REPORT ON EXAMINATION

OF

COMMERCE AND INDUSTRY INSURANCE COMPANY

AS OF

DECEMBER 31, 2015

| | |
|---|---|
| DATE OF REPORT | MAY 26, 2017 |
| EXAMINER | MARIBEL C. NUNEZ, CPCU |

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NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

May 26, 2017

Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31366 dated August 5, 2015, attached hereto, I have made an examination into the condition and affairs of Commerce and Industry Insurance Company as of December 31, 2015, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Commerce and Industry Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company's office located at 80 Pine Street, New York, New York 10005.

## 1. SCOPE OF EXAMINATION

The Department has performed a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2010. This examination covered the five-year period from January 1, 2011 through December 31, 2015. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

New York is the lead state for the American International Group. The examination was conducted in conjunction with the Insurance Department of the Commonwealth of Pennsylvania, which acted as the facilitating state. Other states participating in this examination were Delaware, represented by RIS, Illinois, and Puerto Rico. The examination was performed concurrently with the examination of the following insurers, domiciled as indicated:

American Home Assurance Company ("AHAC"), (NY);
AIU Insurance Company ("AIU"), (NY);
National Union Fire Insurance Company of Pittsburgh, Pa ("NUFIC"), (PA);
AIG Property Casualty Company ("AIG P&C"), (PA);
The Insurance Company of the State of Pennsylvania ("ICPA"), (PA);
AIG Assurance Company ("AIGAC"), (PA);
Lexington Insurance Company, ("LIC"), (DE);
New Hampshire Insurance Company ("NHIC"), (IL);
AIG Specialty Insurance Company ("AIG Specialty"), (IL);
Granite State Insurance Company ("GSIC"), (IL) and
Illinois National Insurance Co. ("INIC"), (IL)

All companies examined are members and participate in the intercompany combined pooling arrangement ("Combined Pool"), as referenced in Item 2C – Reinsurance, of this report. In addition, the examinations of AIG Insurance Company of Puerto Rico and Eaglestone Reinsurance Company ("Eaglestone"), (PA) were conducted concurrently as standalone companies.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook ("Handbook"), which 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 system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company's own control environment assessment and an evaluation based upon the Company's ultimate parent's Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company's independent public accountants, PricewaterhouseCoopers, LLP, where deemed appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

Company history
Management and control
Territory and plan of operation
Loss review and analysis
Reinsurance
Holding company description
Financial statement presentation
Significant subsequent events
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on December 6, 1957, as the American Reciprocal Insurers. On May 27, 1966, ownership shifted when the stockholder of the Company, American Reciprocal Insurers was merged with and into the Company. The subscribers of the reciprocal exchanged their equity in surplus funds for stock of the Company. Ownership passed to the Combined Insurance Company of America of Chicago, Illinois on February 15, 1968 through an exchange of shares. On July 15, 1968, American International Group, Inc. ("AIG") acquired financial control of the Company. The Company is a wholly-owned subsidiary of AIG Property Casualty U.S. Inc. ("AIG PC US"), a Delaware corporation, which is in turn wholly-owned by AIG Property Casualty Inc. ("AIG PC"), a Delaware corporation. AIG PC is ultimately owned by American International Group, Inc. ("AIG"), a Delaware corporation.

As of December 31, 2015, capital paid-in was $5,125,000 consisting of 2,050,000 shares of $2.50 par value per share common stock. During the examination period, capital paid-in increased by $1,927,000 as a result of amendments to its Charter as illustrated in column B of the table below.

As of December 31, 2015, gross paid-in and contributed surplus was $812,865,618. Gross paid-in and contributed surplus decreased by $356,525,633 during the examination period primarily as a result of the following transactions as detailed in column A of the table below:

| | | Column A | Column B |
|---|---|---|---|
| Year | | Gross paid in and contributed surplus | Capital paid in |
| | Gross paid in and contributed surplus and Capital paid in as of December 31, 2010 | $1,169,391,251 | $3,198,000 |
| 2011 | Capital contribution | 3,216,618 | |
| 2011 | Capital contribution | 4,328 | |
| 2011 | Stock compensation | 1,460,590 | |
| 2011 | Capital contribution | 869,734 | |
| (a) 2011 | Capital contribution | 16,076,227 | |
| 2012 | Stock compensation | 50,687 | |
| 2012 | Capital contribution | 449,482 | |
| (b) 2014 | Return of capital | (432,762,668) | (1,161,522) |
| (c) 2014 | Stock par value adjustment | (3,088,522) | 3,088,522 |
| 2014 | Capital contribution | 6,567,475 | |
| 2015 | Capital contribution | 226,722 | |
| 2015 | Capital contribution | 403,694 | |
| (d) 2015 | Capital contribution | 50,000,000 | |
| | Net change during the examination period | $(356,525,633) | $1,927,000 |
| | | | |
| | Gross paid in and contributed surplus and Capital paid in as of December 31, 2015 | $812,865,618 | $5,125,000 |

a) As a result of a combined multi-state market conduct examination, the Company signed a Regulatory Settlement Agreement effective May 29, 2012, whereby it agreed to pay a fine of approximately $16 million. The liability for this fine was transferred to Chartis U.S., Inc. and the amount was deemed a capital contribution.

