

# STATE OF MISSOURI



## DEPARTMENT OF COMMERCE & INSURANCE

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

### ORDER

After full consideration and review of the report of the financial examination of Cornerstone National Insurance Company for the period ended December 31, 2022, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, Chlora Lindley-Myers, Director, Missouri Department of Commerce and Insurance 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, history, corporate records, management and control, territory and plan of operations, accounts and records, financial statements, comments on the financial statements, subsequent events and summary of recommendations.

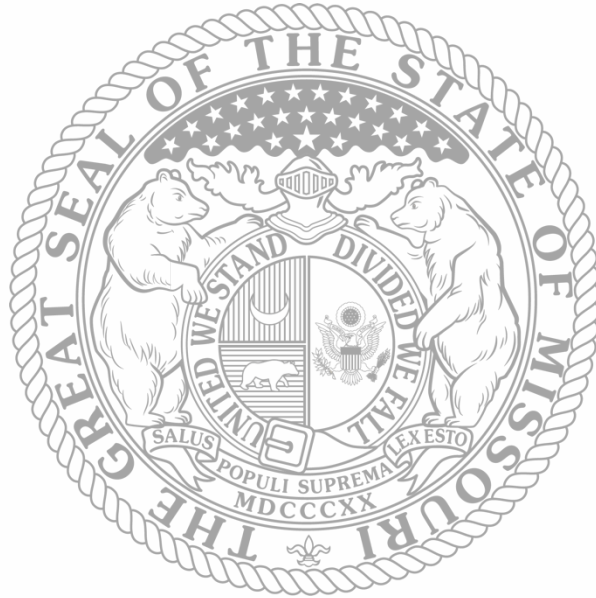
Based on such findings and conclusions, I hereby ORDER that the report of the financial examination of Cornerstone National Insurance Company as of December 31, 2022, be and is hereby ADOPTED as filed and for Cornerstone National Insurance Company to take the following action or actions, which I consider 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 mentioned in the Comments on the Financial Statement and/or Summary of Recommendations section of such report; and (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 28<sup>th</sup> day of December, 2023.



A handwritten signature in blue ink that reads 'Chlora Lindley-Myers'.

Chlora Lindley-Myers, Director  
Department of Commerce and Insurance



REPORT OF  
FINANCIAL EXAMINATION OF

# CORNERSTONE NATIONAL INSURANCE COMPANY

AS OF  
DECEMBER 31, 2022

STATE OF MISSOURI  
DEPARTMENT OF COMMERCE & INSURANCE

JEFFERSON CITY, MISSOURI

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Columbia, MO  
November 17, 2023

Honorable Chlora Lindley-Myers, Director  
Missouri Department of Commerce and Insurance  
301 West High Street, Room 530  
Jefferson City, Missouri 65101

Director Lindley-Myers:

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

**Cornerstone National Insurance Company (NAIC #10783)**

hereinafter referred to as such, as Cornerstone, or as the Company. Its administrative office is located at 19 S. Sixth Street, Columbia, Missouri, 65201, telephone number (573) 817-2481. The fieldwork for this examination began on March 6, 2023, and concluded on the above date.

**SCOPE OF EXAMINATION**

**Period Covered**

The Missouri Department of Commerce and Insurance (Department) has performed a multiple-state financial examination of Cornerstone National Insurance Company. The last examination of the Company by the Department covered the period of January 1, 2017 through December 31, 2019. The current examination covers the period of January 1, 2020 through December 31, 2022, as well as a review of any material transactions and events occurring subsequent to the examination period through the date of this report.

**Procedures**

We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook (Handbook)*, except where practices, procedures, and applicable regulations of the Department or statutes of the state of Missouri prevailed. 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 the identification and evaluation of significant risks that could cause the Company's surplus to be materially misstated, both on a current and prospective basis.

This examination also included a review of significant estimates made by management and evaluation of management's compliance with Statutory 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.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. Those activities considered in the examination as key to Cornerstone included Capital and Surplus, Claims & Reserves, Expenses, Investments, Premiums & Underwriting, Reinsurance, and Related Parties. The examination also included a review and evaluation of information technology general controls.

The examination was conducted concurrently with the examination of the Company's Missouri-domiciled affiliate, CFM Insurance, Inc. (CFM).

This examination report includes significant findings of fact, as mentioned in Section 374.205 RSMo (Examination, director may conduct, when...) and general information about the Company 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.

## **SUMMARY OF SIGNIFICANT FINDINGS**

### **1. Allocation of Expenses between Cornerstone and CFM (Pages 4, 7, 11)**

Expenses are not being allocated appropriately between Cornerstone and CFM. For instance, the majority of Innovated Holdings, Inc. (Innovated) employees' salaries and benefits are allocated to CFM, with a relatively small percentage allocated to Cornerstone. The Cost Allocation Agreement stipulates how expenses are to be allocated between Cornerstone and CFM and states that "[a]ll costs covered under this Agreement will be allocated in accordance with SSAP No. 70, 'Allocation of Expenses.'" The agreement requires a study of employee activities (i.e. time spent), which is then to be used to allocate employee salaries and benefits and other expenses between the companies. The Company has implemented a process to allocate salary and benefits, but the resulting allocations were not fair and reasonable. This is a continuation of the finding reported in the Department's 2019 Examination Report. In addition, there were instances of direct expenses not being recorded to the company incurring the expense. There were also employee costs associated with the adjusting and payment of claims that were not reported as expenses by the Company. Rather, these expenses were ultimately capitalized as an asset by the parent company.

