

REPORT ON EXAMINATION

OF

FAIR AMERICAN INSURANCE AND REINSURANCE COMPANY

AS OF

DECEMBER 31, 2019

DATE OF REPORT

MAY 27, 2021

EXAMINER

SUSAN WEIJOLA

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Department of Financial Services

ANDREW M. CUOMO
Governor

LINDA A. LACEWELL
Superintendent

May 25, 2021

Honorable Linda A. Laceywell
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 32043 dated February 20, 2020, attached hereto, I have made an examination into the condition and affairs of Fair American Insurance and Reinsurance Company as of December 31, 2019, and submit the following report thereon.

Wherever the designation “the Company” or “FAIRCO” appears herein without qualification, it should be understood to indicate Fair American Insurance and Reinsurance 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 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 examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2014. This examination covered the five-year period from January 1, 2015 through December 31, 2019. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted in conjunction with the state of New Hampshire, which was the lead state of the RSUI subgroup. New York was the lead state for the TransRe subgroup. The TransRe subgroup includes the Company, Transatlantic Reinsurance Company (“TRC”), and Fair American Select Insurance Company (“FASIC”). Both subgroups are part of the Alleghany Group. Other states participating in this examination were Delaware, Nebraska, and Wisconsin.

The examination of the Company was performed concurrently with the examinations of the following insurers:

| <u>Insurer</u> | <u>Domicile</u> | <u>NAIC #</u> |
|---|-----------------|---------------|
| Capitol Indemnity Corporation | Wisconsin | 10472 |
| Capitol Specialty Insurance Corporation | Wisconsin | 10328 |
| Covington Specialty Insurance Company | New Hampshire | 13027 |
| Transatlantic Reinsurance Company | New York | 19453 |
| Fair American Select Insurance Company | Delaware | 15201 |
| Landmark American Insurance Company | New Hampshire | 33138 |
| Platte River Insurance Company | Nebraska | 18619 |
| RSUI Indemnity Company | New Hampshire | 22314 |

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
- Reinsurance
- 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

Fair American Insurance and Reinsurance Company was incorporated under the laws of the State of New York on September 30, 1985 as SAI Industrial Assurance Company (“SAI”) as a result of the domestication of the U.S. Branch of the SAI-Societa Assicuratrice Industrials S.P.A of Torino, Italy (“SAI-Italy”) to a New York corporation. The Branch was entered in the United States in 1977 through New York and the home office was established in 1921 under the laws of Italy.

Effective December 12, 1985, American International Group (“AIG”) purchased 100% of SAI’s 1,000 shares of \$500 par value per share common stock from SAI-Italy to become the new sole shareholder of the Company. The Company’s name was changed to Putnam Reinsurance Company on April 29, 1986.

On February 24, 1986, the Company’s authorized capital was increased from \$500,000 to \$2,500,000, consisting of an additional 4,000 shares of \$500 par value per share common stock. On June 30, 1986, the additional 4,000 shares of the Company’s common stock were issued to AIG for consideration of \$2,000,000. On the same date, AIG contributed all 5,000 shares of the Company’s common stock, plus cash, to PREINCO Holdings, Inc. (“PREINCO”) in exchange for a 20.01% interest in PREINCO. PREINCO was organized in the State of Delaware on June 10, 1986, to become the new holding company and sole shareholder of the Company.

Effective April 18, 1990, the name of PREINCO Holdings, Inc. was changed to Transatlantic Holdings, Inc. (“THI”). THI became a public company in June 1990.

In 1995, THI transferred ownership of the Company to its wholly-owned subsidiary, TRC.

As of December 31, 2008, AIG was the majority stockholder of THI, with an ownership of approximately 59%. In June 2009 AIG reduced its ownership in THI, through a secondary offering, to approximately 13.9% of the company's outstanding common shares. In March 2010, AIG reduced its beneficial ownership through another secondary public offering. Immediately following the March 2010 secondary public offering, AIG beneficially owned approximately 1.1% (excluding shares held by certain mutual funds that are advised or managed by subsidiaries of AIG).

In January 2012, the Company’s name was changed to its current title. In March 2012, Alleghany Corporation (“Alleghany”) and THI completed a merger and the Company became an indirect wholly-owned subsidiary of Alleghany.