b) In January 2014, the Department approved the Company's request to decrease capital paid in by $1,161,522 by adjusting the par value of its common stock from $1.56 to $0.9934, and decrease gross paid in and contributed surplus by $432,762,668. This request was part of the overall request to return $660 million of capital to its parent, Chartis U.S. Inc., consisting of a return of capital of $433,924,190 and an extraordinary dividend of $226,075,810. The purpose of the capital distribution was to rebalance capital among pool members, as a result of the admitted lines pool and the surplus lines pool consolidation in 2014.

c) In June 2014, the Department approved the Company's request to increase its capital paid in by $3,088,522 by adjusting the par value of its common stock from $0.9934 per share to $2.50 per share. This adjustment also reduced gross paid in and contributed surplus by $3,088,522. The effect of the adjustment of par value on CIIC's capital accounts is shown in item (c) above.

d) On January 22, 2016, the Department approved the Company's request to record a $50 million contribution from AIG PC US, settled in the form of cash and securities, in its 2015 annual statement. The contribution was reflected as a receivable as of December 31, 2015 and as gross paid-in and contributed surplus pursuant to SSAP No. 9 and SSAP No. 72.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. The board meets four times during each calendar year. At December 31, 2015, the board of directors was comprised of the following thirteen members:

| Name and Residence | Principal Business Affiliation |
|---|---|
| Alexander Ross Baugh<br>Rumson, New Jersey | President - Liability, and Financial Lines,<br>American International Group, Inc. |
| James Bracken<br>New York, New York | Chief Financial Officer – Commercial Insurance,<br>American International Group, Inc. |
| Joseph Daniel Cook<br>Ruxon, Maryland | Deputy CFO - AIG Property and Casualty,<br>American International Group, Inc. |
| Jeremy David Edgecliffe-Johnson<br>Chester Spring, Pennsylvania | President - U.S. Commercial Insurance,<br>American International Group, Inc. |
| Gaurav Garg<br>New York, New York | Chief Executive Officer/Personal Insurance,<br>American International Group, Inc. |
| Stephen Joseph Grabek<br>Wheaton, Illinois | Head of Broker and Client Engagement,<br>American International Group, Inc. |
| Kimberly Margaret Hanna *<br>Hoboken, New Jersey | Head of Environmental and Risk Consulting,<br>American International Group, Inc. |
| Kevin Timothy Hogan<br>Berkeley Heights, New Jersey | Executive Vice President and<br>Chief Executive Officer - Consumer ,<br>American International Group, Inc. |
| Ralph William Mucerino<br>Tinton Falls, New Jersey | Senior Vice President<br>American International Group, Inc. |
| Alessandrea Corrine Quane<br>Short Hills, New Jersey | Executive Vice President and Chief Risk Officer,<br>American International Group, Inc. |

| Name and Residence | Principal Business Affiliation |
|---|---|
| Robert Scott Higgins Schimek<br>Newtown, Pennsylvania | Executive Vice President and Chief Executive Officer – Commercial, American International Group, Inc. |
| Christopher Louis Sparro*<br>Chappaqua, New York | Vice President<br>American International Group, Inc. |
| Amy Elizabeth Stern<br>New York, New York | Head of Reinsurance Purchasing<br>American International Group |

*Subsequent to the examination date, these members are no longer with AIG.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

As of December 31, 2015, the principal officers of the Company were as follows:

| Name | Title |
|---|---|
| Robert Scott Higgins Schimek | Chairman, President, and Chief Executive Officer |
| Joseph Daniel Cook | Senior Vice President and Chief Financial Officer |
| Tanya Evelyn Kent | Secretary |
| Lawrence James Moloney ** | Statutory Controller and Vice President |

** Subsequent to the examination date, this officer is no longer with AIG.

## B. Territory and Plan of Operation

As of December 31, 2015, the Company was licensed to write business in all fifty states and the District of Columbia.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| Paragraph | Line of Business |
| --- | --- |
| 3 | Accident & health |
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 9 | Boiler and machinery |
| 10 | Elevator |
| 11 | Animal |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Workers' compensation and employers' liability |
| 16 | Fidelity and surety |
| 17 | Credit |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine |
| 21 | Marine protection and indemnity |
| 22 | Residual value |
| 24 | Credit unemployment |
| 26 | Gap |
| 27 | Prize indemnification |
| 28 | Service Contract reimbursement |
| 29 | Legal services |

As of the examination date, the Company is also authorized to write such workers' compensation insurance as may be incident to coverage contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including coverage described in the Longshore and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. as amended, 33 USC §901 et seq. as amended).

In addition, the Company is authorized to reinsure risks of every kind or description and to write any and all kinds of insurance on risks outside of the United States, its territories and possessions, except with respect to life insurance, title insurance, and contracts for the payment of annuities, as specified in Section 4102(c) of the New York Insurance Law. The Company is authorized to transact business of special risk insurance (Free Trade Zone) pursuant to Article 63 of the New York Insurance Law.