By not following the Cost Allocation Agreement, Cornerstone's expenses are being understated and the allocation of expenses is not fair and reasonable as required by Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted). Failure to allocate expenses to Cornerstone in conformity with customary insurance accounting practices consistently applied is not in compliance with Section 382.190(3), RSMo. Additionally, by not following the terms of the agreement as previously approved by the Director, the Company is not in compliance with of Section 382.195.1, RSMo (Prohibited transactions, exceptions).

### **2. Expense Ratio (Page 11)**

Cornerstone's expense ratio is higher than industry averages, and expenses were recorded directly by CFM instead of being allocated between companies in accordance with Exhibit B of the Cost Allocation Agreement. Had the Cost Allocation Agreement been followed, Cornerstone would have been allocated additional expenses, further increasing its expense ratio and the need for expense management measures.

**3. Insufficient Controls over Agent Premium Writing (Page 16)**

Subsequent to the exam period, insufficient controls over agent premium writing led to premium written in excess of budgeted numbers. This rapid growth, along with increased storm activity in first half of 2023, have placed strain on the Company's surplus, requiring additional capital contributions. In addition, the reinsurance program for 2023 changed to significantly increase its catastrophe excess of loss reinsurance retentions, as well as discontinue aggregate excess of loss reinsurance, reducing protection from the accumulation of losses.

**COMPANY HISTORY**

**General**

Cornerstone National Insurance Company was organized on March 6, 1997, as a stock property and casualty insurer pursuant to Chapter 379 of the Revised Statutes of Missouri. On March 1, 2019, Innovated purchased 100% of the outstanding stock of Cornerstone. As of December 31, 2022, Innovated was owned 93.2% by CFM and 6.8% by Forrester Mutual Insurance Company (Forrester Mutual), an Illinois-domiciled insurer.

**Mergers, Acquisitions, and Major Corporate Events**

There were no mergers, acquisitions or major corporate events during the current examination period.

**Dividends and Capital Contributions**

There were no dividends or capital contributions during the current examination period. Cornerstone received several capital contributions subsequent to the examination period as described in the Subsequent Events section of the examination report.

**Surplus Notes**

Cornerstone issued a \$5,000,000 surplus note to Dekania CDO II, Ltd. in exchange for cash on July 7, 2004. The interest rate is based on the 3-month LIBOR rate plus 4.2%, and the note has a maturity date of April 29, 2034. The Company reported a surplus note balance of \$6,071,156 as of December 31, 2022, which includes \$1,071,156 in accrued interest.

**MANAGEMENT AND CONTROL**

**Board of Directors**

The management of the Company is vested in a Board of Directors that are elected by the shareholders. The Company's Articles of Incorporation specify that there shall be no less than 9 and no more than 25 Board members. The Board of Directors elected and serving as of December 31, 2022, were as follows:

| <b><u>Name and Address</u></b>                   | <b><u>Principal Occupation and Business Affiliation</u></b>                                       |
|--|---|
| Marla J. Zirkle<br>Oak Grove, Missouri           | Controller<br>Steel City Media  |
| Roger E. Needham<br>Roscoe, Illinois             | Operations Manager / Treasurer<br>Forreston Mutual Insurance Company                              |
| George H. Zimmerschied<br>Independence, Missouri | Sales Manager<br>Kinze Manufacturing  |
| Dale L. Dieckhoff<br>Concordia, Missouri         | Retired Information Technology Director<br>University of Central Missouri                         |
| Garret L. Holzum<br>Columbia, Missouri           | Associate Director of Production<br>Veterans United   |
| Elizabeth J. Mendenhall<br>Columbia, Missouri    | Chief Executive Officer and Owner<br>Re/Max Boone Realty  |
| Eric C. Hoffman<br>Trenton, Missouri             | Owner / Operator<br>Hoffman Farms, Inc.   |
| Jacob R. Black<br>Columbia, Missouri             | President and Chief Executive Officer<br>Cornerstone National Insurance Company                   |
| Robert R. Gass<br>Trenton, Missouri              | Executive Vice President and Chief Underwriting Officer<br>Cornerstone National Insurance Company |
| Cynthia S. Talias<br>Concordia, Missouri         | Director of Quality & Benefits<br>Cornerstone National Insurance Company                          |
| Elizabeth B. Wilkens<br>Warrensburg, Missouri    | Vice President of Sales and Marketing<br>Cornerstone National Insurance Company                   |

**Senior Officers**

The officers elected and serving, as of December 31, 2022, were as follows:

| <b><u>Name</u></b>   | <b><u>Office</u></b>                                    |
|----------------------|---|
| Jacob R. Black       | President and Chief Executive Officer                   |
| David S. Forrest     | Secretary & General Counsel                             |
| Robert R. Gass       | Executive Vice President and Chief Underwriting Officer |
| Dennis W. Lowry      | Chief Financial Officer                                 |
| Elizabeth B. Wilkens | Vice President Sales and Marketing                      |

