

REPORT ON EXAMINATION

OF

AMERICAN PET INSURANCE COMPANY

AS OF

DECEMBER 31, 2019

DATE OF REPORT

NOVEMBER 6, 2020

EXAMINER

IRENE TRAN, CFE

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Department of Financial Services

ANDREW M. CUOMO
Governor

LINDA A. LACEWELL
Superintendent

November 6, 2020

Honorable Linda A. Lacewell
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 31963 dated July 10, 2019, attached hereto, I have made an examination into the condition and affairs of American Pet Insurance Company as of December 31, 2019, and submit the following report thereon.

Wherever the designation “the Company” or “APIC” appears herein without qualification, it should be understood to indicate American Pet 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 commenced at the Company’s home office located at 6100 4th Avenue South, Seattle, WA 98108. Effective March 17, 2020, the examination was conducted remotely due to the Governor’s Executive Order of New York State on PAUSE regarding the COVID-19 pandemic.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of American Pet Insurance Company, a multi-state insurer. The previous examination was conducted as of December 31, 2014. This examination covered the 5-year period from January 1, 2015 through December 31, 2019. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook, which requires that we plan and perform the examination to evaluate the financial condition and identify current and 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 New York laws, statutory accounting principles, and annual statement instructions.

This examination report includes, but is not limited to, the following:

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

A review was also made to ascertain what action was taken by the Company with regard to the 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

American Pet Insurance Company was incorporated under the laws of the State of New York on December 7, 2000, as the Nipponkoa Insurance Company of America to serve as the vehicle for the domestication of the U. S. Branch of the KOA Fire & Marine Insurance Company, Ltd. (“KOA Japan”), pursuant to Article 72 of the New York Insurance Law. The domestication was completed on March 31, 2001, and the Company became licensed on April 1, 2001. On April 1, 2001, the Company’s parent, Koa Japan, merged with and into the Nippon Fire & Marine Insurance Company Ltd, (“Nippon”), with Nippon as the surviving company. The name of the merged companies and new ultimate parent was then changed to Nipponkoa Insurance Company, Limited, Japan (“Nipponkoa Japan”).

As of July 1, 2003, the Company ceased writing new and renewal facultative reinsurance, with all policies expiring July 1, 2004. All of its policies were cancelled effective December 31, 2004.

Effective July 1, 2006, the Company entered into an agreement whereby all of its policy related obligations were transferred to and assumed by the U.S. Branch of Nipponkoa Japan. Additionally, effective July 1, 2006, all of the non-policy related obligations of the Company were transferred to Nipponkoa Management Corporation. Upon consummation of these agreements, the Company became a clean shell insurance company.

On April 25, 2007, the Company was sold to Vetinsurance International Inc. (now known as Trupanion, Inc.), a Delaware corporation. On May 29, 2007, the Company’s name was changed to American Pet Insurance Company. In January 2008, the Company commenced selling pet health insurance.

A. Corporate Governance

Pursuant to the Company’s charter and by-laws, management of the Company is vested in a board of directors.

Section 5(a) of the Company’s charter states, in part:

“The number of directors of this corporation shall at no time be less than thirteen and shall not be more than twenty-one and the exact number of directors that shall constitute the board of directors shall be determined in the manner provided in the bylaws .”

Article II, Section 1 of the Company's by-laws states, in part:

“The business and property of the company shall be conducted and managed by a Board of Directors consisting of not less than seven (7) nor more than twenty-one (21) directors.”

In 2015, the Company filed with the Department its amended by-laws reducing the minimum number of its board of directors to seven.

The charter contains a provision regarding the number of directors that is inconsistent with the provision contained in the by-laws.

It is recommended that the Company amend its charter so that it is consistent with its by-laws.

The board meets four times during each calendar year. At December 31, 2019, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Louis Paul Chames, Jr. Bonney Lake, WA	Assistant Vice President-Regulatory and Compliance, Trupanion Managers USA, Inc.
Gavin Derek Friedman Seattle, WA	General Counsel, Trupanion Managers USA, Inc. Secretary, American Pet Insurance Company
Timothy John Graff Seattle, WA	Senior Vice President, American Pet Insurance Company
Raymond Errol Lee New York, NY	Director, American Pet Insurance Company
Tricia Lynn Plouf Seattle, WA	Chief Financial Officer, American Pet Insurance Company
Mary Lee Rothlisberger Seattle, WA	Vice President, Analytics, Trupanion Managers USA, Inc.
Howard Elliot Rubin Woodland, NJ	Consultant, Trupanion Managers USA, Inc.