Based on the lines of business for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41, and 63 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $35,000,000.

The Company accepts business mainly from insurance brokers, enabling the selection of specialized markets and the retention of underwriting control. Any licensed insurance broker is able to submit business to the Company, but such broker has no authority to commit the Company to accept risk. The Company utilizes certain program administrators for underwriting policy issuance and administration. In addition, third party administrators are contracted to provide claims adjustment services.

The Company writes substantially all lines of property and casualty insurance with an emphasis on U.S. commercial business including large commercial or industrial property insurance, excess liability, inland marine, environmental, workers' compensation, and excess and umbrella coverage. Additionally, the Company offers many specialized forms of insurance such as aviation, accident and health, warranty, equipment breakdown, directors' and officers' liability, difference in conditions, kidnap-ransom, export credit, and political risk, and various types of errors and omissions coverage. Through the Private Client Group, the Company provide personal lines insurance to high net worth individuals.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

| Calendar Year | New York State | Total Premiums | Premiums Written in New York State as a Percentage of Total Premium |
|---|---|---|---|
| 2011 | $132,827,086 | $1,200,277,769 | 11.07% |
| 2012 | $132,530,628 | $1,221,306,734 | 10.85% |
| 2013 | $ 82,032,497 | $1,051,567,728 | 7.80% |
| 2014 | $ 26,953,898 | $ 916,354,534 | 2.94% |
| 2015 | $ 16,149,317 | $ 789,025,150 | 2.05% |

The largest lines of business, by percentage of total 2015 direct written premiums, were Workers' Compensation (43.6%), Other Liability Occurrence (27%), Aircraft (all perils) (11.5%), Commercial Auto Liability (10.99%).

C. Reinsurance

Assumed

The Company's assumed reinsurance consists primarily of its participation in the inter-company reinsurance pooling agreement as described in the following section.

Combined Pooling Agreement

The Company participates in an inter-company reinsurance pooling agreement covering twelve affiliated insurers. Pursuant to the terms of this agreement, the Company and the affiliated entities share in premiums, losses, and expenses based on their respective pool participation.

Effective January 1, 2014, the AIG Property Casualty Admitted Lines Pooling Agreement and the AIG Property Casualty Surplus Lines Pooling Agreement were amended and replaced with a Combined Pooling Agreement among the existing companies and AIU Insurance Company (the "Combined Pooling Agreement").

On December 31, 2015, the Combined Pool consisted of the following wholly-owned subsidiaries of AIG:

| Combined Pool Company | State of Domicile | Combined Pool % |
|---|---|---|
| American Home Assurance Company | New York | 30% |
| National Union Fire Insurance Company of Pittsburgh, Pa.* | Pennsylvania | 30% |
| Lexington Insurance Company | Delaware | 30% |
| Commerce and Industry Insurance Company | New York | 5% |
| AIG Property Casualty Company | Pennsylvania | 5% |
| AIU Insurance Company | New York | 0% |
| The Insurance Company of the State of Pennsylvania | Pennsylvania** | 0% |
| AIG Assurance Company | Pennsylvania** | 0% |
| New Hampshire Insurance Company | Illinois | 0% |
| AIG Specialty Insurance Company | Illinois | 0% |
| Granite State Insurance Company | Illinois | 0% |
| Illinois National Insurance Co. | Illinois | 0% |
| Total Pool | | 100% |

* Lead Company of the Combined Pool

** In 2016, the Companies redomesticated to Illinois from Pennsylvania.

Subsequent to the examination date, on January 1, 2016, the Combined Pooling Agreement was amended and restated to decrease the Company's percentage from 5% to 0% and increase American Home Assurance Company's percentage from 30% to 35%.

On January 1, 2017, the Pooling Agreement was further amended to reduce the pool percentage of AIG Property Casualty Company from 5% to 0% and increase National Union Fire Insurance Company of Pittsburgh, Pa's percentage from 30% to 35%.

The Company utilizes reinsurance accounting as defined in Statement of Statutory Accounting Principle ("SSAP") No. 62 for all of its assumed reinsurance business.

Ceded

The Company has structured its ceded reinsurance program as follows:

External treaty reinsurance is placed by AIG's Global Reinsurance Division ("GRD"). Reinsurance officers within GRD are aligned with specific AIG Profit Centers and are responsible for determining structures, negotiating and placing individual treaty reinsurance programs for various lines of business. GRD also reviews, analyzes, and assists in placing AIG's overall catastrophe reinsurance. AIG maintains extensive reinsurance, with programs placed with U.S. domestic and international reinsurers. During 2015, AIG established an internal limit for natural catastrophe Probable Maximum Loss ("PML") at $3.5 billion for a 1 in 10-year event; $7.5 billion for a 1 in 100-year event; and $10 billion for a 1 in 250-year event.

