard aggregate excess of loss insurance policy issued by the Company and filed by the Administrator Obligor and no states have required a "first dollar" policy.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

This examination was a financial examination, and did not include market conduct procedures. An examination of the market conduct affairs of the Company has never been conducted. A market conduct examination would include detailed reviews of the Company's sales and advertising, agent licensing, timeliness of claims processing, and complaint handling practices and procedures.

The scope of our examination did not include market conduct procedures, including, but not limited to, market conduct procedures in the following areas:

- Policy Forms
- Fair Underwriting Practices
- Advertising and Sales Materials
- Treatment of Policyholders:
  - Claims Processing (Timeliness)
  - Complaints

## **REINSURANCE**

Effective December 31, 2003, the Company entered into an aggregate excess of loss reinsurance agreement with Imagine Insurance Company Limited Barbados (“Imagine”) on a one year term basis. The expiration was extended each year through December 31, 2008. The Company’s retention is equal to 100 percent of its gross written premium, plus 120 percent of the LRF held by the AO. The reinsurer’s limit of liability is \$1,000,000 on an aggregate basis over the term of the agreement. The Company paid a flat fee of \$115,000 annually to the reinsurer. In relation to the agreement, Auto4Life provided a \$1,000,000 letter of credit in favor of Imagine.

The Company has never made a claim or had a recovery under this agreement, and the Company has not taken reinsurance credit for this agreement in its Annual Statements or its audited financial statements. In addition, the agreement was not recognized as reinsurance in the Company’s independent actuary’s analysis of loss reserves. On January 28, 2009 the Department approved the Company’s request to commute the reinsurance agreement effective December 31, 2008, subject to receipt of a \$1,000,000 letter of credit or \$1,000,000 deposit in favor of the D.C. Commissioner.

## **ACCOUNTS AND RECORDS**

The primary locations of the Company’s accounting and corporate records are at the office of its captive manager, Risk Services, LLC in Berlin, Vermont, and at the offices of its administrator obligor, Auto4Life, in Vienna, Virginia. We performed our examination fieldwork at the office of Auto4Life.

The Company’s general accounting records consisted of an automated general ledger and various subsidiary ledgers. Our examination did not disclose any significant deficiencies with these records. However, although the AO, Auto4Life, is not subject to direct regulation by the Department, the Company and the Department have an understanding that the Company would facilitate annual submission, to the Department, of annual audited financial statements of the AO, Auto4Life. However, the audit for 2007 was not completed on a timely basis. See the “Comments and Recommendations” section of this Report, under the caption “Independent Audit of AO,” for further comments regarding this condition.

## **FINANCIAL STATEMENTS**

The following financial statements, prepared in accordance with accounting practices generally accepted in the United States (“GAAP”) reflect the financial condition of the Company as of December 31, 2007, as determined by this examination:

<b><u>STATEMENT</u></b>	<b><u>PAGE</u></b>
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The accompanying “Notes to Financial Statements” are an integral part of these Financial Statements.

## BALANCE SHEET

### ASSETS

	<i>Assets December 31, 2007</i>
Cash (\$1,819,776), cash equivalents (\$0) and short-term investments (\$0)	<u>\$ 1,819,776</u>
Subtotals, cash and invested assets	\$ 1,819,776
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection	94,475
Net deferred tax asset	157,481
Aggregate write-ins for other than invested assets Accounts receivable	7,558
Total	<u>\$ 2,079,290</u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	<i>December 31, 2007</i>
Losses ( <b>NOTE 1</b> )	\$ 874,089
Loss adjustment expenses ( <b>NOTE 1</b> )	0
Other expenses (excluding taxes, licenses and fees)	59,900
Taxes, licenses and fees (excluding federal and foreign income taxes)	<u>19,841</u>
Total liabilities	\$ 953,830
Common capital stock	250,000
Gross paid in and contributed surplus	1,182,688
Unassigned funds (surplus)	<u>(307,228)</u>
Surplus as regards policyholders	\$ 1,125,460
Total	<u><u>\$ 2,079,290</u></u>