As of December 31, 2019, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Timothy Graff *	President
Gavin Derek Friedman	Secretary
Louis Paul Chames, Jr.	Treasurer

*Mr. Graff retired on December 31, 2019. Ms. Plouf, the former Chief Financial Officer, succeeded Mr. Graff as President effective January 1, 2020. However, Ms. Plouf was listed on the jurat page as the Company's president in the filed 2019 annual statement to ensure she would be accountable for any financial changes from December 31, 2019 to March 1, 2020, the regulatory filing date.

B. Territory and Plan of Operation

As of December 31, 2019, the Company was licensed to write business in all 50 states, including the District of Columbia and Puerto Rico.

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:

<u>Paragraph</u>	<u>Line of Business</u>
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
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

Based upon 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 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$4,800,000.

The following schedule shows the direct and assumed premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums</u>	<u>Assumed Premiums</u>	<u>Total Gross Premiums</u>
2015	\$116,618,385	\$9,371	\$116,627,756
2016	\$154,196,104	\$ 0	\$154,196,104
2017	\$205,455,211	\$ 0	\$205,455,211
2018	\$257,620,188	\$ 0	\$257,620,188
2019	\$336,385,825	\$ 0	\$336,385,825

The Company is a direct niche monoline pet insurer that provides medical insurance for domestic cats and dogs across the United States and Puerto Rico. The Company has three business programs: business that is marketed directly to customers (known as the subscription business), and business that is obtained through two unaffiliated managing general agents. Each program has its separate terms and conditions, its own rates, its unique mix of business and its own marketing emphasis. Trupanion Managers USA, Inc., an affiliated managing general agent, manages the Company's business.

Assumed premiums in 2015 is attributable to the stop loss reinsurance agreement with Omega General Insurance of Canada. This reinsurance agreement expired on December 31, 2014.

C. Reinsurance Ceded

The Company does not cede its business.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions.