As party to various treaty and facultative agreements, the Company reinsures the business it writes in order to maximize protection, provide capacity, reduce volatility, and make the best use of market capacity. Reinsurance is further broken down into pro-rata and excess of loss agreements. Facultative reinsurance is purchased to provide added capacity for coverages that are not included in specific treaty agreements. Catastrophe coverage is bought to protect the net of the Combined Pool companies for property exposures. Lines of business covered under various reinsurance protections include global property, commercial casualty, specialty, global marine, financial lines, consumer, other personal lines, and accident and health. In addition, the Company also purchased quota-share protection for other lines of business, including aerospace, fidelity, surety and environmental liability.

Property Catastrophe

For 2015, AIG purchased catastrophe protection for its commercial and personal lines both on an individual occurrence and aggregate basis that included traditional reinsurance and non-traditional reinsurance ("CAT bonds") covering windstorm and earthquake for the United States, Canada, Mexico, and the Caribbean. For a catastrophic event, AIG retained the first $3 billion and had $2.5 billion of reinsurance protection and $1 billion of additional coverage through a worldwide aggregate treaty providing second event coverage and protection from an accumulation of smaller events throughout the world. The reinsurance did not contain a reinstatement provision. AIG's maximum retention under the global property risk excess program on a per risk basis at December 31, 2015 was $450 million.

Subsequent to the examination date, on January 1, 2016, the AIG companies entered into a two-year reinsurance arrangement with Swiss Reinsurance Company Ltd., under which, a share of AIG's new and renewal U.S. casualty portfolio was ceded to the reinsurer.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

Loss Portfolio Transfers

Eaglestone Reinsurance Company ("Eaglestone"), an authorized Pennsylvania domiciled affiliated insurer, was repurposed by AIG management in 2011 to be the "run-off" company within the AIG P&C division. Eaglestone is not a member of the Combined Pool, but has a significant reinsurance relationship with the Combined Pool members. Eaglestone is required to maintain an RBC of at least 225%, in connection with a retrocession agreement with National Indemnity Company, an external reinsurer. The following is an abbreviated summary of loss portfolio transfers between Combined Pool members and Eaglestone:

- Asbestos Loss Portfolio Transfer provides for coverage of up to $5 billion on $2.8 billion of reserves ceded as of January 1, 2011.
- Excess Workers' Compensation Loss Portfolio Transfer provides coverage of up to $5.5 billion on $2.7 billion of reserves ceded as of January 1, 2011, on a funds withheld basis.
- Environmental Loss Portfolio Transfer provides coverage of up to $3.7 billion on $1.5 billion of reserves ceded as of October 1, 2012, on a funds withheld basis.
- In 2014, Eaglestone entered into various smaller loss portfolio transfers, involving certain public entity and occupational accident reserves, with affiliates on a funds withheld basis on $252 million of reserves.
- In 2015, Eaglestone entered into various smaller loss portfolio transfers, including environmental and healthcare reserves, with affiliates on a funds withheld basis on $1.5 billion of reserves.

  The Company earns varying interest yields on a funds withheld for the above Loss Portfolio Transfers.

The Company reported $361 million of reinsurance recoverables from Eaglestone as of December 31, 2015, of which $211 million consisted of funds withheld by the Company. The Pennsylvania Insurance Department has examined Eaglestone as of December 31, 2015.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

The examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer documentation and/or analyses (as applicable) and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions.

## D. Holding Company System

The Company is a wholly-owned subsidiary of AIG Property Casualty U.S., Inc. (“AIG PC US”), a Delaware corporation, which is in turn owned by AIG Property Casualty Inc. (“AIG PC”), a Delaware corporation. The Company’s ultimate parent is American International Group, Inc., (“AIG”), a Delaware corporation.

In 2014, AIG modified the presentation of its results to reflect its new operating structure that consists of two reporting segments and a Corporate and Other category:

1. Commercial Insurance has three operating segments: Property Casualty, Mortgage Guaranty and Institutional Markets.

2. Consumer Insurance also has three operating segments: Retirement, Life and Personal Insurance.

3. Corporate and Other category consists of businesses and items not allocated to AIG's reporting segments.

Subsequent to the examination date, as of December 31, 2016, AIG has a new management structure consisting of the following three reporting segments as well as an Other Operations category:

1. The Commercial reporting segment is comprised of two operating segments: Property & Special Risks and Liability & Financial Lines.

2. The Consumer reporting segment is comprised of four operating segments: Life, Health & Disability, Group Retirement, Individual Retirement, and Personal Insurance.

3. The Legacy reporting segment is comprised of Legacy Life Runoff, Legacy Property & Casualty Runoff, and Legacy Assets.

4. Other Operations comprises various businesses and operations that are not attributable to the reporting segments, and includes, (among other things), the operations of United Guaranty Corporation[1], Institutional Markets, AIG Parent, certain service companies, and intercompany eliminations.

The Company is part of the AIG holding company structure, which includes insurance and management companies, agencies, and other enterprises doing business in the United States and countries around the world. The ultimate parent company, AIG, is a publicly traded company.