On October 1, 2012, the Company acquired 100% of the common stock of Fair American Select Insurance Company (“FASIC”), a surplus line insurer domiciled in Delaware.

Effective November 5, 2015, the Company entered into a stock purchase agreement with its parent, TRC, pursuant to which the Company sold FASIC to TRC.

A. Corporate Governance

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 seven nor more than 15 members. 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> |
|--------------------------------|---|
| Kenneth Apfel New York, NY | Executive Vice President and Chief Actuary, Transatlantic Holdings, Inc. |
| Kenneth W. Brandt Alamo, CA | Executive Vice President, Transatlantic Reinsurance Company |

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|--|--|
| Matthew D. Mahoney Darien, CT | Executive Vice President and Chief Financial Officer, Transatlantic Holdings, Inc. |
| Christopher A. O’Gwen Basking Ridge, NJ | Senior Vice President, Transatlantic Reinsurance Company |
| Michael C. Sapnar New York, NY | President and Chief Executive Officer, Transatlantic Holdings, Inc. |
| Gary A. Schwartz New York, NY | Executive Vice President and General Counsel, Transatlantic Holdings, Inc. |
| Javier E. Vijil* Miami, FL | Executive Vice President, Transatlantic Holdings, Inc. |

*Javier E. Vijil retired from the Board on December 31, 2019.

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

| <u>Name</u> | <u>Title</u> |
|--------------------|-------------------------|
| Michael C. Sapnar | President |
| Amy M. Cinquegrana | Secretary |
| Matthew D. Mahoney | Chief Financial Officer |

B. Territory and Plan of Operation

As of December 31, 2019, the Company was licensed to write business in all 50 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:

| <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 |

| <u>Paragraph</u> | <u>Line of Business</u> |
|------------------|--|
| 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 |

The Company is also authorized to transact such workers' compensation insurance as may be incidental to coverage under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. As amended; 33 USC Section 901 et seq. as amended).

The Company is also authorized by Section 4102(c) of the New York Insurance Law to (i) reinsure risks of every kind or description and (ii) insure property or risks of every kind of description located or resident outside of the United States, its territories and possessions. Additionally, the Company is licensed to conduct the business of special risk insurance pursuant to Article 63 of the New York Insurance Law.

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, 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 did not assume any business during the period under examination. The following schedule shows the direct premiums written by the Company for the period under examination:

| <u>Calendar Year</u> | <u>Total Gross Premiums</u> |
|----------------------|-----------------------------|
| 2015 | \$35,095,644 |
| 2016 | \$38,620,982 |
| 2017 | \$40,016,965 |
| 2018 | \$78,809,005 |
| 2019 | \$85,383,167 |

Prior to 2013, all of the Company's premiums were assumed under a quota share agreement with its parent, TRC. This agreement was terminated and commuted on October 1, 2012. Beginning in 2013, the Company became a direct writer of medical professional liability. During the examination period, the major lines of business written were group accident and health, medical professional liability – occurrence and medical professional liability – claims made.

The Company's medical professional liability business is produced and serviced by Professional Risk Management Services, Inc. ("PRMS"), a wholly-owned subsidiary of THI. On October 1, 2017, the Company entered into a program administration agreement with Rockport Benefits, LLC ("Rockport") to write group accident and health business.

C. Reinsurance Ceded

On October 8, 2012, the Company entered into a 90% quota share reinsurance agreement with TRC of which TRC is the reinsurer. This agreement was filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

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 the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles ("SSAP") No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC annual statement instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

