STATE OF MISSOURI

# DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

RE: Examination Report of Automobile Club Inter-Insurance Exchange December 31, 2009

## ORDER

After full consideration and review of the report of the financial examination of Automobile Club Inter-Insurance Exchange for the period ended December 31, 2009, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, John M. Huff, Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such examination report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo: summary of significant findings, subsequent events, company history, corporate records, management and control, fidelity bond and other insurance, pension, stock ownership and insurance plans, territory and plan of operations, growth of the company, loss experience, reinsurance, accounts and records, statutory deposits, financial statements, and comments on financial statement items.

Based on such findings and conclusions, I hereby ORDER, that the report of the Financial Examination of Automobile Club Inter-Insurance Exchange as of Automobile Club Inter-Insurance Exchange, be and is hereby ADOPTED as filed and for Automobile Club Inter-Insurance Exchange to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement, and verify compliance with each item, if any, mentioned in the Comments on Financial Statement Items and/or Summary of Recommendations section of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this 15th day of June, 2011.

John M. Huff, Director
Department of Insurance, Financial Institutions and Professional Registration

REPORT OF

FINANCIAL EXAMINATION

FILED
JUN 25 2011
DIRECTOR OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION

# Automobile Club Inter-Insurance Exchange

As of:

DECEMBER 31, 2009

STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS
AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

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April 7, 2011

Honorable Joseph Torti III, Superintendent
Division of Insurance Regulation
State of Rhode Island
Chairman, Financial Condition (E) Committee, NAIC

Honorable Stephen Robertson, Commissioner
Department of Insurance
State of Indiana
Secretary, Midwestern Zone, NAIC

Honorable John M. Huff, Director
Missouri Department of Insurance, Financial
Institutions and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65101

Dear Gentlemen:

In accordance with your financial examination warrant, a comprehensive financial examination has been made of the records, affairs and financial condition of

**Automobile Club Inter-Insurance Exchange**

also referred to as "Exchan ge" or the "Company." The examination was conducted at the Company's home office 12901 North Forty Drive, St. Louis, Missouri 63141, telephone number (314) 523-7350. This examination began on March 15, 2010, and concluded on the above date.

## SCOPE OF EXAMINATION

**Period Covered**

The last full scope association financial examination of the Company was made as of December 31, 2005, by examiners from the state of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners ("NAIC") with no other zones participating.

The current full scope financial examination covers the period from January 1, 2006, through December 31, 2009, and was conducted by examiners from the state of Missouri representing the Midwestern Zone of the NAIC with no other zones participating. This examination also included material transactions or events occurring subsequent to December 31, 2009.

**Procedures**

This examination was conducted using guidelines set forth in the Financial Condition Examiners Handbook ("Handbook") of the NAIC, except where practices, procedures, and applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration ("DIFP") or statutes of the state of Missouri prevailed. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating systems controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement Instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The following key activities were identified: Affiliated Companies, Treasury, Investments, Premiums and Underwriting, Claims Handling, Reserves, Debt and Surplus, and Reinsurance.

This examination was conducted in coordination with the examination by the California Department of Insurance ("CDI") of the Interinsurance Exchange of the Automobile Club ("IEAC"), a California domiciled company with which the Company is affiliated. IEAC administers various activities for the Company including three of the key activities identified above: Affiliated Companies, Investments and Reinsurance. California was the lead state for this coordinated examination and the examiners relied upon information and workpapers provided by the CDI for the examination of the Company's activities that are administered by IEAC.

The examiners relied upon information and workpapers provided by the Company's independent auditor, Ernst & Young LLP, of Los Angeles, California, for its audits covering the periods from January 1, 2007, through December 31, 2009. Such reliance included fraud risk analysis, internal control narratives, tests of internal controls and substantive testing.

## SUMMARY OF SIGNIFICANT FINDINGS

The Automobile Club of Missouri ("ACMO") and its subsidiaries, including the Company, entered into an Affiliation Agreement with the Automobile Club of Southern California ("ACSC") and its subsidiaries as of March 1, 2006. Pursuant to this Affiliation Agreement the Company and its subsidiary, Auto Club Family Insurance Company ("Family"), entered into a reinsurance Pooling Agreement with IEAC. The Pooling Agreement provides that all participants shall pool all of their net underwriting business after cessions to non-affiliated reinsurers. As the significantly larger company, IEAC became the pool leader and retains 95% of the total pool. The Compan y and Family assume the other 5% ( 4% and 1% to the Company and Family respectively). The Affiliation Agreement also requires that IEAC shall maintain the Company's ratio of surplus to net premiums at not less than 60% (in effect, a 167% or lower net premiums to surplus ratio) at all times until the termination of the Pooling Agreement.

