



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

Stephen C. Taylor  
Commissioner

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

Re: Report on Examination – **National Service Contract Insurance Company Risk Retention Group, Inc.**, as of December 31, 2016

**ORDER**

In accord with the authority established by D.C. Official Code § 31-1402, an examination of **National Service Contract Insurance Company Risk Retention Group, Inc.** (the “Company”), as of December 31, 2016 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“Department”). The Department reported on the financial condition of the Company in the attached Report on Examination (“Financial Condition Examination Report”).

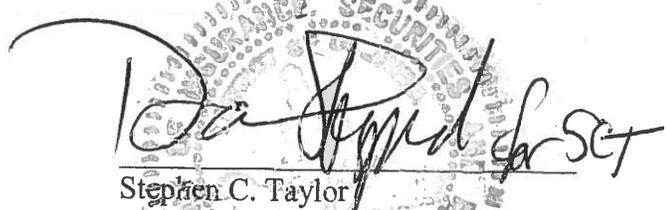
In accord with the provisions of D.C. Official Code § 31-1404(c), it is hereby ordered, on this 13<sup>th</sup> day of June, 2018, that the attached Financial Condition Examination Report be adopted and filed as an official record of the Department.

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

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

Pursuant to D.C. Official Code § 31-1404(d)(1), the Company shall, within 30 days of the issuance of the adopted Financial Condition Examination Report, file affidavits executed by each of the Directors of the Company wherein each of the Directors shall state under oath that they have received a copy of the adopted Financial Condition Examination Report and this order.

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

  
Stephen C. Taylor  
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

NATIONAL SERVICE CONTRACT INSURANCE  
COMPANY RISK RETENTION GROUP, INC.

AS OF

DECEMBER 31, 2016

NAIC NUMBER 10234

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Washington, D.C.  
April 17, 2018

Honorable Stephen C. Taylor  
Commissioner  
Department of Insurance, Securities and Banking  
Government of the District of Columbia  
1050 First Street, NE, Suite 801  
Washington, D.C. 20002

Dear Commissioner Taylor:

In accordance with Section 31-3931.14 of the District of Columbia Official Code (“Code”), and with Chapter 14 of Title 31 of the Code, we have examined the financial condition and activities of

**National Service Contract Insurance Company Risk Retention Group, Inc.**

hereinafter referred to as the “Company” or “NSCIC”.

**SCOPE OF EXAMINATION**

This full-scope examination, covering the period from January 1, 2012 through December 31, 2016, including any material transactions and/or events noted occurring subsequent to December 31, 2016, was conducted by the District of Columbia Department of Insurance, Securities and Banking (the “Department”).

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook (“Handbook”) and the policies and standards established by the Department. The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer’s surplus to be materially misstated both currently and prospectively.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management’s compliance with Generally Accepted Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company’s financial statements.

This examination report includes significant findings of fact, pursuant to Section 31-1404(a) of the District of Columbia Official Code and general information about the insurer and its

financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but are separately communicated to other regulators and/or the company.

The Company was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2012 through 2016. We placed substantial reliance on the audited financial statements for calendar years 2012 through 2015, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2016. We obtained and reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2016. We placed reliance on the work of the auditor and directed our efforts, to the extent practical, to those areas not covered by the firm's work papers.

### **SUMMARY OF SIGNIFICANT FINDINGS**

The results of this examination disclosed no material adverse findings or material changes in financial statements. However, significant compliance and operational findings were noted. See the "Summary of Recommendations" section of this report for further details regarding these findings.

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

A full scope financial examination was conducted by the Department as of December 31, 2011 which covered the period January 1, 2007 through December 31, 2011. In the report on the prior examination, dated April 18, 2012, the Department noted four exception conditions and related recommendations. Our examination included a review to determine the current status of the four recommendations in the prior exam report, and determined the Company had taken actions to address these recommendations and they are not repeated in this report.

### **HISTORY**

#### **General:**

The Company was incorporated in Hawaii on April 4, 1995, as a captive risk retention group, and commenced business in the state of Hawaii on April 21, 1995. Effective May 26, 2005, the Company re-domesticated to the District of Columbia, operating as a risk retention group under the captive insurance laws of the District of Columbia.

The Company provides aggregate excess of loss insurance coverage to Vehicle Service Contract ("VSC") providers (also known as administrator obligors and dealer obligors), which are in the business of selling and/or administering automobile, recreational vehicle, motorcycle, marine, and other vehicle-type extended service contracts. Interstate National Dealer Services, Inc. ("INDS"), an administrator obligor, is the majority member/policyholder of the Company.