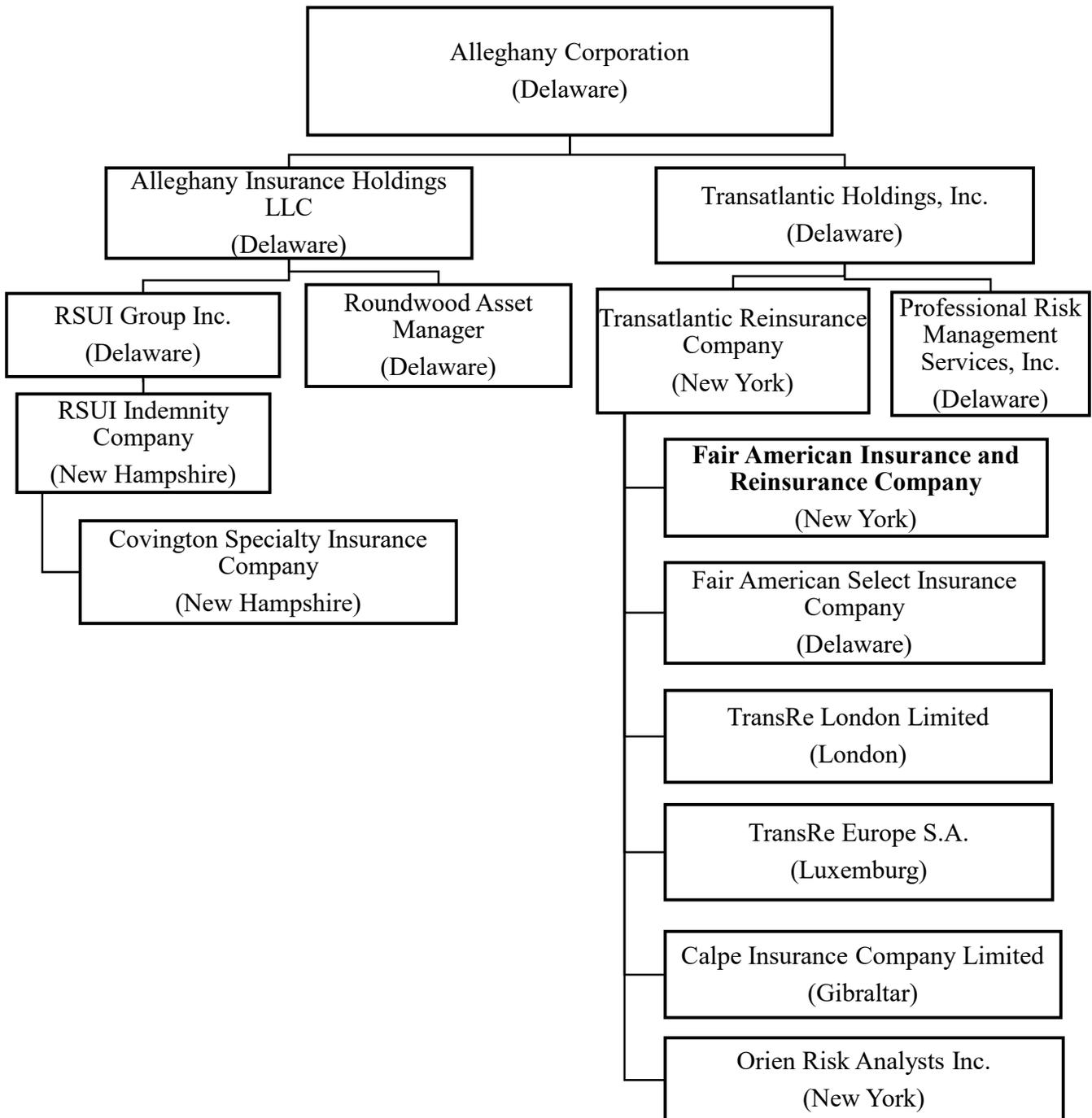
D. Holding Company System

The Company is a member of the Alleghany Group. The Company is a wholly-owned subsidiary of TRC, a New York corporation. TRC is a wholly-owned subsidiary of THI, which is ultimately controlled by Alleghany, a public corporation that is listed on the New York Stock Exchange.

Alleghany owns and supports various operating subsidiaries. Regarding its core position of property and casualty reinsurance and insurance, through THI, Alleghany is engaged in property and casualty reinsurance business, and through Alleghany Insurance Holdings LLC, a wholly-owned intermediate holding company, Alleghany is engaged in property and casualty insurance business.

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:



Holding Company Agreements

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

Managing General Agent Agreement

The Company entered into a managing general agent agreement, effective January 1, 2013 and subsequently amended on October 30, 2015 and on August 1, 2016, with its affiliate, PRMS. Pursuant to the agreement, the Company appointed PRMS as the Company's exclusive agent and producer of insurance policies comprising specified covered business. PRMS receives compensation at a fixed commission rate.