In 2008, AIG received $182 billion of government support from the Federal Reserve Bank of New York ("FRBNY") and the U.S. Treasury. During the examination period, commitments to the FRBNY and the U.S. Treasury expired or were repaid by AIG through a series of transactions.

[1] On August 15, 2016 AIG entered into an agreement to sell United Guaranty Corporation ("UGC"). UGC was sold effective December 31, 2016.

A review of the Holding Company Registration Statements filed with this Department indicated that the filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

As of December 31, 2015, the Company was party to the following significant agreements with other members of its holding company system:

Service and Expense Agreement

The Company and several named affiliates are parties to a service and expense agreement effective February 1, 1974. Pursuant to the terms of this agreement, AIG and /or any of its subsidiaries may provide various services and facilities specified in the agreement, at cost, to any named party to the agreement. Services include, but are not limited to, advertising, legal, investment, actuarial, claims adjustment, underwriting, accounting, tax, employee cafeteria, office space, payroll and employees benefits. The service and expense agreement has been amended many times over the years, mostly to add additional affiliates.

Administrative Services Agreement

On September 30, 2013, AIG PC Global Services, Inc. ("GS") entered into Master Agreements for Professional Services with AIG Shared Services Corporation, AIG Shared Services (M) Sdn Bhd, and AIG Shared Services Business Processing Inc., thereinafter, the "service providers." Pursuant to the agreements, the service providers shall provide support for finance/accounting, claims, information technology, and business processing. Under these agreements, services provided by the service providers to GS may be passed on to US based AIG PC insurance companies by GS pursuant to the 1974 AIG Service and Expense Agreement described above.

Tax Sharing Agreement

The Company is party to a written tax sharing agreement (the "TSA") with AIG, effective January 1, 2012, as amended. The TSA provides that the Company will pay AIG for its separate company tax liability, generally computed as if the Company had filed a separate federal income tax return. The amended agreement contains the following significant provisions:

> With respect to any sale or exchange of assets within the consolidated US federal income tax group that gives rise to a deferred intercompany transaction ("DIT"), any Combined Pool member is required to book the related deferred tax asset or liability on a separate company basis and will remain liable for any cash tax if such DIT is triggered in the future.
>
> The agreement does not contain a claw-back provision for tax attributes generated by the parties in transactions deemed outside the "ordinary course" of business and FIN 48 reserves remain on the books of the individual Pooled Companies.
>
> The sections of the Internal Revenue Code relating to Alternative Minimum Tax ("AMT") are applied, but only if the Parent has a consolidated AMT liability.
>
> Tax Reserves will no longer be assumed by the Parent, but remain on the balance sheet of the Company.

In accordance with New York Department of Insurance Circular Letter 1979-33, the Parent shall establish and maintain an escrow account for amounts where the Company's separate return liability exceeds the consolidated tax liability of the Parent.

In 2014, the Department approved a side letter to the TSA with respect to the treatment of the distribution of the Company's ownership of AIG Europe Holdings Limited ("AEHL"). The amended agreement states in part, that the intercompany gain resulting from the distribution of AEHL will be treated as currently taxable and the Company's resulting tax liability will be waived in the form of a deemed capital contribution.

Investment Advisory Agreement

The Company is party to an investment advisory agreement with AIG Asset Management (U.S.), LLC ("Manager") to receive investment management and advisory services with respect to the investments owned by the Company. The agreement authorizes the Manager to supervise and direct all investments and to exercise whatever powers the Company may possess with respect to its invested assets, subject in all cases to the ultimate direction and control of the Company. Investment transactions effected by the Manager must be in accordance with investment guidelines established by the Company and conform to statutory and administrative limits and restrictions.

Investment transactions are further subject to AIG's policies for mitigating and controlling market, credit and similar enterprise risks, as communicated to the Manager in writing from time to time. Within these limitations, the Manager may buy, sell, exchange, convert, and otherwise trade in and engage in investment transactions of any nature whatsoever involving any stocks, bonds, commercial paper, money market instruments and other securities and assets when it deems appropriate and without prior consultation with the Company. The Manager may also select, retain, oversee and terminate other investment managers of the Company. The agreement has been amended to update and clarify the nature and scope of services, and to modify the investment guidelines from time to time as required by the Company and its regulators.

Master Intra-Company Services Agreement

Effective December 1, 2015, the Company and other AIG affiliates entered into a Master Intra-Company Services Agreement with AIG Technologies, Inc. ("AIGTI"). Pursuant to the agreement, AIGTI will provide network connectivity, application hosting, data process related services and other IT-related infrastructure services to the Company.

Claims Services Agreement

Effective July 15, 2012, the Company and other AIG affiliates entered into a Claims Services Agreement with AIG Claims, Inc. ("AIG Claims"), formerly known as Chartis Claims, Inc. Pursuant to the agreement, AIG Claims will provide claims administration services on behalf of the Company. The agreement was amended on April 4, 2014 to reflect AIG Claims becoming licensed as a third-party administrator for accident and health business and to make certain state-required modifications to the agreement.