## SUBSEQUENT EVENTS

None

## COMPANY HISTORY

### General

The Company commenced business on April 15, 1927, in St. Louis at the headquarters of Automobile Club of Missouri ("ACMO"), an affiliate of American Automobile Association ("AAA"). In 1940 the Company changed its name from Inter-Insurance Exchange to Automobile Club of Missouri, and then to Automobile Club Inter-Insurance Exchange.

### Capital Stock and Paid-In Surplus

The Company is a reciprocal inter-insurance exchange and therefore is not authorized to issue capital stock. The Subscriber's Agreement (Power of Attorney) provides that surplus funds of the Company will be distributed to the subscribers upon liquidation.

### Dividends

No dividends have ever been paid to subscribers.

### Acquisitions, Mergers and Major Corporate Events

On March 1, 2006, ACMO, the Company and its attorney-in-fact, Club Exchange Corporation ("CEC"), entered into an affiliation agreement with IEAC and its following California affiliates: ACSC, ACSC Management Services Inc., and Auto Club Enterprises ("ACE"). As a result of the affiliation agreement, ACSC became the ultimate controlling entity of the Company. The Affiliation Agreement provides for the pooling of all net business written by the Company and Family (after cessions to non-affiliated reinsurers) with the business written by IEAC. IEAC is the pool leader and it retains 95% of the pooled business and cedes 4% of the pooled business to the Company and 1% to Family.

### Surplus Debentures

Pursuant to the Affiliation Agreement, on June 30, 2006, the Company issued a subordinated surplus note to IEAC in return for $50 million in cash. The surplus note has a stated interest rate of prime plus one percent per annum on the unpaid balance until the scheduled maturity date on June 30, 2026. The $50,000,000 note plus accrued interest of $13,333,904 resulted in a total reported value of $63,333,904 as of December 31, 2009.

## CORPORATE RECORDS

A review was made of the Articles of Incorporation and Bylaws of CEC. Per the Articles, the number of directors is fixed in the manner provided by the Bylaws. The Bylaws were revised in 2009 to change the number of directors from 14 to 13. The Bylaws were revised again in 2010 to change the number of directors to 11.

The minutes of the meetings of the stockholder and board of directors of CEC, and of the Advisory Board and the committee meetings of the Company were reviewed for the period under examination. The minutes provided sufficient documentation of major corporate transactions. The minutes of the July 2007 meetings reflect that both the Advisory Board and the board of CEC reviewed and approved the prior examination report.

## MANAGEMENT AND CONTROL

**Board of Directors**

The Advisory Board of the Company consists of nine members, elected for one year terms. The members elected and serving as of December 31, 2009, were as follows:

| Name | Principal Occupation |
|---|---|
| David R. Carpenter<br>Santa Barbara, California | Chairman and CEO<br>Unihealth Foundation |
| Peter K. Barker<br>Santa Barbara, California | California Chair<br>J.P. Morgan Chase |
| Antonia Hernandez<br>Pasadena, California | President and CEO<br>California Community Foundation |
| Kenneth A. Johnson<br>Chesterfield, Missouri | Retired President and CEO<br>Automobile Club of Missouri |
| Raymond R. Martin<br>Rolling Hills Estates, California | Retired Chairman and CEO<br>Coast Federal Bank |
| Thomas V. McKernan<br>Arcadia, California | Chief Executive Officer<br>Automobile Club of Southern California |
| Gilbert T. Ray<br>Los Angeles, California | Retired Partner<br>O'Melveny & Myers LLP |
| Eugene M. Toombs<br>Chesterfield, Missouri | Chairman and CEO<br>MiTek, Inc. |
| Willis B. Wood, Jr.<br>Irvine, California | Retired Chairman and CEO<br>Pacific Enterprises |

Pursuant to the Subscriber's Agreement (Power of Attorney), the affairs of the Company are managed by its attorney-in-fact, CEC. The CEC Board of Directors consisted of 13 members as of December 31, 2009, elected at the annual meeting of the single stockholder, ACMO. As authorized by CEC's Articles of Incorporation, each director is elected for a one-year term. The members elected and serving as of December 31, 2009, were as follows:

| Name | Principal Occupation |
| --- | --- |
| Thomas V. McKernan<br>Arcadia, California | Chief Executive Officer<br>Automobile Club of Southern California |
| Robert T. Bouttier<br>Laguna Niguel, California | President<br>Automobile Club of Southern California |
| John F. Boyle<br>Coto de Caza, California | Executive Vice President<br>Automobile Club of Southern California |
| Susan Corrales-Diaz<br>Orange, California | President<br>Systems Integrated |
| Janet T. Davidson<br>Corona Del Mar, California | Retired Partner<br>Paul, Hastings, Janofsky, & Walker, LLP |
| Lawrence M. Higby<br>Newport Beach, California | Vice Chairman and Advisor<br>Apria Healthcare |
| Kenneth A. Johnson<br>Chesterfield, Missouri | Retired President and CEO<br>Automobile Club of Missouri |
| Thomas E. Larkin, Jr.<br>Newport Beach, California | Vice Chairman<br>TCW Group, Inc. |
| Raymond R. Martin<br>Rolling Hills Estates, California | Retired Chairman and CEO<br>Coast Federal Bank |
| Martha F.M. Smith<br>Birmingham, Alabama | Retired President and CEO<br>Alabama Motorists Association, Inc. |
| Ralph E. Struzziero<br>Cape Elizabeth, Maine | Self-Employed Business Consultant |
| Eugene M. Toombs<br>Chesterfield, Missouri | Chairman and CEO<br>MiTek Industries, Inc. |
| Willis B. Wood, Jr.<br>Irvine, California | Retired Chairman and CEO<br>Pacific Enterprises |

**Officers**

Officers elected by the Advisory Board and serving as of December 31, 2009, were as follows:

| Name | Office |
| --- | --- |
| David R. Carpenter | Chairman |
| Peter K. Barker | Vice-Chairman |

| | |
|---|---|
| Gail C. Louis | Secretary |
| David M. Mattingly | Treasurer |
| Avery R. Brown | Assistant Secretary |
| Carl D. Kraft | Assistant Secretary |

The CEC officers elected and serving as of December 31, 2009 were:

| Name | Office |
|---|---|
| Arthur W. Johnson | President and CEO |
| David M. Mattingly | Vice President, CFO and Treasurer |
| Michael J. Right | Vice President |
| Robert J. Schreiber | Vice President |
| Gail C. Louis | Secretary |
| Avery R. Brown | Vice President, General Counsel and Assistant Secretary |
| Carl D. Kraft | Assistant Secretary |

**Committees**

The Company has an Investment Policy Committee and an Audit Committee. Members serving on these committees as of December 31, 2009, were as follows:

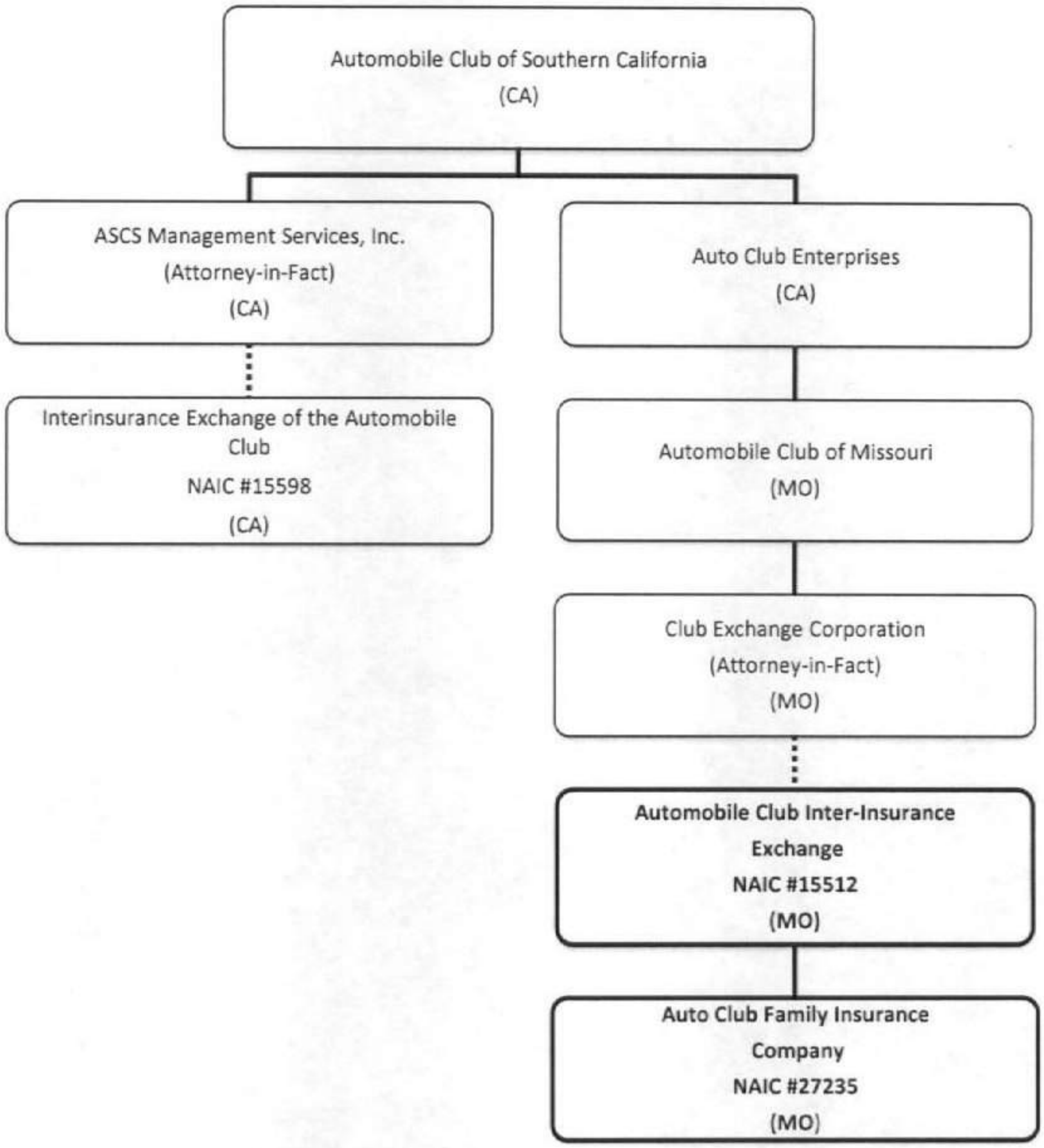
| Investment Policy Committee | Audit Committee |
|---|---|
| Peter K. Barker | Peter K. Barker |
| David R. Carpenter | Kenneth A. Johnson |
| Raymond R. Martin | Raymond R. Martin |
| Willis B. Wood, Jr. | Gilbert T. Ray |