Claims Service Agreement

The Company entered into a claims service agreement, effective March 14, 2013 and subsequently amended on August 1, 2016, with its affiliate, PRMS. Pursuant to the agreement, PRMS agrees to provide claim service for the Company and its policyholders under psychiatrists and neurologists professional liability insurance programs for a specified fee.

Service Agreement

Effective October 2, 2013, FAIRCO and FASIC entered into a service agreement pursuant to which FAIRCO provides insurance facilities and certain administrative services at cost to FASIC including claims adjustments and investigations; underwriting and processing services; customer service functions; printing and mailing of all policies and endorsements; file and record keeping of all policies and endorsements; accounting and investment services; actuarial services; and other administrative services.

Tax Sharing Agreement

Effective April 29, 2014, the Company entered into a tax sharing agreement with Alleghany, THI, TRC and FASIC. Pursuant to the agreement, the Company is part of the consolidated federal income tax return of Alleghany and provides for the allocation of the consolidated income tax liability among Alleghany's subsidiary groups which is allocated primarily on a separate return basis.

Transition and Consulting Services Agreement

Effective November 11, 2019, FAIRCO and Capitol Indemnity Corporation ("CIC") entered into an agreement whereby each party procures from and provides to the other certain services, access to facilities, equipment, software and other assistance on a transitional basis. As consideration for providing the services and access to the facilities, during the term, beginning with the quarterly period ending on December 31, 2019 until and including December 31, 2023, the Company shall pay to CIC a fixed quarterly fee, with the right to offset.

As of December 31, 2019, the Company also had in place with PRMS a Business Associate and Data Protection Agreement, effective February 19, 2019.

All agreements subject to Section 1505 of the New York Insurance Law were submitted to the Department.

E. Significant Ratios

The Company's operating ratios, 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 | 4% |
| Adjusted liabilities to liquid assets | 9% |
| Two-year overall operating | 1% |

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 | \$17,172,470 | 62.22% |
| Other underwriting expenses incurred | 7,087,059 | 25.68% |
| Net underwriting gain (loss) | <u>3,338,052</u> | <u>12.10%</u> |
| Premiums earned | <u>\$27,597,581</u> | <u>100.00%</u> |

The Company's reported risk-based capital ("RBC") score was 14,216% 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> | Net Admitted <u>Assets</u> |
|--|----------------------|--------------------------------|-------------------------------|
| Bonds | \$208,854,068 | \$0 | \$208,854,068 |
| Cash, cash equivalents and short-term investments | 6,176,010 | 0 | 6,176,010 |
| Receivables for securities | 47,719 | 0 | 47,719 |
| Investment income due and accrued | 1,392,538 | 0 | 1,392,538 |
| Uncollected premiums and agents' balances in the course of collection | 500,791 | 0 | 500,791 |
| Net deferred tax asset | 177,544 | 0 | 177,544 |
| Other receivable | 5,420,231 | 0 | 5,420,231 |
| Claims escrow account | 750,000 | 0 | 750,000 |
| NYS Medical malpractice insurance pool | <u>1,919,821</u> | <u>0</u> | <u>1,919,821</u> |
| Total assets | <u>\$225,238,722</u> | <u>\$0</u> | <u>\$225,238,722</u> |

Liabilities, Surplus and Other FundsLiabilities

| | |
|---|------------------|
| Losses and loss adjustment expenses | \$ 8,426,331 |
| Commissions payable, contingent commissions and other similar charges | 177,393 |
| Other expenses (excluding taxes, licenses and fees) | 709,195 |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | 2,429,371 |
| Current federal and foreign income taxes | 1,591,657 |
| Unearned premiums | 1,767,753 |
| Funds held by company under reinsurance treaties | 1,727,839 |
| Other miscellaneous payables | <u>1,889,497</u> |
| Total liabilities | \$ 18,719,036 |

Surplus and Other Funds

| | |
|--|----------------------|
| Common capital stock | \$ 5,000,000 |
| Gross paid in and contributed surplus | 88,227,719 |
| Unassigned funds (surplus) | <u>113,291,967</u> |
| Surplus as regards policyholders | <u>206,519,686</u> |
| Total liabilities, surplus and other funds | <u>\$225,238,722</u> |

Note: The IRS has undertaken a limited scope audit of the Alleghany Group for 2015 through 2017 which focused on the foreign tax credits of the Company. The Company has stated that the audit is in the final stages in that the auditor's report is with the Joint Committee of Taxation, and that the report did not identify any adjustments.