Below is a summary of the percentage the officers' salaries that were allocated to Cornerstone during 2022. The Company is party to a Cost Allocation Agreement (See Intercompany Transactions section below) that requires employee salaries to be allocated to Cornerstone and affiliate CFM based upon activities provided by each employee on behalf of the individual company. Note that none of the salaries of Cornerstone's President/Chief Executive Officer or the Vice President of Sales and Marketing were allocated to Cornerstone. As such, according to Cornerstone, its President/Chief Executive Officer and Vice President of Sales and Marketing did not perform any services covered by the Cost Allocation Agreement—services which include marketing and advertising, strategic planning, regulatory compliance, and public relations—for Cornerstone during 2022.



| <b><u>Name</u></b>   | <b><u>2022 Payroll Allocation (%)</u></b> |
|----------------------|---|
| Jacob R. Black       | 0%  |
| David S. Forrest     | 45%                                       |
| Robert R. Gass       | 15%                                       |
| Dennis W. Lowry      | 5%  |
| Elizabeth B. Wilkens | 0%  |

**Principal Committees**

The Company's Bylaws specify the Board may authorize and designate one or more executive committees with each committee consisting of two or more directors. Currently, the Board has established the following committees:

**Audit / Investment**

Garret L. Holzum, Chair  
 Roger E. Needham  
 George H. Zimmerschied

**Executive / Corporate Governance**

Marla Zirkle, Chair  
 George H. Zimmerschied  
 Jacob R. Black

**Human Resource / Compensation**

Eric C. Hoffman, Chair  
 Dale L. Dieckhoff  
 George H. Zimmerschied  
 Marla J. Zirkle

**Enterprise Risk Management**

George H. Zimmerschied, Chair  
 Eric C. Hoffman  
 Garrett L. Holzum

**Product, Rate, Reinsurance, and Actuary**

Dale L. Dieckhoff, Chair  
 Robert R. Gass  
 Garrett L. Holzum

The Audit / Investment Committee met at least annually during the examination period. The Enterprise Risk Management and the Product, Rate, Reinsurance, and Actuary Committees held a meeting in November 2022. Other committees established by the Board held no meetings during the examination period. The Board Chair and Board Vice-Chair of the Board of Directors and the President and Chief Executive Officer may attend the meeting of any committees in which they are not otherwise appointed to serve as a member.

**Corporate Records**

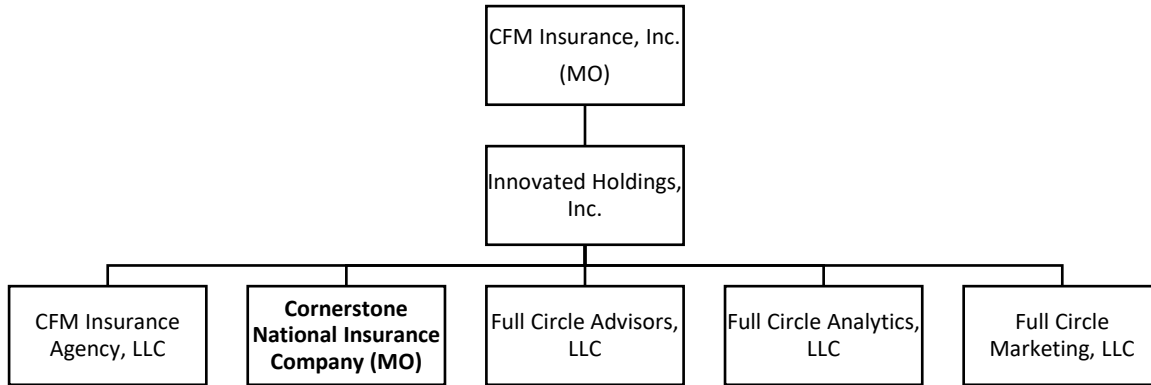
The Company's Articles of Incorporation (Articles) and Bylaws were reviewed. The Articles were amended on October 16, 2020, and filed with the Missouri Secretary of State. The Bylaws were amended on March 15, 2022, and filed with the Department. The minutes of the shareholder, board of directors and committees were reviewed for the period under examination.

**Holding Company, Subsidiaries, and Affiliates**

Cornerstone is a member of an Insurance Holding Company System, as defined by Section 382.010, RSMo (Definitions). Cornerstone is wholly-owned by Innovated, an insurance holding company that owns four non-insurance limited liability companies. CFM is the ultimate controlling entity within the holding company system.

**Organizational Chart**

The following organizational chart depicts the applicable portion of the holding company group as of December 31, 2022. All subsidiaries are wholly-owned except as follows. As of December 31, 2022, Innovated was owned by CFM (93.2%) and Forreston Mutual (6.8%). Forreston Mutual is not considered an affiliate under Section 382.010, RSMo.



**Intercompany Transactions**

The following agreements represent significant contracts executed with affiliated entities that were in effect as of December 31, 2022. A brief description of these agreements are as follows:

**Tax Allocation Agreement:** Cornerstone, CFM, and Innovated are parties to a Tax Allocation Agreement effective February 1, 2019. The terms of the agreement state that the tax liability apportioned to each member of the group is based on the relative federal income tax liability each company would have incurred on a separate company basis. Estimated payments or refunds are to be made quarterly, with a final settlement to be made within 30 days of filing the combined return or receipt of refund.