**Holding Company, Subsidiaries and Affiliates**

The Company is part of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). The Company is a reciprocal inter-insurance exchange. The affairs of the Company are managed by CEC, the attorney-in-fact that is appointed by the subscribers of the Company. CEC is wholly owned by ACMO, an affiliate of the American Automobile Association. ACSC is the ultimate controlling entity.

**Organization Chart**

The following organization chart depicts the insurance holding company system as of December 31, 2009. Only entities that have direct and indirect ownership of the Company or that have a contractual relationship with the Company are listed. Dotted lines indicate a contractual relationship.




**Affiliated Transactions**

The Company has entered into various agreements with affiliates. These agreements are discussed below.

***Affiliation Agreement***

Parties: Exchange, ACMO, CEC, IEAC, ACSC, ACSC Management Services, Inc. and ACE.

Effective: March 1, 2006

Terms: The parties agreed to take the following actions pursuant to this agreement:

- The Board of Directors and other internal governing bodies were consolidated to accommodate representation of all companies.

- The Company and Family commuted their existing 100% inter-company reinsurance pooling treaty. In turn, a new inter-company reinsurance pooling treaty between the Company, Family and IEAC was executed with the Company and Family ceding 100% of all premiums written to the pool, after outside reinsurance, and the pool retroceding 4% and 1% of the pooled premiums to the Company and Family respectively.

- ACE and ACMO entered into a service agreement whereby the parties provide certain services to each other following the closing.

- The Company issued a surplus note in the principal amount of $50 million to IEAC. $22 million of the proceeds of the new surplus note was used to retire the $20 million surplus note that was previously issued by the Company to ACMO.

- IEAC agreed to maintain the "surplus ratio" of the Company at no less than 60% (in effect, a 167% or lower net premiums to surplus ratio) after giving effect to the new inter-company pooling agreement between the parties.

- IEAC agreed to become licensed, accredited or qualified in the state of Missouri in order for the Company and Family to take full reserve credit for amounts ceded to IEAC under the new inter-company reinsurance pooling agreement between the parties.

- The Company and Family agreed to become accredited in the state of California in order for IEAC to take full reserve credit for amounts retroceded to the Company and Family under the new inter-company reinsurance pooling agreement.

- In order to effectuate the accreditation of Family as a reinsurer in California, the Company contributed $5 million to the surplus of Family to place its surplus position above $20 million. The Company also provided a minimum surplus guaranty of $20 million for Family.

Rate(s): The Company did not earn or incur any fees in 2009 under this agreement.

***Reinsurance Pooling Agreement***

Parties: Exchange, Family and IEAC.

Effective: July 1, 2006

Terms: Under this agreement the Company and Family cede 100% of their net premiums, after outside reinsurance, to IEAC. In turn IEAC retrocedes 4% and

1% of the pooled premiums to the Company and Family respectively, and retains 95% of the premiums for itself. All losses, loss adjustment and other expenses related to this pooled business are allocated to the Company and Family on the same basis as the original retrocession percentages.

Rate(s): The Company did not earn or incur any fees in 2009 under this agreement.

***Intercompany Tax Allocation Agreement***

Parties: Exchange and Family.

Effective: January 1, 1990

Terms: This agreement provides that the parties will file a consolidated federal income tax return. The consolidated income tax liability is allocated to each of the parties on the basis of its contribution to the consolidated taxable income. Tax benefits from net operating losses and tax credits are allocated to the party generating the operating loss or tax credit.