## STATEMENT OF INCOME

	<i>2007</i>
UNDERWRITING INCOME	
Premiums earned	\$ 707,475
DEDUCTIONS	
Losses incurred	\$ 530,606
Loss expenses incurred	0
Other underwriting expenses incurred	<u>270,373</u>
Total underwriting deductions	<u>\$ 800,979</u>
Net underwriting gain (loss)	\$ (93,504)
INVESTMENT INCOME	
Net investment income earned	\$ 55,333
OTHER INCOME	
Finance and service charges not included in premiums	<u>\$ 56,598</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	\$ 18,427
Federal and foreign income taxes incurred	(9,364)
Net income	<u><u>\$ 27,791</u></u>

### **CAPITAL AND SURPLUS ACCOUNT**

Surplus as regards policyholders, December 31, 2003	\$	<u>0</u>
Initial paid in capital	\$	250,000
Surplus adjustments: Paid in		801,907
Net loss, 2004		<u>(232,241)</u>
Net change in surplus as regards policyholders, 2004		819,666
Surplus as regards policyholders, December 31, 2004	\$	<u>819,666</u>
Surplus adjustments: Paid in	\$	80,782
Net loss, 2005		<u>(154,801)</u>
Net change in surplus as regards policyholders, 2005		(74,019)
Surplus as regards policyholders, December 31, 2005	\$	<u>745,647</u>
Surplus adjustments: Paid in	\$	200,000
Net income, 2006		<u>52,022</u>
Net change in surplus as regards policyholders, 2006		252,022
Surplus as regards policyholders, December 31, 2006	\$	<u>997,669</u>
Surplus adjustments: Paid in	\$	100,000
Net income, 2007		<u>27,791</u>
Net change in surplus as regards policyholders, 2007		127,791
Surplus as regards policyholders, December 31, 2007	\$	<u>1,125,460</u>

### **ANALYSIS OF EXAMINATION CHANGES TO SURPLUS**

There were no changes to the Company's surplus as a result of our examination.

### **COMPARATIVE FINANCIAL POSITION OF THE COMPANY**

The comparative annual financial position of the Company for the periods since inception is as follows:

	2007	2006	2005	2004
Assets	\$ 2,079,290	\$ 1,388,618	\$ 867,744	\$ 867,323
Liabilities	953,830	390,949	122,097	47,657
Capital and surplus	1,125,460	997,669	745,647	819,666
Gross written premium	707,475	346,925	95,150	15,900
Net earned premium	707,475	237,675	19,050	(115,000)
Net investment income	55,333	18,089	4,603	5,351
Net income / (loss)	\$ 27,791	\$ 52,022	\$ (154,801)	\$ (232,241)

**Note:** Amounts in the preceding financial statements for the years ended December 31, 2004 through December 31, 2006 were taken from the Company's Annual Statements as filed with the Department. Amounts for the year ended December 31, 2007 are per examination.



## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE 1 – Loss and Loss Adjustment Expense Reserves:**

The Company reported “Losses” and “Loss adjustment expenses” reserves totaling \$874,089 and \$0, respectively. These reserves represent management’s best estimate of the amounts necessary to pay all claims and related expenses that have been incurred but are still unpaid as of December 31, 2007.

As previously indicated in this report, the Company provides aggregate excess of loss insurance coverage to automobile service contract providers (also known as AOs), which are in the business of selling and/or administering automobile extended service contracts. The Company’s aggregate excess of loss policies insure the AOs for contractual liabilities related to the insureds’ obligations under the automobile extended service contracts. The Company’s policies provide coverage to the insureds for amounts in excess of the insured’s deductibles which are equal to the amount of the underlying LRFs that should be set aside each policy term plus the investment income earned thereon. The Company’s financial responsibility triggers only upon exhaustion of the deductible.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expenses reserves as of December 31, 2007, were reviewed as part of our examination. As part of our review, we relied on the Company’s independent actuary, who concluded that the Company’s reserves appeared to be sufficient. In addition, as part of our review of the Company’s reserves, we engaged an independent actuary to review the methods employed, assumptions relied upon, and conclusions reached by the Company’s independent actuary. The independent actuary utilized in our examination concluded that the methodologies and assumptions utilized by the Company’s independent actuary to compute these reserves, and the adequacy of the reserves as of December 31, 2007, were reasonable and adequate.