**Cost Allocation Agreement:** Cornerstone, CFM, and Innovated are parties to a Cost Allocation Agreement effective April 1, 2019. Per the terms of the agreement, Innovated will provide various management and administrative support services to Cornerstone and CFM, including claims processing, underwriting, marketing/advertising, accounting/tax, and numerous others. On the effective date of the agreement, all employees of Cornerstone and CFM became employees of Innovated. The monthly fee paid by Cornerstone and CFM is equal to the direct costs incurred by Innovated for the provision of such services.

Exhibit B of the Cost Allocation Agreement between the parties states that the allocable portion of the salary and benefits of Innovated employees will be determined by a study of employee activities by company (i.e. time spent) and will be adjusted annually as necessary.

The Company's process to allocate salary and benefits between companies is to have employee directors and managers determine allocation percentages during the annual budget and planning process. However, this process of allocation did not yield the most accurate results in accordance with SSAP 70 and was not fair and reasonable in accordance with Section 382.190 RSMo, as noted in the following examples:

- The Chief Executive Officer and the Vice President of Sales and Marketing had zero percent of salary and benefits allocated to Cornerstone.
- The Chief Financial Officer had only five percent of salary and benefits allocated to Cornerstone, and the remaining employees with accounting duties had zero percent of salary and benefits allocated to Cornerstone. While CFM is the larger company by asset and premium volume, the majority of financial reporting responsibilities in the holding company system are attributable to Cornerstone.
- A report from the Company's claims system show one employee was the assigned claims adjuster on 280 paid claims in 2022; however, 100 percent of the salary and benefits for this individual was capitalized to a software project and reported as an asset by the parent company.
- Three employees in 2021 and two employees in 2022 had 100 percent of salary and benefits capitalized to a software project and reported as an asset by the parent company. The job titles of these employees included Underwriting Manager, Executive Personal Assistant, and Claims Adjuster, suggesting various other duties unrelated to computer or software systems.

The capitalizing of loss adjusting expense as a future benefit illustrates how the Company's process in place does not result in fair and reasonable allocation based on statutory accounting principles. Furthermore, SSAP 70, paragraph 9, states "...personnel costs associated with the adjusting and paying of claims, must be borne solely by the reporting entity and are not to be apportioned to other entities within a group."

The Company did not follow the Cost Allocation Agreement in the allocation of other expenses in Exhibit B. The majority of expenses in these categories that should have been subject to allocation per the agreement were recorded directly to a specific company instead of being allocated based on percentage of payroll. The Company's process for allocating credit card expenses was to provide employees with credit cards issued under each company name as necessary and appropriate. Purchases on credit cards issued to CFM and Cornerstone were recorded directly to the respective company's accounting records. Purchases on credit cards issued under Innovated were allocated between companies based on review of individual transactions. This process does not meet the requirement in the Cost Allocation Agreement to allocate expenses in specified categories based on percentage of total payroll.

In addition to not following the Cost Allocation Agreement, the process to allocate expenses in specified categories did not result in fair and reasonable allocation. Purchases on CFM and Cornerstone credit cards in 2022 combined for a total of \$2,022,928 in charges, with 98 percent of expenses recorded to CFM and 2 percent recorded to Cornerstone. Review of two months of purchases on Innovated credit cards noted 96 percent of expenses were recorded to CFM and 4 percent were recorded to Cornerstone.

Travel and entertainment, education and training, and board fees and expenses are listed as categories to be allocated between companies. In 2022, CFM had credit card transactions recorded directly to general ledger accounts of travel/ meeting registration totaling \$503,967 and board fees totaling \$121,002. These expenses were not allocated based on percentage of total payroll. For example, a Director and Company officer retreat with Board and Board Committee meetings was held for each company within the Holding Company System. Cornerstone's Board of Directors and Board Committees held four separate meetings during this retreat, but Cornerstone was not allocated any of the costs associated with the retreat.

It was noted that expenses were not always reported by the company incurring the expense. For example, review of the 2022 credit card statements for the credit card issued to the National Sales Director identified travel related transactions in the states of Arkansas, Illinois, Kansas, Oklahoma, and Tennessee, all states where Cornerstone wrote business in 2022. However, these expenses were recorded as being incurred by CFM, which is authorized to conduct business only in the state of Missouri.

Another example of not allocating direct expenses to the company incurring the expense is a transaction at a hotel in Little Rock, Arkansas for hotel, meeting room and catering expenses. The Company's explanation for the purpose of transaction is to host Arkansas agents and train them on the new quoting system. Again, this expense was recorded as being incurred by CFM, which is authorized to conduct business only in the state of Missouri. The agency listing provided for CFM did not include any agents with an Arkansas business address.

Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted), require that material transactions by registered insurers with their affiliates have terms that are fair and reasonable, and that charges or fees for services be reasonable. Per SSAP No. 25, paragraph 20, expenses that result from cost allocations shall be allocated subject to a fair and reasonable standard. Paragraph 20 further states, "Regulatory scrutiny of related party transactions where amounts charged for services that do not meet the fair and reasonableness standard established, may result in (a) amounts charged being recharacterized as dividend or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action." The processes used by the companies to allocate employee salary and benefit expenses and thus also other total expenses, as required in Exhibit B of the Cost Allocation Agreement, did not meet the fair and reasonable standard required by Section 382.190(1) and (2) and SSAP No. 25. In addition, as required in Exhibit B of the Cost Allocation Agreement, direct costs paid by Innovated were not passed through to the appropriate entity.

Based on the above-described issues, the allocation of expenses resulted in Cornerstone's expenses being understated. The allocation of expenses to Cornerstone was not fair and reasonable under Section 382.190(1) and (2), RSMo (Transactions with affiliates, how conducted), and the failure to allocate expenses to Cornerstone in conformity with customary insurance accounting practices consistently applied did not comply with Section 382.190(3). Additionally, the allocation of expenses to Cornerstone outside of the allocation method prescribed in the Cost Allocation Agreement constitutes a cost sharing arrangement that the Director did not approve as required by Section 382.195.1, RSMo (Prohibited transactions, exceptions).

**TERRITORY AND PLAN OF OPERATION**

Cornerstone is licensed as a property and casualty insurer by the Missouri Department of Commerce and Insurance under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed in 19 states, but only wrote in seven states during 2022. The states with the largest percentage of written premiums in 2022 were Arkansas (39%), Oklahoma (33%), Illinois (18%), and Missouri (9%). Cornerstone utilizes independent agents to market its products.

The Company's largest lines of business by percentage of 2022 net written premiums are homeowners multiple peril (34%), other private passenger auto liability (29%), and private passenger auto physical damage (24%). The Company also writes other liability – occurrence (11%) through partnership with Forreston Mutual.

**GROWTH OF COMPANY AND LOSS EXPERIENCE**

Net premiums written in 2020 and 2021 decreased significantly from 2019 net premiums written of \$10.7 million as the Company moved away from non-standard auto business and ended relationships with unprofitable agencies. In the second half of 2022, the Company began to increase the amount of business written. Net written premiums increased 32% in 2022.

The table below summarizes the Company's premium writings and writing ratios for the period under examination:

*(\$000s omitted)*

| <b>Year</b> | <b>Net Premiums Written</b> | <b>Change in Net Premiums</b> | <b>Capital and Surplus</b> | <b>Ratio of Net Premiums to Surplus</b> |
|-------------|-----------------------------|-------------------------------|----------------------------|---|
| 2020        | \$ 5,881                    | \$ (4,862)                    | \$ 7,436                   | 79%                                     |
| 2021        | 5,794                       | (87)                          | 7,424                      | 78%                                     |
| 2022        | 7,636                       | 1,842                         | 4,935                      | 155%                                    |

Cornerstone reported an underwriting loss for each year in the examination period. The loss ratio decreased in 2020 and 2021 from the loss ratio in 2019 of 85.6%. Net losses and loss adjustment expenses and the loss ratio increased significantly in 2022.

The table below summarizes the Company's incurred losses and loss ratios for the period under examination:

*(\$000s omitted)*

| <b>Year</b> | <b>Net Premiums Earned</b> | <b>Net Losses and Loss Adjustment Expenses</b> | <b>Loss Ratio</b> |
|-------------|----------------------------|--|-------------------|
| 2020        | \$ 6,473                   | \$ 4,736                                       | 73%               |
| 2021        | 5,455                      | 2,833  | 52%               |
| 2022        | 5,666                      | 4,865  | 86%               |

## REINSURANCE

### General

The Company's premium activity on a direct written, assumed, and ceded basis for the period under examination is detailed below:

| <i>(\$000s omitted)</i>     |             |              |             |              |             |              |
|-----------------------------|-------------|--------------|-------------|--------------|-------------|--------------|
| <b>Premium Type</b>         | <b>2020</b> |              | <b>2021</b> |              | <b>2022</b> |              |
| Direct Premiums Written     | \$          | 7,883        | \$          | 6,605        | \$          | 8,882        |
| Reinsurance Ceded:          |             |              |             |              |             |              |
| Non-Affiliates              |             | 2,002        |             | 811          |             | 1,245        |
| <b>Net Premiums Written</b> | <b>\$</b>   | <b>5,881</b> | <b>\$</b>   | <b>5,794</b> | <b>\$</b>   | <b>7,636</b> |

### Assumed Reinsurance

The Company did not assume any premiums during the period under examination.

### Ceded Reinsurance

Cornerstone utilizes reinsurance broker BMS Intermediaries, Inc. for the placement of most reinsurance coverage. Grinnell Mutual Reinsurance Company (Grinnell) is the primary reinsurer utilized and has an "A" (Excellent) rating by AM Best. Cornerstone has multi-line excess of loss, umbrella quota share, property catastrophe excess of loss, and aggregate stop loss reinsurance agreements with Grinnell.

Under Coverage A (property) of the multi-line excess of loss agreement, the Company has a retention of \$200,000 with a reinsurer limit of \$19,800,000. Under Coverage B (liability), the Company has a retention of \$200,000 with a reinsurer limit of \$1,800,000.