The Company is a wholly owned subsidiary of INDS which in turn is a wholly owned subsidiary of Interstate National Corporation (“Interstate”). Interstate is a wholly owned subsidiary of Warranty Topco, Inc. (Topco), a Delaware corporation. Various private equity funds managed by SEC-registered investment advisor Golden Gate Private Equity, Inc. are the ultimate beneficial owners of approximately 84 percent of Topco, and various minority shareholders including members of management of the Company, INDS, Interstate, and Topco are the remaining 16 percent owners of Topco, with no such individual owning more than 10 percent. David Dominik is the Company’s ultimate controlling person.

**Membership:**

As a risk retention group, the Company is owned by its member/policyholders. As of December 31, 2016, the Company’s common capital stock as recorded in its corporate records is as follows:

	<b>Par value</b>	<b>Shares Authorized</b>	<b>Shares Outstanding</b>
Class A Common Stock	\$0.01	10,000,000	2,100,000
Class B Common Stock	\$0.01	1,000,000	911,253

Pursuant to the Company’s Articles of Re-domestication, holders of class A common stock shall be entitled to one vote per share on each matter submitted to a vote at a meeting of shareholders. The holders of class B common stock are not entitled to vote on any matters.

In addition, the Company is authorized by its Articles of Incorporation to issue 10,000,000 shares of preferred stock, par value \$.01, but has never issued any preferred shares.

As of December 31, 2016, as recorded in the Company’s stock records, INDS owned 100 percent of the Company’s class A common stock, and 99.9 percent (911,251 out of 911,253 shares outstanding) of class B common stock.

**Dividends and Distributions:**

On March 22, 2016, with Department approval, the Company declared and paid a shareholder dividend of \$1 million to INDS, holder of the class A common stock.

**MANAGEMENT AND CONTROL**

**Board of Directors and Officers:**

The Company’s directors serving as of December 31, 2016 were as follows:

<u>Name and State of Residence</u>	<u>Principal Occupation</u>
Eugene Becker Florida	Chief Executive Officer Interstate National Dealers Services, Inc.

Mark Mishler  
Illinois Retired

Michael Rogers  
Florida Chief Executive Officer  
Risk Services, LLC

The following persons were serving as the Company's officers as of December 31, 2016:

<u>Name</u>	<u>Position</u>
Eugene Becker	President
Anthony Levinson	Treasurer
Breanne Morley	Secretary
Michael Rogers	Assistant Secretary & Assistant Treasurer
Renee LaGue	Assistant Secretary

Committees:

As of December 31, 2016, there were no formal committees. During 2013, the Company notified the Department that the entire board of directors of the Company constitutes the audit committee.

Conflicts of Interest:

The Company has an established procedure for the disclosure of any material interests or affiliations on the part of its directors and officers. Our review of the conflict of interest statements signed by the Company 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 board of directors and members for the period under examination. Based on our review, it appears that the minutes have documented the review and approval of the Company's significant transactions and events.

Captive Manager:

Risk Services, LLC ("Risk Services") provides captive management services, including accounting and regulatory services, to the Company.

Affiliated Parties and Transactions:

The Company is a member of a holding company system with David Dominik being the ultimate controlling person. As indicated in the "History: General" section of this report, the Company is a wholly owned subsidiary of INDS.

During the period under examination and up to the date of this Report, the Company has the following transactions in place with INDS and other affiliates:

Effective January 1, 2013, the Company entered into a Program Administrator Agreement (the “Agreement”) with INDS. Based on the Agreement, INDS provides daily management and administrative services, including marketing, underwriting, premium collection and claims handling to the Company. In return, the Company pays INDS \$10 per vehicle service contract written. The five-year agreement expires December 31, 2018. During 2016, INDS earned fees totaling \$343,280 under this agreement.

The Company reported “Receivables from parent, subsidiaries and affiliates” totaling \$657,256 as of December 31, 2016. This balance includes the net of various payable balances to and receivable balances from INDS.

Effective January 1, 2013, the Company entered into a Tax Sharing Agreement with Topco and other affiliates. Pursuant to the agreement, Topco is responsible for filing consolidated federal income tax returns on behalf of the affiliated group, allocating the consolidated tax liability among the members, compensating affiliates for use of their losses, deductions or tax credits, and collecting the applicable portion of the group’s tax liability from member companies.