In addition, the Company reported “Losses incurred” and “Loss expenses incurred” for 2007 totaling \$530,606 and \$0, respectively. Although since inception, the Company has never paid losses or loss adjustment expenses (as all obligations relating to the VSCs insured by the Company have been paid out of the LRFs established and maintained by the insureds of the Company), management has recorded “incurred but not reported” loss reserves for 2007 to recognize the possibility, however remote, that losses had been incurred as of December 31, 2007, but had not yet been reported to the Company by that date. (As of the date of this report, no losses had been reported to the Company for accident years 2007 and prior.)

During our examination, as part of our review of the adequacy of the Company’s reserves, we also reviewed the LRFs established and maintained by the Company’s insureds. As part of this review, we relied on the work of an independent actuary which was performed on behalf of the insureds. The independent actuary concluded that as of December 31, 2007, the insureds’ estimated future contractual liabilities including losses and refunds on the VSCs insured by Pinnacle totaled \$1,357,000. As of December 31, 2007, the LRF had a balance of \$2,254,177 which is in trust for the benefit of Pinnacle. The Company’s independent actuary therefore

concluded that the LRF of \$2,254,117 is adequate to cover the estimated future liabilities with a margin of \$897,177 or 39.8 percent of the LRF. The independent actuary engaged as part of our examination reviewed the methods employed, assumptions relied upon, and conclusions reached by the Company's independent actuary regarding the LRF. The independent actuary utilized in our examination concluded that the methodologies and assumptions utilized to compute the estimate of the ultimate losses to be incurred by the insureds were reasonable and adequate.

During the examination, we performed procedures to verify the existence of the assets totaling \$2,254,177 backing the LRF. These assets, consisting of cash, cash equivalents, and short term U.S. Treasury Notes, are held in various trust accounts for the benefit of Pinnacle. As part of these procedures, we obtained the audited financial statements of Auto4Life. However, these statements were not available on a timely basis. See the "Comments and Recommendations" section of this report, under the caption "Independent Audit of AO" for further comments regarding this condition.

We noted that in 2008, Auto4Life utilized \$1,200,000 of the LRF assets toward the purchase of a building, which remained as an asset of the LRF. Although the LRF appears to contain sufficient additional liquid assets as of December 31, 2008 to cover the estimated future liabilities of the LRF as of that date, it appears, because of the addition of the building to the LRF assets, Auto4Life is not fulfilling certain requirements in the Administration Agreement related to the level of liquid assets held in the LRF. See the "Comments and Recommendations" section of this report, under the caption "Contractual Liability Aggregate Excess of Loss Policy," for further comments regarding this condition.

## **COMMENTS AND RECOMMENDATIONS**

### **Fidelity Bond and Other Insurance:**

Under the terms of the Company's Administration Agreement with Auto4Life, Auto4Life is required to maintain fidelity bond or employee dishonesty coverage, as well as errors and omissions insurance. The agreement does not specify a minimum limit on these coverages. However, Auto4Life does not maintain either of these coverages as required by the administration agreement with Pinnacle. **We recommend that the Company modify the Administration Agreement with Auto4Life to specify an amount of coverage of fidelity bond and E&O insurance that Auto4Life should maintain. The fidelity bond coverage should at least meet the minimum NAIC recommended amount of \$50,000. We also recommend that the Company ensure that Auto4Life maintains the required fidelity bond and E&O insurance coverage at all times in compliance with the administration agreement.**

### **Company Financial Responsibility:**

As previously indicated in the "Territory and Plan of Operation" section of this Report, the Company's aggregate excess of loss policy ("policy") insures policyholders for amounts in excess of policyholders' deductible, which is equal to the amount required to be maintained in the LRF, regardless of the amount actually maintained in the LRF. If the LRF is not maintained at the required funding, the deductible does not change, and is still calculated at the amount required to be maintained in the LRF. Once losses incurred by the insureds equal the deductible, the Company is then responsible for any further claims.