Under the umbrella quota share agreement, the Company cedes 95% quota share participation on umbrella liability business of the first \$1 million of net liability as respects each occurrence, each policy. Grinnell assumes 100% of the liability in excess of \$1 million subject to a maximum liability of \$5 million each occurrence, each policy.

Under the property catastrophe agreement, Grinnell provides loss coverage of \$4.8 million in excess of \$200,000 any one loss occurrence. Under the aggregate stop loss agreement, Grinnell is liable for 100% of losses that exceed 67.5% of net earned premium.

In addition, Cornerstone has a 100% quota share agreement with Grinnell for earthquake coverage, a 100% quota share agreement with Munich Reinsurance America, Inc. for inland flood property coverage, and a 100% quota share agreement with Factory Mutual Insurance Company for equipment breakdown coverage.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance contract.

**ACCOUNTS AND RECORDS**

**Independent Auditor**

The certified public accounting (CPA) firm, Cain Ellsworth & Company, LLP in Sheldon, Iowa, performed the statutory audit of the Company for the years under examination. This examination included a review of the Company’s audit function, which included a review of the work of the external auditor.

**Actuarial Opinion**

The Company’s actuarial opinion regarding loss reserves, loss adjustment expense (LAE) reserves, and other actuarial items was issued by Scott Anderson, FCAS, MAAA, for all years in the examination period. Mr. Anderson is employed by Actuarial Advisors, Inc. in Minneapolis, Minnesota.

**Consulting Actuary**

Pursuant to a contract with the Department, Kristine M. Fitzgerald, ACAS, MAAA, FCA, of Actuarial & Technical Solutions, Inc., reviewed the underlying actuarial assumptions and methodologies used by Cornerstone to determine the adequacy of loss reserves and LAE reserves. Ms. Fitzgerald determined that the Company made a reasonable provision for the loss and LAE reserves that were reported in the statutory financial statements, as of December 31, 2022. Julie Lederer, FCAS, MAAA, the Department’s Property and Casualty Actuary, reviewed the work performed by the consulting actuary.

**Information Systems**

In conjunction with this examination, Alicia Galm, CFE, Information Systems Financial Examiner, and Kimberly Dobbs, CFE, AES, CISA, Information Systems Financial Examiner-in-Charge, with the Department, conducted a review of the Company’s information systems.

**Key Activity Review - Expenses**

Our examination included a review of expenses as a key activity. Our review determined Cornerstone’s expense ratio was higher than its peers. Cornerstone was purchased in 2019, and new management took various measures to cut expenses in its plan to become profitable. Despite these actions, Cornerstone’s expense ratio has increased from 44% in 2019 and remained in a range of 50% to 54% during the examination period as shown in the table below. The NAIC 2022 Annual Report on the U.S. Property & Casualty and Title Insurance Industries reports that U.S. property and casualty insurance industry had an average expense ratio between 26% to 27% during this period. Additional cost cutting measures are required to reduce expense ratio within range of industry average.

The table below summarizes the Company’s underwriting ratios for the period under examination:

| <b><u>Underwriting Analysis</u></b> | <b><u>2020</u></b> | <b><u>2021</u></b> | <b><u>2022</u></b> |
|-------------------------------------|--------------------|--------------------|--------------------|
| Expense Ratio                       | 53%                | 54%                | 50%                |
| Loss Ratio                          | 73%                | 52%                | 86%                |
| Combined Ratio                      | 126%               | 106%               | 136%               |

The 2023 budget approved by the Company’s Board of Directors included an expense ratio of 57%, which is higher than each year under examination and significantly higher than the industry average. Additionally, as described in the Intercompany Transaction section of the Examination Report, our review determined that the Company’ process for allocating expenses resulted in Cornerstone’s reported expense ratio and loss ratio being understated.

## **FINANCIAL STATEMENTS**

The following financial statements are based on the statutory financial statements filed by the Company with the Department and present the financial condition of Cornerstone National Insurance Company for the period ending December 31, 2022. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the financial statements and should be considered an integral part of the financial statements. The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Comments on Financial Statement Items.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual key activity.



**ASSETS**

As of December 31, 2022

|   | <b>Assets</b>        | <b>Nonadmitted<br/>Assets</b> | <b>Net Admitted<br/>Assets</b> |
|---|----------------------|-------------------------------|--------------------------------|
| Bonds   | \$ 9,581,449         | \$ 0                          | \$ 9,581,449                   |
| Stocks:   |                      |                               |                                |
| Common Stocks   | 654,781              | 0                             | 654,781                        |
| Cash, Cash Equivalents, and Short-<br>Term Investments                      | 974,982              | 0                             | 974,982                        |
| Investment Income Due and Accrued   | 41,200               | 0                             | 41,200                         |
| Premiums and Considerations:  |                      |                               |                                |
| Uncollected Premiums and<br>Agents' Balances in the Course<br>of Collection | 1,341,775            | 0                             | 1,341,775                      |
| Reinsurance:  |                      |                               |                                |
| Amounts Recoverable from<br>Reinsurers                                      | 45,208               | 0                             | 45,208                         |
| Net Deferred Tax Asset  | 1,343,115            | 1,343,115                     | 0                              |
| Electronic Data Processing<br>Equipment and Software                        | 22,403               | 22,403                        | 0                              |
| Aggregate Write-Ins for Other-Than-<br>Invested Assets                      | 101,176              | 9,175                         | 92,001                         |
| <b>TOTAL ASSETS</b>   | <b>\$ 14,106,089</b> | <b>\$ 1,374,693</b>           | <b>\$ 12,731,396</b>           |