Rate(s): The Company did not earn or incur any fees in 2009 under this agreement.

***Parental Guarantees***

Parties: Exchange and Family.

Effective: August 29, 1991 (Guarantee to Kansas)
June 28, 2006 (Guarantee to California)

Terms: The Company has provided a guarantee to the Insurance Department of the state of Kansas that the surplus of Family will not fall below $1.25 million at any point in time. This guarantee was requested by Kansas as a contingency for approval of Family to write homeowners business in Kansas. No fees are exchanged between Family and the Company for this guarantee. The size of this guarantee did not require a filing for approval for the Company or Family prior to its issuance. In addition, it is not expected that this guarantee will ever require any action on the part of the Company because the minimum surplus required of Family under Missouri statutes is $2.4 million, well above the Kansas requirement. Additionally, the Company has provided to the state of California a guarantee that the surplus of Family will not fall below $20 million at any time, which was a requirement for the initial registration of Family as an accredited reinsurer in California.

Rate(s): The Company did not earn or incur any fees in 2009 under this agreement.

***Service Agreement***

Parties: Exchange, Family, CEC and ACMO

Effective: October 12, 2009

Terms: The Company is a party to a Service Agreement under which ACMO agrees to provide all of the personnel, office furniture, fixtures and supplies (excluding data processing systems and equipment owned and provided by the Company) necessary to perform the following services on behalf of Family, CEC and the Company:

- Sales, sales promotion and administration
- Public relations and advertising
- Investment of surplus and reserves
- Claims and claims adjustment
- Underwriting
- Actuarial
- Data processing
- Occupancy of premises (i.e. custodial, maintenance, etc.)
- General office and secretarial
- Legal, accounting and auditing
- General management and administration

As compensation, the Company pays ACMO a management fee based on gross premiums written. In addition, the Company reimburses ACMO for the direct costs and overhead costs incurred by ACMO on behalf of the Company. Direct costs include those departments (such as underwriting and claims) that provide services only to the Company and Family. Overhead costs consist of other departments and functions that provide services to the insurance companies and other non-insurance affiliates. Appendix A of the agreement is re-determined periodically and represents the procedure used by ACMO to allocate expenses to the Company and Family.

Rate(s): The Company incurred $50,435,751 and paid $48,124,916 in 2009 relating to this agreement.

***Multiple Cedent Allocation Agreement***

Parties: Exchange, Family and IEAC.

Effective: January 1, 2008

Terms: The purpose of this agreement is to properly allocate and record reinsurance premiums, reinstatement premiums, and recoveries among the parties as cedents to a multiple-cedent reinsurance arrangement as required by SSAP 62. Premiums are allocated in accordance with schedules contained in the agreement. The schedules are developed using the required premium deposit amounts for each reinsurance contract at the beginning of a treaty year.

Rate(s): The Company did not earn or incur any fees in 2009 under this agreement.

## FIDELITY BOND AND OTHER INSURANCE

The Company is insured on a fiduciary policy purchased by ACSC that provides aggregate coverage of $25,000,000 with a $100,000 per loss deductible. This coverage complies with the suggested minimum amount of coverage according to NAIC guidelines.

The Company was also a named insured on other coverages that include but are not limited to directors' and officers' liability, errors and omissions liability, commercial liability, excess crime, property insurance, commercial auto and commercial excess umbrella.

## PENSIONS, STOCK OWNERSHIP AND INSURANCE PLANS

The Company does not have any direct employees. Services are provided by employees of ACMO pursuant to a service agreement.

The benefits received by the personnel covered in the above mentioned service agreement include but are not limited to paid holidays, paid vacations, paid sick leave, workers' compensation, unemployment insurance, excused absences, leave of absence, tuition reimbursement, access to the employee assistance program, and ACMO membership. In addition, ACMO provides employees a flexible benefit plan under which each employee receives an allowance (partially based on age, earnings and the cost of medical and dental coverage) which may be used to purchase the individual benefits and coverages desired. The benefits and coverages available include group life insurance, group health/dental/vision care, accidental death and dismemberment, long term disability, 401(k) profit sharing plan and defined benefit pension plan.

## TERRITORY AND PLAN OF OPERATIONS

**Territory and Plan of Operations**

The Company is licensed by the Missouri DIFP under Chapter 379 RSMo (Insurance other than life) to write property, liability, accident & health and miscellaneous insurance. The Company is also licensed in the states of Alabama, Arkansas, Illinois, Indiana, Kansas, Louisiana, Mississippi and Ohio. The Company was previously licensed in Oklahoma but surrendered its Oklahoma license in 2009. Approximately 53% of the 2009 direct premiums were written in Missouri.