However, during the examination we noted that the standard VSC form issued by Auto4Life indicates the service contract holder has the right to bring a claim directly against Pinnacle in the event Auto4Life fails to fulfill its obligations under the contract. However, as stated above, under terms of the Company's aggregate excess of loss policy, the Company has no responsibility until satisfaction of the deductible by the policyholder. **Accordingly, we recommend the Company obtain written acknowledgement from Auto4Life that they understand that under the terms of the Company's aggregate excess of loss policy, regardless of any direct claims brought directly against Pinnacle by VSC holders, Pinnacle does not have any obligation to pay a claim until satisfaction of the deductible by the policyholder.**

### **Contractual Liability Aggregate Excess of Loss Policy:**

As previously noted in this report, the Company's excess of loss contractual liability insurance policy ("policy") provides insurance for amounts in excess of the deductible. The LRF is established and maintained by the insured in a trust account which the Company is a party to, pursuant to the specific formulas and provisions written in the policy. During our examination, we noted the following:

## 1. Loss Reserve Fund Assets:

The Administration Agreement between the Company and Auto4Life requires that at least 95 percent of the LRF be invested in liquid assets. Based on our examination, the assets in the LRF met this requirement as of December 31, 2007. However, we noted that in 2008, Auto4Life utilized \$1,200,000 of the LRF assets toward the purchase of a building, which remained as an asset of the LRF. Although the LRF appears to contain sufficient additional liquid assets as of December 31, 2008 to cover the estimated future liabilities of the LRF as of that date, because of the addition of the building to the LRF assets, Auto4Life is not in compliance with requirement to maintain 95 percent of the LRF assets as liquid assets. **We recommend the Company ensure Auto4Life maintains compliance at all times with the terms of the Administration Agreement.**

## 2. Loss Reserve Funding:

The insurance policy between the Company and Auto4Life requires the policyholder to maintain a LRF equal to \$65 per VSC sold plus investment income earned thereon. Our examination determined that the amount in the LRF should be \$2,328,777 plus investment income as of December 31, 2007. However, the balance in the LRF is \$2,254,117 as of that date, indicating a deficiency of \$74,660 plus investment income earned for the period under examination.

We also noted some discrepancies between the terms of the insurance policy and the Insurance Treaty Trust Account Agreement (“Trust Agreement”), which governs the trust account in which the LRF assets are held. The policy permits withdrawals from the LRF only for the payment of claims. However, contrary to the policy terms, the Trust Agreement between the parties grants Auto4Life the unqualified right to receive the interest or other income upon the assets included in the trust fund, but is silent as respects the right to withdraw funds only for the payment of claims.

Based on our examination, the \$74,660 LRF shortage noted above, as well as the discrepancies between the policy and the Trust Agreement, have no material financial impact on the Company’s financial position at December 31, 2007. However, to avoid any future potential risks to the Company from these conditions, **we recommend that the Company ensure strict compliance at all times with the terms of the insurance policy between the Company and Auto4Life. In addition, we recommend that the Company amend the Trust Agreement to ensure the terms are consistent with the terms of the insurance policy between the Company and Auto4Life.**

## Independent Audit of AO:

Although the AO, Auto4Life, is not subject to direct regulation by the Department, the Company and the Department have an understanding that the Company would facilitate annual submission, to the Department, of annual audited financial statements of the AO, Auto4Life. The Department

received the audit of the AO for the years ending 2005 and 2006 (although the audited financial statements were flawed in that the balance sheet did not balance). Upon commencement of our examination of the Company during 2008, we were informed that the 2007 audit report of the AO was not yet available but would be forthcoming. During the examination, there were numerous delays in obtaining the audit for the AO, and there was uncertainty regarding what period the audit would cover (through December 31, 2007, or possibly a different period). The December 31, 2007 audit was eventually completed, and was provided to the Department in March 2009. However it was an audit of the balance sheet only, and did not include the income or other statements. **We recommend that the Company ensure the Department is annually provided with properly completed audited financial statements of the AO, prepared on a calendar year basis, and submitted to the Department on a timely basis.**

## **CONCLUSION**

Our examination disclosed that as of December 31, 2007 the Company had:

Admitted Assets	\$ 2,079,290
Liabilities and Reserves	953,830
Common Capital Stock	250,000
Gross paid in and contributed surplus	1,182,688
Unassigned Funds (Surplus)	(307,228)
Total Surplus	1,125,460
Total Liabilities, Capital and Surplus	\$ 2,079,290

Based on our examination, the accompanying balance sheet properly presents the financial position of the Company at December 31, 2007, and the accompanying statement of income properly presents the results of operations for the period then ended.