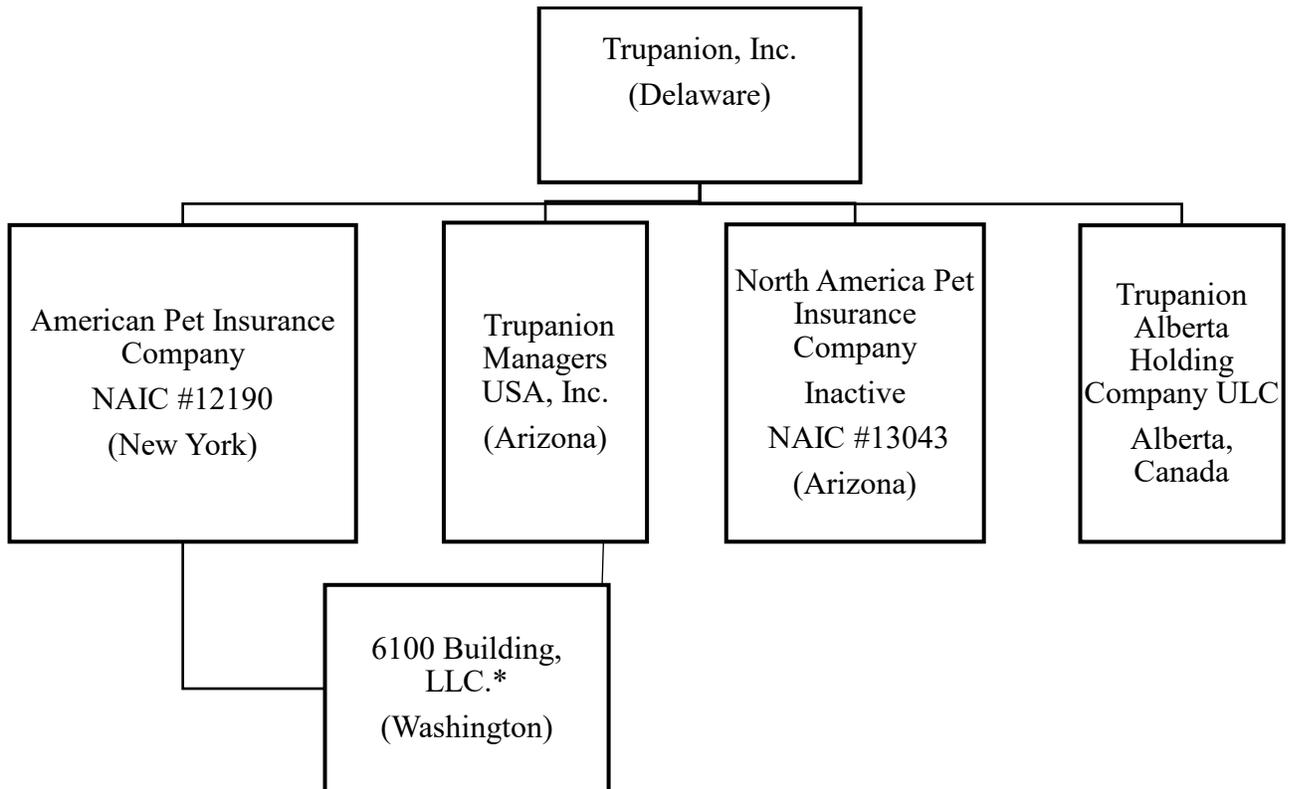
D. Holding Company System

The Company is 100% owned by Trupanion, Inc. ("Trupanion"), a Delaware corporation publicly traded on the New York Stock Exchange. Trupanion and its affiliated entities provide pet insurance coverage across the United States, Canada, and Puerto Rico. Additionally, Trupanion also owns Trupanion Managers USA, Inc. ("TMUI"), an Arizona company, which acts as the Company's managing general agent

pursuant to a general agency agreement. The Company and TMUI have joint ownership of its home office building.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2019:



*At December 31, 2019, the Company owns 22.04% LLC; TMUI owns 77.96%

Holding Company Agreements

At December 31, 2019, the Company was party to the following agreements with other members of its holding company system:

Cost Sharing and Shared Services Agreement

Effective July 1, 2016, the Company entered into a cost sharing and shared services agreement with its affiliate, TMUI. Pursuant to this agreement, TMUI provides APIC certain administrative services which include accounting, underwriting, claims processing, premiums collection, actuarial, legal, data processing, investment, regulatory compliance, and human resources function. In addition, the agreement provides a method for allocating related managing and administrative expenses of APIC's underwriting business. The Company paid \$65.5 million in 2019 to TMUI for services provided under this agreement.

The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

General Agency Agreement

Effective July 1, 2016, the Company entered into a general agency agreement with TMUI. Pursuant to the terms of the agreement, the Company appoints TMUI as its managing general agent for the purpose of producing and handling the policies of the Company. This agreement was amended on October 1, 2018 to replace the existing/prior profit commission program.

The agreement and amendment were filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Federal Income Tax Allocation Agreement

Effective May 16, 2007, the Company entered into a tax allocation agreement with its parent and other members of the holding company system. Pursuant to the terms of the agreement, for each consolidated return year, the consolidated tax liability of the group shall be allocated among the members who agree to pay an amount equal to the separate tax liability for each member. The separate return tax liability of each member shall not exceed the amount each member would have paid if it had filed on a separate return basis. The agreement was filed with the Department pursuant to New York Circular Letter No. 33 (1979).

A review of the Company's consolidated federal income tax return indicated that members included in the consolidated return do not agree to the parties in the tax allocation agreement.

It is recommended that the Company amend its tax allocation agreement to reflect the proper identity of all parties to the agreement to ensure that all members included in its consolidated federal income tax return are parties to the tax allocation agreement.

Additionally, pursuant to the tax allocation agreement, Trupanion files the consolidated federal income tax return. Examination review revealed that an escrow account, which ensure the rights of the Company to recoup federal income tax from Trupanion in the event of future net loss, was not established. New York Circular Letter No. 33 (1979) states, in part:

". . . To help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses an escrow account consisting of assets eligible as an investment for the domestic insurer shall be established and maintained by the parent in an amount equal to the excess of the amount paid by the domestic insurer to the parent for federal income taxes over the actual payment made by the parent to the Internal Revenue Service . . . "

It is recommended that the Company establish an escrow account in accordance with New York Circular Letter No. 33 (1979).

E. Significant Ratios

The Company's operating ratios, except the ratio denoted with an asterisk, computed as of December 31, 2019, fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC.

<u>Operating Ratios</u>	<u>Result</u>
Net premiums written to policyholders' surplus	456%*
Adjusted liabilities to liquid assets	37%
Two-year overall operating	93%

*The Company's net premiums written to policyholders' surplus ratio is more than the benchmark ratio of 300%. This is due to the Company's deliberate growth in recent years.