The Company markets standard private passenger automobile insurance and personal umbrella insurance policies through 229 licensed captive agents who are employed by ACMO and located in 72 branch offices, and through 302 independent agents, who accounted for 24.6% of direct premium in 2009. Beginning in November 2010, insurance is only sold to members of ACMO.

The employees of ACMO also sell non-standard private passenger automobile insurance, homeowners insurance and rental dwelling insurance for Family. In addition, the employees sell memberships for ACMO as well as life, health and other insurance products for non-affiliated licensed insurance companies.

**Treatment of Policyholders**

The Missouri DIFP has a market conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent market conduct report covered the period 2001-2003 and resulted in a forfeiture of \$5,225. The impact of this examination was immaterial to the financial statements.

## GROWTH OF COMPANY

The Company's financial position has improved since the affiliation agreement with IEAC became effective. The Company has reported net income in three of the last five years. Total capital and surplus has increased in three of the last four years. The lone exception was the decrease in surplus experienced in 2008 that was primarily due to realized and unrealized capital losses on investments. As shown below, capital and surplus has increased by more than 25% since 2005:

| Year | Net Income | Change in Net Unrealized Capital Gains | Paid In Surplus | Dividends to Stockholders | Year End Capital & Surplus |
|---|---|---|---|---|---|
| 2005 | \$ 8,117,700 | \$ 2,646,848 | \$ - | \$ - | \$122,539,478 |
| 2006 | (9,202,361) | 124,722 | - | - | 142,210,744 |
| 2007 | 5,657,281 | 2,288,254 | - | - | 149,922,272 |
| 2008 | (4,333,748) | (12,814,117) | - | - | 131,506,505 |
| 2009 | 10,126,569 | 3,917,301 | - | - | 154,313,508 |

## LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Company over the last five years:

| Year | Premium Earned | Total Benefits & Expenses | Investment Income | Net Income |
|---|---|---|---|---|
| 2005 | \$ 168,879,204 | \$ 166,863,643 | \$ 6,498,113 | \$ 8,117,700 |
| 2006 | 135,624,331 | 156,341,369 | 5,095,797 | (9,202,361) |
| 2007 | 101,222,624 | 96,517,359 | 6,991,505 | 5,657,281 |
| 2008 | 100,531,483 | 93,589,299 | (5,483,792) | (4,333,748) |
| 2009 | 99,686,546 | 85,314,454 | 5,941,598 | 10,126,569 |

Net premiums and benefits have decreased significantly as a result of the pooling agreement with IEAC. This is because the Company assumes 4% of the activity from the reinsurance pool whereas the percentage ceded to the pool is higher. While net premiums have decreased, direct premiums have actually increased slightly since the affiliation. Direct losses remained relatively stable over the past five years.

## REINSURANCE

### General

Premiums written during the current examination period were as follows:

| Premiums | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|
| Direct Business | $ 175,899,366 | $ 165,225,734 | $ 169,047,398 | $ 164,354,253 |
| Reinsurance Assumed | 98,603,549 | 100,787,417 | 100,200,890 | 93,726,337 |
| Reinsurance Ceded | 175,899,366 | 165,225,734 | 169,047,398 | 110,318,023 |
| Net Premiums | $ 98,603,549 | $ 100,787,417 | $ 100,200,890 | $ 147,762,567 |

### Assumed

The Company participates in a reinsurance pooling agreement with IEAC and Family. Under this agreement the Company and Family cede 100% of their net premiums and losses after outside reinsurance to IEAC. In turn, IEAC retrocedes 4% and 1% of the pooled premiums and losses to the Company and Family respectively, and retains 95% for itself.

### Ceded

The Company participates in a reinsurance program with other members of the ACSC organization including Family, AAA Texas County Mutual Insurance Company, Auto Club Casualty Company and Auto Club Indemnity Company. The organization uses two reinsurance intermediaries, Guy Carpenter and BMS, to manage the program. Below is a summary of the limits of liabilities under the treaties (all numbers are in 000's):

| Type of Contract | Reinsurer(s) Name | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| **Property Catastrophe Excess of Loss (*)** | | | |
| 1st Layer | Various/Authorized and Unauthorized | (A) $150,000 per Risk<br>(B) $50,000 per Risk | $50,000 per Risk |
| 2nd Layer | Various/Authorized and Unauthorized | (A) $200,000 per Risk<br>(B) $100,000 per Risk | $150,000 per Risk |
| 3rd Layer | Various/Authorized and Unauthorized | (A) $350,000 per Risk<br>(B) $250,000 per Risk | $200,000 per Risk |
| 4th Layer | Various/Authorized and Unauthorized | (A) $550,000 per Risk<br>(B) $450,000 per Risk | $350,000 per Risk |
| 5th Layer | Various/Authorized and Unauthorized | (A) $900,000 per Risk<br>(B) $800,000 per Risk | $50,000 per Risk |
| 6th Layer | Various/Authorized and Unauthorized | (A) $950,000 per Risk<br>(B) $850,000 per Risk | $25,000 per Risk |