Chapter 39 (“CAPTIVE INSURANCE COMPANIES”) of Title 31 (“Insurance and Securities”) of the D.C. Official Code specifies the level of capital and surplus required for the Company. We concluded that the Company’s capital and surplus funds exceeded the minimum requirements during the period under examination.

## SIGNATURES

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Christina M. Bonney, Collins Consulting, Inc.  
Terry Corlett, CFE, CIE, FLMI, Collins Consulting, Inc.  
John G. Gantz, Collins Consulting, Inc.

The actuarial portion of this examination was completed by N. Terry Godbold, ACAS, MAAA, FCA, President & Senior Actuary, Godbold, Malpere & Co.

Respectfully submitted,



Pamela C. Woodroffe  
Examiner-In-Charge  
Collins Consulting, Inc.

Under the Supervision of,



Xiangchun (Jessie) Li, CFE  
Supervising Examiner  
District of Columbia, Department of Insurance,  
Securities and Banking

**Government of the District of Columbia**  
**Department of Insurance, Securities and Banking**



**Thomas E. Hampton**  
**Commissioner**

June 26, 2009

Joseph T. Prendergast  
President  
Pinnacle Risk Retention Group, Inc.  
c/o Risk Services, LLC  
2233 Wisconsin Avenue, N.W., Suite 310  
Washington, DC 20007

Dear Mr. Prendergast:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Examination ("Report") of the affairs and financial condition of **Pinnacle Risk Retention Group, Inc.**, as of December 31, 2007.

Please submit, to my attention, a written response calling attention to any errors or omissions in the draft Report. In addition, the Company's response shall include responses to each of the recommendations included in the "Comments and Recommendations" section of this Report. These responses should indicate the Company's agreement or disagreement with each recommendation, as well as a summary of the corrective measures which will be taken by the Company for each recommendation. If the Company disagrees with any of these recommendations, the response shall indicate the reason(s) for the disagreement, as well as an explanation of alternative measures to be taken by the Company to address the condition which lead to the recommendation.

The response must be in writing and shall be furnished to this Department by **July 13, 2009**. In addition to a hard-copy response, please also furnish the response electronically via e-mail to me, in a Microsoft "Word" format, to [sean.o'donnell@dc.gov](mailto:sean.o'donnell@dc.gov).

Sincerely,

P. Sean O'Donnell  
Director of Financial Examination,  
Risk Finance Bureau

Enclosure



# Pinnacle Risk Retention Group, Inc.

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**VIA E-MAIL & U.S. MAIL**

E-mail: [sean.o'donnell@dc.gov](mailto:sean.o'donnell@dc.gov)

July 10, 2009

P. Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau  
Department of Insurance, Securities and Banking  
1400 L Street, N.W., Suite 400  
Washington, D.C. 20005

**Re: Pinnacle Risk Retention Group, Inc. ("Pinnacle")**  
**NAIC Company Code: 11858; NAIC Group Code: 0000; FEIN: 86-1092034**

Dear Mr. O'Donnell:

We are in receipt of the draft Report on Examination of the Company for the period January 5, 2004 through December 31, 2007 forwarded by the Risk Finance Bureau on June 26, 2009. The following responses are submitted with respect to the comments and recommendations contained in that report and duplicated below:

**Fidelity Bond and Other Insurance:**

*Under the terms of the Company's Administration Agreement with Auto4Life, Auto4Life is required to maintain fidelity bond or employee dishonesty coverage, as well as errors and omissions insurance. The agreement does not specify a minimum limit on these coverages. However, Auto4Life does not maintain either of these coverages as required by the administration agreement with Pinnacle. We recommend that the Company modify the Administration Agreement with Auto4Life to specify an amount of coverage of fidelity bond and E&O insurance that Auto4Life should maintain. The fidelity bond coverage should at least meet the minimum NAIC recommended amount of \$50,000. We also recommend that the Company ensure that Auto4Life maintains the required fidelity bond and E&O insurance coverage at all times in compliance with the administration agreement.*

**COMPANY RESPONSE**

The Company will amend the Administration Agreement with Auto4Life as recommended to specify the amount of coverage of fidelity bond and E&O insurance to be maintained by Auto4Life. A copy of this amendment will be submitted to the Department under separate cover.