Loan Agreement

Effective December 18, 2014, the Company, and certain affiliates entered into a loan agreement with AIG Inc., whereby the Company may borrow funds from AIG Inc., up to $30,000,000. Under the agreement, the aggregate outstanding principal for all loans made to the

Company and its affiliates, at any given time, cannot exceed $500,000,000. On June 5 2015, the agreement was amended to increase the individual borrowing limits for the Company and APCC from $30,000,000 to $100,000,000. As of December 31. 2015, CIIC did not report any outstanding loans related to the loan agreement.

Master Reinsurance Allocation Agreement

As of February 29, 2008, for multiple cedant reinsurance agreements incepting on or after January 1, 2007, the Company and various affiliates entered into a Master Reinsurance Allocation Agreement (the “Allocation Agreement”). The Allocation Agreement was entered into to satisfy the requirement of SSAP No. 62 requirement that reinsurance agreements with multiple cedants be subject to written allocation agreements. The Allocation Agreement does not amend any existing pooling agreement and does not affect the rights of the Company or any of its affiliates under any reinsurance contract. Effective April 1, 2016, the Allocation Agreement was superseded by a new Master Reinsurance Allocation Agreement, which sets forth the method for allocating premium and losses under multiple cedant reinsurance agreements incepting on or after April 1, 2016.

Program Administration Agreement

The Company entered into several program administrator agreements with certain risk specialist companies (“program administrators”), whereby the program administrators will provide insurance placement and other program administration services to certain members of the Combined Pool. Services provided include assisting the Company in developing producer and underwriting guidelines and modifications thereto, for the underwriting program, processing applications for insurance, collecting and accounting for premiums, and endorsing checks payable to the Company.

International Swap Dealers Association

Effective November 1, 2012, the Company is party to an International Swap Dealers Association Master Agreement with AIG Markets, Inc., which provides the framework for the

Company and AIG Markets, Inc., to enter into over-the counter derivative transactions with one another. The agreement was amended on April 15, 2015.

## E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2015, based upon the results of this examination:

| | |
|---|---|
| Net premiums written to surplus as regards policyholders | 95% |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 94% |
| Premiums in course of collection to surplus as regards policyholders | 13% |

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five- year period covered by this examination:

| | | |
|---|---|---|
| Losses and loss adjustment expenses incurred | $5,124,449,146 | 83.32 |
| Other underwriting expenses incurred | 1,710,794,898 | 27.82 |
| Net underwriting loss | (684,856,127) | (11.14) |
| Premiums earned | $6,150,387,917 | 100.00% |

## 3. FINANCIAL STATEMENTS

### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2015 as reported by the Company:

| Assets | Assets | Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $3,179,126,895 | $ 0 | $3,179,126,895 |
| Preferred stocks (stocks) | 16,300,000 | 0 | 16,300,000 |
| Common stocks (stocks) | 62,701,621 | 37,468,014 | 25,233,607 |
| First liens - mortgage loans on real estate | 222,319,168 | 0 | 222,319,168 |
| Cash, cash equivalents and short-term investments | 119,367,127 | 0 | 119,367,127 |
| Derivatives | 657,833 | 0 | 657,833 |
| Other invested assets | 124,265,564 | 232,981 | 124,032,583 |
| Receivables for securities | 3,724,130 | 0 | 3,724,130 |
| Investment income due and accrued | 24,312,133 | 0 | 24,312,133 |
| Uncollected premiums and agents' balances in the course of collection | 137,542,452 | 11,498,987 | 126,043,465 |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 48,249,613 | 63,680 | 48,185,933 |
| Accrued retrospective premiums | 100,040,674 | 2,313,410 | 97,727,264 |
| Amounts recoverable from reinsurers | 50,575,708 | 0 | 50,575,708 |
| Funds held by or deposited with reinsured companies | 30,648,207 | 0 | 30,648,207 |
| Current federal and foreign income tax recoverable and interest thereon | 8,399,067 | 8,228,808 | 170,259 |
| Guaranty funds receivable or on deposit | 1,130,897 | 0 | 1,130,897 |
| Electronic data processing equipment and software | 1,520,528 | 1,520,528 | 0 |
| Receivables from parent, subsidiaries and affiliates | 59,585,371 | 0 | 59,585,371 |
| Amounts Receivable Under High Deductible Policies | 12,481,310 | 3,234,267 | 9,247,043 |
| Other Assets | 10,634,652 | 1,830,887 | 8,803,765 |
| Loss Funds on Deposit | 6,328,651 | 0 | 6,328,651 |
| Equities and Deposits in Pools and Association | 2,949,837 | 932,110 | 2,017,727 |
| Deposit Accounting Asset | 747,498 | 0 | 747,498 |
| Collateral on Derivative Assets | 89,402 | 0 | 89,402 |
| Retroactive Recoverable | 66,281 | 0 | 66,281 |
| Intangible Assets - from Sale of Affiliate | 62,974,715 | 62,974,715 | 0 |
| Allowance Provision | (13,705,032) | 0 | (13,705,032) |
| Totals | $4,273,034,302 | $130,298,387 | $4,142,735,915 |