**Property Per Risk Excess of Loss**

| | | | |
|---|---|---|---|
| Property Per Risk Excess of Loss | Various/Authorized and Unauthorized | \$3,000 per Risk | \$5,000 per Risk<br>\$10,000 per Occurrence |

**85% Personal Umbrella Quota Share**

| | | | |
|---|---|---|---|
| 1st Layer | Various Authorized | 15% Retention | 85% of \$5,000 Per Risk |
| 2nd Layer | Various Authorized | 15% Retention | 85% of \$5,000 in excess of \$5,000 |

(*) The ACE companies participate at a rate of 50% in the 1st Layer and 5% in all other Layers.
(A) California Market
(B) All Other Markets

## ACCOUNTS AND RECORDS

**Independent Auditor**

The Company's financial statements were audited by PricewaterhouseCoopers for the year 2006. Subsequent to the execution of the Affililation Agreement discussed previously in this report, the Company changed auditors to Ernst & Young LLP, which performed the audits for the years 2007 to 2009. The workpapers and reports of the most recent independent audit were reviewed for this examination. These workpapers and reports were used in the course of this examination as deemed appropriate.

**Independent Actuaries**

Reserves and related actuarial accounts reported in the financial statements were reviewed and certified by Christopher Walker, FCAS, MAAA of PricewaterhouseCoopers LLP on behalf of the Company.

As a result of the Company's participation in the Reinsurance Pooling Agreement with IEAC, 100% of the Company's reserves are assumed from the pool. Since IEAC assumes 95% of the total pool reserves and is the pool leader, this examination relied on the actuarial review of the entire pool reserves performed by the independent actuary employed by the CDI for its examination of IEAC rather than contracting with a separate actuary to review the Company's share of the pool reserves. The CDI actuary's report stated that the methods used to produce the pool reserves were appropriate, appeared to be conservative, and that the reported loss and LAE reserves were reasonable.

**Information Systems**

In conjunction with this examination, Andrew Balas, AES, Information Systems Financial Examiner with the DIFP, conducted a review of the Company's information systems. His evaluation did not identify any significant weaknesses.

## STATUTORY DEPOSITS

**Deposits with the State of Missouri**

The funds on deposit with the Missouri Department of Insurance, Financial Institutions and Professional Registration as of December 31, 2009, as reflected below, were deemed sufficient in par and market value to meet the $1,200,000 deposit requirement of the state of Missouri per Section 379.098(1) RSMo (Securities deposits). The Special Deposits with the Missouri Department of Insurance, Financial Institutions and Professional Registration are held for the benefit of all policyholders, claimants and creditors of the Company.

| Security | Par Value | Market Value | Statement Value |
|---|---|---|---|
| U.S. Treasury Bond | $ 1,355,000 | $ 1,683,059 | $ 1,353,897 |
| U.S. Treasury Note | 200,000 | 206,094 | 199,460 |
| Totals | $ 1,555,000 | $ 1,889,153 | $ 1,553,357 |

**Deposits with Other States**

The Company maintains funds on deposit with other states in which it is licensed to satisfy their statutory deposit requirements. The funds on deposit with other states, which are not held for the benefit of all policyholders, claimants and creditors of the Company, as of December 31, 2009, are listed below.

| State | Security | Par Value | Market Value | Statement Value |
|---|---|---|---|---|
| Arkansas | U.S. Treasury Bond | $ 75,000 | $ 103,049 | $ 84,419 |
| Oklahoma | U.S. Treasury Note | 325,000 | 333,837 | 325,595 |
| | Totals | $ 400,000 | $ 436,886 | $ 410,014 |

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2009, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Comments on Financial Statements" which follow the financial statements.

There may have been additional differences found in the course of this examination that are not shown in the "Comments on Financial Statements." These differences were determined to be immaterial in relation to the financial statements and therefore were only communicated to the Company and noted in the workpapers for each individual annual statement item.