**LIABILITIES, SURPLUS AND OTHER FUNDS**

As of December 31, 2022

|   |                      |
|---|----------------------|
| Losses  | \$ 2,222,835         |
| Loss Adjustment Expenses  | 783,552              |
| Commissions Payable, Contingent Commissions, and Other Similar<br>Charges | 365,228              |
| Other Expenses  | 329,690              |
| Unearned Premiums   | 3,851,725            |
| Advance Premiums  | 81,461               |
| Ceded Reinsurance Premiums Payable (Net of Ceding Commissions)            | 58,085               |
| Payable to Parent, Subsidiaries, and Affiliates                           | 104,294              |
| <b>TOTAL LIABILITIES</b>  | <b>\$ 7,796,870</b>  |
| Common Capital Stock  | 2,500,000            |
| Surplus Notes   | 6,071,156            |
| Gross Paid In and Contributed Surplus                                     | 212,897              |
| Unassigned Funds (Surplus)  | (3,849,527)          |
| <b>TOTAL CAPITAL AND SURPLUS</b>  | <b>\$ 4,934,526</b>  |
| <b>TOTAL LIABILITIES AND SURPLUS</b>                                      | <b>\$ 12,731,396</b> |

**STATEMENT OF INCOME**  
For the Year Ended December 31, 2022

|  |                              |
|--|------------------------------|
| Premiums Earned  | \$ 5,665,852                 |
| DEDUCTIONS:  |                              |
| Losses Incurred  | 4,545,300                    |
| Loss Adjustment Expenses Incurred                            | 319,683                      |
| Other Underwriting Expenses Incurred – Note 1                | 3,844,049                    |
| Total Underwriting Deductions                                | <u>\$ 8,709,032</u>          |
| <b>Net Underwriting Gain (Loss)</b>                          | <b>\$ (3,043,180)</b>        |
| Net Investment Income Earned                                 | 418,475                      |
| Net Realized Capital Gains                                   | (126,100)                    |
| <b>Net Investment Gain (Loss)</b>                            | <b>\$ 292,375</b>            |
| Net Gain (Loss) from Agents' or Premium Balances Charged Off | (16,230)                     |
| Finance and Service Charges Not Included in Premiums         | <u>468,552</u>               |
| <b>NET INCOME (LOSS)</b>                                     | <b><u>\$ (2,298,483)</u></b> |

**RECONCILIATION OF CAPITAL AND SURPLUS**  
Changes from January 1, 2020 to December 31, 2022

*(\$000s omitted)*

|   | <u>2020</u>            | <u>2021</u>            | <u>2022</u>            |
|---|------------------------|------------------------|------------------------|
| Capital and Surplus, Beginning of Year  | \$ 7,590               | \$ 7,436               | \$ 7,424               |
| Net Income (Loss)                       | 23                     | 53                     | (2,298)                |
| Change in Net Unrealized Capital Gains  |                        |                        |                        |
| (Losses) Less Capital Gains Tax         | 66                     | 18                     | (224)                  |
| Change in Net Deferred Income Tax       | (63)                   | (15)                   | 534                    |
| Change in Nonadmitted Assets            | (180)                  | 55                     | (501)                  |
| Change in Surplus Notes                 | 338                    | 143                    | 303                    |
| Aggregate Write-Ins for Gains and       |                        |                        |                        |
| Losses in Surplus                       | (338)                  | (265)                  | (303)                  |
| Net Change in Capital and Surplus       | <u>(154)</u>           | <u>(11)</u>            | <u>(2,490)</u>         |
| <b>Capital and Surplus, End of Year</b> | <b><u>\$ 7,436</u></b> | <b><u>\$ 7,424</u></b> | <b><u>\$ 4,935</u></b> |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### Note 1: Other Underwriting Expenses Incurred

While no financial statement changes resulted from the examination, as noted in the Intercompany Transaction section of the examination report, not following the Cost Allocation Agreement in the allocation of expenses resulted in Cornerstone's Other Underwriting Expenses Incurred being understated.

## FINANCIAL STATEMENT CHANGES RESULTING FROM EXAMINATION

None.

## SUMMARY OF RECOMMENDATIONS

### Senior Officers

Page 4

Cornerstone should properly and fairly allocate sufficient officer and management time to allow for the planning and operation of the Company. The Company should also develop a detailed allocation plan and file the plan with the Department, along with evidence the plan is being followed.

### Intercompany Transactions

Page 7

The Company's processes should be revised to ensure that the percentage of salaries and benefits and other total expenses allocated between the companies, as well as the assignment of direct expenses, meet the fair and reasonable standard required by SSAP No. 25 (Affiliates and Other Related Parties), and to comply with SSAP No. 70 (Allocation of Expenses) and Sections 382.190 and 382.195, RSMo. The Company should file the revised processes and the allocation results with the Department, or file a new cost allocation agreement with other acceptable methodologies to allocate costs.