**Company Financial Responsibility:**

*As previously indicated in the "Territory and Plan of Operation" section of this Report, the Company's aggregate excess of loss policy ("policy") insures policyholders for amounts in excess of policyholders' deductible, which is equal to the amount required to be maintained in the LRF, regardless of the amount actually maintained in the LRF. If the LRF is not maintained at the required funding, the deductible does not change, and is still calculated at the amount required to be maintained in the LRF. Once losses incurred by the insureds equal the deductible, the Company is then responsible for any further claims.*

2233 Wisconsin Avenue, N.W., Suite 310, Washington, DC 20007

*However, during the examination we noted that the standard VSC form issued by Auto4Life indicates the service contract holder has the right to bring a claim directly against Pinnacle in the event Auto4Life fails to fulfill its obligations under the contract. However, as stated above, under terms of the Company's aggregate excess of loss policy, the Company has no responsibility until satisfaction of the deductible by the policyholder. Accordingly, we recommend the Company obtain written acknowledgement from Auto4Life that they understand that under the terms of the Company's aggregate excess of loss policy, regardless of any direct claims brought directly against Pinnacle by VSC holders, Pinnacle does not have any obligation to pay a claim until satisfaction of the deductible by the policyholder.*

#### COMPANY RESPONSE

The Company shall, as recommended, obtain written acknowledgement from Auto4Life that regardless of any direct claims brought against the Company by Auto4Life VSC holders, under the terms of the Company's aggregate excess of loss policy the Company has no obligation to pay a claim until satisfaction of the deductible by the policyholder. A copy of that acknowledgement will be submitted to the Department under separate cover.

#### Contractual Liability Aggregate Excess of Loss Policy:

*As previously noted in this report, the Company's excess of loss contractual liability insurance policy ("policy") provides insurance for amounts in excess of the deductible. The LRF is established and maintained by the insured in a trust account which the Company is a party to, pursuant to the specific formulas and provisions written in the policy. During our examination, we noted the following:*

##### **1. Loss Reserve Fund Assets:**

*The Administration Agreement between the Company and Auto4Life requires that at least 95 percent of the LRF be invested in liquid assets. Based on our examination, the assets in the LRF met this requirement as of December 31, 2007. However, we noted that in 2008, Auto4Life utilized \$1,200,000 of the LRF assets toward the purchase of a building, which remained as an asset of the LRF. Although the LRF appears to contain sufficient additional liquid assets as of December 31, 2008 to cover the estimated future liabilities of the LRF as of that date, because of the addition of the building to the LRF assets, Auto4Life is not in compliance with requirement to maintain 95 percent of the LRF assets as liquid assets. We recommend the Company ensure Auto4Life maintains compliance at all times with the terms of the Administration Agreement.*

#### COMPANY RESPONSE

The Company respectfully notes that although the LRF was not 95 percent liquid as of December 31, 2008 due to the purchase of the aforementioned building in 2008, the LRF still did have liquid assets in excess of the actuarial high-end estimate of potential future claims as of December 31, 2008.

As the Department is aware, the Company had sought to revise its policy form to permit withdrawals of funds that are in excess of the required LRF balance based on actuarial analysis, which proposal would have enabled the Company to remain in compliance with the above noted liquidity requirement. However, the Department has informed the Company that it will not authorize any business plan changes at this time pending final resolution of new rules being promulgated by the

Department governing the operation of risk retention groups that provide insurance to vehicle service contract administrators. The Company remains willing to discuss with the Department its prior proposal and/or any other potential changes in its current business plan that are not inconsistent with the new rules once finalized.

**2. Loss Reserve Funding:**

*The insurance policy between the Company and Auto4Life requires the policyholder to maintain a LRF equal to \$65 per VSC sold plus investment income earned thereon. Our examination determined that the amount in the LRF should be \$2,328,777 plus investment income as of December 31, 2007. However, the balance in the LRF is \$2,254,117 as of that date, indicating a deficiency of \$74,660 plus investment income earned for the period under examination.*

*We also noted some discrepancies between the terms of the insurance policy and the Insurance Treaty Trust Account Agreement ("Trust Agreement"), which governs the trust account in which the LRF assets are held. The policy permits withdrawals from the LRF only for the payment of claims. However, contrary to the policy terms, the Trust Agreement between the parties grants Auto4Life the unqualified right to receive the interest or other income upon the assets included in the trust fund, but is silent as respects the right to withdraw funds only for the payment of claims.*