Our examination did not disclose any unusual terms associated with these intercompany agreements.

### **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2016, the Company was licensed in the District of Columbia, and was registered as a risk retention group in all states except Connecticut, Florida, Louisiana, and Wisconsin.

During 2016, the Company wrote approximately \$750,000 in direct business, of which the top five states totaled 51 percent of the total premiums. These included Texas (25 percent), Arizona (11 percent), Virginia (5 percent), North Carolina (5 percent), and Georgia (5 percent). Per Company management, as of December 31, 2016, the Company no longer writes business in the following states: California, Missouri, New York, Oklahoma, Vermont and Washington.

The Company has no employees. The majority member/policyholder, INDS, pursuant to the terms of the aforementioned Agreement, acts as the Company’s program manager and manages the Company’s daily business activities.

During the period under examination, the Company wrote direct business as follows:

#### **Contractual Liability Insurance:**

The Company provides aggregate excess of loss insurance coverage directly to its members (“insureds”) who are in the business of selling and/or administering vehicle service contracts

(VSCs). Coverage provided by the underlying VSCs varies for new and used vehicles with terms ranging from 3 months to 10 years. According to management, the Company did not incur any claims during the period under examination, and has never incurred a claim under its aggregate excess of loss insurance policies since its inception in 1995.

According to the Company, during the period under examination, the Company issued aggregate excess of loss insurance policies to INDS, an Administrator Obligor (“AO”), and to four Dealer Obligors (DOs), Acquaviva Auto Sales (“Acquaviva”), Independence Auto Sales (“Independence”), Sweeney Buick GMC (“Sweeney Buick”) and Sweeney Chevrolet (“Sweeney Chevrolet”). As of December 31, 2016, the Company was no longer insuring Acquaviva and Independence and these two DOs were no longer members of the Company.

The terms “DO” and “AO” can be used differently by different entities in the VSC industry such as the Company. According to the Company, the above two DOs, Sweeney Buick and Sweeney Chevrolet, are members and owners of the Company, and market and sell VSCs themselves. The DOs then contract with INDS to administer the VSCs, including maintenance of the Loss Reserve Fund (“LRF”) (see below for comments regarding the LRF). The AO is responsible for administering the VSC programs, including premium collection, loss payments, and maintenance of the LRF. The AO can also directly sell VSCs itself. INDS and the current two DOs are the owners of NSCIC. INDS is the Company’s major policyholder, and currently generates 99 percent of the Company’s direct written premium.

INDS (which is itself an AO) and the two DOs sell and administer VCSs. These warranties are offered by vehicle dealers to a buyer upon the sale of a vehicle and are optional to the buyer. The cost to the purchasers of the VSCs varies based on the type of vehicle, whether it is new or used, mileage, and various other factors. A portion of the contract cost is retained by the seller (generally the automobile dealer) for commission and administrative expenses, and the remainder is remitted to the DOs and INDS, which then administer the contracts and are liable for payments under the contracts. Claims payments to the purchaser of the automobile extended service contracts are made directly by the insured and are deducted from the LRF (see below for comments regarding the LRF).

From the sale price of each VSC, the Company receives premium income under its aggregate excess of loss policies issued to the AOs and DOs. Premiums received by the Company for each VSC range, depending on the type of vehicle and coverage, from \$5 to \$32, with the average of \$20 to \$25 per VSC. This is the amount recorded on the Company’s Schedule “T” in its Annual and Quarterly Statement filings. During 2016, the Company recorded premiums totaling \$750,183.

In addition, from the sale price of each VSC, the AO or DO allocates a loss reserve amount to a LRF for the payment of future VSC claims. Under a contractual excess of loss policy, NSCIC’s liability attaches once the aggregate amount of losses in each program exceeds the actuarially determined amount in the LRF required to pay all claims for all VSCs. NSCIC’s liability is subject to a maximum limit per loss equal to the actual cash value of the covered vehicle and an aggregate limit for each service contract equal to the purchase price of the covered vehicle or \$75,000, whichever is less. As of December 31, 2016, the Company’s policies with INDS and its two DOs do not specifically define how the LRF shall be computed and maintained.