## ASSETS

| | Assets | Nonadmitted Assets | Net Admitted Assets |
|---|---|---|---|
| Bonds | $ 132,548,569 | $ - | $ 132,548,569 |
| Common stocks | 63,297,290 | - | 63,297,290 |
| Real estate occupied by the company | 1,428,247 | - | 1,428,247 |
| Cash and short-term investments | 22,741,578 | - | 22,741,578 |
| Receivables for securities | 363,488 | - | 363,488 |
| Investment income due and accrued | 1,544,325 | - | 1,544,325 |
| Uncollected premiums | 31,163,457 | 29,489 | 31,133,968 |
| Deferred premiums | 13,889,430 | - | 13,889,430 |
| Amounts recoverable from reinsurers | 29,201,867 | - | 29,201,867 |
| Current federal income tax recoverable | 40,001 | - | 40,001 |
| Net deferred tax asset | 2,573,347 | - | 2,573,347 |
| Guaranty funds receivable or on deposit | 2,672 | - | 2,672 |
| Receivables from affiliates | 1,664,438 | - | 1,664,438 |
| California Fair Plan | (21,767) | 58,833 | (80,600) |
| Missouri premium tax credit | 8 | - | 8 |
| Total Assets | $ 300,436,950 | $ 88,322 | $ 300,348,628 |

## LIABILITIES, SURPLUS AND OTHER FUNDS

| | |
|---|---|
| Losses | $ 26,074,224 |
| Reinsurance payable | 15,961,828 |
| Loss adjustment expenses | 6,807,670 |
| Other expenses | 185,770 |
| Taxes, licenses and fees | 343,590 |
| Unearned premiums | 47,196,431 |
| Advance premium | 961,435 |
| Policyholders dividends declared and unpaid | 3,040,000 |
| Ceded reinsurance premiums payable | 44,755,348 |
| Amounts withheld or retained by company | 132,060 |
| Remittances and items not allocated | 31,086 |
| Payable for securities | 363,489 |
| Accounts payable other | 2,190 |
| Claim payments assigned not issued | 167,999 |
| Litigation reserve | 12,000 |
| Total Liabilities | $ 146,035,120 |
| | |
| Surplus notes | $ 63,333,904 |
| Unassigned funds (surplus) | 90,979,604 |
| Total Surplus | $ 154,313,508 |
| | |
| Total Liabilities and Surplus | $ 300,348,628 |

## STATEMENT OF INCOME

| | | |
|---|---|---|
| **UNDERWRITING INCOME** | | |
| Premiums earned | $ | 99,686,546 |
| **DEDUCTIONS** | | |
| Losses incurred | | 51,584,381 |
| Loss adjustment expenses incurred | | 9,955,447 |
| Other underwriting expenses incurred | | 23,774,626 |
| Total underwriting deductions | $ | 85,314,454 |
| Net underwriting gain | $ | 14,372,092 |
| **INVESTMENT INCOME** | | |
| Net investment income earned | | 8,723,262 |
| Net realized capital losses | | (2,781,664) |
| Net investment gain | $ | 5,941,598 |
| **OTHER INCOME** | | |
| Net loss from agents' or premium balances charged off | | (184,701) |
| Finance and service charges not included in premiums | | 2,214,076 |
| Miscellaneous income | | (368,129) |
| Total other income | $ | 1,661,246 |
| Net income before dividends and FIT | $ | 21,974,936 |
| Dividends to policyholders | | 6,041,417 |
| Federal and foreign income taxes incurred | | 5,806,950 |
| Net income | $ | 10,126,569 |

## SURPLUS

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31 prior year | $ | 131,506,505 |
| Net income | | 10,126,569 |
| Change in net unrealized capital gains or (losses) less capital gains tax | | 3,917,301 |
| Change in net deferred income tax | | 512,271 |
| Change in nonadmitted assets | | 5,946,212 |
| Change in surplus notes | | 13,333,904 |
| Cumulative effect of changes in accounting principles | | 2,304,650 |
| Accrued but unapproved interest on surplus note | | (13,333,904) |
| Change in surplus as regards policyholders for the year | $ | 22,807,003 |
| Surplus as regards policyholders, December 31 current year | $ | 154,313,508 |

## COMMENTS ON FINANCIAL STATEMENTS

There are no comments on the Company's financial statements.

## GENERAL COMMENTS OR RECOMMENDATIONS

There are no general comments or recommendations.

## ACKNOWLEDGEMENT

The assistance and cooperation extended by the officers and employees of Automobile Club Inter-Insurance Exchange during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, John Boczkiewicz, CFE, CPA, examiner for the Missouri Department of Insurance, Financial Institutions and Professional Registration participated in this examination.

## VERIFICATION

State of Missouri )
) ss
County of St. Louis)

I, Richard Hayes, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Richard Hayes, CFE
Examiner-in-Charge
Department of Insurance, Financial Institutions
and Professional Registration

Sworn to and subscribed before me this 28 day of February 2011
My commission expires: 2-1-2015

Notary Public

SALLY A SNEED
Notary Public-Notary Seal
State of Missouri, Jefferson County
Commission # 11003415
My Commission Expires Feb 1, 2015

## SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Michael Shadowens, CFE
Audit Manager, St. Louis
Missouri Department of Insurance, Financial Institutions and Professional Registration