*Based on our examination, the \$74,660 LRF shortage noted above, as well as the discrepancies between the policy and the Trust Agreement, have no material financial impact on the Company's financial position at December 31, 2007. However, to avoid any future potential risks to the Company from these conditions, we recommend that the Company ensure strict compliance at all times with the terms of the Administration Agreement. In addition, we recommend that the Company amend the Trust Agreement to ensure the terms are consistent with the terms of the Administration Agreement.*

**COMPANY RESPONSE**

The shortage was a result of a carryover of funds due to be paid into the LRF but not as yet paid in on December 31, 2007. It represented approximately 50% of the monthly contribution to the LRF at that particular point in time. Every effort will be made by the AO to keep current on contributions to the LRF to eliminate any shortage at any point in time.

As stated above, the Company had previously sought to revise its policy form to permit withdrawals of funds that are in excess of the required LRF balance based on actuarial analysis. The proposed policy revision would have ensured consistency of the policy form with the terms of the Trust Account Agreement. The Company remains willing to discuss with the Department its prior proposal and/or any other potential changes in its current business plan that are not inconsistent with new rules applicable to risk retention groups that provide insurance to vehicle service contract providers once finalized.

**Independent Audit of AO:**

*Although the AO, Auto4Life, is not subject to direct regulation by the Department, the Company and the Department have an understanding that the Company would facilitate annual submission, to the Department, of annual audited financial statements of the AO, Auto4Life. The Department received the*

July 10, 2009

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*audit of the AO for the years ending 2005 and 2006 (although the audited financial statements were flawed in that the balance sheet did not balance). Upon commencement of our examination of the Company during 2008, we were informed that the 2007 audit report of the AO was not yet available but would be forthcoming. During the examination, there were numerous delays in obtaining the audit for the AO, and there was uncertainty regarding what period the audit would cover (through December 31, 2007, or possibly a different period). The December 31, 2007 audit was eventually completed, and was provided to the Department in March 2009. However it was an audit of the balance sheet only, and did not include the income or other statements. We recommend that the Company ensure the Department is annually provided with properly completed audited financial statements of the AO, prepared on a calendar year basis, and submitted to the Department on a timely basis.*

COMPANY RESPONSE

The Company shall endeavor to ensure that properly completed audited financial statements of the AO are submitted to the Department on a timely basis.

Thank you. Should you have any questions, please don't hesitate to contact me.

Sincerely,



Michael T. Rogers  
President  
**Risk Services, LLC**  
As Managers for  
**Pinnacle Risk Retention Group, Inc.**

MTR/hr

**Government of the District of Columbia**  
**Department of Insurance, Securities and Banking**



**Thomas E. Hampton**  
**Commissioner**

July 23, 2009

Joseph T. Prendergast  
President  
Pinnacle Risk Retention Group, Inc.  
C/o Risk Services, LLC  
2233 Wisconsin Avenue, N.W., Suite 310  
Washington, DC 20007

Dear Mr. Prendergast:

We are in receipt of a response dated July 10, 2009, from Michael T. Rogers, President, Risk Services, LLC, as Managers for **Pinnacle Risk Retention Group, Inc.** ("Pinnacle" or "Company"), which addresses the corrective actions taken or to be taken by Pinnacle to comply with the recommendations made in the Report on Examination as of December 31, 2007. The response adequately addresses the recommendations made in the Report, except for the following:

**Contractual Liability Aggregate Excess of Loss Policy:**

**1. Loss Reserve Fund Assets:**

**We recommended that the Company ensure Auto4Life maintains compliance at all times with the terms of the Administration Agreement.**

**Company Response:**

The Company respectfully notes that although the LRF was not 95 percent liquid as of December 31, 2008 due to the purchase of the aforementioned building in 2008, the LRF still did have liquid assets in excess of the actuarial high-end estimate of potential future claims as of December 31, 2008.

As the Department is aware, the Company had sought to revise its policy form to permit withdrawals of funds that are in excess of the required LRF balance based on actuarial analysis, which proposal would have enabled the Company to remain in compliance with the above noted liquidity requirement. However, the Department has

informed the Company that it will not authorize any business plan changes at this time pending final resolution of new rules being promulgated by the Department governing the operation of risk retention groups that provide insurance to vehicle service contract administrators. The Company remains willing to discuss with the Department its prior proposal and/or any other potential changes in its current business plan that are not inconsistent with the new rules once finalized.