However, in 2017, the Company amended its policy with INDS to define how the LRF shall be computed and maintained as follows:

It shall be the sole responsibility of the Insured to ensure that all amounts, as required by the Company pursuant to Section IV of this Policy to be held in a Loss Reserve Fund by the Insured are available to pay Service Contract Holder Losses. Any deficiency in the Loss Reserve Fund as the result of an advance or other distribution from the Loss Reserve Fund other than for the payment of Service Contract Holder Losses shall remain an absolute liability of the Insured, and shall not be the responsibility of the Company. Deficiency shall be defined as the actuarially calculated future claims liabilities in excess of eligible available assets in the Loss Reserve Fund. Eligible assets are defined as those listed in § 31-1373.02(a)(1)(A) through § 31-1373.02(a)(1)(G) of the DC Official Code, or as subsequently amended.

As indicated above, under the terms of its policy with INDS, the Company's obligation attaches at the amount of the actuarially determined LRF. However, under the terms of the VSCs issued to the VSC holders, if the insureds are unable to perform their obligations for any reason, regardless of the amounts in the LRF or the amounts that are supposed to be in the LRF or, in the event the insureds are no longer in business, or for whatever reason, the Company will assume the responsibilities of the insureds and will provide directly to the VSC holder all benefits to which the VSC holder is entitled under the terms of the VSC. According to the Company, this provision is required by the various states in which the VSCs are issued and management agrees this provision is contradictory to the provisions of the aggregate excess of loss policy issued to INDS which indicated the Company's responsibility does not attach until claims in the required amount in the LRF are incurred. To address this discrepancy, beginning in 2017, the Company added the following provision to its policy with INDS:

It is agreed and understood that the self-insured retention shall not be considered satisfied and the Company shall have no liability under this policy unless and until Losses actually incurred by the Insured for valid Service Contract Holder Losses exceed the aggregate of all amounts that are required by this policy to be placed into a loss reserve fund. In the event that the Insured fails to fund or maintain the amounts in a loss reserve fund as required by this policy, this insurance shall not replace such amounts but shall apply as if the loss reserve fund had been fully funded and maintained.

The policy issued to INDS covers losses above the total required LRF for all VSCs that INDS has issued and/or administered through various dealers. Some of these dealers have established their own Producer Owned Reinsurance Companies ("PORCs") in which the LRF required to fund the business produced by the respective dealers is maintained. Thus, there are multiple loss reserve funds related to the Company's policy with INDS; one LRF for the business sold and administered by INDS as an AO, and one for each PORC. INDS has effective security control over the LRF and such loss funds are dedicated to each PORC, and no excess funds from one PORC can be used to offset deficiencies in another PORC fund.

As of December 31, 2016, the Company's policies with INDS and its two DOs contained no requirement regarding how the LRF is held (e.g., in a trust or fiduciary account). However,

during 2017, the Company amended its policy with INDS to require the LRF to be held in a trust account, with INDS as the grantor, and the Company as beneficiary.

We also noted that during the examination period, the Company entered into a Trust Agreement with INDS and entered into trust agreements with the above-mentioned PORCs. However, these agreements were not submitted to or approved by the Department. Subsequent to December 31, 2016, these agreements were submitted to and approved by the Department, however it was noted the Company was not enforcing certain provisions of the trust agreement with INDS. See the “Summary of Recommendations” section this report, under the caption “Trust Agreements” for further comments regarding these conditions.

## **REINSURANCE**

### **Assumed Reinsurance:**

In addition to its contractual liability business written by the Company, through December 31, 2006, NSCIC assumed reinsurance from Business Alliance Insurance Company (“BAIC”). Under its agreement with BAIC, the Company assumed, on a quota share basis, 100 percent of the liability for losses under the Mechanical Breakdown Insurance (“MBI”) policies issued by BAIC in the State of California, and produced by INDS’s subsidiary, Warranty Direct Insurance Services. The BAIC policy paid the reasonable costs to repair or replace covered parts due to a “failure” of the covered parts up to the actual cash value of the insured vehicle subject to a maximum aggregate limit of the lesser of \$75,000 or the retail cost of the vehicle. The MBI policies period ran from inception for a specified term (3 months to 10 years) subject to a mileage limitation.

This agreement was terminated effective January 1, 2007 on a run off basis and the Company was liable for all cessions in force at the time of termination and continued to administer all policies in-force at the time of the termination until such time that all claims were settled. INDS administered the BAIC policies on behalf of the Company.