### Key Activity Review – Expenses

Page 11

Cornerstone should file a plan with the Department that outlines measures to reduce underwriting losses. The plan should include a description of the measures the Company is implementing to achieve a reduction in expenses.

### Subsequent Events – Premium Growth

Page 16

The Company should file a plan with the Department outlining what procedures the Company is implementing to better control premium writings to ensure premiums written stay within a reasonable range of the amount budgeted. The Company should file its plan to achieve these goals with the Department.

### Subsequent Events – Capital Contribution

Page 16

Innovated and Cornerstone should provide the Department with proper notice for any transaction subject to requirements of Section 382.195.1, RSMo, and 20 CSR 200-11.101(16)(A).

## SUBSEQUENT EVENTS

Several significant events and/or transactions occurred subsequent to the examination period, as follows:

- Cornerstone had significant growth in written premium during the first half of 2023. Cornerstone reported net written premiums of \$7,755,181 as of June 30, 2023, which is a 163% increase over net premiums written of \$2,949,750 as of June 30, 2022. The Board of Directors approved a budget for 2023 with net written premiums for the year of \$7,281,929. As of June 30, 2023, Cornerstone had exceeded the approved amount for the entire year even with the Company putting a moratorium on most new business in late May. This rapid growth along with increased storm activity in first half of 2023 have placed strain on the Company's surplus.
- Aggregate excess of loss coverage for Cornerstone was not placed in 2023. In 2022, the Company had stop loss reinsurance limiting annual losses to 67.5% of net earned premiums. This increased the Company's exposure to losses accumulating throughout the year. The property catastrophe excess of loss retention changed from \$200,000 in 2022 to \$500,000 in 2023, thereby increasing the Company's exposure to losses resulting from catastrophic events.
- The Department approved a Form D filing for a SSAP 72 cash contribution in the amount of \$500,000 from Innovated to Cornerstone with an effective date of March 31, 2023. The Company failed to provide proper notice of the transaction under the requirements of Section 382.195.1, RSMo, and 20 CSR 200-11.101(16)(A).
- On April 30, 2023, Oakwood Mutual Insurance Company (Oakwood Mutual), an Indiana insurance corporation, purchased 495 shares of Class C common stock in Innovated. As a result of the transaction, Innovated was owned by CFM (90.2%), Forrester Mutual (6.5%), and Oakwood Mutual (3.3%).
- On May 31, 2023, Cornerstone submitted a Form D filing requesting approval of a capital contribution of \$1,300,000 to Cornerstone from Innovated. The Department non-disapproved the contribution on June 1, 2023. On June 9, 2023, Cornerstone received a \$1,300,000 cash contribution from Innovated.
- During the months of April and May 2023, the Company reduced and then placed a moratorium on the writing of most new business.
- On August 9, 2023, Cornerstone submitted a Form D filing requesting approval of a capital contribution of \$2,000,000 from CFM to Innovated to Cornerstone. The filing sought the Director's approval that the contribution be considered an admitted asset on Cornerstone's June 30, 2023, statutory financial statements as a receivable under SSAP 72, paragraph 8. The Department non-disapproved the contribution on August 10, 2023. On August 14, 2023, Cornerstone received a \$2,000,000 cash contribution from CFM.

In consideration for CFM's \$2,000,000 capital contribution, Innovated issued 990 shares of Class A common stock to CFM effective June 30, 2023. As a result of the transaction, Innovated was owned by CFM (90.8%), Forrester Mutual (6.1%), and Oakwood Mutual (3.1%).

- The Company reported a net loss of (\$2,724,407) through September 30, 2023, in its statutory financial statements. Through September 30, 2023, the Company had a combined ratio of 131%, a loss ratio of 94%, and an expense ratio of 37%. The Company attributed the losses to increased storm activity in Midwestern states during early 2023 and resulting exposure to two separate catastrophe events through June 30, 2023. As a result of the three above-noted capital contributions totaling \$3,800,000, the Company reported surplus of \$6,036,304 as of September 30, 2023.

**ACKNOWLEDGMENT**

In addition to the undersigned, Joshua Nash, CPA, CFE, Examiner-In-Charge, and Tim Tunks, CPA, CFE, and Rebecca Edwards, APIR, Examiners, for the Missouri Department of Commerce and Insurance, also participated in this examination.

**VERIFICATION**

State of Missouri            )  
  )    ss  
County of Cole             )

I, Brian D. Hammann, CPA, CFE, 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 Cornerstone National Insurance 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.

*Brian D. Hammann*

\_\_\_\_\_  
Brian D. Hammann, CPA, CFE  
Examiner-In-Charge  
Missouri Department of Commerce and  
Insurance

Sworn to and subscribed before me this 20<sup>th</sup> day of November, 2023.

My commission expires: May 18, 2024 *Kimberly Landers*  
\_\_\_\_\_  
Notary Public



KIMBERLY LANDERS  
My Commission Expires  
May 18, 2024  
Callaway County  
Commission #12558402

### **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, except where practices, procedures, and applicable regulations of the Missouri Department of Commerce and Insurance and statutes of the state of Missouri prevailed.



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Michael Shadowens, CFE  
Assistant Chief Financial Examiner  
Missouri Department of Commerce and  
Insurance