**Department Response:**

The Department understands the Company's point that although the LRF was not 95 percent liquid as of December 31, 2008, the LRF still did have liquid assets in excess of the estimated potential future claims as of that date. In addition, the Department acknowledges the Company had sought to revise its policy form, but for the reasons stated above, the Department has not approved the revisions. However, this does not change the fact that the Administration Agreement between the Company and Auto4Life requires that at least 95 percent of the total LRF assets be invested in liquid assets. As indicated in the Examination Report, the Company shall ensure compliance at all times with the terms of the Administration Agreement which it has entered in to with Auto4Life. Pending issuance by the Department of the new rules governing the operation of insurers licensed by the Department that insure businesses that service contracts, warranties, extended warranties, etc., the Company should contact the Department to discuss a temporary resolution of the issue of compliance with the terms of the Administration Agreement which it has entered in to with Auto4Life.

**2. Loss Reserve Funding:**

**We recommended that the Company ensure strict compliance at all times with the terms of the Administration Agreement. In addition, we recommend that the Company amend the Trust Agreement to ensure the terms are consistent with the terms of the Administration Agreement.**

Please note: the above recommendation erroneously referred to the "Administration Agreement". The correct reference should have been to the "insurance policy between the Company and Auto4Life". We have corrected the recommendation to read as follows:

**We recommended that the Company ensure strict compliance at all times with the terms of the insurance policy between the Company and Auto4Life. In addition, we recommend that the Company amend the Trust Agreement to ensure the terms are consistent with the terms of the insurance policy between the Company and Auto4Life.**

Company Response:

The shortage was a result of a carryover of funds due to be paid into the LRF but not as yet paid in on December 31, 2007. It represented approximately 50% of the monthly contribution to the LRF at that particular point in time. Every effort will be made by the AO to keep current on contributions to the LRF to eliminate any shortage at any point in time.

As stated above, the Company had previously sought to revise its policy form to permit withdrawals of funds that are in excess of the required LRF balance based on actuarial analysis. The proposed policy revision would have ensured consistency of the policy form with the terms of the Trust Account Agreement. The Company remains willing to discuss with the Department its prior proposal and/or any other potential changes in its current business plan that are not inconsistent with new rules applicable to risk retention groups that provide insurance to vehicle service contract providers once finalized.

Department Response:

The Department acknowledges the Company had sought to revise its policy form, but for reasons previously stated above, the Department has not approved the revisions. As indicated in the Examination Report, the Company shall ensure compliance at all times with the terms of the insurance policy between the Company and Auto4Life. Upon issuance by the Department of the new rules governing the operation of insurers licensed by the Department that insure businesses that service contracts, warranties, extended warranties, etc., the Company shall make necessary amendments to its policy form and Trust Agreement to ensure consistency among the terms of these documents.

Independent Audit of AO:

**We recommended that the Company ensure the Department is annually provided with properly completed audited financial statements of the AO, prepared on a calendar year basis, and submitted to the Department on a timely basis.**

Company Response:

The Company shall endeavor to ensure that properly completed audited financial statements of the AO are submitted to the Department on a timely basis.

Department Response:

Because Pinnacle Risk Retention Group, Inc., being owned by the AO and managed by common management, is in a position to ensure timely submission of properly completed

Joseph T. Prendergast  
Pinnacle Risk Retention Group, Inc.  
July 23, 2009  
Page 4 of 4


audited financial statements of the AO, the Department believes that Pinnacle should do more than endeavor to ensure this, but rather Pinnacle shall unequivocally ensure that properly completed audited financial statements of the AO are submitted to the Department on a timely basis.

The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. After this 10 day period has passed, the Report will be publicly available, and will be forwarded electronically to each Commissioner whose name is set forth on Page 1 of the Report, as well as to the National Association of Insurance Commissioners, and to each state in which the Company is registered.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each Company director stating under oath that he or she has received a copy of the adopted examination Report and related Order shall be filed with this Department. Please send these affidavits to my attention at the Department.

Please contact me at 202-442-7785 if you have any questions.

Sincerely,



P. Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau

Enclosures