Liabilities, surplus and other funds

| Liabilities | | Company |
|---|---|---|
| Losses and Loss Adjustment Expenses | | $2,182,867,985 |
| Reinsurance payable on paid losses and loss adjustment expenses | | 34,136,760 |
| Commissions payable, contingent commissions and other similar charges | | (287,331) |
| Other expenses (excluding taxes, licenses and fees) | | 4,123,459 |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | | 34,937,915 |
| Unearned premiums | | 521,187,049 |
| Ceded reinsurance premiums payable (net of ceding commissions) | | 46,506,562 |
| Funds held by company under reinsurance treaties | | 227,027,667 |
| Amounts withheld or retained by company for account of others | | 488,908 |
| Remittances and items not allocated | | 1,243,353 |
| Provision for reinsurance | | 5,421,158 |
| Payable to parent, subsidiaries and affiliates | | 4,635,197 |
| Payable for securities | | 1,787,644 |
| Collateral Deposit Liabilities | | 55,737,106 |
| Other Liabilities | | 36,331,412 |
| Deposit Accounting Liabilities | | 9,962,141 |
| Deferred Commission Earnings | | 5,598,944 |
| Accrued Retrospective Premiums | | 4,578,715 |
| Statutory Contingency Reserve | | 3,631,599 |
| Servicing Carrier Liabilities | | 908,477 |
| Deposit Accounting Liability - Funds Held | | 43,592 |
| Retroactive Reinsurance Payable | | 17,855 |
| Retroactive Reinsurance Reserves - Ceded | | (1,818,126) |
| Paid Loss Clearing | | (10,314,947) |
| Total liabilities | | $3,168,753,094 |
| Surplus and Other Funds | | |
| Special Surplus From Retroactive Reinsurance | $ 234,643 | |
| Special Surplus From Health Insurance Providers | 131,792 | |
| Common capital stock | 5,125,000 | |
| Gross paid in and contributed surplus | 812,865,618 | |
| Unassigned funds (surplus) | 155,625,768 | |
| Surplus as regards policyholders | | $ 973,982,821 |
| Total liabilities, surplus and other funds | | $4,142,735,915 |

Note 1: In 2016, the pooling agreement was amended to decrease the Company's percentage from 5% to 0% and to increase AHAC's percentage from 30% to 35%. Therefore, the one-year runoff deficiency is reflected within the deficiency recommended in the AHAC report on exam.

Note 2: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 1999. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 2000 through 2010 are currently under examination. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2011 through 2014. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Net income for the five-year examination period, January 1, 2011 through December 31, 2015, was $1,495,748,863 detailed as follows:

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $6,150,387,917 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | $5,124,449,146 | |
| Other underwriting expenses incurred | 1,710,794,898 | |
| Total underwriting deductions | | 6,835,244,044 |
| Net underwriting gain or (loss) | | (684,856,127) |
| Investment Income | | |
| Net investment income earned | 1,147,746,022 | |
| Net realized capital gain | 829,591,594 | |
| Net investment gain or (loss) | | $1,977,337,616 |
| Other Income | | |
| Net gain or (loss) from agents' or premium balances charged off | (16,332,318) | |
| Finance and service charges not included in premiums | 3,348 | |
| Aggregate write-ins for miscellaneous income | (23,452,281) | |
| Total other income | | (39,781,251) |
| Net income after dividends to policyholders but before federal and foreign income taxes | | 1,252,700,238 |
| Federal and foreign income taxes incurred | | (243,048,625) |
| Net Income | | $1,495,748,863 |

C. Capital and Surplus Account

Surplus as regards policyholders decreased $912,972,501 during the five year examination period January 1, 2011 through December 31, 2015, detailed as follows:

| | | | |
|---|---|---|---|
| Surplus as regards policyholders per Company as of December 31, 2010 | | | $1,886,955,322 |
| | Gains in Surplus | Losses in Surplus | |
| Net income | $1,495,748,863 | | |
| Net unrealized capital gains or (losses) | | 488,445,988 | |
| Change in net unrealized foreign exchange capital gain (loss) | 6,602,082 | | |
| Change in net deferred income tax | | 488,983,730 | |
| Change in non-admitted assets | 291,894,783 | | |
| Change in provision for reinsurance | 23,916,700 | | |
| Cumulative effect of changes in accounting principles | | 18,127,846 | |
| Capital changes paid in | 1,927,000 | | |
| Surplus adjustments paid in | | 356,525,633 | |
| Dividends to stockholders | | 1,195,575,810 | |
| Aggregate write-ins for gains and losses in surplus | | 185,402,922 | |
| Net increase (decrease) in surplus | $1,820,089,428 | $2,733,061,929 | $ (912,972,501) |
| Surplus as regards policyholders per Company as of December 31, 2015 | | | $ 973,982,821 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $2,182,867,985 is the same as reported by the Company as of December 31, 2015. The examination analysis of the Losses and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 55 (“SSAP No. 55”).