Underwriting Ratios

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

	<u>Amounts</u>	<u>Ratio</u>
Losses and loss adjustment expenses incurred	\$ 754,575,392	73.34%
Other underwriting expenses incurred	217,832,978	21.17
Net underwriting gain (loss)	<u>56,522,104</u>	<u>5.49</u>
 Premiums earned	 <u>\$1,028,930,474</u>	 <u>100.00%</u>

The Company's reported risk-based capital ("RBC") score was 266.9% at December 31, 2019. The RBC score is a measure of the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. An RBC score of 200% or below can result in regulatory action.

There were no financial adjustments in this report that impacted the Company's RBC score.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2019, as reported by the Company:

Assets

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 1,000,000	\$ 0	\$ 1,000,000
Cash, cash equivalents and short-	81,888,813	0	81,888,813
Other invested assets	14,327,640	0	14,327,640
Investment income due and accrued	38,702	0	38,702
Uncollected premiums and agents' balances in the course of collection	3,300,063	5,550	3,294,513
Deferred premiums, agents' balances and installments booked but deferred and not yet due	49,978,281	0	49,978,281
Other amounts receivable under reinsurance contract	127,736	0	127,736
Net deferred tax asset	2,688,790	25,921	2,662,869
Receivables from parent, subsidiaries and affiliates	1,438,916	150,000	1,288,916
Prepaid expenses	253,288	253,288	0
State income tax recoverable	118,404	0	118,404
Miscellaneous receivable	<u>3,744</u>	<u>0</u>	<u>3,744</u>
Total assets	<u>\$155,164,377</u>	<u>\$434,759</u>	<u>\$154,729,618</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and Loss Adjustment Expenses	\$ 20,093,559
Commissions payable, contingent commissions and other similar charges	3,269,016
Other expenses (excluding taxes, licenses and fees)	183,804
Taxes, licenses and fees (excluding federal and foreign income taxes)	2,638,445
Current federal and foreign income taxes	2,117,396
Unearned premiums	49,770,316
Payable to parent, subsidiaries and affiliates	1,422,358
Uncashed checks pending escheatment	<u>1,425,169</u>
 Total liabilities	 \$ 80,920,063

Surplus and Other Funds

Common capital stock	\$ 4,800,000
Gross paid in and contributed surplus	22,880,538
Unassigned funds (surplus)	<u>46,129,017</u>
 Surplus as regards policyholders	 <u>73,809,555</u>
 Total liabilities, surplus and other funds	 <u>\$154,729,618</u>

Note: The Internal Revenue Service has not audited the Company's consolidated Federal Income Tax returns covering tax years 2014 through 2019. 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

The net income for the examination period as reported by the Company was \$40,306,153, as detailed below:

Underwriting Income

Premiums earned		\$1,028,930,474
Deductions:		
Losses and loss adjustment expenses incurred	\$754,575,392	
Other underwriting expenses incurred	<u>217,832,978</u>	
Total underwriting deductions		<u>972,408,370</u>
Net underwriting gain or (loss)		\$ 56,522,104

Investment Income

Net investment income earned	\$ 2,511,606	
Net investment gain or (loss)		2,511,606

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (1,474,925)	
Total other income or (loss)		<u>(1,474,925)</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ 57,558,785
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ 57,558,785
Federal and foreign income taxes incurred		<u>17,252,632</u>
Net income		<u>\$ 40,306,153</u>

C. Capital and Surplus

Surplus as regards policyholders increased \$50,148,366 during the five-year examination period January 1, 2015 through December 31, 2019, as reported by the Company, detailed as follows:

Surplus as regards policyholders, as reported by the Company as of December 31, 2014			\$23,661,189
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$40,306,153		
Change in net deferred income tax	1,655,581		
Change in nonadmitted assets		\$313,368	
Surplus adjustments paid in	<u>8,500,000</u>	<u>0</u>	
Total gains and losses	<u>\$50,461,734</u>	<u>\$313,368</u>	
Net increase (decrease) in surplus			<u>50,148,366</u>
Surplus as regards policyholders, as reported by the Company as of December 31, 2019			<u>\$73,809,555</u>

No adjustments were made to surplus as a result of this examination.