B. Statement of Income

The net income for the examination period as reported by the Company was \$28,113,475, as detailed below:

Underwriting Income

| | | |
|--|------------------|-------------------|
| Premiums earned | | \$27,597,581 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | \$17,172,470 | |
| Other underwriting expenses incurred | <u>7,087,059</u> | |
| Total underwriting deductions | | <u>24,259,529</u> |
| Net underwriting gain or (loss) | | \$ 3,338,052 |

Investment Income

| | | |
|--|------------------|---------------------|
| Net investment income earned | \$30,084,204 | |
| Net realized capital gain | <u>1,180,035</u> | |
| Net investment gain or (loss) | | <u>31,264,239</u> |
| Net income before federal and foreign income taxes | | \$34,602,291 |
| Federal and foreign income taxes incurred | | <u>6,488,816</u> |
| Net income | | <u>\$28,113,475</u> |

C. Capital and Surplus

Surplus as regards policyholders decreased \$36,537,262 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 | | | \$243,056,948 |
| | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income | \$28,113,475 | | |
| Net unrealized capital gains or (losses) | | \$ 886,992 | |
| Change in net deferred income tax | 1,557,889 | | |
| Dividends to stockholders | | 59,000,000 | |
| Change in treasury stock | | | |
| Prior period error adjustment | | (1,138,813) | |
| Aggregate write-ins for gains and losses in surplus | <u>0</u> | <u>(5,182,821)</u> | |
| Total gains and losses | \$29,671,364 | \$ 66,208,626 | |
| Net increase (decrease) in surplus | | | <u>(36,537,262)</u> |
| Surplus as regards policyholders as reported by the Company as of December 31, 2019 | | | <u>\$206,519,686</u> |

No adjustments were made to surplus as a result of this examination. Capital paid in is \$5,000,000 consisting of 10,000 shares of \$500 par value per share common stock. Gross paid in and contributed surplus is \$88,227,719.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$8,426,331 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. The reserves are concentrated in the medical professional liability – occurrence line of business.

5. SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared an outbreak of a novel coronavirus (“COVID-19”) pandemic. The COVID-19 pandemic has continued to develop throughout 2020 and 2021, with significant uncertainty remaining regarding the full effect of COVID-19 on the U.S. and global insurance and reinsurance industry. At the time of releasing this report, the examination’s review noted that the Company currently does not have any material COVID-19 loss exposure. The Department has been in communication with the Company regarding the impact of COVID-19 on its business operations and financial position. The Department continues to closely monitor the impact of the pandemic on the Company and will take necessary action if a solvency concern arises.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained three recommendations as follows (page numbers refer to the prior report):

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|-----------------|
| <p>A. <u>Holding Company System</u> It was recommended that the Company submit such agreement to the Department pursuant to the provisions of Section 1608 of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p> | <p>10</p> |
| <p>B. <u>Accounts and Records</u></p> <p>i. It was recommended that the Company exercise greater care and compete Schedule Y in accordance with the NAIC's annual statement instructions.</p> <p>The Company has complied with this recommendation.</p> | <p>12</p> |
| <p>ii. It was recommended that the Company exercise greater care and complete the Annual Statement Supplement in accordance with the Annual Statement Supplement Instructions.</p> <p>The Company has complied with this recommendation.</p> | <p>12</p> |

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

This report on examination contains no comments or recommendations.

Respectfully submitted,

_____/S/_____
Susan Weijola, CPCU
Associate Insurance Examiner

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

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

_____/S/_____
Susan Weijola

Subscribed and sworn to before me
this _____ day of _____, 2021.

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:

Susan Weijola

as a proper person to examine the affairs of the

Fair American Insurance and Reinsurance 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 20th day of February, 2020

LINDA A. LACEWELL
Superintendent of Financial Services



By:

Joan C. Riddell

Joan Riddell
Deputy Bureau Chief