While the Statement of Actuarial Opinion states that the Appointed Actuary reconciled the data to Schedule P-Part 1, no reconciliation exhibit is included in the Actuarial Report. The Actuarial Report did not include a description of the actuary’s role and relationship to the Company and the review and valuation date for each Detailed Valuation Reserve study.

In accordance with the NAIC Instructions to the Annual Statement, it is recommended that the Actuarial Report underlying the Statement of Actuarial Opinion contain both narrative and technical components in sufficient detail to clearly explain how all memos and exhibits tie together, as well as including an exhibit that reconciles and maps the data used by the Actuary to the Annual Statement Schedule P line of business reporting.

AIG’s methodology and assumptions for calculating workers’ compensation discount are not fully compliant with the laws and approved practices for discounting workers’ compensation reserves in New York and its combined pooling agreement.

It is recommended that AIG amend the order of operations in its workers’ compensation discounting calculation by first distributing nominal reserves to each statutory Company in accordance with the pooling agreement and then, discount the reserves of each statutory company separately, pursuant to the approved discounting practices of the respective domiciliary states.

It is also recommended that AIG develop an individual claim model to calculate workers’ compensation tabular discount on eligible claims, based on the attributes of the claims being discounted.

## 5. SUBSEQUENT EVENTS

On January 26, 2016, AIG announced its intention to return $25 billion of capital to shareholders. As of May 4, 2017, AIG had returned approximately $18.1 billion to its shareholders. Dividends received from insurance subsidiaries are a significant component of the return of capital plan.

### Reserve Strengthening

On February 3, 2017, AIG announced that the total amount of the 2016 year-to-date adverse development charge for its non-life business to be $5.8 billion. Approximately $4.9 billion of this reserve change relates to reporting segments within the Combined Pool.

### Adverse Development Coverage

On January 20, 2017, the Combined Pool entered into an adverse development reinsurance agreement with National Indemnity Company ("NICO"), a subsidiary of Berkshire Hathaway Inc., under which the Combined Pool ceded to NICO eighty percent of its reserve risk above an attachment point on substantially all of its U.S. Commercial long tail exposures for accident years 2015 and prior. Under this agreement, the Combined Pool ceded to NICO eighty percent of net paid losses and net allocated loss adjustment expenses on subject business on or after January 1, 2016 in excess of $25 billion of net paid losses, up to an aggregate limit of $25 billion. NICO's limit of liability under the contract is $20 billion.

### AIG CEO Transition (CEO Resignation and New CEO Appointed)

On March 9, 2017, AIG announced that Mr. Peter Hancock, President and Chief Executive Officer, had informed the board of directors of his intention to resign. As part of the transition plan, Mr. Hancock remained as CEO until a successor was named. On May 15, 2017, AIG announced the appointment of Brian Duperreault as its new President, Chief Executive Officer and Director, effective May 14, 2017.

John Paulson to Leave AIG Board of Directors

Mr. John Paulson is not being nominated for re-election to the AIG Board. Mr. Paulson's one-year term will end at the AIG annual meeting to be held on June 28, 2017.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained no recommendations.

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| ITEM | | PAGE NO. |
|---|---|---|
| A | Losses and Loss Adjustment Expenses | |
| i. | It is recommended that the Actuarial Report underlying the Statement of Actuarial Opinion contain both narrative and technical components in sufficient detail to clearly explain how all memos and exhibits tie together, as well as including an exhibit that reconciles and maps the data used by the Actuary to the Annual Statement Schedule P line of business reporting. | 25 |
| ii. | It is recommended that AIG amend the order of operations in its workers' compensation discounting calculation by first distributing nominal reserves to each statutory company in accordance with the pooling agreement and then, discount the reserves of each statutory company separately, pursuant to the approved discounting practices of the respective domiciliary states. | 25 |
| iii. | It is also recommended that AIG develop an individual claim model to calculate workers' compensation tabular discount on eligible claims, based on the attributes of the claims being discounted. | 25 |

Respectfully submitted,

__________________________
Maribel C. Nunez, CPCU
Associate Insurance Examiner

STATE OF NEW YORK )
)ss:
COUNTY OF NEW YORK )

Maribel C. Nunez, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

__________________________
Maribel C. Nunez

Subscribed and sworn to before me

this__________ day of ____________________, 2017.

*APPOINTMENT NO. 31366*

*NEW YORK STATE*

# *DEPARTMENT OF FINANCIAL SERVICES*

*I, ANTHONY ALBANESE, Acting Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:*

***Maribel Nuñez***

*as a proper person to examine the affairs of the*

***Commerce and Industry Insurance Company***

*and to make a report to me in writing of the condition of said*

***COMPANY***

*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by name*
*and affixed the official Seal of the Department*
*at the City of New York*

*this 17th day of August, 2015*

*ANTHONY ALBANESE*
*Acting Superintendent of Financial Services*

*By:*

*Rolf Kaumann*
*Deputy Chief Examiner*