During the examination period, the Company paid claims approximately \$117,000 under the BAIC run-off policy (\$91,000 in 2012 and \$26,000 in 2013). The Company has not paid any claims under the BAIC policy since 2013 and as of December 31, 2016, the Company did not report any assumed loss reserves under the BAIC policy.

### **Ceded Reinsurance:**

Effective April 1, 2016, the Company’s direct business was reinsured through a multi-year aggregate excess of loss reinsurance agreement with AmTrust International Insurance, Ltd. (AmTrust), domiciled in Bermuda. This agreement applies to paid losses arising out of service contracts issued by INDS. The limit under this coverage is \$2,000,000 of claims in the aggregate in excess of the Company’s policy year retention, defined as 200 percent of the required amount of the LRF in respect of Contractual Liability business. As of January 1, 2017, the limit

of the coverage was changed to \$1,000,000 of claims in the aggregate in excess of the Company's policy year retention. This change in reinsurance coverage was approved by the Department.

The annual ceded reinsurance premium under the AmTrust agreement is \$110,000. During the period under examination, the Company did not report ceded reinsurance other than that noted above.

## FINANCIAL STATEMENTS

The following financial statements are based on the Annual Statement filed by the Company with the Department and present the financial condition of the Company for the period ending December 31, 2016. The financial statements were prepared in accordance with Generally Accepted Accounting Principles (“GAAP”) prescribed or permitted by the Department. Management is responsible for the preparation and fair presentation of these financial statements. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

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**BALANCE SHEET**

**ASSETS**

	<b>December 31, 2016</b>
Bonds	\$ 7,968,630
Preferred stock	107,909
Common stock	106,384
Cash and short-term investments	<u>3,309,733</u>
Subtotal cash and invested assets	\$ 11,492,656
Investment income due or accrued	59,005
Net deferred tax asset	203,442
Receivables from parent, subsidiaries, and affiliates	657,256
Aggregate write-ins for other-than-invested assets	27,500
Total	<u><u>\$ 12,439,859</u></u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

	<b>December 31, 2016</b>
Losses and loss adjustment expenses ( <b>NOTE 1</b> )	\$ -
Other expenses (excluding taxes, licenses and fees)	106,245
Taxes, licenses and fees (excluding federal and foreign income taxes)	18,181
Unearned premiums (after deducting unearned premiums for ceded reinsurance of (\$0))	<u>1,780,966</u>
Total liabilities	<u>\$ 1,905,392</u>
Common capital stock	\$ 30,113
Gross paid in and contributed surplus	7,159,092
Unassigned funds	<u>3,345,262</u>
Surplus as regard policyholders	<u>\$ 10,534,467</u>
<b>Total</b>	<u><u>\$ 12,439,859</u></u>

**STATEMENT OF INCOME**

	<b>December 31, 2016</b>
<b>UNDERWRITING INCOME</b>	
Net premiums earned	\$ 594,797
<b>DEDUCTIONS</b>	
Other underwriting expenses	681,241
Total underwriting expenses	\$ 681,241
Underwriting loss	\$ (86,444)
<b>INVESTMENT INCOME</b>	
Net investment income earned	\$ 216,637
Net realized capital gains	125
Income before dividends and taxes	\$ 130,318
Federal Taxes	584,515
Net Income	\$ <u>(454,197)</u>

## CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2011	\$ 7,653,658
Net income	27,961
Change in net unrealized capital gains	50,501
Paid in surplus	3,036,765
Prior period audit adjustment	38,060
Net change in surplus as regards policyholders, 2012	<u>3,153,287</u>
Surplus as regards policyholders, December 31, 2012	\$ 10,806,945
Net income, 2013	66,944
Change in net unrealized capital gains	(290,381)
Paid in capital	(200)
Paid in surplus	200
Net change in surplus as regards policyholders, 2013	<u>(223,437)</u>
Surplus as regards policyholders, December 31, 2013	\$ 10,583,508
Net income, 2014	218,856
Change in net unrealized capital gains	179,425
Paid in surplus	(100)
Net change in surplus as regards policyholders, 2014	<u>398,181</u>
Surplus as regards policyholders, December 31, 2014	\$ 10,981,689
Net income, 2015	1,101,822
Change in net unrealized capital gains	(71,183)
Net change in surplus as regards policyholders, 2015	<u>1,030,639</u>
Surplus as regards policyholders, December 31, 2015	\$ 12,012,328
Net income, 2016	(454,197)
Change in net unrealized capital gains	(5,702)
Dividends to stockholders	(1,000,000)
Prior period adjustment	(17,962)
Net change in surplus as regards policyholders, 2016	<u>(1,477,861)</u>
Surplus as regards policyholders, December 31, 2016	\$ 10,534,467

## ANALYSIS OF EXAMINATION CHANGES TO SURPLUS

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

## NOTES TO FINANCIAL STATEMENTS

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

The Company reported “Losses” and “Loss adjustment expenses” reserves totaling \$0. According to the Company, these reserves are associated with the Company’s excess of loss contractual liability business and represent management’s best estimate of the amounts necessary to pay all claims and related expenses that have been incurred under these policies, and unpaid as of December 31, 2016.