Capital paid in is \$4,800,000 consisting of 1,600 shares of \$3,000 par value per share common stock. Gross paid in and contributed surplus is \$22,880,538. APIC's parent, Trupanion, made two capital contributions during the examination period, as shown below. All the contributions were received in cash, except, in 2018, \$2.5 million of the \$7.5 million was received in the form of a note receivable. Cash for the note receivable was received in February 2019. Gross paid in and contributed surplus and/or capital paid in increased by \$8,500,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
2014	Beginning gross paid in and contributed surplus		\$14,380,538
2015	Surplus contribution	\$1,000,000	
2018	Surplus contribution	<u>7,500,000</u>	
	Total surplus contributions		<u>8,500,000</u>
2019	Ending gross paid in and contributed surplus		<u>\$22,880,538</u>

4. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$20,093,559 is the same as reported by the Company as of December 31, 2019. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including SSAP No. 55.

5. **SUBSEQUENT EVENTS**

On March 11, 2020, the World Health Organization declared an outbreak of a novel coronavirus (“COVID-19”) pandemic. The risks and uncertainties surrounding the COVID-19 pandemic may impact the Company’s, and its competitors’, operational and financial performance. The extent of the impact of the COVID-19 pandemic on the Company’s operational and financial performance will depend on certain developments, including the duration and spread of the outbreak, regulatory decisions, and the impact on the financial markets. All of these developments are uncertain and cannot be predicted. While to-date the Company has not experienced a material adverse impact on its business due to COVID-19, the impact of the pandemic and related economic conditions cannot reasonably be estimated at this time.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained the following recommendations (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Capital Contribution</u> It was recommended that the Company comply with the notification requirements set forth in Section 1505(d)(1) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	4
<p>B. <u>Management</u></p> <p>i. <u>Board of Directors' Attendance</u></p> <p>It was recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.</p> <p>The Company has complied with this recommendation.</p>	5
<p>ii. <u>Board of Directors' Meetings</u></p> <p>It was recommended that the Company comply with its by-laws by conducting regular meetings of the board of directors at least once each quarter of the year.</p> <p>The Company has complied with this recommendation.</p>	5
<p>C. <u>Holding Company</u> <u>Affiliated Agreement</u></p> <p>It was recommended that the Company file all future affiliated agreements with the Department prior to implementation in accordance with Section 1505(d) of New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	9
<p>D. <u>Accounts and Records</u></p> <p>i. <u>Conflict of Interest Policy and Statements</u></p> <p>It was recommended that the Company have each member of the board of directors, all officers, and all key employees sign a conflict of interest statement annually.</p> <p>The Company has complied with this recommendation.</p>	11

ii. Underwriting and Investment Exhibit

It was recommended that Company comply with the NAIC Annual Statement Instructions and SSAP No.70 by reporting its affiliated and non-affiliated expenses in the annual statement Underwriting & Investment Exhibit, Part 3 as the costs had been borne directly by the Company and allocate such expenses to the appropriate annual statement lines and not report them as a one line expense. 12

The Company has complied with this recommendation.

iii. Department Regulation No. 30

It was recommended that Company establish and maintain an expense cost allocation worksheet that details expense allocation in compliance with Department Regulation No. 30. 12

The Company has complied with this recommendation.

iv. Policy Cancellation

It was recommended that the Company comply with the notification requirements set forth in Section 3425 (c)(2)(A) of the New York Insurance Law. 13

The Company has complied with this recommendation.

v. Premium Collection

It was recommended that the Company establish an appropriate system to track billed and unbilled premiums balances and follow-up regularly to ensure premiums are being collected as required in the general agency agreement with its MGAs. 13

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Corporate Governance</u>	
	It is recommended that the Company amend its charter so that it is consistent with its by-laws.	4
B.	<u>Holding Company</u>	
i.	It is recommended that the Company amend its tax allocation agreement to reflect the proper identity of all parties to the agreement to ensure that all members included in its consolidated federal income tax return are parties to the tax allocation agreement	9
ii.	It is recommended that the Company establish an escrow account with the Department in accordance with New York Circular Letter No. 33 (1979).	9

Respectfully submitted,

_____/S/_____
Irene Tran, CFE
Senior Insurance Examiner

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

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

_____/S/_____
Irene Tran

Subscribed and sworn to before me

this _____ day of _____, 2021.

APPOINTMENT NO. 31963

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Linda A. Lacewell, 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:

Irene Tran

as a proper person to examine the affairs of the

American Pet Insurance Company

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

COMPANY

with such other information as she 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 10th day of July, 2019

LINDA A. LACEWELL
Superintendent of Financial Services



By:

Joan P. Riddell

Joan Riddell
Deputy Bureau Chief