As previously indicated in this report, the Company provides aggregate excess of loss insurance coverage to vehicle service contract providers which are in the business of selling and/or administering vehicle extended service contracts. The Company’s policies provide coverage to its insureds for amounts in excess of the loss reserve fund (LRF) established and maintained by each insured. The Company’s financial responsibility triggers only upon exhaustion of the required amount in the LRF.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expenses reserves as of December 31, 2016, 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, the Department utilized an examination actuary to review the methods employed, assumptions relied upon, and conclusions reached by the Company’s actuary. The examination actuary concluded that the methodologies and assumptions utilized by the Company’s independent actuary to compute these reserves, and the amount of loss reserves reported by the Company as of December 31, 2016, were reasonable and adequate.

During our examination, as part of our review of the adequacy of the Company’s reserves, we also reviewed the LRF established and maintained by the Company’s insureds. As part of this review, we relied on the work, performed on behalf of INDS, of an independent actuary, who concluded that as of December 31, 2016, INDS’s ultimate losses on its in-force vehicle service contracts totaled approximately \$29.3 million. The actuary indicated that as of December 31, 2016, INDS had assets totaling approximately \$51.9 million in its LRF. The examination actuary utilized reviewed the methods employed, assumptions relied upon, and conclusions reached by the Company’s independent actuary regarding INDS’s LRF. The examination actuary concluded that the methodologies and assumptions utilized by the Company’s independent actuary to compute the estimate of the ultimate losses to be incurred by INDS were reasonable. However, we concluded assets totaling approximately \$24.5 million of the \$51.9 million were readily available to cover liabilities related to the aggregate excess of loss policies written by the Company. The \$24.5 million consisted of \$21.7 million held in a LRF Trust Account for the benefit of the Company and \$2.8 million in accounts receivable related to vehicle service contracts insured by the Company. As a result, we estimate a projected deficiency of approximately \$4.8 million in the LRF related to the aggregate excess of loss policies written by the Company.

Because there has been no triggering event (e.g., exhaustion of the loss reserve funds), or

claim made or obligation asserted against the Company, no adjustment has been made to the Company's financial statements as a result of our examination. However, the deficiency in the INDS LRF and the potential future exposure to the Company must be addressed by the Company going forward. See the "Summary of Recommendations" section of this Report, under the caption "Loss Reserve Fund Deficiency" for further comments regarding this condition.

### **SUBSEQUENT EVENTS**

Other than events subsequent to December 31, 2016 as already noted in this report, we noted no significant subsequent events as of the date of this report.

### **SUMMARY OF RECOMMENDATIONS**

#### **Loss Reserve Fund Deficiency:**

As previously noted in this report, the Company's contractual liability insurance policies provide coverage to the insureds for amounts in excess of the insureds' required LRF, and the Company's financial responsibility triggers upon exhaustion of the required amount of the LRF. Also, as indicated previously in this Report, the Company's independent actuary estimated the INDS LRF future liabilities related to the aggregate excess of loss policies written by the Company at \$29.3 million as of December 31, 2016. The independent actuary utilized in our examination concluded that the methodologies and assumptions utilized by the Company's independent actuary to compute the estimate of future liabilities were reasonable, and that the estimate was reasonable.

Under terms of the Company's policy with INDS, INDS is required to fund the LRF. During the examination, we performed procedures to verify the investments and other assets backing the LRF related to the aggregate excess of loss policies written by the Company. As indicated in NOTE 1 in the "Notes to Financial Statements" section of this report, according to the Company and to its actuary, the INDS investments and other assets backing the LRF totaled approximately \$59.1 million as of December 31, 2016. However, we concluded assets totaling approximately \$24.5 million of the \$51.9 million were readily available to cover liabilities related to the aggregate excess of loss policies written by the Company and as a result, we estimate a projected deficiency of approximately \$4.8 million in the LRF as of December 31, 2016 related to the aggregate excess of loss policies written by the Company.

Remaining assets making up the \$51.9 million included restricted cash accounts, receivables to INDS unrelated to VSC liabilities under the aggregate excess of loss policies written by the Company, intercompany receivables unrelated to the Company, investments in limited partnerships, and prepaid expenses. We therefore concluded these assets were not readily available to pay claims related to VSCs insured by the Company.

During the examination we were informed by Company management that they agreed the LRF related to the Company's policies was underfunded, and management took steps to infuse additional funds into the LRF during 2017. However, an analysis of the liabilities and assets of the

LRF subsequent to December 31, 2016 was not within the scope of this examination. In addition, information provided by management indicates the funds infused as of June 30, 2017 would not have fully funded the LRF.

**We recommend that the Company ensure the LRF is always fully funded with eligible assets in an amount at least equal to the actuarially estimated liabilities related to the aggregate excess of loss policies written by the Company.**

Trust Agreements:

1. As previously indicated in the “Territory and Plan of Operation” section of this Report, during the examination period, the Company entered in to a Trust Agreement under which INDS is required to establish and maintain a trust account, for the benefit of the Company, in which assets backing the LRF for VSC liabilities related to the aggregate excess of loss policies written by the Company are held. In addition, and also as previously indicated in the “Territory and Plan of Operation” section of this Report, during the examination period the Company entered in to Trust Agreements with certain PORCs. However, these trust agreements were not submitted to or approved by the Department. During the examination, the Department reviewed the INDS and PORC trust agreements and approved them after certain revisions requested by the Department were made. **We recommend the Company submit any future trust agreements and revisions to the current trust agreements, and any other business plan changes requiring review and prior approval, to the Department for review and prior approval.**
2. Under terms of the trust agreement entered in to by the Company during the examination period, INDS was required to provide the Company with its annual audited financial statement. In addition, under terms of the trust agreement, semi-annual actuarial opinions of the funds and securities in the trust account were to be provided to the Company. However, we were informed during the examination that audited financial statements of INDS were not available for the years under examination, and while annual actuarial reviews of the estimated future liabilities of INDS were performed, semi-annual actuarial opinions of the funds and securities in the trust account were not performed. **We recommend the Company ensure full compliance with all terms of the trust agreements.**

## SIGNATURES

In addition to the undersigned, the following personnel from Lewis & Ellis, Inc., representing the Department, participated in this examination as members of the examination team: Ryne Davison, CFE, and Phil Schmoyer, CISA, AES.

The actuarial portion of this examination was completed by David A. Christhlf, ACAS, MAAA, of the Department.

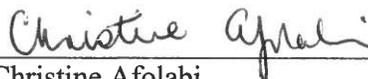
Respectfully submitted,



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David Palmer, CFE  
Examiner-In-Charge  
Lewis & Ellis, Inc.

Under the Supervision of,



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Christine Afolabi  
Supervising Examiner  
District of Columbia Department of Insurance,  
Securities and Banking



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

**Stephen C. Taylor**  
**Commissioner**

May 24, 2018

Breanne Morley  
President  
National Service Contract Insurance Company Risk Retention Group, Inc.  
C/o Risk Services Companies  
58 East View Lane, Suite 2  
Barre, VT 05641

**RE: Examination of National Service Contract Insurance Company Risk Retention Group, Inc.,**  
as of December 31, 2016

Dear Ms. Morley:

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 National Service Contract Insurance Company Risk Retention Group, Inc. (the “Company”), as of December 31, 2016.

Please submit, to my attention, a written response calling attention to any errors or omissions. In addition, if this Report contains a section entitled “Summary of Recommendations” that discloses certain areas requiring action, the Company shall submit a statement covering the corrective measures which will be taken. If the Company’s position on any of these points is contrary to the Examiner’s findings, an explanation should be submitted covering each contested comment and/or recommendation.

If there are no errors or omissions to be brought to our attention, and there is no “Summary of Recommendations” requiring a response, please submit a statement that the Company accepts the Report.

The response must be in writing and shall be furnished to this Department by June 13, 2018. The signed response should be on company’s letterhead and sent electronically via e-mail to me, in an adobe “pdf” format, to [sean.odonnell@dc.gov](mailto:sean.odonnell@dc.gov).

Sincerely,

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

Enclosure

# **National Service Contract Insurance Company Risk Retention Group, Inc.**

**2233 Wisconsin Ave., N.W., Suite 310, Washington, DC 20007**

May 30, 2018

Attn: Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau  
Department of Insurance, Securities and Banking  
1050 First Street, N.E., Suite 801  
Washington, DC 20002

**Re: National Service Contract Insurance Company Risk Retention Group, Inc. ("NSC")  
NAIC Company Code: 10234; NAIC Group Code: 0000; FEIN: 99-0319305**

Dear Mr. O'Donnell:

In response to the examination report of December 31, 2016, please regard the following:

**1. Loss Reserve Fund Deficiency**

**We recommend that the Company ensure the LRF is always fully funded with eligible assets in an amount at least equal to the actuarially estimated liabilities related to the aggregate excess of loss policies written by the Company.**

During 2017, the Company added eligible assets to the LRF. As of December 31, 2017, the LRF had assets of \$30,870,304 (comprised of cash and investments of \$27,519,000 and eligible accounts receivable of \$3,351,304) which exceeded actuarially estimated liabilities computed by GPW & Associates of \$28,485,000 by \$2,385,304. As such, with DISB agreeing that the Company can use accounts receivable with respect to calculating the LRF, the Company believes the 2017 infusions did fully fund the LRF as noted above, notwithstanding of the comment counter to that on page 17 of the Exam Report.

**2. Trust Agreements**

**1. We recommend the Company submit any future trust agreements and revisions to the current trust agreements, and any other business plan changes requiring review and prior approval, to the Department for review and prior approval.**

The Company agrees to submit any and all future business plan changes to the Department for review and approval.

2. **We recommend the Company ensure full compliance with all terms of the trust agreements**

In lieu of the standalone audited financial statements for INDS, the Company will submit to the Department the following: audited financial statements of Warranty Topco, Inc. (parent of INDS), consolidating unaudited balance sheet and income statement worksheets which aggregate to the totals in the Warranty Topco, Inc. audited financial statements and an agreed upon procedures report, approved by the Department, from an independent accounting firm which independently confirms the funds in the trust account as of the year-end represented by the financial statements.

Should you have any questions or require anything further in connection with this matter, please do not hesitate to contact me by telephone at (802) 479-7803 or via email at [rlague@pboa.com](mailto:rlague@pboa.com).

Sincerely,



Renee LaGue  
Senior Account Manager  
**Risk Services, LLC**  
As Captive Managers for  
**National Service Contract Insurance Company**  
**Risk Retention Group, Inc.**



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

**Stephen C. Taylor**  
**Commissioner**

June 13, 2018

Breanne Morley  
President

National Service Contract Insurance Company Risk Retention Group, Inc.  
C/o Risk Services Companies  
58 East View Lane, Suite 2  
Barre, VT 05641

**RE: Examination of National Service Contract Insurance Company Risk Retention Group, Inc., as of December 31, 2016**

Dear Ms. Morley:

We are in receipt of Ms. Renee LaGue's response ("Response"), dated May 30, 2018, regarding the Report on Examination ("Report") of National Service Contract Insurance Company Risk Retention Group, Inc. (the "Company") as of December 31, 2016. The response is deemed adequate.

Regarding the Company's comments in the Response regarding "Loss Reserve Fund Deficiency", we note the Company's commitment to ensure full funding of the loss reserve fund ("LRF") and we note the Company's comments that the LRF was fully funded by year-end 2017. Please note that during the examination, information regarding the LRF as of June 30, 2017 was made available to the examiners but information regarding the LRF subsequent to that date was not made available to the examiners and therefore an evaluation of the LRF as of December 31, 2017 by the examiners was not completed. During the pending financial analysis of the Company's December 31, 2017 financial filings, the Department of Insurance, Securities and Banking's Risk Finance Bureau will review the LRF as of December 31, 2017. As recommended in the Report, the Company should continue to ensure the LRF is always fully funded with eligible assets in an amount at least equal to the actuarially estimated liabilities related to the aggregate excess of loss policies written by the Company.

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 District of Columbia 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.

Breanne Morley  
June 13, 2018  
Page 2

Pursuant to Section 31-1404(d)(1) of the District of Columbia Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each of the Company's directors 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 202-442-8153 if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Sean O'Donnell". The signature is written in black ink and is positioned above the typed name.

Sean O'Donnell  
Director of Financial Examination  
Risk Finance Bureau

Enclosures